

Spansion Inc.  
Form 10-Q  
August 08, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 29, 2008

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 000-51666

**SPANSION INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**20-3898239**  
(I.R.S. Employer  
Identification No.)

**915 DeGuigne Drive**

**Sunnyvale, California**  
(Address of principal executive offices)

**94088**  
(Zip Code)

**Registrant's telephone number, including area code: (408) 962-2500**

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the close of business on August 1, 2008:

| <b>Class</b>                            | <b>Number of Shares</b> |
|---|-------------------------|
| Class A Common Stock, \$0.001 par value | 160,750,957             |
| Class C Common Stock, \$0.001 par value | 1                       |

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Spansion Inc.****Condensed Consolidated Statements of Operations****(in thousands, except per share amounts)****(Unaudited)**

|   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|---|---------------------------|-------------------------|-------------------------|-------------------------|
|   | <b>Jun. 29<br/>2008</b>   | <b>Jul. 1,<br/>2007</b> | <b>Jun. 29<br/>2008</b> | <b>Jul. 1,<br/>2007</b> |
| Net sales   | \$ 426,268                | \$ 373,710              | \$ 826,451              | \$ 788,665              |
| Net sales to related parties                        | 186,452                   | 235,462                 | 356,541                 | 448,278                 |
| <b>Total net sales</b>                              | <b>612,720</b>            | <b>609,172</b>          | <b>1,182,992</b>        | <b>1,236,943</b>        |
| Expenses:   |                           |                         |                         |                         |
| Cost of sales <i>(Note 7)</i>                       | 503,571                   | 501,033                 | 979,381                 | 1,039,003               |
| Research and development <i>(Note 7)</i>            | 108,303                   | 110,900                 | 228,624                 | 212,891                 |
| Sales, general and administrative <i>(Note 7)</i>   | 68,264                    | 61,946                  | 133,028                 | 120,187                 |
| In-process research and development <i>(Note 3)</i> |                           |                         | 10,800                  |                         |
| Restructuring charges <i>(Note 13)</i>              | 9,922                     |                         | 9,922                   |                         |
| Operating loss                                      | (77,340)                  | (64,707)                | (178,763)               | (135,138)               |
| Other income (expense):                             |                           |                         |                         |                         |
| Loss on early extinguishment of debt                |                           | (3,435)                 |                         | (3,435)                 |
| Interest and other income (expense), net            | 2,536                     | 15,107                  | 5,915                   | 24,038                  |
| Interest expense                                    | (27,663)                  | (17,542)                | (48,654)                | (41,688)                |
| Other income (expense), net                         | (25,127)                  | (5,870)                 | (42,739)                | (21,085)                |
| Loss before income taxes                            | (102,467)                 | (70,577)                | (221,502)               | (156,223)               |
| Income tax benefit                                  | 1,824                     | 3,676                   | 2,388                   | 13,843                  |
| Net loss  | \$ (100,643)              | \$ (66,901)             | \$ (219,114)            | \$ (142,380)            |
| Net loss per common share:                          |                           |                         |                         |                         |
| Basic and diluted                                   | \$ (0.63)                 | \$ (0.50)               | \$ (1.47)               | \$ (1.06)               |
| Shares used in per share calculation:               |                           |                         |                         |                         |
| Basic and diluted                                   | 160,196                   | 134,827                 | 149,480                 | 134,683                 |

See accompanying notes

**Table of Contents****Spansion Inc.****Condensed Consolidated Balance Sheets**

(in thousands)

|   | <b>Jun. 29<br/>2008<br/>(Unaudited)</b> | <b>Dec. 30<br/>2007 (*)</b> |
|---|---|-----------------------------|
| <b>Assets</b>   |   |                             |
| Current assets:   |   |                             |
| Cash and cash equivalents   | \$ 240,442                              | \$ 199,092                  |
| Marketable securities   | 108,479                                 | 216,650                     |
| Trade accounts receivable, net                                      | 200,851                                 | 181,443                     |
| Trade accounts receivable from related parties, net <i>(Note 7)</i> | 154,982                                 | 186,646                     |
| Other receivables   | 8,565                                   |                             |
| Other receivables from related parties <i>(Note 7)</i>              | 7,001                                   | 11,873                      |
| Inventories:  |   |                             |
| Raw materials   | 20,443                                  | 31,877                      |
| Work-in-process   | 519,779                                 | 421,765                     |
| Finished goods  | 96,167                                  | 130,227                     |
| Total inventories   | 636,389                                 | 583,869                     |
| Deferred income taxes   | 29,133                                  | 26,607                      |
| Prepaid expenses and other current assets                           | 43,277                                  | 46,452                      |
| Total current assets  | 1,429,119                               | 1,452,632                   |
| Property, plant and equipment, net                                  | 2,365,211                               | 2,271,964                   |
| Deferred income taxes   | 40,014                                  | 29,957                      |
| Acquisition related intangible assets, net <i>(Note 3)</i>          | 60,437                                  |                             |
| Goodwill <i>(Note 3)</i>  | 19,289                                  |                             |
| Other assets  | 85,619                                  | 61,092                      |
| Total assets  | \$ 3,999,689                            | \$ 3,815,645                |
| <b>Liabilities and Stockholders Equity</b>                          |   |                             |
| Current liabilities:  |   |                             |
| Notes payable to banks under revolving loans                        | \$ 128,930                              | \$                          |
| Accounts payable  | 517,010                                 | 489,163                     |
| Accounts payable to related parties <i>(Note 7)</i>                 | 77,212                                  | 56,929                      |
| Accrued compensation and benefits                                   | 78,099                                  | 60,778                      |
| Accrued liabilities to related parties <i>(Note 7)</i>              | 6,397                                   | 9,666                       |
| Other accrued liabilities   | 93,636                                  | 88,006                      |
| Income taxes payable  | 4,809                                   | 13,818                      |
| Deferred income on shipments  | 46,688                                  | 39,957                      |
| Current portion of long-term debt                                   | 104,922                                 | 68,705                      |
| Current portion of long-term obligations under capital leases       | 39,845                                  | 33,092                      |
| Total current liabilities   | 1,097,548                               | 860,114                     |
| Deferred income taxes   | 7,023                                   | 186                         |
| Long-term debt, less current portion                                | 1,259,031                               | 1,258,616                   |
| Long-term obligations under capital leases, less current portion    | 53,346                                  | 40,920                      |
| Other long-term liabilities   | 28,595                                  | 23,361                      |
| Commitments and contingencies                                       |   |                             |

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|  |              |              |
|--|--------------|--------------|
| Stockholders' equity                       | 1,554,146    | 1,632,448    |
| Total liabilities and stockholders' equity | \$ 3,999,689 | \$ 3,815,645 |

\* Derived from audited financial statements at December 30, 2007.

**See accompanying notes**

**Table of Contents****Spansion Inc.****Condensed Consolidated Statements of Cash Flows****(in thousands)****(Unaudited)**

|  | <b>Six Months Ended</b>  |                         |
|--|--------------------------|-------------------------|
|  | <b>Jun. 29,<br/>2008</b> | <b>Jul. 1,<br/>2007</b> |
| <b>Cash Flows from Operating Activities:</b>   |                          |                         |
| Net loss   | \$ (219,114)             | \$ (142,380)            |
| Adjustments to reconcile net loss to net cash provided by operating activities:                          |                          |                         |
| Depreciation and amortization  | 307,084                  | 257,252                 |
| Write-off of in-process research and development   | 10,800                   |                         |
| Loss on pension curtailment  |                          | 2,010                   |
| Loss on early extinguishment of debt   |                          | 3,435                   |
| Provision for doubtful accounts  | 1,572                    | 1,727                   |
| Benefit for deferred income taxes  | (9,961)                  | (36,697)                |
| Net gain on sale and disposal of property, plant and equipment, net                                      | (18,426)                 | (14,597)                |
| Gain on sale of marketable securities  | (621)                    |                         |
| Compensation recognized under employee stock plans   | 9,938                    | 7,341                   |
| Amortization of premium on floating rate notes and discount on senior subordinated and senior notes, net | 1,128                    | 1,198                   |
| Changes in operating assets and liabilities:   |                          |                         |
| Decrease (increase) in trade account receivables from related parties                                    | 28,688                   | (9,805)                 |
| Increase in other receivables from related parties   | (1,616)                  | (6,758)                 |
| (Increase) decrease in trade account receivables and other receivables                                   | (7,686)                  | 24,371                  |
| Increase in inventories  | (52,519)                 | (22,864)                |
| Decrease (increase) in prepaid expenses and other current assets   | 6,746                    | (27,136)                |
| Increase in other assets   | (8,204)                  | (2,457)                 |
| Increase in accounts payable and accrued liabilities to related parties                                  | 22,187                   | 37,894                  |
| Increase in accounts payable and accrued liabilities   | 36,130                   | 289,896                 |
| Increase (decrease) in accrued compensation and benefits   | 17,322                   | (2,334)                 |
| (Decrease) increase in income taxes payable  | (9,009)                  | 20,746                  |
| Increase in deferred income on shipments   | 6,614                    | 4,368                   |
| Net cash provided by operating activities  | 121,053                  | 385,210                 |
| <b>Cash Flows from Investing Activities:</b>   |                          |                         |
| Proceeds from sale of property, plant and equipment  | 5,593                    | 186,226                 |
| Purchases of property, plant and equipment   | (286,590)                | (769,889)               |
| Proceeds from maturity and sale of marketable securities   | 133,695                  | 633,050                 |
| Purchases of marketable securities   | (36,950)                 | (607,075)               |
| Loan made to an investee   | (3,125)                  |                         |
| Cash proceeds from Saifun acquisition  | 733                      |                         |
| Net cash used in investing activities  | (186,644)                | (557,688)               |
| <b>Cash Flows from Financing Activities:</b>   |                          |                         |
| Proceeds from borrowings, net of issuance costs  | 239,577                  | 605,707                 |
| Payments on debt and capital lease obligations   | (121,127)                | (570,952)               |
| Proceeds from issuance of common stock, net of offering costs  |                          | 60                      |

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|  |            |            |
|--|------------|------------|
| Net cash provided by financing activities                    | 118,450    | 34,815     |
| Effect of exchange rate changes on cash and cash equivalents | (11,508)   | (5,208)    |
| Net (decrease) increase in cash and cash equivalents         | 41,350     | (142,871)  |
| Cash and cash equivalents at the beginning of period         | 199,092    | 759,794    |
| Cash and cash equivalents at end of period                   | \$ 240,442 | \$ 616,923 |
| Non-cash investing and financing activities:                 |            |            |
| Equipment capital leases                                     | \$ 50,474  | \$         |
| Issuance of common stock and stock options to acquire Saifun | 108,898    |            |
| <b>See accompanying notes</b>                                |            |            |



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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

Spansion Inc. (the Company) is a semiconductor manufacturer headquartered in Sunnyvale, California, with research and development, manufacturing and assembly operations in the United States, Europe and Asia. The Company designs, develops, manufactures, markets, licenses and sells Flash memory technology and solutions.

The Company's Flash memory devices primarily address the integrated category of the Flash memory market and are incorporated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, personal computers and PC peripheral applications. The Company licenses its Flash memory technology to semiconductor manufacturers who use this technology to develop and manufacture a variety of stand-alone and embedded non-volatile Flash memory products.

**2. Summary of Significant Accounting Policies**

**Basis of Presentation**

The accompanying condensed consolidated financial statements of the Company have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The condensed consolidated financial statements and notes thereto are unaudited. In the opinion of the Company's management, these financial statements contain all adjustments (consisting of normal recurring adjustments) that are necessary for a fair presentation of the Company's operating results, financial position and cash flows. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent interim period or for the full fiscal year ending December 28, 2008.

The condensed consolidated financial statements include all the accounts of the Company and those of its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated.

The condensed consolidated financial statements do not include certain financial footnotes and disclosures required under U.S. generally accepted accounting principles for audited financial statements. Therefore, the unaudited condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and footnotes thereto for the year ended December 30, 2007 included in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission (the SEC) on February 28, 2008.

The Company uses a 52- to 53-week fiscal year ending on the last Sunday in December. The three months ended June 29, 2008 and July 1, 2007 both consisted of 13 weeks. The six months ended June 29, 2008 and July 1, 2007 both consisted of 26 weeks.

