Spansion Inc.
Form 10-K
February 25, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended December 29, 2013
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from to
Commission File Number 001-34747

SPANSION INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-3898239**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

915 DeGuigne Drive

P.O. Box 3453

Sunnyvale, CA 94088

(408) 962-2500

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**(Name of each exchange on which registered)**
Class A Common Stock, $0.001 par value per share	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of Class A Common Stock (Common Stock) held by non-affiliates of the registrant based upon the closing sale price on the New York Stock Exchange on June 30, 2013 was approximately $733.1million. Shares held by each executive officer, director and by certain persons that own 10% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13, or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

1

As of February 20, 2014, the registrant had 60,074,340 shares of Class A Common Stock outstanding at $0.001 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of our Definitive Proxy Statement for our 2014 Annual Meeting of Stockholders (2014 Proxy Statement) are incorporated by reference into Part III hereof.

Spansion Inc.

FORM 10-K

For The Fiscal Year Ended December 29, 2013

INDEX

		Page
PART I		
ITEM 1.	BUSINESS	4
ITEM 1A.	RISK FACTORS	10
ITEM 1B.	UNRESOLVED STAFF COMMENTS	19
ITEM 2.	PROPERTIES	19
ITEM 3.	LEGAL PROCEEDINGS	20
ITEM 4.	MINE SAFETY DISCLOSURES	
PART II		
ITEM 5.	MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES	21
ITEM 6.	SELECTED FINANCIAL DATA	22
ITEM 7.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	24
ITEM 7A.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	39
ITEM 8.	FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA	41
ITEM 9.	CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE	86
ITEM 9A.	CONTROLS AND PROCEDURES	86
ITEM 9B.	OTHER INFORMATION	86
PART III		
ITEM 10.	DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE	87
ITEM 11.	EXECUTIVE COMPENSATION	87
ITEM 12.	SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS	87
ITEM 13.	CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE	87
ITEM 14.	PRINCIPAL ACCOUNTANT FEES AND SERVICES	87

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES 88
SIGNATURES 104

PART I

Cautionary Statement Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements. These statements relate to future events or our future financial performance. Forward-looking statements may include words such as "may," "will," "should," "expect," "plan," "intend," "anticipate," "believe," "estimate," "predict," "potential," "continue" or other wording indicating future results or expectations. Forward-looking statements are subject to risks and uncertainties, and actual events or results may differ materially. Factors that could cause our actual results to differ materially include, but are not limited to, those discussed under "Risk Factors" in this report. We also face risks and uncertainties associated with substantial indebtedness and its impact on our financial health and operations; fluctuations in foreign currency exchange rates; the sufficiency of workforce and cost reduction initiatives. Other risks and uncertainties relating to our business include our ability to: implement our business strategy focused on the embedded flash memory, microcontrollers, mixed-signal and analog markets; maintain or increase our average selling price and lower our average costs; accurately forecast customer demand for our products; attract new customers; obtain additional financing in the future; maintain our distribution relationships and channels in the future; successfully enter new markets and manage our international expansion; successfully compete with existing and new competitors, or with new memory or other technologies; successfully develop new applications and markets for our products; maintain manufacturing efficiency; obtain adequate supplies of satisfactory materials essential to manufacture our products; successfully develop and transition to the latest technologies; negotiate patent and other intellectual property licenses and patent cross-licenses and acquire additional patents; protect our intellectual property and defend against infringement or other intellectual property claims; maintain our business operations and demand for our products in the event of natural or man-made catastrophic events; and effectively manage, operate and compete in the current highly competitive business environment. Except as required by law, we undertake no obligation to revise or update any forward-looking statements to reflect any events or circumstances that arise after the date of this report, or to conform such statements to actual results or changes in our expectations.

ITEM 1. BUSINESS

Overview

We are a leading designer, manufacturer and developer of embedded systems semiconductors, which include flash memory, microcontroller, mixed-signal and analog products and embedded system-on-chip solutions. Our leading-edge intellectual property and products are driving the development of high quality, reliable and economical devices that are high performing, intelligent, efficient and secure.

The embedded markets we focus on are transportation, industrial, consumer, communications and gaming. These markets require reliable flash memory solutions, microcontrollers, mixed-signal and analog and other programmable semiconductors that run applications in a broad range of electronic systems. The embedded markets are generally characterized by longer design and product life cycles, relatively stable pricing, more predictable supply-demand outlook and lower capital investments. Within this embedded industry, we serve a well-diversified customer base through a predominantly differentiated, non-commodity, service oriented model that strives to meet our customers' needs. Our embedded solutions are incorporated in products manufactured by leading original equipment manufacturers (OEMs). We spend many years refining our product and service strategy to address market requirements and deliver high-quality products that go into a broad range of electronic applications such as automobiles, airplanes, set top boxes, games, telecommunications equipment, smart meters, factory automation and medical devices.