**Use of Estimates**

The preparation of consolidated financial statements and disclosures in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of commitments and contingencies and the reported amounts of revenues and expenses during the reporting periods. Estimates are used to account for the fair value of certain marketable securities, revenue, the allowance for doubtful accounts, inventory valuation, valuation of acquired intangible assets, impairment of long-lived assets, income taxes, stock based compensation expenses, product warranties and pension and postretirement benefits. Actual results may differ from those estimates, and such differences may be material to the financial statements.

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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements-Continued**

**(Unaudited)**

**Financial Statements Reclassifications**

Certain prior period amounts in the consolidated statements of operations and statements of cash flows have been reclassified to conform to the current period presentation. There is no material impact to the Company's results from operations due to these reclassifications.

**Inventories**

Inventories are stated at standard cost adjusted to approximate the lower of actual cost (first-in, first-out method) or market. The Company records a provision for excess and obsolete inventory based on its estimated forecast of product demand. Demand for the Company's products can fluctuate significantly from period to period. Historically, inventories in excess of forecasted customer demand over the next six months were not valued. However, during the second quarter of fiscal 2008, as part of a strategy to efficiently manage its new production capacity and to maintain strategic inventory levels of certain products, the Company built and valued certain inventory to meet estimated demand as much as twelve months into the future. Obsolete inventories are written off.

**Goodwill**

As a result of the Saifun acquisition, the Company recorded approximately \$19.3 million of goodwill on its books. In accordance with FASB Statement No. 142 (Statement 142), *Goodwill and Other Intangible Assets*, the Company is required to review goodwill for impairment at least annually or more often if there are indicators of impairment present. The Company will perform its annual impairment analysis during the fourth quarter of each year, with the first impairment test related to Saifun goodwill to be performed during the fourth quarter of 2008.

**Fair Value**

The Company adopted FASB Statement No. 157 (Statement 157), *Fair Value Measurements*, effective January 1, 2008. Statement 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Statement 157 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1 Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date. Examples of the assets carried at Level 1 fair value generally are equities listed in active markets and investments in publicly traded mutual funds with quoted market prices.

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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements-Continued**

**(Unaudited)**

Level 2 Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the asset/liability's anticipated life.

Level 3 Inputs reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model.

The availability of observable inputs can vary and is affected by a wide variety of factors, including, for example, the type of a security, whether the security is new and not yet established in the marketplace, and other characteristics particular to a transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. When observable prices are not available, the Company either uses implied pricing from similar instruments or valuation models based on net present value of estimated future cash flows, adjusted as appropriate for liquidity, credit, market and/or other risk factors. Fair value is a market-based measure considered from the perspective of a market participant rather than an entity-specific measure. Therefore, even when market assumptions are not readily available, the Company's own assumptions are set to reflect those it believes market participants would use in pricing the asset or liability at the measurement date. Please see Note 12 for fair value disclosure on the Company's marketable securities.

**New Accounting Pronouncements**

In February 2008, the FASB issued FASB Staff Position (FSP) No. 157-2 (FSP FAS 157-2), *Effective Date of FASB Statement No. 157*, which provides a one year deferral of the effective date of Statement 157 for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. The Company has adopted the provisions of Statement 157 with respect to its financial assets and liabilities only.

In February 2007, the FASB issued Statement No. 159 (Statement 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. Under Statement 159, a company may choose, at specified election dates, to measure eligible financial instrument and certain other items at fair value that are not otherwise required to be so measured. If a company elects the fair value option for an eligible item, changes in that item's fair value in subsequent reporting periods must be recognized in current earnings. Statement 159 is effective as of the beginning of the fiscal year beginning after November 15, 2007. Upon initial adoption, this statement provides entities with a one-time chance to elect the fair value option for the eligible items. The effect of the first measurement to fair value should be reported as a cumulative-effect adjustment to the opening balance of retained earnings in the year the statement is adopted. The Company adopted Statement 159 at the beginning of its fiscal year 2008 on December 31, 2007 and did not make any elections for fair value accounting. Therefore, the Company did not record a cumulative-effect adjustment to its opening retained earnings balance.

In March 2008, the FASB issued Statement No. 161 (Statement 161), *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (Statement 133). Statement 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items

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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements-Continued**

**(Unaudited)**

affect an entity's financial position, financial performance and cash flows. The guidance in Statement 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the impact of adopting Statement 161 on its consolidated financial statements.

In May 2008, the FASB issued FSP APB No. 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. The FSP will require convertible debt which may be settled in cash upon conversion including partial cash conversion to be separated into debt and equity components at issuance with a value to be assigned to each. The value assigned to the debt component will be the estimated fair value, as of the issuance date, of a similar bond without the conversion feature. The difference between the bond cash proceeds and this estimated fair value will be recorded as a debt discount and amortized to interest expense over the life of the bond. Although FSB APB 14-1 will have no impact on the Company's actual past or future cash flows, it will require the Company to record additional non-cash interest expense as the debt discount is amortized which will increase expenses and adversely impact earnings per share. FSP APB 14-1 will become effective January 1, 2009 and will require retrospective application. In June 2006, the Company, issued \$207.0 million of aggregate principal amount of 2.25% Exchangeable Senior Subordinated Debentures due 2016 (Exchangeable Debt). The Company's accounting for the Exchangeable Debt will be impacted by the FSP as the related indenture provides the Company with the option to settle some or all of the instrument in cash. The Company is currently evaluating the impact of adopting FSP APB No. 14-1 on its consolidated financial statements.

In April 2008, the FASB issued FSP FASB 142-3, *Determination of the Useful Life of Intangible Assets*. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142 (Statement 142), *Goodwill and Other Intangible Assets*. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset under Statement 142 and the period of expected cash flows used to measure the fair value of the asset under Statement 141 (Revised 2007), *Business Combinations*, and other U.S. GAAP. This FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is prohibited. The Company is currently evaluating the impact that this FSP will have on its operations, financial position and cash flows.

**3. Acquisition of Saifun Semiconductors Ltd. (Saifun)**

On March 18, 2008, the Company completed the acquisition of all of the outstanding shares of Saifun Semiconductor Ltd., a publicly held company headquartered in Netanya, Israel (the Acquisition). The Company has included the results of operations of Saifun beginning March 18, 2008 in its condensed consolidated statements of operations for the six months ended June 29, 2008.

Saifun is a provider of intellectual property (IP) solutions for the non-volatile memory (NVM) market and licenses its IP to semiconductor manufacturers that use this technology to develop and manufacture a variety of stand-alone and embedded NVM products. The Company believes that the acquisition of Saifun expands its product portfolio and enables its entry into the technology licensing business.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

The aggregate consideration paid by the Company for all outstanding Saifun common shares consisted of approximately 22.7 million shares of the Company's Class A common stock. In addition, the Company also assumed all of the outstanding Saifun stock options which were converted into options to purchase approximately 4.3 million shares of the Company's Class A common stock. The total purchase price for Saifun was \$117.8 million and is comprised of:

|   | <b>In millions</b> |
|---|--------------------|
| 22.7 million shares of Class A common stock | \$ 98.4            |
| Fair value of vested options issued         | 10.5               |
| Acquisition related transaction costs       | 8.9                |
| <b>Total purchase price</b>                 | <b>\$ 117.8</b>    |

The fair value of the Company's common stock issued was determined in accordance with Emerging Issues Task Force (EITF) Issue No. 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*, which reflected the average of the closing prices of the Company's common stock on the NASDAQ for the two trading days prior to and following December 13, 2007, the date that the number of issuable shares became fixed. The fair value of the Company's options and restricted stock units was determined under FASB Statement No. 123R (Statement 123R), *Accounting for Stock-Based Compensation*. The vested portion of these options and restricted stock units was valued at approximately \$10.5 million. The unvested portion was valued at approximately \$6.3 million and will be amortized ratably over the future remaining service periods.

In accordance with EITF Issue No. 04-01, *Accounting for Pre-existing Relationships between the Parties to a Business Combination*, the Company reviewed its existing contracts with Saifun as of the date of the acquisition to determine if such contracts included terms that were favorable or unfavorable when compared to pricing for current market transactions for the same or similar terms which will result in a settlement gain or loss as of this date. A settlement gain or loss is measured as the lesser of (a) the amount by which the agreements were favorable or unfavorable to market terms or (b) the stated settlement provisions of the agreements available to the Company. The Company concluded that the terms in the pre-existing relationship were neither favorable nor unfavorable and, accordingly, the Company recognized no gain or loss relating to its existing contracts with Saifun as of the acquisition date.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)*****Preliminary Purchase Price Allocation***

The total purchase price was preliminarily allocated to Saifun's tangible and identifiable intangible assets and liabilities based on their estimated fair values as of March 18, 2008, as set forth below:

|                                     | <b>In millions</b> |
|-------------------------------------|--------------------|
| Net tangible assets acquired        | \$ 24.2            |
| Existing technology                 | 42.8               |
| In process research and development | 10.8               |
| Non-competition agreement           | 1.3                |
| Customer relationships              | 18.0               |
| Trade name                          | 1.4                |
| Goodwill (1)                        | 19.3               |
| <b>Total purchase price</b>         | <b>\$ 117.8</b>    |

(1) Adjustments to goodwill in the second quarter of fiscal 2008 represents adjustment of the purchase price allocation to assets acquired and the settlement of direct acquisition costs.

As of June 29, 2008, the primary areas of purchase price allocation that have not been finalized relate to deferred taxes and the final quantification of direct acquisition costs which are expected to be finalized within fiscal 2008 and which may result in an adjustment in goodwill.

Management performed an analysis to determine the fair value of each tangible and identifiable intangible asset, including the portion of the purchase price attributable to acquired in-process research and development projects.

***In-Process Research and Development***

Of the total purchase price, approximately \$10.8 million was allocated to in-process research and development (IPR&D) and was expensed in the first quarter of fiscal 2008. Projects that qualify as IPR&D represent those that have not reached technological feasibility and have no alternative future use at the time of the acquisition. These projects included development of top injection technology and Nitride-Read-Only-Memory (NROM) design projects.

The value assigned to IPR&D was determined using a discounted cash flow methodology, specifically an excess earnings approach, which estimates value based upon the discounted value of future cash flows expected to be generated by the in-process projects, net of all contributory asset returns. The approach includes consideration of the importance of each project to the overall development plan, estimating costs to develop the purchased IPR&D into commercially viable products

The discount rates applied to individual projects were selected after consideration of the overall estimated weighted average cost of capital and the discount rates applied to the valuation of the other assets acquired. Such weighted average cost of capital was adjusted to reflect the difficulties and uncertainties in completing each project and thereby achieving technological feasibility, the percentage of completion of each project, anticipated market acceptance and penetration, market growth rates and risks related to the impact of potential changes in future target markets. In developing the estimated fair values, the Company used a discount rate of 20.8 percent.

***Other Acquisition Related Intangible Assets***

Existing technology represents Saifun's core technology, Nitride-Read-Only-Memory (NROM) intellectual property. NROM technology doubles the storage of a Flash memory cell by creating two distinct and independent charges in a single cell. This technology asset was estimated to have a useful life of six years.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

Customer relationships represent Saifun s existing contractual relationships as of March 18, 2008, which were estimated to have an average useful life of seven years.

Trade names were estimated to have an average useful life of four years.

Non-competition agreements represent agreements with four key employees and were estimated to have a useful life of two years.

The Company determined the fair value of the above intangible assets using income approaches and based the rates on the most current financial forecast available as of March 18, 2008. The discount rates used to discount net cash flows to their present values was 17.8 percent. The Company determined these discount rates after consideration of the Company s estimated weighted average cost of capital. The Company recorded the excess of the purchase price over the net tangible and identifiable intangible assets as goodwill.

The estimated useful lives for the acquired intangible assets were based upon Saifun s historical experience with technology life cycles, product roadmaps and Spansion s intended future use of the intangible assets. The Company amortizes acquisition related intangible assets using the straight-line method over their estimated useful lives.