Our products are designed to accommodate various voltage, interface and density requirements for a wide range of applications and customer platforms. The majority of our NOR flash memory product designs are based on our proprietary two-bit-per-cell MirrorBit® technology, which has a simpler cell architecture, higher yields and lower costs than competing floating gate NOR flash memory technology. While we are most known for our NOR products, we are expanding our portfolio in the areas of NAND flash memory, microcontroller, mixed-signal and analog products, as well as programmable system solutions or embedded system-on-chip solutions to broaden our customer engagement and bring differentiated products to embedded markets. In support of this strategy, we completed the acquisition of the microcontroller and analog business (the MCA business) of Fujitsu Semiconductor Limited (FSL) on August 1, 2013, for purchase consideration of $150.0 million, net of cash acquired (the Fujitsu Acquisition).

In addition to our products, we generate revenue by licensing our intellectual property to third parties and we assist our customers in developing and prototyping their designs by providing software and hardware development tools, drivers and simulation models for system-level integration.

For fiscal 2013, we had net sales of $971.7 million and net loss of $78.3 million.

For fiscal 2012, we had net sales of $915.9 million and net income of $24.9 million.

For fiscal 2011, we had net sales of $1,069.9 million and net loss of $55.9 million.

We are headquartered in Silicon Valley in California, with research and development, manufacturing, assembly and sales operations in the United States, Asia, Europe and the Middle East. We own and operate a wafer fabrication facility in Austin, Texas and a final manufacturing facility in Bangkok, Thailand. Final manufacturing consists of assembly, test, mark and pack operations. We also own a manufacturing facility in Penang, Malaysia, which does small volumes of sort and pack operations. For geographical information with respect to our sales and assets refer to Note 18 of Consolidated Financial Statements.

We were incorporated in Delaware in 2005. Our mailing address and executive offices are located at 915 DeGuigne Drive, Sunnyvale, California 94085, and our telephone number is (408) 962-2500. References in this report to "Spansion," "we," "us," "our," or the "Company" shall mean Spansion Inc. and our consolidated subsidiaries, unless the contex indicates otherwise. We are subject to the information and periodic reporting requirements of the Securities Exchange Act of 1934, as amended or Exchange Act, and, in accordance therewith, file periodic reports, proxy statements and other information with the Securities and Exchange Commission, or SEC. Such periodic reports, proxy statements and other information are available for inspection and copying at the SEC's Public Reference Room at 100 F Street, NE. Washington, DC 20549 or may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a website at *http://www.sec.gov* that contains reports, proxy statements and other information regarding issuers that file electronically with the SEC. We also post on the Investor Relations section of our website, *http://www.spansion.com*, under *"Financial Information"* a link to our filings with the SEC. We post our Code of Ethics for our Chief Executive Officer, Chief Financial Officer, Corporate Controller and other Senior Finance Executives, our Code of Business Conduct, which applies to all directors and all our employees, and the charters of our Audit, Compensation and Nominating and Corporate Governance committees under *"Corporate Governance"* on the Investor Relations section of our website. Our filings with the SEC are posted as soon as reasonably practical after they are filed electronically with the SEC. Please note that information contained on our website is not incorporated by reference in, or considered to be a part of, this report.

Industry Overview

The proliferation of electronic systems, such as broadband access devices, automotive infotainment, instrument cluster and safety control, digital TVs, set-top boxes, printers, digital cameras, gaming machines, wireless and wired infrastructure, white goods, industrial automation and control modules are driving the increasing use of embedded systems solutions to deliver an enhanced end-user experience. Electronic systems need to store both operating instructions in the form of software code as well as content or data that needs to be processed. As electronic systems across various applications add increasingly complex features to process rich multimedia content with higher performance, they require more processing, code and data storage without compromising reliability and system cost.

Overview of embedded systems solutions

Embedded systems solutions address a variety of applications, including automotive, consumer electronics, networking and telecommunications equipment, smart phones, tablets, PCs, gaming consoles and industrial equipment with a broad range of products. We have two major product groups for embedded applications: flash memory and microcontroller and analog products.

The flash memory market consists of two major architectures: NOR and NAND flash memory. NOR flash memory is predominantly used for reliable code execution and performance-oriented storage in consumer electronics, automobiles, communications, gaming and industrial applications. NAND flash memory is predominantly used for data storage in applications, such as solid-state drives, removable storage devices and embedded managed NAND devices. Overall, customers seeking fast read performance and superior reliability traditionally have chosen NOR flash memory, while those seeking high density and fast write speeds have chosen NAND flash memory. We offer a broad family of parallel and serial NOR flash memory and a select range of lower density NAND flash memory products targeting non-commodity embedded applications.

Microcontrollers are a small computer on a single integrated circuit containing a processor core, memory, and programmable input/output peripheral capability. Microcontrollers are designed for embedded applications where they are frequently the principle, and sometimes sole integrated circuit. Microcontrollers are also frequently designed with flexibility for applicability across multiple applications and uses. We have a family of 8-, 16-, 32-bit proprietary and 32-bit ARM based microcontrollers that are used in automotive such as body electronics, chassis and safety, power train and hybrid, home appliances, digital audio / video equipment, industrial and office equipment. The ARM based solutions offer some of the most innovative feature sets for advanced automotive dashboard and instrument clusters and the automation and control industrial segments.

Analog semiconductors measure, condition and regulate “real world” functions such as temperature, speed, sound and electrical current. We offer environmentally-friendly power management technology through our lineup of power management integrated circuits (PMIC), including DC/DC converters, voltage regulators and supervisors, and power monitoring and reset integrated circuits (ICs). In addition, we offer a family of LED lighting driver ICs and energy harvesting solutions.

Technology

We own and use fundamental intellectual property in two flash memory technologies, floating gate and charge trapping MirrorBit technology. Compared to competing floating gate multilevel cell NOR technology, two-bit-per-cell MirrorBit technology has a simpler cell architecture that requires fewer manufacturing steps and supports higher yields, resulting in lower manufacturing costs. Our current mid- and high-density products and new advanced products are based primarily on MirrorBit two-bit-per-cell technology.

Floating Gate Technology. Floating gate is the conventional flash memory cell technology that is utilized by most flash memory companies today for both NOR and NAND products. We have created innovations in floating gate technology that have become industry standards, such as negative gate erase, single power supply and embedded programming algorithms. Some of our new products designed to service the low density market are based on floating gate technology.

MirrorBit Technology. MirrorBit NOR technology is the foundation of our current mid- and high-density product roadmap. Also referred to as charge trapping technology, MirrorBit NOR technology stores two distinct charges in a single physical memory cell, with each charge equivalent to one bit of data thereby doubling the density of each physical memory cell and enabling higher density, lower cost products.

Embedded Charge Trap Technology (eCT). Our 40nm embedded charge trap technology is the foundation process technology for our next generation microcontrollers and system-on-chip solutions.

Sales and Marketing

We market and sell substantially all of our products worldwide under the Spansion trademark. We sell to our customers directly or through distributors.

We market our products through a variety of direct and indirect channels. We have direct relationships with many of our top customers worldwide. We supplement this effort with programs to support the design-in of our products on reference designs from third parties, which are typically used by embedded customers when choosing solutions. In addition, we focus a portion of our marketing efforts on providers of complementary semiconductor products such as chipsets to ensure that our products interoperate effectively with the most widely used components in various

embedded applications.

Our marketing activities target customers, reference design houses and our potential partners; and include a combination of direct marketing activities such as trade shows, events and marketing collateral, and indirect activities such as public relations and other marketing communications activities.

Customers

We serve our customers worldwide directly or through our distributors, who buy products from us and resell them to OEMs and original design manufacturer, or ODMs, either directly or through their own distributors. Customers for our products consist of OEMs, ODMs, distributors and contract manufacturers. Our global direct sales force is predominantly organized by customer end markets in order to bring dedicated expertise, knowledge and response to our customers. No end customer accounted for more than 10% of our net sales for the fiscal years 2013, 2012 and 2011.

Third-Party Distributors

Our third-party distributors typically resell to OEMs, ODMs and contract manufacturers. Sales through our direct distributors are made pursuant to agreements that provide them price protection and limited rights of return for discontinued products or for other products within one year of their date of manufacture. Distributors get price protection by way of credits for the difference between the original price paid and the current price that we offer. Price protection is based on market conditions, competitive considerations and other factors. In addition, our agreements with distributors may also contain standard stock rotation provisions permitting limited levels of product returns. Since we are unable to reliably estimate the resale price to our end customer and returns under the stock rotation rights to our distributors, we defer the recognition of revenue and related product costs on these sales as deferred income until distributors submit Point of Sales reports to us. We also sell some of our products to certain distributors under sales arrangements that do not allow for rights of return or price protection on unsold products. We recognize revenue on these sales when the earnings process is complete, as evidenced by an agreement with the customer, transfer of title, fixed or determinable pricing and when collectability is reasonably assured.

We generally warrant that products sold to our customers and our distributors will, at the time of shipment, be free from defects in workmanship and materials and conform to our approved specifications. Subject to specific exceptions, we offer a one year limited warranty.