The changes in the balances of acquisition related intangible assets for the quarter ended June 29, 2008 and the net book value of acquisition related intangible assets as of this date were as follows:

| (In millions)              | Intangible Assets, Gross |                  | Amortization<br>Expense for three<br>months ended |                  | Accumulated<br>Amortization<br>Total | Net Book Value   |                  | Weighted<br>average<br>amortization in<br>months |
|----------------------------|--------------------------|------------------|---|------------------|--------------------------------------|------------------|------------------|--|
|                            | Mar. 30,<br>2008         | Jun. 29,<br>2008 | Mar. 30,<br>2008                                  | Jun. 29,<br>2008 |                                      | Mar. 30,<br>2008 | Jun. 29,<br>2008 |  |
| Existing Technology        | \$ 42.8                  | \$ 42.8          | \$ 0.2  | \$ 1.9           | \$ 2.1                               | \$ 42.6          | \$ 40.7          | 72   |
| Customer Relationships     | 18.0                     | 18.0             | 0.1   | 0.6              | 0.7                                  | 17.9             | 17.3             | 84   |
| Trademarks and Trade names | 1.4                      | 1.4              |   | 0.1              | 0.1                                  | 1.4              | 1.3              | 48   |
| Non Competition Agreement  | 1.3                      | 1.3              |   | 0.2              | 0.2                                  | 1.3              | 1.1              | 24   |
| Goodwill                   | 17.8                     | 19.3             |   |                  |                                      | 17.8             | 19.3             |  |
| <b>TOTAL</b>               | <b>\$ 81.3</b>           | <b>\$ 82.8</b>   | <b>\$ 0.3</b>                                     | <b>\$ 2.8</b>    | <b>\$ 3.1</b>                        | <b>\$ 81.0</b>   | <b>\$ 79.7</b>   |  |



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

Estimated future amortization expense related to acquisition related intangible assets as of June 29, 2008 is as follows:

| <b>Fiscal Year</b> | <b>In millions</b> |
|--------------------|--------------------|
| 2008 (6 months)    | \$ 5.3             |
| 2009               | 10.7               |
| 2010               | 10.2               |
| 2011               | 10.1               |
| 2012               | 9.8                |
| 2013               | 9.7                |
| Thereafter         | 4.6                |
| <b>Total</b>       | <b>\$ 60.4</b>     |

**Pro Forma Information**

The following pro forma information gives effect to the Saifun acquisition as if it had occurred at the beginning of the fiscal periods presented. The pro forma information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of each of the periods presented nor is it indicative of future financial performance.

|   | <b>Six Months Ended</b>                         |                     |
|---|---|---------------------|
|   | <b>Jun. 29,<br/>2008</b>                        | <b>Jul. 1, 2007</b> |
|   | <b>(in thousands, except per share amounts)</b> |                     |
| Total net sales                             | \$ 1,185,522                                    | \$ 1,246,192        |
| Net loss                                    | \$ (224,663)                                    | \$ (151,725)        |
| Basic and diluted net loss per common share | \$ (1.41)                                       | \$ (0.96)           |

**4. Stock-Based Compensation****Saifun Semiconductors Ltd. Employee Share Option Plans (Saifun Option Plans)**

The Company assumed all outstanding option shares under the Saifun Semiconductor Ltd.'s 1997, 2001 and 2003 plans (Saifun Option Plans), which were converted into options to purchase shares of the Company's Class A common stock. Each option share assumed continues to have, and be subject to, the same terms and conditions of such options immediately prior to the acquisition date.

When Saifun implemented the Saifun Semiconductors Ltd. 2003 Share Option Plan (Saifun 2003 Plan), all Saifun shares that were then available for grant under the earlier Saifun share option plans were acquired by the Saifun 2003 Plan. At that time, Saifun stopped granting awards under the prior plans, and granted all subsequent awards under the Saifun 2003 Plan. The Saifun 2003 Plan provides that awards may be granted to employees, contractors, directors, and consultants of Saifun and Saifun subsidiaries, although certain option awards that are governed by specific Israeli tax rules may be granted to eligible employees and directors only.

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For options granted under the Saifun Option Plans, the exercise period may not exceed 10 years from the date of grant. Options are granted with an exercise price equal to the market price of the stock at the date of grant or at a lower price as may be determined by the compensation committee of the board of directors at the date of grant. Prior to the Acquisition, option awards vested over a period of up to five

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

years; restricted stock unit and option awards granted after the Acquisition will vest over a period of up to four years. Awards granted under any of the Saifun Option Plans from the inception of the Saifun 2003 Plan through the Acquisition that are forfeited or cancelled revert to the Saifun 2003 Plan reserve. Future awards granted under the Saifun 2003 Plan that are forfeited or cancelled will also revert to that plan's reserve.

**Shares Available to Grant**

The numbers of shares of Class A common stock available for grant under the Spansion Inc. 2007 Equity Incentive Plan (the 2007 Plan) and the Saifun 2003 Plan are shown in the following table:

|   |             |
|---|-------------|
| Number of shares available for grant:                                       |             |
| Shares reserved for grant <sup>(1)</sup>                                    | 12,126,424  |
| Shares available under the 2005 Plan <sup>(2)</sup>                         | 495,224     |
| Stock options granted through June 29, 2008, net of cancelled stock options | (6,885,907) |
| RSU awards granted through June 29, 2008, net of cancelled RSU awards       | (2,049,152) |
| Shares available for grant under the 2007 Plan and Saifun 2003 Plan         | 3,686,589   |

<sup>(1)</sup> The 12,126,424 shares reserved for grant consisted of 6,675,000 shares approved for grant under the 2007 Plan, 920,523 shares transferred from the 2005 Plan and 4,530,901 shares from Saifun Option Plans.

<sup>(2)</sup> The shares available under the 2005 Plan were related to stock options or RSU awards which were cancelled subsequent to the adoption of the 2007 Plan and thus available for grant under the 2007 Plan.

**Valuation and Expense Information**

The following table sets forth the total recorded stock-based compensation expense for the Spansion Stock-Based Incentive Compensation Plans (Spansion Plans and Saifun Option Plans) by financial statement caption, resulting from the Company's stock options and restricted stock unit (RSU) awards for the three and six months ended June 29, 2008 and July 1, 2007:

|  | Three Months Ended  |                 | Six Months Ended    |                 |
|--|---------------------|-----------------|---------------------|-----------------|
|  | Jun.<br>29,<br>2008 | Jul. 1,<br>2007 | Jun.<br>29,<br>2008 | Jul. 1,<br>2007 |
|  | (in thousands)      |                 |                     |                 |
| Cost of sales  | \$ 1,183            | \$ 1,154        | \$ 2,504            | \$ 2,055        |
| Research and development                             | 1,555               | 1,171           | 2,823               | 2,065           |
| Sales, general and administrative                    | 2,465               | 2,021           | 4,612               | 3,221           |
| Stock-based compensation expense before income taxes | 5,203               | 4,346           | 9,939               | 7,341           |

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### Income tax benefit <sup>(1)</sup>

|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Stock-based compensation expense after income taxes <sup>(1)</sup> | \$ 5,203 | \$ 4,346 | \$ 9,939 | \$ 7,341 |
|--|----------|----------|----------|----------|

<sup>(1)</sup> There is no income tax benefit relating to stock option expenses because all of the Company's U.S. deferred tax assets, net of U.S. deferred tax liabilities, continue to be subjected to a full valuation allowance.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

The weighted average fair value of the Company's stock options granted in the three months ended June 29, 2008 and July 1, 2007 under Spansion Plans and Saifun Option Plans was \$1.32 and \$4.85 per share, respectively. The weighted average fair value of the Company's stock options granted in the six months ended June 29, 2008 and July 1, 2007 under Spansion Plans and Saifun Option Plans was \$1.89 and \$4.91 per share, respectively. The fair value of each stock option was estimated at the date of grant using a Black-Scholes-Merton option pricing model, with the following assumptions for grants:

|                          | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|--------------------------|---------------------------|-------------------------|--------------------------|-------------------------|
|                          | <b>Jun. 29,<br/>2008</b>  | <b>Jul. 1,<br/>2007</b> | <b>Jun. 29,<br/>2008</b> | <b>Jul. 1,<br/>2007</b> |
| Expected volatility      | 48.61%                    | 48.70%                  | 48.66%                   | 48.80%                  |
| Risk-free interest rate  | 3.03%                     | 4.80%                   | 2.67%                    | 4.78%                   |
| Expected term (in years) | 4.61                      | 4.61                    | 5.05                     | 4.61                    |
| Dividend yield           | 0%                        | 0%                      | 0%                       | 0%                      |

The Company's dividend yield is zero because the Company has never paid dividends and does not have plans to do so over the expected life of the stock options. The expected volatility is based on the Company's historical volatility since its initial public offering in December 2005 and the volatilities of the Company's competitors who are in the same industry sector with similar characteristics (guideline companies) given the limited historical realized volatility data of the Company. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bond with a remaining term equal to the expected stock option life. The expected term is based on the simplified method provided in Staff Accounting Bulletin Topic 14, *Share-Based Payment*, for developing the estimate of the expected life of a plain vanilla stock option except for options granted to Saifun on the date of acquisition for which expected term was based on historical option exercise activity. Under this approach, the expected term is presumed to be the mid-point between the average vesting date and the end of the contractual term. The Company estimated forfeitures based on its historical forfeiture rates. Statement 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates in order to derive the Company's best estimate of awards ultimately expected to vest.

As of June 29, 2008, the total unrecognized compensation cost related to unvested stock options and RSU awards under Spansion Plans and Saifun Option Plans was approximately \$49.6 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2012.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)****Stock Option and Restricted Stock Unit Activity**

The following table summarizes stock option activity and related information under Spansion Plans and Saifun Option Plans for the period presented:

|                                     | Number of<br>Shares | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual Life<br>(in years) | Aggregate<br>Intrinsic<br>Value<br>(in thousands) |
|-------------------------------------|---------------------|---|---|---|
| <b>Options:</b>                     |                     |   |   |   |
| Outstanding as of December 31, 2006 | 2,134,906           | \$ 12.63                                  | 6.08  | \$ 4,761  |
| Granted                             | 1,770,062           | \$ 10.39                                  |   |   |
| Cancelled                           | (363,000)           | \$ 12.45                                  |   |   |
| Exercised                           | (5,000)             | \$ 12.00                                  |   |   |
| Outstanding as of December 30, 2007 | 3,536,968           | \$ 11.53                                  | 5.66  | \$  |
| Granted <sup>(1)</sup>              | 6,806,119           | \$ 1.48                                   |   |   |
| Cancelled                           | (156,952)           | \$ 5.60                                   |   |   |
| Exercised                           | (11,154)            | \$ 0.09                                   |   |   |
| Outstanding as of June 29, 2008     | 10,174,981          | \$ 4.91                                   | 6.93  | \$ 9,102  |
| Exercisable as of June 29, 2008     | 2,090,299           | \$ 8.61                                   | 5.08  | \$ 1,301  |

(1) The number of options granted in the six months ended June 29, 2008 includes 4,364,829 shares of options granted in March 2008 under Saifun Option Plans in accordance with the provisions of the Acquisition Agreement.

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of \$2.30 as of June 27, 2008, which was the last trading day prior to June 29, 2008, which would have been received by the stock option holders had all stock option holders exercised their stock options as of that date.

The following table summarizes RSU award activity and related information for the period presented:

|                                  | Number of<br>Shares | Weighted-Average<br>Grant-date<br>Fair Value |
|----------------------------------|---------------------|--|
| <b>Restricted Stock Units:</b>   |                     |  |
| Unvested as of December 31, 2006 | 2,923,615           | \$ 12.33                                     |
| Granted                          | 1,680,532           | \$ 10.35                                     |
| Cancelled                        | (303,430)           | \$ 11.95                                     |

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|                                  |             |    |       |
|----------------------------------|-------------|----|-------|
| Vested                           | (1,147,291) | \$ | 12.27 |
| Unvested as of December 30, 2007 | 3,153,426   | \$ | 11.33 |
| Granted                          | 1,833,600   | \$ | 2.99  |
| Cancelled                        | (132,023)   | \$ | 10.26 |
| Vested                           | (767,628)   | \$ | 11.52 |
| Unvested as of June 29, 2008     | 4,087,375   | \$ | 7.59  |

### 5. Net Loss per Share

Basic and diluted net loss per share is computed based on the weighted-average number of common shares outstanding during the periods presented.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

For the three and six months ended June 29, 2008, the Company excluded approximately 26.0 million of potential common shares issuable upon exercise of outstanding stock options, upon vesting of outstanding restricted stock units and upon conversion of Spansion LLC's 2.25% Exchangeable Senior Subordinated Debentures because they had an antidilutive effect due to net losses recorded in each of those periods.

For the three and six months ended July 1, 2007, the Company excluded approximately 19.0 million of potential common shares issuable upon exercise of outstanding stock options, upon vesting of outstanding restricted stock units and upon conversion of Spansion LLC's 2.25% Exchangeable Senior Subordinated Debentures because they had an antidilutive effect due to net losses recorded in each of those periods.