We have long-standing relationships with our distributors. We believe that distributors provide an effective means of reaching our broad and diverse target customer base. Customers recognize us for our products and brand name and use distributors as an effective supply channel. Approximately 71%, 68% and 69% of our sales were through distributors for fiscal 2013, fiscal 2012 and fiscal 2011, respectively. One distributor, FSL, and its subsidiaries accounted for approximately 39%, 33% and 29% of our total net sales for fiscal 2013, fiscal 2012 and fiscal 2011, respectively. The increase of sales through FSL to 39% of our total net sales in fiscal 2013 related to MCA business for which FSL is the sole distributor in Japan.

Research and Development

Our investment and strategy in research and development are geared towards providing competitive, embedded solutions to our customers through three product families: flash memory, microcontrollers, and analog. Our research and development (R&D) efforts span across process technology, product design, systems engineering, and software, with teams in various locations around the world, including the Sunnyvale, California headquarters, as well as Israel, Japan, Germany, Malaysia, and China.

Several strategic R&D activities are ongoing. With Wuhan XinXin Semiconductor Manufacturing Corporation (XMC) in China, we completed the qualification of 45nm MirrorBit® Technology in February 2013 and started shipping our 8Gb product, the industry's highest-density monolithic NOR. We are now focused on 32nm MirrorBit development as we believe that the two-bits-per-cell MirrorBit technology continues to be the benchmark in the high-density NOR industry for performance, reliability, and scalability based on evidence from many generations of scaling. We are also partnering with XMC for floating-gate NOR technologies for our line of serial NOR products.

In February 2013, we entered into an agreement with United Microelectronics Corporation (UMC) to integrate our eCTTM Technology with UMC's low-power logic at the 40nm node. We expect that eCT, which is a derivative of our proven, charge trap technology, will provide highly competitive cell size, along with the performance and reliability needed in microcontroller products for automotive, industrial, and consumer applications. With the acquisition of the MCA business, 40nm eCT is expected to extend the competitiveness of our microcontroller products beyond the 55nm embedded Flash technology, which is being developed with FSL.

Our alliance with SK Hynix Inc. (SK Hynix) continues to enable our offering of high quality and reliability SLC NAND products for embedded applications. In 2013, we introduced 32nm SLC NAND products, adding to the

existing portfolio of 48nm and 41nm product families.

We have entered into many agreements for our microcontroller and analog business with FSL. We are in production with a 90nm integrated logic and flash memory process while developing 55nm technology for the next generation of microcontroller products.

Innovations driven by R&D are a key enabler in delivering the long-term value to our customers. Through judicious planning and by leveraging strategic arrangements, we expect to continue to maximize the return on our R&D investment.

Our research and development expenses for fiscal 2013, fiscal 2012 and fiscal 2011were $126.8, $107.9 and $106.6 million, respectively. For more information, see Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Manufacturing

We own and operate one wafer fabrication facility, Fab 25, which is located in Austin, Texas and has approximately 114,000 square feet of clean room space. This facility produces 200-millimeter wafers using 130-nanometer, 110-nanometer, 90-nanometer and 65-nanometer process technologies. We own and operate a final manufacturing facility in Bangkok, Thailand. Final manufacturing consists of assembly, test, mark and pack operations. We also own a manufacturing facility in Penang, Malaysia, which does small volumes of sort and pack operations. In addition to our own internal capacity, we outsource wafer manufacturing and assembly and test services to third parties to supplement our internal resources.

We direct significant efforts toward the invention and development of manufacturing process technologies to achieve the objectives of reducing our manufacturing costs, improving our device performance and adding product features and capabilities. We achieve these objectives primarily through a combination of optimizing the number of process steps required to produce a product and by reducing the scale or size of key structures in our integrated circuits such as the memory cells used to store charge and the surrounding circuits that manage and interface to these cells. We develop each process technology using particular design rules and refer to this as the process or technology node designated in nanometers. By shrinking the features, we enable more transistors in the same area, which allows us to incorporate more bits per wafer at each successive process node, decreasing the cost per bit and either increasing the number of die per wafer for a given density or increasing the memory density per die.

We outsource a portion of our manufacturing function to external wafer foundry companies in order to augment our internal wafer fabrication capacity. We have agreements with XMC, FSL, SK Hynix and Dongbu HiTek Co., Ltd. The arrangement with XMC provides production support for advanced NOR technology products at 65, 45 and 32 nanometers. This agreement and the related production support were transferred to XMC from Semiconductor Manufacturing International Corporation (SMIC) in 2013. Agreements with FSL include agreements for the supply of product wafer foundry services, sort services and assembly and test services relating to the microcontroller and analog businesses. We also had an arrangement with FSL for the supply of legacy products on legacy production process nodes for our flash memory business, which ended in fiscal 2013. The arrangement with SK Hynix provides for the development and supply of SLC NAND products at the 4x, 3x and 2x nodes. The arrangement with Dongbu HiTek provides for the supply of floating-gate NOR products at the 90-nanometer node. Cooperation with foundries for advanced process node development allows for a cost effective solution for process technology development as an alternative to an in-house research and development facility.

Our supply agreements with FSL relating to the microcontroller and analog businesses were entered into at the time of our acquisition of these businesses from FSL. These agreements are at competitive market rates and enable us to leverage FSL’s existing manufacturing capabilities spanning across various technologies, processes, geometries and wafer sizes in their wafer fabrication facilities and package solutions in their back-end manufacturing facilities, until such time that we can either move these internally to our fabrication and back-end facilities or find more competitive solutions. The fabrication facilities are all located in Japan, while the back-end facilities are in Japan and other Asian countries. The supply agreements do not call for any minimum purchase commitments.

Our manufacturing processes require many raw materials, such as silicon wafers, mold compounds, substrates, and various chemicals and gases, and the necessary capital equipment for manufacturing. We obtain these materials and equipment from a large number of suppliers located throughout the world.

Environmental Matters

Many of our facilities are located on properties or in areas with a long history of industrial activity. Prior to 2003, environmental audits were conducted for each of our manufacturing facilities. The audits described various conditions customary of facilities in our industry and, in particular, noted historical soil and groundwater contamination at our Sunnyvale, California facility arising from the leakage of chlorinated solvent storage tanks that previously had been located on this property. This property is listed on the U.S. Environmental Protection Agency’s Superfund National Priorities List. Advanced Micro Devices, Inc., or AMD, the former owner of the property and responsible party, is investigating and remediating this contamination.

In 2003, each of AMD and FSL agreed to indemnify us against losses arising out of the presence or release, prior to June 30, 2003, of hazardous substances at or from these and other sites they each contributed to us in connection with the formation of our joint venture predecessor, FASL LLC. Conversely, Spansion LLC, our operating subsidiary agreed to indemnify each of AMD and FSL from and against liabilities arising out of events or circumstances occurring after June 30, 2003, in connection with the operation of our business. AMD and FSL, on the one hand, and we, on the other, agreed to indemnify the other against liability arising from permit violations attributable to our respective activities. To the extent AMD and FSL cannot meet their obligations under any of their indemnity agreements, or material environmental conditions arise, we may be required to incur costs to address these matters, which could have a material adverse effect on us.

We have made and will continue to make capital and other expenditures to comply with environmental laws, but we do not expect compliance with environmental requirements to result in material expenditures in the foreseeable future. Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time, all of which are factors that could alter the current outlook. See Item 1A. “Risk Factors—We are subject to a variety of environmental laws that could result in liabilities.”

Conflict Minerals

In August 2012, the SEC issued final rules requiring disclosure of the use of conflict minerals (tantalum, tin, tungsten and gold) originating in the Democratic Republic of Congo and adjoining countries. We have determined that conflict minerals are necessary to the functionality or production of our products and are in the process of verifying the country of origin for these conflict minerals with our suppliers. Our first disclosure report for the 2013 calendar year is due as of May 31, 2014.

Competition

Our competitors include but are not limited to:

- Analog Devices, Inc.
- Freescale Semiconductor, Inc.
- Infineon Technologies Corporation
- Intel Corporation
- Macronix International Co., Ltd.
- Maxim Integrated Products, Inc.
- Micron Technology, Inc.
- Microchip Technology Inc.
- Renesas Electronics Corp.
- SK Hynix Inc. (“SK Hynix”)
- ST Microelectronics N.V.
- Toshiba Semiconductor Company Inc.
- Winbond Electronics Corporation

We believe providers of embedded systems solutions must possess the following attributes to remain competitive:

- strong relationships with OEMs, ODMs and contract manufacturers that are acknowledged leaders within their respective industries;
- discipline to continually reduce costs ahead of historically declining semiconductor market prices;
- strong market focus to identify emerging flash memory-based embedded systems applications;
- advanced research and development;
- flexibility in manufacturing capacity and utilization so as to take advantage of industry conditions through market cycles;
- access to the financial resources needed to maintain a highly competitive technological position;
- focus on sustainable and profitable portions of the markets;

- the ability to establish and sustain strategic relationships and alliances with key industry participants;
- the ability to manufacture products with a high degree of quality, performance, market acceptance and a low cost structure;
- rapid time to market for new products, measured by the time elapsed from first conception of a new product to its commercialization, and
- a strong network of enabling and ecosystem partners

Employees

We had 3,685 employees as of December 29, 2013.

Backlog

We generally manufacture and market standard lines of our products. Sales are made primarily pursuant to purchase orders for delivery or agreements covering purchases over a period of time. These orders or agreements may be revised or canceled without penalty. In this respect, the amount of backlog as of any particular date is not the sole indicator of future results.