**6. Comprehensive Loss**

The following are the components of comprehensive loss:

|  | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|--|---------------------------|----------------|-------------------------|----------------|
|  | <b>Jun. 29,</b>           | <b>Jul. 1,</b> | <b>Jun. 29,</b>         | <b>Jul. 1,</b> |
|  | <b>2008</b>               | <b>2007</b>    | <b>2008</b>             | <b>2007</b>    |
|  | <b>(in thousands)</b>     |                |                         |                |
| Net loss   | \$ (100,643)              | \$ (66,901)    | \$ (219,114)            | \$ (142,380)   |
| Net change in pension plan, net of taxes                                   | 156                       | 16             | (597)                   | 194            |
| Pension curtailment loss   |                           | 2,010          |                         | 2,010          |
| Net change in cumulative translation adjustment                            | (52,138)                  | (26,439)       | 30,327                  | (19,459)       |
| Net change in unrealized losses on marketable securities, net of \$0 taxes | (12,757)                  |                | (12,757)                |                |
| Total comprehensive loss   | \$ (165,382)              | \$ (91,314)    | \$ (202,141)            | \$ (159,635)   |

**7. Related Party Transactions**

Upon the issuance of the Company's Class A common stock to complete the acquisition of Saifun on March 18, 2008, Advanced Micro Devices (AMD) voting interest in the Company declined below 10 percent. AMD is no longer deemed to be a related party of the Company as its percentage of voting interest in the Company fell below 10 percent and it has no representation on the Company's board of directors.



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

The transactions with AMD for the period from December 31, 2007 to March 18, 2008, the closing date of the Saifun acquisition were not material. The following tables present the related party transactions and account balances between the Company and AMD for the three and six months ended July 1, 2007 and as of December 30, 2007:

|                                      | <b>Three Months Ended<br/>Jul. 1, 2007</b> | <b>Six Months Ended<br/>Jul. 1, 2007</b> |
|--------------------------------------|--|--|
| Cost of sales:                       |  |  |
| Royalties to AMD                     | \$ 794                                     | \$ 1,555                                 |
| Service fees to AMD <sup>(1)</sup> : |  |  |
| Cost of sales                        | \$ (513)                                   | \$ (1,115)                               |
| Research and development             | 104  | 179                                      |
| Sales, general and administrative    | 105  | 214                                      |
| Service fees to AMD                  | \$ (304)                                   | \$ (722)                                 |

<sup>(1)</sup> Service fees to AMD are net of reimbursements from AMD, primarily for facility related charges.

|  | <b>Dec. 30, 2007<br/>(in thousands)</b> |
|--|---|
| Trade accounts receivable from AMD, net of allowance for doubtful accounts | \$ 2,976                                |
| Other receivables from AMD   | \$ 6,488                                |
| Accounts payable to AMD  | \$ 3,597                                |
| Royalties payable to AMD   | \$ 1,629                                |

The Company receives certain administrative services from Fujitsu, a holder of 10 percent or more of the Company's voting securities. The charges for these services are negotiated annually between the Company and Fujitsu based on the Company's expected requirements and the estimated future costs of the services to be provided. The service charges are billed monthly on net 45 days terms. Fujitsu provides test and assembly services to the Company on a contract basis and also provides foundry and sort services to the Company since consummation of the JV1/JV2 transaction which occurred in the second quarter of fiscal 2007. Please see Note 14 for amendments to the Foundry Agreement with Fujitsu subsequent to the end of the second quarter of fiscal 2008. The Company also purchases commercial die from Fujitsu, which is packaged together with the Company's Flash memory devices.

The Company licenses certain intellectual property from Fujitsu in exchange for the payment of royalties to Fujitsu. These royalty expenses are recognized in cost of sales. The Company is required to pay Fujitsu semi-annual royalties based on net sales (minus the costs of commercial die). The royalty as a percentage of sales will decline to zero over a specified time. The term of the agreement expires in 2013.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

The following tables present the significant related party transactions and account balances between the Company and Fujitsu:

|  | Three Months Ended |              | Six Months Ended |              |
|--|--------------------|--------------|------------------|--------------|
|  | Jun. 29, 2008      | Jul. 1, 2007 | Jun. 29, 2008    | Jul. 1, 2007 |
|  | (in thousands)     |              |                  |              |
| Net sales to Fujitsu   | \$ 186,452         | \$ 235,462   | \$ 356,542       | \$ 448,278   |
| Cost of sales:   |                    |              |                  |              |
| Royalties to Fujitsu   | \$ 817             | \$ 794       | \$ 1,567         | \$ 1,555     |
| Other purchases of goods and services from Fujitsu and rental expense to Fujitsu | 19,553             | 16,420       | 40,325           | 43,901       |
| Subcontract manufacturing and commercial die purchases from Fujitsu              | 1,807              | 2,829        | 5,163            | 14,877       |
| Wafer purchases, processing and sort services from Fujitsu <sup>(1)</sup>        | 61,600             | 58,962       | 129,741          | 58,962       |
| Net gain recognized on sale of assets to Fujitsu on April 2, 2007 <sup>(1)</sup> | (8,907)            | (9,567)      | (17,045)         | (9,567)      |
| Reimbursement on costs of employees seconded to Fujitsu <sup>(1)</sup>           | (7,427)            | (5,968)      | (14,029)         | (5,968)      |
| Pension curtailment loss <sup>(1)</sup>  |                    | 2,010        |                  | 2,010        |
| Equipment rental income from Fujitsu <sup>(1)</sup>                              | (973)              | (2,030)      | (1,971)          | (2,030)      |
| Administrative services income from Fujitsu <sup>(1)</sup>                       | (273)              | (290)        | (1,087)          | (290)        |
|  | \$ 66,197          | \$ 63,160    | \$ 142,664       | \$ 103,450   |
| Service fees to Fujitsu:   |                    |              |                  |              |
| Cost of sales  | \$ 19              | \$ 248       | \$ 19            | \$ 583       |
| Research and development   |                    | 231          | 10               | 600          |
| Sales, general and administrative  | 153                | 331          | 305              | 708          |
| Service fees to Fujitsu  | \$ 172             | \$ 810       | \$ 334           | \$ 1,891     |

<sup>(1)</sup> These amounts relate to the JV1/JV2 Transaction which was consummated on April 2, 2007.

|  | Jun. 29, 2008  | Dec. 30, 2007 |
|--|----------------|---------------|
|  | (in thousands) |               |
| Trade accounts receivable from Fujitsu | \$ 154,982     | \$ 183,670    |
| Other receivables from Fujitsu         | \$ 7,001       | \$ 5,385      |
| Accounts payable to Fujitsu            | \$ 77,212      | \$ 53,332     |
| Royalties payable to Fujitsu           | \$ 1,568       | \$ 1,629      |
| Accrued liabilities to Fujitsu         | \$ 4,829       | \$ 6,461      |

**8. Warranties and Indemnities**

The Company generally offers a one-year limited warranty for its Flash memory products.



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

Changes in the Company's liability for product warranty during the three and six months ended June 29, 2008 and July 1, 2007 are as follows:

|   | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b> |                         |
|---|---------------------------|-------------------------|-------------------------|-------------------------|
|   | <b>Jun. 29<br/>2008</b>   | <b>Jul. 1,<br/>2007</b> | <b>Jun. 29<br/>2008</b> | <b>Jul. 1,<br/>2007</b> |
|   | (in thousands)            |                         |                         |                         |
| Balance, beginning of period  | \$ 1,305                  | \$ 1,350                | \$ 1,305                | \$ 1,350                |
| Provision for warranties issued   | 5,436                     | 1,220                   | 7,022                   | 2,484                   |
| Settlements   | (5,470)                   | (973)                   | (7,320)                 | (1,108)                 |
| Changes in liability for pre-existing warranties during the period, including expirations | 218                       | 3                       | 482                     | (1,126)                 |
| <b>Balance, end of period</b>   | <b>\$ 1,489</b>           | <b>\$ 1,600</b>         | <b>\$ 1,489</b>         | <b>\$ 1,600</b>         |

In addition to product warranties, the Company, from time to time in its normal course of business, indemnifies other parties with whom it enters into contractual relationships, including customers, directors, lessors and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against specified losses, such as those arising from a breach of representations or covenants, third-party infringement claims or other claims made against certain parties. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim and indemnification provision.

**9. Debt and Capital Lease Obligations**

The Company's debt and capital lease obligations consist of:

|   | <b>Jun. 29,<br/>2008</b> | <b>Dec. 30,<br/>2007</b> |
|---|--------------------------|--------------------------|
|   | (in thousands)           |                          |
| <b>Debt obligations:</b>  |                          |                          |
| Spansion China Bank Enterprise Cooperation Loan Facility                  | \$                       | \$ 5,405                 |
| Senior Notes  | 231,826                  | 230,628                  |
| Spansion Penang Loan  | 1,178                    | 2,028                    |
| Exchangeable Senior Subordinated Debentures                               | 207,000                  | 207,000                  |
| Spansion Japan 2007 Credit Facility                                       | 298,262                  | 256,503                  |
| Senior Secured Floating Rate Notes  | 625,687                  | 625,757                  |
| Senior Secured Revolving Credit Facility                                  | 44,000                   |                          |
| Spansion Japan 2007 Revolving Credit Facility                             | 84,930                   |                          |
| Obligations under capital leases  | 93,191                   | 74,012                   |
| <b>Total debt and capital lease obligations</b>                           | <b>1,586,074</b>         | <b>1,401,333</b>         |
| Less: current portion   | 273,697                  | 101,797                  |
| <b>Long-term debt and capital lease obligations, less current portion</b> | <b>\$ 1,312,377</b>      | <b>\$ 1,299,536</b>      |



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**Table of Contents**

**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements-Continued**

**(Unaudited)**

**New Debt and Capital Lease Obligations and Activities for the six months ended June 29, 2008:**

**Debt Obligations**

***Spansion China Bank Enterprise Cooperation Loan Facility***

In June 2008, Spansion China repaid the remaining principal balance of approximately \$5.4 million and accrued interest under this facility and voluntarily terminated the facility.

***Spansion Japan 2007 Credit Facility***

In March 2008, Spansion Japan borrowed an additional amount of 5.6 billion yen (approximately \$52.8 million as of June 29, 2008) under this facility. The drawdown period expired on March 31, 2008. In June 2008, the Company made the first quarterly principal payment in the amount of 2.7 billion yen (approximately \$25.5 million as of the date of repayment). As of June 29, 2008, the total outstanding balance under this facility is 31.6 billion yen (approximately \$298.3 million). The amount bears interest at approximately 2.84 percent and is scheduled to be repaid in quarterly principal installments through the fourth quarter of fiscal 2010.

***Senior Secured Revolving Credit Facility***

In February 2008, the Company borrowed \$50.0 million under this credit facility. In June 2008, the Company repaid the principal amount of \$6.0 million and accrued interest under this facility. This amount bears interest at approximately 4.30 percent as of June 29, 2008. The Company had approximately \$59.5 million available under this facility as of June 29, 2008. The Company is required to maintain at least \$35 million of availability under this credit facility if it fails to meet the minimum predetermined EBITDA (earnings before interest expense, income tax, depreciation and amortization) thresholds. As of June 29, 2008, the Company has met the minimum EBITDA requirement.

***Spansion Japan 2007 Revolving Credit Facility***

During the quarter ended March 30, 2008, Spansion Japan borrowed 8 billion yen (approximately \$80.4 million) under this credit facility. During the quarter ended June 29, 2008, the Company borrowed an additional 1 billion yen (approximately \$8.5 million). As of June 29, 2008, the outstanding balance under this facility is 9 billion yen (approximately \$84.9 million as of June 29, 2008). This amount bears interest at approximately 1.17 percent as of June 29, 2008. Spansion Japan had approximately 5 billion yen (approximately \$47.2 million) available under this facility as of June 29, 2008.

***Spansion China 2008 Revolving Credit Facility***

In June 2008, Spansion China entered into a revolving credit facility agreement with a local financial institution, effective as of June 27, 2008, in the aggregate principal amount of up to 80 million Yuan RMB (approximately \$11.7 million as of June 29, 2008). The borrowings must be used for working capital purposes. The interest rate for each drawdown denominated in RMB is a floating rate that is benchmarked to the rate published by the People's Bank of China for RMB loans with the same term and may, thereafter, be adjusted every month. The interest rate for each drawdown denominated in U.S. dollars is six-month LIBOR plus four percent and may, thereafter, be adjusted every six months. The last drawdown against this credit facility can be made on or before May 27, 2009.

As of June 29, 2008, the Company had not borrowed any amounts under this credit facility.