Patents, licenses and trademarks

Our success depends in part on our proprietary technology. We rely on a combination of protections provided by contracts, including confidentiality and non-disclosure agreements, copyrights, patents, trademarks and common law rights, such as trade secrets, to protect our intellectual property against infringement or misappropriation by others and to ensure that we have the ability to generate royalty and other licensing revenues. We intend to continue to license our intellectual property to third parties. In fiscal 2013 we sold some patents that were non-essential to our core businesses and we may continue to sell or enter into other business arrangements with third parties relative to individual patents or portfolios of patents on a selective basis. We also acquired or were assigned a significant amount of IP, including approximately 1,311 patents and patent applications, in connection with our acquisition of the MCA business from FSL.

9

As of December 29, 2013, we had 2,560 U.S. patents and 1,530 foreign patents as well as 383 patent applications pending in the United States and 563 patent applications pending outside the United States. We expect to file future patent applications in both the United States and abroad on significant inventions, as we deem appropriate. There can be no assurance that the claims allowed on any patents we hold will be sufficiently broad to protect our technology, or that any patents will be issued from any application pending or filed by us.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described below and the other information in this Annual Report on Form 10-K. If any of the following risks materialize, our business could be materially harmed, and our financial condition and results of operations could be materially and adversely affected.

The risks described below are not the only ones facing us. Additional risks not currently known to us or that we currently believe are immaterial may also impair our business, results of operations, financial condition and liquidity.

The semiconductor market is highly competitive and subject to rapid, highly volatile changes in demand, pricing and product mix that are difficult to predict. Our failure to adequately forecast our customers' needs could materially adversely affect our business.

The semiconductor market is mature and subject to business cycles that can include extended periods of oversupply and constant downward price pressure, which is due, in substantial part, to the relatively large number of competing firms and technologies. Our competitors include Analog Devices, Inc., Freescale Semiconductor, Inc., Infineon Technologies Corporation, Macronix International Co., Ltd, Maxim Integrated Products, Inc., Micron Technology, Inc., Renesas Electronics Corp., SK Hynix Inc. ("SK Hynix"), ST Microelectronics N.V., Toshiba Semiconductor Company Inc. and Winbond Electronics Corporation.

During economic downturns, periods of extremely intense competition, or the presence of oversupply in the industry, the selling prices for our products have declined at a rapid rate over relatively short time periods as compared to historical rates of decline. When such pricing declines occur, we may not be able to mitigate their effects by selling more or higher margin units, or by reducing our manufacturing costs in a corresponding fashion. In such circumstances, our operating results could be materially adversely affected and we may determine that goodwill or other intangible assets have become impaired.

To forecast demand and value inventory, we consider, among other factors, inventory on hand, historical customer demand data, backlog data, the competitiveness of product offerings, target market growth, market conditions and product life cycles. If we are unable to accurately assess these factors and anticipate future demand or market conditions, we may have excess or obsolete inventory resulting in inventory write-down which would be reflected in cost of sales in the period the write-down is made. In addition, during periods of industry overcapacity, customers generally do not order products as far in advance of the scheduled shipment date as they do during periods when our industry is operating closer to capacity, which can exacerbate the difficulty in forecasting capacity requirements and may result in increased inventory levels. Similarly, when customers change orders booked with us, our planned manufacturing capacity may be greater or less than actual demand, resulting in less than optimal capacity usage. When this occurs, we adjust our production levels, but downward adjustments may not prevent our production of excess inventory. An inability to address challenges like the ones described above would have a negative impact on our gross margin in that period. Moreover, inaccurate forecasting could also result in shortages in inventory that would cause us to fail to meet customer demand. If we are unable to produce the types and quantities of products within the timeframes and on delivery schedules required by our customers, we may lose customers or, in certain circumstances, be liable for losses incurred by our customers, which would materially adversely affect our business and financial results.

Investment in new business strategies and acquisitions, such as our acquisition of the Fujitsu MCA business, involves numerous risks and may not result in the strategic and financial benefits we expected, and may present risks not originally contemplated.

On August 1, 2013, we completed the acquisition of the MCA business. This transaction involved challenges and risks that could adversely affect our business and operating results, including:

- the transaction may not provide the advantages that we anticipated;
- we have little experience in producing, marketing and selling MCA products and may not be able to do so successfully;
- we will be required to dedicate a significant amount of time and attention of our senior management and other employees to the integration of the MCA business operations, and this may adversely affect their capacity to manage the combined business or pursue other opportunities;
- we may not realize a satisfactory return;
- we may be unable to retain key personnel;
- we may experience difficulty in integrating new employees, business systems, and technology;
- the acquired MCA business may not have adequate controls, processes, and procedures to ensure compliance with laws and regulations, including controls in accordance with Section 404 of the Sarbanes-Oxley regulations, and our due diligence process may not have identified compliance issues or other liabilities;
- we may be unable to retain the customers and partners of acquired businesses; and/or
- there may be unanticipated intellectual property disputes or other litigation.

We may also be subject to additional liabilities imposed by law as a result of our participation in a multi-employer defined benefit pension plan. The Plan imposes certain liabilities upon an employer who is a contributor to a multi-employer pension plan under specific circumstances such as the employer withdraws from the plan, or the plan is terminated, or experiences a mass withdrawal. These liabilities include an allocable share of the underfunded vested benefits in the plan for all plan participants, not merely the benefits payable to a contributing employer’s own retirees. As a result, participating employers may bear a higher proportion of liability for underfunded vested benefits if other participating employers cease to contribute or withdraw, with the reallocation of liability being more acute in cases when a withdrawn employer is insolvent or otherwise fails to pay its withdrawal liability. Also, contribution rates could increase if the performance of plan assets does not meet expectations.

The MCA business is currently concentrated primarily in Japan in automotive and consumer applications, which exposes us to certain risks, including Japanese currency exchange rate fluctuations, contraction in automotive and consumer end- market demand due to adverse regional or worldwide economic conditions, as well as a decline in the automotive industry in Japan. If we are unable to achieve greater diversification in our MCA business, we could be materially adversely affected.

In addition, we may in the future invest in other new business strategies or acquisitions that may involve significant risks and uncertainties, including the distraction of our management team from current operations, greater than expected liabilities and expenses, inadequate return on capital, and unidentified issues not discovered during our due diligence. Our results of operations may be adversely impacted by costs associated with our acquisitions, including one-time charges associated with restructurings. Further, our acquisitions could fail to produce the benefits that we anticipate, or could have other adverse effects that we currently do not foresee. In addition, some of the assumptions that we have relied upon, such as achievement of operating synergies, may not be realized.

Our operating results are dependent on the performance of distributors, including FSL, who is our primary distributor for Japan.

A significant portion of our sales are through independent distributors that are not under our control. For example, sales through distributors accounted for 71%, 68% and 69% of our net sales for fiscal 2013, 2012 and 2011, respectively. Generally, our agreements with third party distributors may be terminated for convenience by either party upon relatively short notice and are non-exclusive, permitting our>PJM Interconnection L. L. C.

PLR
Provider of Last Resort
PPUC
Pennsylvania Public Utility Commission
PRP
Potentially Responsible Party
PUCO
Public Utilities Commission of Ohio
PUHCA
Public Utility Holding Company Act of 1935
RCP
Rate Certainty Plan
RFP
Request for Proposal
RSP
Rate Stabilization Plan
RTC
Regulatory Transition Charge
RTO
Regional Transmission Organization
S&P
Standard & Poor’s Ratings Service
SAIFI
System Average Interruption Frequency Index
SBC
Societal Benefits Charge
SEC
U.S. Securities and Exchange Commission
SFAS
Statement of Financial Accounting Standards
SFAS 123

SFAS No. 123, "Accounting for Stock-Based Compensation"
SFAS 123(R)
SFAS No. 123(R), "Share-Based Payment"
SFAS 133
SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”
SFAS 140
SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities”
SFAS 143
SFAS No. 143, "Accounting for Asset Retirement Obligations"
SFAS 144
SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"
SFAS 155
SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140"

GLOSSARY OF TERMS Cont'd.

SO_2	Sulfur Dioxide
TBC	Transition Bond Charge
TMI-1	Three Mile Island Unit 1
TMI-2	Three Mile Island Unit 2
VIE	Variable Interest Entity

PART I. FINANCIAL INFORMATION

FIRSTENERGY CORP. AND SUBSIDIARIES
OHIO EDISON COMPANY AND SUBSIDIARIES
PENNSYLVANIA POWER COMPANY AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. - ORGANIZATION AND BASIS OF PRESENTATION

FirstEnergy's principal business is the holding, directly or indirectly, of all of the outstanding common stock of its eight principal electric utility operating subsidiaries: OE, CEI, TE, Penn, ATSI, JCP&L, Met-Ed and Penelec. Penn is a wholly owned subsidiary of OE. FirstEnergy's consolidated financial statements also include its other principal subsidiaries: FENOC, FES and its subsidiary FGCO, NGC, FESC and FSG.

FirstEnergy and its subsidiaries follow GAAP and comply with the regulations, orders, policies and practices prescribed by the SEC, FERC and, as applicable, PUCO, PPUC and NJBPU. The preparation of financial statements in conformity with GAAP requires management to make periodic estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. Actual results could differ from these estimates. The reported results of operations are not indicative of results of operations for any future period.