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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements-Continued**

**(Unaudited)**

***Obligations under Capital Leases***

On March 26, 2008, the Company entered into an equipment lease agreement with a third-party financial institution. Under the lease agreement, the Company leased certain equipment for a period of 36 months, in the amount of approximately \$52.1 million, beginning on March 27, 2008. The Company accounted for the lease transaction as a capital lease. The first rental installment of approximately \$9.4 million was paid on March 27, 2008. The remaining payments under this lease are scheduled to be paid in 11 consecutive quarterly installments of approximately \$4.0 million beginning July 1, 2008 and on the first day of each quarter thereafter. At the end of the lease agreement, the Company may elect to purchase the equipment at its then fair market value, renew the lease agreement with similar terms and conditions as the original lease agreement, or return the equipment.

**10. Income Taxes**

The Company recorded an income tax benefit of \$1.8 million in the three months ended June 29, 2008 as compared to \$3.7 million of income tax benefit in the three months ended July 1, 2007. The income tax benefit recorded in the three months ended June 29, 2008 was primarily related to an income tax benefit of \$3.9 million associated with a loss in Japan, offset by tax provisions in profitable foreign locations of \$2.1 million. The income tax benefit recorded in the three months ended July 1, 2007 was primarily due to a decrease in the valuation allowance associated with deferred tax assets of the Company's Japanese subsidiary, in part due to the gain recognized on the sale of JV1/JV2, offset by tax provisions of its foreign subsidiaries. This decrease of the valuation allowance was made as the Company believed that it was more likely than not that these deferred tax assets would be realized.

The Company recorded an income tax benefit of \$2.4 million in the six months ended June 29, 2008 as compared to \$13.8 million of income tax benefit in the six months ended July 1, 2007. The income tax benefit recorded in the six months ended June 29, 2008 was primarily related to an income tax benefit of \$5.4 million associated with a loss in Japan, offset by tax provisions in profitable foreign locations of \$3.0 million. The income tax benefit recorded in the six months ended July 1, 2007 was primarily due to the decrease in the valuation allowance associated with deferred tax assets of the Company's Japanese subsidiary because the Company believed that it was more likely than not that these deferred tax assets would be realized, offset by tax provisions of its foreign subsidiaries.

As of June 29, 2008, the Company's U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance. The realization of these assets is dependent on substantial future taxable income which at June 29, 2008, in management's estimate, is not more likely than not to be achieved.

**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)****11. Spansion Japan Pension Plan**

The following table summarizes the components of the net periodic pension expense related to the Spansion Japan pension plan for the three and six months ended June 29, 2008 and July 1, 2007:

|   | Three Months Ended |                 | Six Months Ended |                 |
|---|--------------------|-----------------|------------------|-----------------|
|   | Jun. 29, 2008      | Jul. 1, 2007    | Jun. 29, 2008    | Jul. 1, 2007    |
|   | (in thousands)     |                 |                  |                 |
| Service cost                              | \$ 1,638           | \$ 1,311        | \$ 3,270         | \$ 2,637        |
| Interest cost                             | 457                | 393             | 912              | 791             |
| Expected return on plan assets            | (1,011)            | (859)           | (2,018)          | (1,729)         |
| Amortization of prior service cost        | 161                | 2,026           | 316              | 2,205           |
| <b>Total net periodic pension expense</b> | <b>\$ 1,245</b>    | <b>\$ 2,871</b> | <b>\$ 2,480</b>  | <b>\$ 3,904</b> |

On April 2, 2007, in accordance with FASB Statement No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, the Company recorded a curtailment loss, which was included in the amortization of prior service cost for the six and three months ended July 1, 2007, of approximately \$2.0 million relating to the Spansion Japan Pension Plan as a result of entering into the Employer Secondment and Transfer Agreement with Fujitsu under the JV1/JV2 transaction.

**12. Fair Value**

As of June 29, 2008, the fair value measurements of the Company's cash equivalents and marketable securities consisted of the following and which are categorized in the table below based upon the fair value hierarchy:

|   | Level 1       | Level 2   | Level 3       | Total         |
|---|---------------|-----------|---------------|---------------|
|   | (in millions) |           |               |               |
| Money market funds                                      | \$ 164        | \$        | \$            | \$ 164        |
| Auction rate securities                                 |               |           | 109           | 109           |
| <b>Total cash equivalents and marketable securities</b> | <b>\$ 164</b> | <b>\$</b> | <b>\$ 109</b> | <b>\$ 273</b> |



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

The table below presents reconciliations for market securities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 29, 2008:

|  | <b>Three Months Ended<br/>June 29, 2008<br/>(in millions)</b> |
|--|---|
| Beginning balance as of March 31, 2008                 | \$ 122  |
| Unrealized loss included in other comprehensive income | (13)  |
| Ending fair value as of June 29, 2008                  | \$ 109  |

  

|  | <b>Six Months Ended<br/>June 29, 2008<br/>(in millions)</b> |
|--|---|
| Beginning balance as of December 31, 2007              | \$  |
| Transfer in  | 122   |
| Unrealized loss included in other comprehensive income | (13)  |
| Ending fair value as of June 29, 2008                  | \$ 109  |

*Marketable Securities*

The Company's marketable securities at June 29, 2008 consist of \$108.5 million of auction rate securities (ARS) valued at fair value which are substantially backed by student loans and are guaranteed by the U.S. government Federal Family Education Loan Program (FFELP). These securities have credit ratings of AAA and Aaa. Prior to February 2008, these securities were publicly quoted and traded in auctions relating to such investments. The fair value of these securities approximated face value due to the frequent auction periods, generally every 7 to 28 days, which provided liquidity to these investments. However, subsequent to February 2008, all of these securities failed to be traded in these auctions. Given the failures in the auction markets, as well as the lack of any correlation of these instruments to other observable market data, there are no longer observable inputs available as defined by Levels 1 and 2 of the fair value hierarchy of Statement 157 by which to value these securities. Therefore, these auction rate securities are classified within Level 3 and their valuation requires substantial judgment and estimation of factors that are not currently observable in the market due to the lack of trading in the securities.

The Company has estimated the fair values of its ARS investments at June 29, 2008 using a discounted cash flow (DCF) methodology. Significant inputs used in the DCF models were the credit quality of the instruments the percentage and the types of guarantees (such as FFELP), the probability of the auction succeeding or the security being called, and an illiquidity discount factor. The key assumptions used in the discounted cash flow analyses to determine the fair values as of June 29, 2008 were the discount factor to be applied and the period over which the cash flows would be expected to occur. The discount factor used was based on the three-month LIBOR (2.79% as of June 29, 2008) adjusted by 120 basis points (bps) to reflect the then current market conditions for instruments with similar credit quality at the date of the valuation. In addition, the discount factor was incrementally adjusted for a liquidity discount of 280 bps to reflect the risk in the marketplace for these investments that has arisen due to the lack of an active market. The Company applied this discount factor over the expected life of the estimated cash flows of its ARS with projected interest income of 4.19% per annum. The projected interest income is based on a trailing 12-month average 91-day T-bill rate at 2.99% as of June 29, 2008 plus 120 bps, which is the average annual yield of the Company's ARS assuming auctions continue to fail. Although the Company has received unsolicited offers to purchase its ARS at a discount level, the Company believes that the offered prices do not represent the fair values of its securities due to the high credit quality of these securities.



**Table of Contents****Spansion Inc.****Notes to Condensed Consolidated Financial Statements-Continued****(Unaudited)**

The Company's analysis indicated the fair value of its ARS investments was approximately \$108.5 million, as compared to a face value of approximately \$121.9 million as of June 29, 2008. The impairment in value, or \$13.4 million, is currently considered by the Company to be temporary because the failures in the ARS market are still recent in nature and have been experienced for less than six months and, accordingly, has been recorded as an unrealized loss in the comprehensive income (loss) component of stockholders' equity.

The Company has classified its investments in ARS as current assets. The Company believes issuers of ARS will refinance these securities as they have the ability to raise funds at rates that are lower than they anticipate in the future based on mandatory reset rates in the failed auction securities. The Company is aware that through June 2008 approximately \$3.4 billion of SLARS have been called at par value, substantially all of which were FFELP backed SLARS. Approximately \$1.2 billion of the \$3.4 billion were called in the month of June 2008 alone, which demonstrated a growth in call activity in recent months and thus indicated that the development of alternative channels of liquidity for these investments continues to improve as compared to earlier in the year.

Therefore, the Company currently believes that it will be able to sell these securities and have the proceeds available for use in its operations within the next twelve months through a future successful auction, a sale to a buyer outside of the auction process, a call on these investments, or a redemption by which issuers establish a different form of financing to replace these securities.

**13. Restructuring Charges**

In the second quarter of fiscal 2008, as part of the Company's ongoing strategic effort to improve overall productivity, the Company eliminated regular and contract positions globally, through planned consolidations, attrition, and a reduction in regular, contract and temporary workers in manufacturing, engineering, management and administrative support functions. The Company incurred approximately \$9.9 million of restructuring charges during this period.

Restructuring charges for the three months ended June 29, 2008 were as follows:

|   | <b>Three Months Ended<br/>Jun. 29, 2008<br/>(in thousands)</b> |
|---|--|
| Employee severance pay and benefits         | \$ 9,742   |
| Relocation of property, plant and equipment | 112  |
| Other                                       | 68   |
| Total restructuring charges                 | \$ 9,922   |

The following table summarizes the restructuring activity for the three months ended June 29, 2008:

|  | <b>(In thousands)</b> |
|--|-----------------------|
| Accrued restructuring balance as of March 30, 2008 | \$                    |
| Additional accruals                                | 9,922                 |
| Cash payments                                      | (1,577)               |
| Accrued restructuring balance as of June 29, 2008  | \$ 8,345              |



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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements-Continued**

**(Unaudited)**

The accrued restructuring balance was included in accrued compensation and benefits in the Company's condensed consolidated balance sheet as of June 29, 2008.

**14. Subsequent Event**

**Amendments to the Foundry Agreement with Fujitsu Limited ( Fujitsu )**

On July 14, 2008, the Company entered into amendments to the Amended and Restated Foundry Agreement with Fujitsu Limited effective as of September 28, 2006 (the Foundry Agreement ). The amendments consist of Amendment No. 1 ( Amendment No. 1 ) and a letter agreement dated as of July 14, 2008 (the Letter Agreement ) (collectively, the Amendments ), which provide as follows:

Amendment No. 1 to the Foundry Agreement sets forth the Company's wafer purchase commitments and pricing on purchases from Fujitsu for each of the third and fourth quarters of fiscal 2008 and both parties further agree to negotiate in good faith the wafer purchase commitments and pricing for fiscal 2009 by October 31, 2008. All other terms and conditions of the Foundry Agreement shall remain unchanged and in full force and effect; and

The Letter Agreement (i) defers certain payments due under the Foundry Agreement, (ii) provides a right of offset with respect to such deferred payments under the Foundry Agreement and certain other existing agreements between the parties, and (iii) provides both parties with a permanent right of offset under all existing and future agreements between the parties.

Please refer to Note 7 for further details of the Company's relationship and transactions with Fujitsu.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Forward-Looking Statements**

*This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under Section 21E of the Securities Exchange Act of 1934 (the Exchange Act), particularly statements regarding the products that will represent the majority of total net sales, increases in sales of certain products, anticipated future cash flows and cash balances, planned capital spending, liquidity, the effects of our acquisition of Saifun Semiconductors Ltd., the reasonableness of our critical accounting policies and tax provisions, and the amount of liability exposure related to our indemnities, commitments and guarantees. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, seeks, estimates, continues, may, will, should, predict, potential and variations of such words and other expressions indicating future results or expectations are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified in Part II, Item 1A, under Risk Factors, and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.*

**Overview**

We are a semiconductor device company exclusively dedicated to designing, developing, manufacturing, marketing, licensing and selling Flash memory technology and solutions. There are two major architectures of Flash memory in the market today: NOR Flash memory, which is primarily used for code and data storage in mobile phones and primarily for code storage in consumer and industrial electronics, and NAND Flash memory, which is primarily used for data storage in removable memory applications, such as Flash memory cards and USB drives, and is increasingly being used in high-end mobile phones and embedded applications such as MP3 players. Global demand for NAND Flash memory has grown much faster than that for NOR Flash memory largely on the strength of growth in multimedia consumer applications such as MP3 audio players, video players and removable storage applications such as Flash memory cards, USB storage and solid state drive solutions.

The Flash memory market can be divided into two major categories based on application: the integrated category, which includes wireless and embedded applications, and the removable storage category. Within the integrated category, portable, battery-powered communications applications are referred to as wireless and all other applications, such as consumer, industrial, telecommunications and automotive electronics, are referred to as embedded. Within the removable storage category, applications include Flash memory cards and USB drives. We focus primarily on providing NOR Flash memory solutions for the integrated category of the Flash memory market. Our Flash memory is integrated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, and personal computer peripherals.

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Approximately 79 percent of our net sales for the second quarter of fiscal 2008 were for sales of our products based on our MirrorBit technology, and the balance of our net sales were for products based on single-bit-per-cell floating gate technology. We expect that products using our MirrorBit technology will continue to represent a substantial majority of total net sales.

The following events occurred during the first two quarters of fiscal 2008:

In the first quarter of fiscal 2008, we closed the acquisition of Saifun Semiconductors Ltd. (Saifun), enabling entry into the technology licensing business and adding engineering resources to expand our product portfolio.

In the first quarter of fiscal 2008, our SP1 facility reached a run rate of 25,000 wafer starts per quarter, and we began recognizing revenue from the sales of our 65 nanometer MirrorBit technology products manufactured in this facility.

In the second quarter of fiscal 2008, we announced the elimination of approximately 500 regular and contract positions, including positions which were unfilled at the time of elimination, and incurred approximately \$9.9 million of restructuring charges. This action is part of our ongoing strategic effort to improve overall productivity.

Our total net sales for the three months ended June 29, 2008 and July 1, 2007 were approximately \$612.7 million and \$609.2 million, respectively. The increase in total net sales was primarily due to the increase in net sales in CSID and the consolidation of revenue generated by Saifun, which was partially offset by the decrease in net sales in WSD. Our unit shipments for Flash memory products increased by two percent, which was offset by a two percent decline in blended average selling price (defined as total net sales divided by total unit shipments) as compared to the corresponding period in fiscal 2007. The sales from products based on our MirrorBit technology continue to grow as a percentage of our total net sales, representing approximately 79 percent of our total net sales and approximately 59 percent of our total units shipped during the three months ended June 29, 2008, as compared to approximately 69 percent of our total sales and 42 percent of our total units shipped for the corresponding period in fiscal 2007.

Our total net sales for the six months ended June 29, 2008 and July 1, 2007 were approximately \$1,183.0 million and \$1,236.9 million, respectively. The decrease in total net sales in the 2008 period compared to the 2007 period was primarily due to a seven percent decline in blended average selling price, partially offset by a two percent increase in unit shipments. The sales from products based on our MirrorBit technology continue to grow as a percentage of our total net sales, representing approximately 78 percent of our total net sales and 57 percent of our total units shipped during the six months ended June 29, 2008, as compared to approximately 68 percent of our total sales and 40 percent of our total units shipped for the corresponding period in fiscal 2007.

Our net losses for the three and six months ended June 29, 2008 were approximately \$100.6 million and \$219.1 million, respectively, as compared to approximately \$66.9 million and \$142.4 million for the three and six months ended July 1, 2007, respectively. Our net loss for the six months ended June 29, 2008 was higher as compared to the same period of the prior year primarily due to lower net sales recognized in the first half of fiscal 2008, the inclusion of approximately \$10.8 million related to the write-off of in-process research and development, and \$9.9 million of restructuring charges incurred in 2008. The benefit for income taxes included in our net losses for the three and six months ended June 29, 2008 was approximately \$1.8 million and \$2.4 million, respectively, as compared to approximately \$3.7 million and \$13.8 million for the three and six months ended July 1, 2007, respectively.

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Our cash, cash equivalents and marketable securities totaled approximately \$348.9 million as of June 29, 2008 and consisted of cash, money market funds and commercial paper of approximately \$240.4 million and auction rate securities of approximately \$108.5 million. We believe that our anticipated cash flows from operations and current cash balances, our existing credit facilities and available external financing will be sufficient to fund working capital requirements, capital investments, debt service and operations, and to meet our needs for at least the next twelve months. Our capital expenditures for the second half of fiscal 2008 will be significantly reduced as compared with recent prior periods. Our capital expenditures were approximately \$1.1 billion in fiscal 2007 and approximately \$286.6 million in the first half of fiscal 2008. We expect our capital expenditures to be approximately \$150.0 million in the second half of fiscal 2008 depending on the timing of capital deliveries.

Our ability to fund our cash needs over the short term and long term will depend on our ability to generate cash in the future, which is subject to general economic, financial, competitive and other factors, such as those discussed in Part II, Item 1A Risk Factors, many of which are beyond our control. Should we require additional funding, such as to satisfy our short-term and long-term debt obligations when due or to make additional capital investments, we may need to raise the required additional funds through additional bank borrowings or public or private sales of debt or equity securities. We cannot assure you that such funding will be available in needed quantities or on terms favorable to us, if at all.

## **Basis of Presentation**

We use a 52- to 53-week fiscal year ending on the last Sunday in December. The three months ended June 29, 2008 and July 1, 2007 both consisted of 13 weeks.

## **Critical Accounting Policies**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts in our consolidated financial statements. We evaluate our estimates on an on-going basis, including those related to our revenues, inventories, asset impairments, income taxes and pension benefits. We base our estimates on experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The actual results may differ from these estimates or our estimates may be affected by different assumptions or conditions.

Other than our accounting policies described below regarding inventories, fair value, goodwill and business combinations, our critical accounting policies, which incorporate our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements, are the same as those described in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended December 30, 2007.



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### ***Inventory Valuation***

At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. This evaluation includes analysis of sales levels by product and projections of future demand. These projections assist us in determining the carrying value of our inventory and are also used for near-term factory production planning. Historically, we have generally used a six month demand forecast in assessing the salability of inventory on hand and did not value inventory in excess of six months of estimated demand. During the second quarter of fiscal 2008, as part of a strategy to efficiently manage our new production capacity and to maintain strategic inventory levels of certain products, we built and valued certain product inventory to meet estimated demand as much as twelve months into the future. We write off inventories that we consider obsolete and adjust remaining specific inventory balances to approximate the lower of our standard manufacturing cost or market value. Among other factors, management considers forecasted demand in relation to the inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining obsolescence and net realizable value. If we anticipate future demand or market conditions to be less favorable than our previous projections, additional inventory write-downs may be required and would be reflected in cost of sales in the period the write-down is made. This would have a negative impact on our gross margin in that period. If in any period we are able to sell inventories that were not valued or that had been written down in a previous period, related revenues would be recorded without any offsetting charge to cost of sales, resulting in a net benefit to our gross margin in that period.

### ***Deferred Revenue***

We sell to distributors and provide such distributors certain rights of return, stock rotation and price protection as discussed below. We defer the recognition of revenue and related product costs on these sales as deferred income on shipments until the merchandise is resold by our distributors. We also sell some of our products to certain distributors under sales arrangements with terms that do not allow for rights of returns or price protection on unsold products held by them. In these instances, we recognize revenue when we ship the product directly to the distributors.

Rights of return are granted whereby we are obligated to repurchase inventory from a distributor upon termination of the distributor's sales agreement with us. However, we are not required to repurchase the distributor's inventory under certain circumstances, such as the failure to return the inventory in saleable condition or we may only be required to repurchase a portion of distributor's inventory, for example when distributor has terminated the agreement for its convenience.

Stock rotation rights are provided to distributors when we have given written notice to the distributor that a product is being removed from our published price list. The distributor has a limited period of time to return the product. All returns are for credit only; the distributor must order a quantity of products, the dollar value of which equals or exceeds the dollar value of the products being returned. Some distributors are also offered quarterly stock rotation. Such stock rotation is limited to a certain percentage of the previous three months' net shipments.

A general price protection is granted to a distributor if we publicly announce a generally applicable price reduction relating specifically to certain products, whereby the distributor is entitled to a credit equal to the difference between the price paid by the distributor and the newly announced price.

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Price protection adjustments are provided to distributors solely for those products that: 1) are shipped by us to the distributor during the period preceding the price reduction announcement by us, 2) are part of the distributor's inventory at the time of the announcement, and 3) are located at geographic territories previously authorized by us.

In addition, if in our sole judgment, a distributor demonstrates that it needs a price lower than the current published price list in order to secure an order from the distributor's customers, we may, but we have no obligation to, grant the distributor a credit to our current published price. The distributor must submit the request for a reduction in price prior to the sale of products to its customer. If the request is approved and the sale occurs, the distributor must make a claim with the proof of resale to end customers for a credit within a specified time period.

Gross deferred revenue and gross deferred cost of sales on shipments to distributors as of June 29, 2008 and December 30, 2007 are as follows:

|   | Jun. 29, 2008  | Dec. 30, 2007 |
|---|----------------|---------------|
|   | (in thousands) |               |
| Deferred revenue to distributors            | \$ 83,721      | \$ 75,010     |
| Less: deferred costs of sales               | (39,102)       | (35,053)      |
| Deferred income on shipments <sup>(1)</sup> | \$ 44,619      | \$ 39,957     |

(1) The deferred income on shipments of \$46,688 thousand on the condensed consolidated balance sheets as of June 29, 2008 included \$2,069 thousand of deferred revenue related to our licensing revenue that was excluded in the table above.

Our distributors provide us with periodic data regarding the product, price, quantity, and end customer when products are resold as well as the quantities of our products they still have in stock. We use estimates and apply judgments to reconcile distributors' reported inventories to their activities. Error in our judgment could lead to inaccurate reporting of our revenues, deferred income and allowances on sales to distributors.

***Fair Value of Marketable Securities***

Our marketable securities at June 29, 2008 consist of approximately \$108.5 million of auction rate securities (ARS) valued at fair value which are substantially backed by student loans and are guaranteed by the U.S. government Federal Family Education Loan Program (FFELP). These securities have credit ratings of AAA and Aaa. Prior to February 2008, these securities were publicly quoted and traded in the auctions relating to such investments.

Historically, the fair value of our ARS investments has approximated face value due to the frequent auction periods, generally every 7 to 28 days, which provided liquidity to these investments. However, subsequent to February 2008, all auctions involving these securities have failed. The result of a failed auction is that these ARS will continue to pay interest in accordance with their terms at each respective auction date; however, liquidity of the securities will be limited until there is a successful auction, the issuer redeems the securities, the securities mature

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or until such time as other markets for these ARS investments develop. We cannot be certain regarding the amount of time it will take for an auction market or other markets to develop. Accordingly, we have concluded that the estimated fair value of the ARS no longer approximates the face value primarily due to the lack of liquidity.

We have estimated the fair values of our ARS investments at June 29, 2008 using a discounted cash flow (DCF) methodology. Significant assumptions considered in the DCF models were the credit quality of the instruments, the percentage and the types of guarantees (such as FFELP), the probability of the auction succeeding or the security being called, and an illiquidity discount factor. The key assumptions used in the discounted cash flow analyses that were to determine the fair values as of June 29, 2008 were the discount factor to be applied and the period over which the cash flows would be expected to occur. The discount factor used was based on the three-month LIBOR (2.79% as of June 29, 2008) adjusted by 120 basis points (bps) to reflect the then current market conditions for instruments with similar credit quality at the date of the valuation. In addition, the discount factor was incrementally adjusted for a liquidity discount of 280 bps to reflect the risk in the marketplace for these investments that has arisen due to the lack of an active market for these instruments. We applied this discount factor over the expected life of the estimated cash flows of our ARS with projected interest income of 4.19% per annum. The projected interest income is based on a trailing 12-month average 91-day T-bill rate at 2.99% as of June 29, 2008 plus 120 bps, which is the average annual yield of our ARS assuming auctions continue to fail.

Our analysis indicated the fair value of our ARS investments was approximately \$108.5 million, as compared to a face value of approximately \$121.9 million as of June 29, 2008. The impairment in value, or \$13.4 million, is currently considered by us to be temporary in nature and, accordingly, has been recorded as an unrealized loss in the comprehensive income (loss) component of stockholders' equity.

We believe that the unrealized loss is temporary because the failures in the ARS market are still recent in nature and have been experienced for less than six months and we have classified our investments in ARS as current assets after considering the following factors, among others:

Substantially all of our ARS are backed by student loans and guaranteed by FFELP with credit ratings of AAA and Aaa.

We believe that, within the Student Loan Auction Rate Securities (SLARS) market, securities guaranteed by FFELP are of higher credit quality than securities that are not guaranteed by FFELP, and therefore, are more likely to be re-financed and called in the near future.