These statements should be read in conjunction with the financial statements and notes included in the combined Annual Report on Form 10-K for the year ended December 31, 2005 for FirstEnergy and the Companies. The consolidated unaudited financial statements of FirstEnergy and each of the Companies reflect all normal recurring adjustments that, in the opinion of management, are necessary to fairly present results of operations for the interim periods. Certain businesses divested in the first and second quarters of 2005 have been classified as discontinued operations on the Consolidated Statements of Income (see Note 4). As discussed in Note 13, interim period segment reporting in 2005 was reclassified to conform with the current year business segment organizations and operations.

FirstEnergy and its subsidiaries consolidate all majority-owned subsidiaries over which they exercise control and, when applicable, entities for which they have a controlling financial interest. Intercompany transactions and balances are eliminated in consolidation. FirstEnergy consolidates a VIE (see Note 9) when it is determined to be the VIE's primary beneficiary. Investments in nonconsolidated affiliates over which FirstEnergy and its subsidiaries have the ability to exercise significant influence, but not control, (20-50 percent owned companies, joint ventures and partnerships) are accounted for under the equity method. Under the equity method, the interest in the entity is reported as an investment in the Consolidated Balance Sheet and the percentage share of the entity's earnings is reported in the Consolidated Statement of Income. Certain prior year amounts have been reclassified to conform to the current presentation.

FirstEnergy's and the Companies' independent registered public accounting firm has performed reviews of, and issued reports on, these consolidated interim financial statements in accordance with standards established by the PCAOB. Pursuant to Rule 436(c) under the Securities Act of 1933, their reports of those reviews should not be considered a report within the meaning of Section 7 and 11 of that Act, and the independent registered public accounting firm's liability under Section 11 does not extend to them.

Restatement of the Consolidated Statements of Cash Flows

FirstEnergy, OE and Penn are restating their respective Consolidated Statements of Cash Flows for the three months ended March 31, 2006. This corrects a misclassification of a cash receipt by Penn of $78 million from the liquidation of cash investments (restricted cash related to the 2005 generation asset transfers) in the first quarter of 2006. Penn is a subsidiary of OE, which is a direct subsidiary of FirstEnergy. This correction also resulted in the restatement of FirstEnergy's and OE's consolidated statements of cash flows. The cash receipt was previously reported under "Prepayments and other current assets" in cash flows from operating activities for the quarter ended March 31, 2006 and should have been reported under "Cash Investments" for FirstEnergy, OE and Penn in cash flows from investing activities for the quarter ended March 31, 2006. This reclassification resulted in a $78 million decrease in the previously reported cash flows from operating activities and a corresponding increase in cash flows provided from (used for) investing activities in FirstEnergy's, OE's and Penn's consolidated statements of cash flows for the three months ended March 31, 2006. This correction does not change their previously reported consolidated statements of income and comprehensive income for the three months ended March 31, 2006, their consolidated balance sheets as of March 31, 2006 or the net increase or decrease in cash and cash equivalents for the three months ended March 31, 2006 in their respective statements of cash flows.

The effect of this correction on FirstEnergy's, OE's and Penn's Consolidated Statements of Cash Flows for the three months ended March 31, 2006 are as follows:

The effect of this correction on FirstEnergy's, OE's and Penn's Consolidated Statements of Cash Flows for the three months ended March 31, 2006 are as follows:

FIRSTENERGY

	Three Months Ended March 31, 2006	
	As Previously Reported	As Restated
	(In millions)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 221	$ 221
Adjustments to reconcile net income to net cash from operating activities -		
Provision for depreciation	148	148
Amortization of regulatory assets	222	222
Deferral of new regulatory assets	(59)	(59)
Nuclear fuel and lease amortization	20	20
Deferred purchased power and other costs	(125)	(125)
Deferred income taxes and investment tax credits, net	6	6
Deferred rents and lease market valuation liability	(38)	(38)
Accrued compensation and retirement benefits	(19)	(19)
Commodity derivative transactions, net	26	26
Cash collateral	(106)	(106)
Decrease (Increase) in operating assets -		
Receivables	226	226
Materials and supplies	(52)	(52)
Prepayments and other current assets	(15)	(93)
Increase (Decrease) in operating liabilities -		
Accounts payable	(114)	(114)
Accrued taxes	8	8
Accrued interest	100	100
Electric service prepayment programs	(14)	(14)
Other	(33)	(33)
Net cash provided from operating activities	402	324
CASH FLOWS FROM FINANCING ACTIVITIES	(50)	(50)

CASH FLOWS FROM INVESTING ACTIVITIES:		
Property additions	(447)	(447)
Proceeds from asset sales	57	57
Proceeds from nuclear decommissioning trust fund sales	481	481
Investments in nuclear decommissioning trust funds	(484)	(484)
Cash investments	25	103
Other	(20)	(20)
Net cash used for investing activities	(388)	(310)
Net decrease in cash and cash equivalents	$ (36)	$ (36)

OE

	Three Months Ended March 31, 2006	
	As Previously Reported	As Restated
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 63,830	$ 63,830