Through June 2008, approximately \$3.4 billion of SLARS have been called at par value, substantially all of which were FFELP backed SLARS. Moreover, approximately \$1.2 billion of the \$3.4 billion were called in the month of June 2008 alone, which demonstrated a growth in call activity in recent months and thus indicated to us that the development of alternative channels of liquidity for these investments continue to improve as compared to earlier in the year.

Therefore, we currently believe that we will be able to sell these securities and have the proceeds available for use in our operations within the next twelve months through such scenarios as a future successful auction, a sale to a buyer outside of the auction process, through a call on these investments, or through a redemption by which issuers establish a different form of financing to replace these securities. We believe that FFELP backed securities will continue to be called due to the high credit quality of these securities. However, changes in the financial markets or issuers' access to funding sources may limit future call activities.

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Our auction rate securities have been classified as Level 3 assets in accordance with FASB Statement No. 157, *Fair Value Measurements*, as their valuation requires substantial judgment and estimation of factors that are not currently observable in the market due to the lack of trading in the securities. If different assumptions were used for the various inputs to the valuation approach including, but not limited to, assumptions involving the estimated lives of the ARS investments, the estimated cash flows over those estimated lives, and the estimated discount rates, especially the liquidity discount rate, applied to those cash flows, the estimated fair value of these investments could be significantly higher or lower than the fair value we determined as of June 29, 2008.

We continue to closely monitor the general market for ARS, as well as for our specific ARS investments. This is an area of significant subjectivity of judgment and there is a fluidity of market conditions and other factors outside of our control which we may be unable to reasonably and accurately predict. It is possible that our assumptions about future alternative liquidity sources will prove to be overly optimistic. If the fair value of our investments deteriorates further and if no liquidity vehicles are available in the near future, we may be required to realize an impairment charge as an other than temporary expense through our statements of operations. Refer to the Risk Factor described as Our investments in marketable debt securities are subject to risks which may cause losses and affect the liquidity of these investments.

### ***Goodwill***

As a result of the Saifun acquisition, we recorded approximately \$19.3 million of goodwill on our books. In accordance with FASB Statement No. 142 (Statement 142), *Goodwill and Other Intangible Assets*, we are required to review goodwill for impairment at least annually or more often if there are indicators of impairment present. The review of goodwill includes determining its fair value involving the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted discount rates, future economic and market conditions and determination of appropriate market comparables. Fair value estimates are also based on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates. We will perform our annual impairment analysis during the fourth quarter of each year, with the first impairment test related to Saifun goodwill to be performed during the fourth quarter of 2008.

### ***Business Combinations***

In accordance with business combination accounting, we have allocated the purchase price of Saifun to tangible and acquisition related intangible assets acquired and liabilities assumed as well as to in-process research and development based on their estimated fair values. These valuations require us to make significant estimates and assumptions, especially with respect to acquisition related intangible assets.

We will review the acquisition related intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recovered.

We make estimates of fair value using reasonable assumptions based on historical experience and information obtained from the management of the acquired company. Critical estimates in valuing certain of the acquisition related intangible assets include but are not limited to: future expected cash flows from the sale of products, expected costs to develop in-process

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research and development projects into commercially viable products and estimated cash flows from the projects when completed; the market's awareness of the acquired company's brand, market position and assumptions about the period of time the acquired brand will continue to be used in the combined company's product portfolio; and discount rates. Unanticipated events may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

**Results of Operations***Net Sales*

|  | Three Months Ended                |                 |                        |                        | Six Months Ended                  |                 |                        |                        |
|--|-----------------------------------|-----------------|------------------------|------------------------|-----------------------------------|-----------------|------------------------|------------------------|
|  | Jun. 29,<br>2008                  | Jul. 1,<br>2007 | Variance in<br>Dollars | Variance in<br>Percent | Jun. 29,<br>2008                  | Jul. 1,<br>2007 | Variance in<br>Dollars | Variance in<br>Percent |
|  | (in thousands, except percentage) |                 |                        |                        | (in thousands, except percentage) |                 |                        |                        |
| Wireless Solutions Division (WSD)                    | \$ 296,226                        | \$ 337,514      | (\$41,288)             | -12%                   | \$ 592,199                        | \$ 724,106      | (\$131,907)            | -18%                   |
| Consumer, Set Top Box and Industrial Division (CSID) | 312,160                           | 271,487         | 40,673                 | 15%                    | 585,927                           | 512,132         | 73,795                 | 14%                    |
| Other  | 4,334                             | 171             | 4,163                  | 2435%                  | 4,866                             | 705             | 4,161                  | 590%                   |
| Total net sales                                      | \$ 612,720                        | \$ 609,172      | \$ 3,548               | 1%                     | \$ 1,182,992                      | \$ 1,236,943    | (\$53,951)             | -4%                    |

Total net sales for the three months ended June 29, 2008 increased one percent as compared to total net sales for the three months ended July 1, 2007 primarily due to the increase in net sales in CSID and the inclusion of revenue generated by Saifun, which were partially offset by the decrease in net sales in WSD in the second quarter of fiscal 2008. Our total unit shipments for Flash memory products increased by two percent, which was offset by a two percent decline in blended average selling price (ASP). The decrease in blended ASP was primarily the result of price declines in the overall Flash memory market.

Total net sales for the six months ended June 29, 2008 decreased four percent as compared to total net sales for the six months ended July 1, 2007. The decrease was primarily attributable to approximately seven percent decline in blended ASP, which was partially offset by a two percent increase in unit shipments. The decline in blended ASP was primarily the result of price declines in the overall Flash memory market.

Net sales in our Wireless Solutions Division (WSD) decreased approximately 12 percent and 18 percent for the three and six months ended June 29, 2008 as compared to the three and six months ended July 1, 2007, respectively. Almost all of the decrease was attributable to the decline in blended ASP for WSD.

Net sales in our Consumer, Set Top Box and Industrial Division (CSID) increased approximately 15 percent and 14 percent for the three and six months ended June 29, 2008 as compared to the three and six months ended July 1, 2007, respectively. The increase was primarily attributable to a 13 percent and 12 percent increase in blended ASP for the three and six months ended June 29, 2008, respectively, primarily as a result of increased sales of our high density MirrorBit products.

For the three months ended June 29, 2008, our WSD business accounted for approximately 48 percent of our total net sales, and our CSID business accounted for approximately 51 percent of our total net sales, as compared to 55 percent and 45 percent, respectively for the corresponding period of fiscal 2007. For the six months ended June 29, 2008, our WSD business accounted for approximately 50 percent of our total net sales, and our CSID business accounted for approximately 50 percent of our total net sales, as compared to 59 percent and 41 percent, respectively for the corresponding period of fiscal 2007. The percentage shift between our two main business units was primarily the result of the ASP decline in our WSD business resulting in decreased net sales year-over-year and also of an increase in net sales for our CSID business due to the increase in high density MirrorBit product sales.

**Table of Contents****Comparison of Gross Margin, Operating Expenses, Interest and Other Income, Net, Interest Expense and Income Tax Benefit**

The following is a summary of gross margin; operating expenses; interest and other income, net; interest expense and income tax benefit for three and six months ended June 29, 2008 and July 1, 2007.

|   | Three Months Ended                    |                 |                        |                        | Six Months Ended                      |                 |                        |                        |
|---|---------------------------------------|-----------------|------------------------|------------------------|---------------------------------------|-----------------|------------------------|------------------------|
|   | Jun. 29,<br>2008                      | Jul. 1,<br>2007 | Variance in<br>Dollars | Variance in<br>Percent | Jun. 29,<br>2008                      | Jul. 1,<br>2007 | Variance in<br>Dollars | Variance in<br>Percent |
|   | (in thousands, except for percentage) |                 |                        |                        | (in thousands, except for percentage) |                 |                        |                        |
| Net sales                                       | \$ 612,720                            | \$ 609,172      | \$ 3,548               | 1%                     | \$ 1,182,992                          | \$ 1,236,943    | \$ (53,951)            | -4%                    |
| Cost of sales                                   | 503,571                               | 501,033         | 2,538                  | 1%                     | 979,381                               | 1,039,003       | (59,622)               | -6%                    |
| Gross margin                                    | 18%                                   | 18%             |                        |                        | 17%                                   | 16%             |                        |                        |
| Research and development                        | 108,303                               | 110,900         | (2,597)                | -2%                    | 228,624                               | 212,891         | 15,733                 | 7%                     |
| Sales, general and administrative               | 68,264                                | 61,946          | 6,318                  | 10%                    | 133,028                               | 120,187         | 12,841                 | 11%                    |
| In-process research and development             |                                       |                 |                        |                        | 10,800                                |                 | 10,800                 | -100%                  |
| Restructuring charges                           | 9,922                                 |                 | 9,922                  | -100%                  | 9,922                                 |                 | 9,922                  | -100%                  |
| Operating loss                                  | (77,340)                              | (64,707)        | (12,633)               | 20%                    | (178,763)                             | (135,138)       | (43,625)               | 32%                    |
| Interest income and other income (expense), net | 2,536                                 | 11,672          | (9,136)                | -78%                   | 5,915                                 | 20,603          | (14,688)               | -71%                   |
| Interest expense                                | (27,663)                              | (17,542)        | (10,121)               | 58%                    | (48,654)                              | (41,688)        | (6,966)                | 17%                    |
| Benefit for income taxes                        | 1,824                                 | 3,676           | (1,852)                | -50%                   | 2,388                                 | 13,843          | (11,455)               | -83%                   |

Our gross margin was flat for the three months ended June 29, 2008 as compared to the corresponding period of fiscal 2007 and increased by one percent for the six months ended June 29, 2008 as compared to the same period of fiscal 2007. Our cost per bit (defined as total cost of sales divided by total bits shipped) decreased by 21 percent for the six months ended June 29, 2008 as compared to the six months ended July 1, 2007, which decrease was largely offset by a decrease in our blended ASP per bit (defined as net sales divided by total Flash memory bits shipped) of 20 percent. The increase in gross margin percentage for the six months ended June 29, 2008 was primarily due to our cost reduction efforts that included increased productivity and output of JV3 and Fab 25, improvement of cumulative product yields, reduction of test time and better pricing from suppliers. These cost savings were partially offset by SP1 manufacturing costs incurred in the first half of fiscal 2008. The gross margin for the three and six months ended July 29, 2008 and July 1, 2007 included a portion of the gain recognized from the JV1/JV2 Transaction. See Note 7 of Notes to Condensed Consolidated Financial Statements.

The decrease in research and development expenses for the three months ended June 29, 2008 was primarily due to a decrease of approximately \$9.6 million in development costs related to SP1 and Fab 25. The decrease in SP1 and Fab 25 research and development expenses for the three months ended June 29, 2008 was partially offset by \$6.3 million of research and development expenses related to Saifun.

The increase in research and development expenses for the six months ended June 29, 2008 was primarily due to an increase of approximately \$7.9 million of 300-millimeter development costs related to SP1, \$7.0 million of higher labor costs primarily related to the development of the next generation of MirrorBit technology and the inclusion of approximately \$6.3 million of research and development costs related to Saifun in the second quarter of fiscal 2008. The increase in research and development expenses for the six months ended June 29, 2008 was partially offset by a reduction of approximately \$7.1 million of development costs incurred in Fab 25.

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The increase in sales, general and administrative expenses for the three and six months ended June 29, 2008 as compared to the corresponding periods of fiscal 2007 was primarily due to higher legal fees, primarily related to litigation expenses, and the inclusion of sales, general and administrative expenses related to Saifun in the second quarter of fiscal 2008. The higher legal fees and sales, general and administrative expenses related to Saifun represented approximately 53 percent of the increase in our total sales, general and administrative expenses for the three and six months ended June 29, 2008.

In the first quarter of fiscal 2008, we expensed \$10.8 million of Saifun acquisition related IPR&D charges in connection with the acquisition of Saifun. Projects that qualify as IPR&D are those that have not reached technological feasibility and have no alternative future use at the time of the acquisition. We did not have a similar charge during the same period in fiscal 2007.

In the second quarter of fiscal 2008, we eliminated approximately 500 regular and contract positions, including positions which were unfilled at the time of elimination, and shut down a research center in Japan. We incurred approximately \$9.9 million of restructuring charges during this period, of which approximately \$3.1 million was related to manufacturing. We did not have a similar charge during the same period in fiscal 2007.

The decrease in interest and other income (expense), net for the three and six months ended June 29, 2008 was primarily due to the recognition of approximately \$7.5 million of gain from the sale of land in Asia in the second quarter of fiscal 2007, which was partially offset by approximately \$3.4 million of loss resulted from an early extinguishment of a debt in the same period. Interest income has also decreased due to the combined effect of the decrease in our invested cash, cash equivalents and marketable securities balances, and the decrease in our average investment portfolio yield by approximately 3.01 percent and 1.96 percent for the three and six months ended June 29, 2008.

The increase in interest expense for the three and six months ended June 29, 2008 was primarily due to an adjustment of approximately \$8.2 million in interest expense related to a capital lease during the second quarter of fiscal 2007. Excluding the effects of the \$8.2 million adjustment, interest expense increased by approximately \$2.0 million for the three months ended June 29, 2008 and decreased by approximately \$1.2 million for the six months ended June 29, 2008. The increase in interest expense was a result of a higher average debt balance for the three months ended June 29, 2008. The increase in interest expense is offset by the capitalization of approximately \$6.5 million of interest related to the financing of our SP1 facility in the first quarter of fiscal 2008 and lower average interest rates on our debt portfolio for the three and six months ended June 29, 2008 as compared to the same periods in fiscal 2007. The average interest rates on our debt portfolio were 6.1 percent and 6.4 percent for the three and six months ended June 29, 2008 as compared to 7.6 percent and 7.5 percent for the three and six months ended July 1, 2007.

We recorded an income tax benefit of \$1.8 million in the three months ended June 29, 2008 as compared to \$3.7 million of income tax benefit in the three months ended July 1, 2007. The income tax benefit recorded in the three months ended June 29, 2008 was primarily related to an income tax benefit of \$3.9 million associated with a loss in Japan, offset by tax provisions in profitable foreign locations of \$2.1 million. The income tax benefit recorded in the three months ended July 1, 2007 was primarily due to a decrease in the valuation allowance associated with

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deferred tax assets of our Japanese subsidiary, in part due to the gain recognized on the sale of JV1/JV2, offset by tax provisions of our foreign subsidiaries. This decrease of the valuation allowance was made as we believed that it was more likely than not that these deferred tax assets would be realized.

We recorded an income tax benefit of \$2.4 million in the six months ended June 29, 2008 as compared to \$13.8 million of income tax benefit in the six months ended July 1, 2007. The income tax benefit recorded in the six months ended June 29, 2008 was primarily related to an income tax benefit of \$5.4 million associated with a loss in Japan, offset by tax provisions in profitable foreign locations of \$3.0 million. The income tax benefit recorded in the six months ended July 1, 2007 was primarily due to the decrease in the valuation allowance associated with deferred tax assets of our Japanese subsidiary because we believed that it was more likely than not that these deferred tax assets would be realized, offset by tax provisions of our foreign subsidiaries.

As of June 29, 2008 our U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance. The realization of these assets is dependent on substantial future taxable income which at June 29, 2008, in management's estimate, is not more likely than not to be achieved.

**Other Items**

The impact on our operating results from changes in foreign currency exchange rates has not been material, principally because our expenses denominated in yen are generally comparable to our sales denominated in yen and we enter into foreign currency exchange contracts to mitigate our exposure when yen denominated expenses and sales are not comparable.

As of June 29, 2008, the total unrecognized compensation cost related to unvested stock options and RSU awards was approximately \$49.6 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2012.

**Contractual Obligations**

The following table summarizes our contractual obligations as of June 29, 2008, presented on a fiscal year basis.

|   | Total          | Remaining<br>2008 | 2009       | 2010       | 2011       | 2012      | 2013 and<br>Beyond |
|---|----------------|-------------------|------------|------------|------------|-----------|--------------------|
|   | (in thousands) |                   |            |            |            |           |                    |
| Senior Secured Floating Rate Notes                | \$ 625,000     | \$                | \$         | \$         | \$         | \$        | \$ 625,000         |
| Spansion Japan Term Loan                          | 298,262        | 51,872            | 103,743    | 142,647    |            |           |                    |
| Spansion Japan 2007 Credit Facility               |                |                   |            |            |            |           |                    |
| Senior Notes                                      | 250,000        |                   |            |            |            |           | 250,000            |
| Exchangeable Senior Subordinated Debentures       | 207,000        |                   |            |            |            |           | 207,000            |
| Spansion Japan 2007 Revolving Credit Facility     | 84,930         | 84,930            |            |            |            |           |                    |
| Senior Secured Revolving Credit Facility          | 44,000         | 44,000            |            |            |            |           |                    |
| Capital lease obligations                         | 109,400        | 20,833            | 46,289     | 26,064     | 16,214     |           |                    |
| Other Credit Facility - Subsidiaries              | 1,178          | 884               | 294        |            |            |           |                    |
| Other long term liabilities                       | 9,783          | 1,304             | 2,609      | 2,609      | 2,609      | 652       |                    |
| Operating leases                                  | 29,778         | 7,980             | 13,196     | 4,374      | 2,433      | 893       | 902                |
| Unconditional purchase commitments <sup>(1)</sup> | 402,113        | 168,578           | 119,798    | 66,647     | 31,845     | 15,025    | 220                |
| Interest payments on debt                         | 474,132        | 39,802            | 77,965     | 74,898     | 72,331     | 72,331    | 136,804            |
| Total contractual obligations                     | \$ 2,535,576   | \$ 420,183        | \$ 363,894 | \$ 317,239 | \$ 125,432 | \$ 88,901 | \$ 1,219,926       |

- (1) Unconditional purchase commitments include agreements to purchase goods or services that are enforceable and legally binding on us and that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Unconditional purchase commitments exclude agreements that are cancelable without penalty. These agreements are related principally to inventory and other items.





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***Spansion Japan 2007 Credit Facility***

In March 2008, Spansion Japan borrowed an additional amount of 5.6 billion yen (approximately \$52.8 million as of June 29, 2008) under this facility. The drawdown period expired on March 31, 2008. In June 2008, we made the first quarterly principal payment in the amount of 2.7 billion yen (approximately \$25.5 million as of the date of repayment). As of June 29, 2008, the total outstanding balance under this facility is 31.6 billion yen (approximately \$298.3 million). The amount bears interest at approximately 2.84 percent and is scheduled to be repaid in quarterly principal installments through the fourth quarter of fiscal 2010.

***Senior Secured Revolving Credit Facility***

In February 2008, we borrowed \$50.0 million under this credit facility. In June 2008, we repaid the principal balance of \$6.0 million and accrued interest under this facility. This amount bears interest at approximately 4.30 percent as of June 29, 2008. We had approximately \$59.5 million available under this facility as of June 29, 2008.

***Spansion Japan 2007 Revolving Credit Facility***

During the quarter ended March 30, 2008, Spansion Japan borrowed 8 billion yen (approximately \$80.4 million) under this credit facility. During the quarter ended June 29, 2008, we borrowed additional 1 billion yen (approximately \$8.5 million). As of June 29, 2008, the outstanding balance under this facility is 9 billion yen (approximately \$84.9 million as of June 29, 2008). This amount bears interest at approximately 1.17 percent as of June 29, 2008. Spansion Japan had approximately 5 billion yen (approximately \$47.2 million) available under this facility as of June 29, 2008.

***Spansion China 2008 Revolving Credit Facility***

In June 2008, Spansion China entered into a revolving credit facility agreement with a local financial institution, effective as of June 27, 2008, in the aggregate principal amount of up to 80 million Yuan RMB (approximately \$11.7 million as of June 29, 2008). The borrowings must be used for working capital purposes. The interest rate for each drawdown denominated in RMB is a floating rate that is benchmarked to the rate published by the People's Bank of China for RMB loans with the same term and may, thereafter, be adjusted every month. The interest rate for each drawdown denominated in U.S. dollars is six-month LIBOR plus four percent and may, thereafter, be adjusted every six months. The last drawdown against this credit facility can be made on or before May 27, 2009.

As of June 29, 2008, we have not borrowed any amounts under this credit facility.

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***Obligations under Capital Leases***

On March 26, 2008, we entered into an equipment lease agreement with a third-party financial institution. Under the lease agreement, we leased certain equipment for a period of 36 months, in the amount of approximately \$52.1 million, beginning on March 27, 2008. We accounted for the lease transaction as a capital lease. The first rental installment of approximately \$9.4 million was paid on March 27, 2008. The remaining payments under this lease are scheduled to be paid in 11 consecutive quarterly installments of approximately \$4.0 million beginning July 1, 2008 and on the first day of each quarter thereafter. At the end of the lease agreement, we may elect to purchase the equipment at its then fair market value, renew the lease agreement with similar terms and conditions as the original lease agreement, or return the equipment.

**Liquidity and Capital Resources**

***Financial Condition (Sources and Uses of Cash)***

Our cash, cash equivalents and marketable securities totaled approximately \$348.9 million as of June 29, 2008 and consisted of cash, money market funds and commercial paper of approximately \$240.4 million and auction rate securities of approximately \$108.5 million. We are subject to certain restrictions on our distribution of cash contained in our third-party loan agreements described in our Annual Report on Form 10-K for the fiscal year ended December 30, 2007 filed with the SEC on February 28, 2008.

***Net Cash Provided by Operating Activities***

Net cash provided by operating activities was approximately \$121.1 million in the six months ended June 29, 2008. Non-cash charges included in the net loss consisted primarily of approximately \$307.1 million of depreciation and amortization, approximately \$10.8 million of acquisition related in-process research and development, approximately \$10.0 million of deferred income taxes benefit and approximately \$9.9 million of stock compensation costs. The net changes in operating assets and liabilities in the six months ended June 29, 2008 consisted primarily of a decrease in accounts receivable of approximately \$19.4 million due to a decline in net sales, an increase in inventory of approximately \$52.5 million and an increase in accounts payable and accrued liabilities of approximately \$58.3 million. Our days of inventory were 115 days in the second quarter of fiscal 2008 as compared to 121 days in the first quarter of fiscal 2008.

***Net Cash Used in Investing Activities***

Net cash used in investing activities was approximately \$186.6 million in the six months ended June 29, 2008, primarily as a result of approximately \$286.6 million of capital expenditures used to purchase property, plant and equipment, principally related to our investment in 300-millimeter equipment at SP1 and SDC, offset by a net cash inflow of approximately \$96.7 million from the sale of our auction rate securities.

***Net Cash Provided by Financing Activities***

Net cash provided by financing activities was approximately \$118.5 million in the six months ended June 29, 2008. This amount included approximately \$239.6 million of borrowing proceeds from our Spansion Japan 2007 Revolving Credit Facility, Spansion Japan 2007 Credit Facility and Senior Secured Revolving Credit Facility, offset in part by approximately \$121.1 million in repayments on debt (primarily under the Spansion Japan 2007 Revolving Credit Facility and Spansion Japan 2007 Credit Facility) and capital lease obligations during the six months ended June 29, 2008.

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***Liquidity***

Our future uses of cash are expected to be primarily for working capital, capital expenditures, debt service and other contractual obligations. Our capital expenditures for the second quarter of fiscal 2008 were approximately \$110.2 million, which were primarily related to development of the 65- and 45-nanometer technology on 300-millimeter wafers. Our capital expenditures for the second half of fiscal 2008 are expected to be approximately \$150.0 million depending on the timing of the capital delivery. We expect that our cash need for capital deliveries will be financed from existing credit facilities, capital leases, available external financing and cash on hand. Timing of the payments will depend on terms negotiated with individual vendors, and will affect our cash and debt positions during the remainder of fiscal 2008. Additionally, the total amount due on debt service and other contractual obligations for the six months remaining in fiscal 2008 is approximately \$420.2 million.

As of June 29, 2008, we had cash and cash equivalents of \$240.4 million, marketable securities of approximately \$108.5 million and availability under our existing revolving credit facilities of approximately \$118.4 million, totaling approximately \$467.3 million of liquidity. Availability under our credit facilities is subject to certain borrowing base calculations derived from accounts receivable in Spansion Japan and Spansion LLC. With regards to the \$59.5 million available under the Senior Secured Revolving Credit Facility, we would be required to maintain at least \$35 million of availability under this credit facility if we failed to meet the minimum predetermined EBITDA (earnings before interest expense, income tax, depreciation and amortization) thresholds. As of June 29, 2008, we had met the minimum EBITDA requirement. Our marketable securities currently consist solely of auction rate securities, which are variable rate debt instruments, having long-term maturity dates (typically 24 to 39 years), but whose interest rates historically would reset through an auction process, most commonly at intervals of 7, 28 and 35 days. Substantially all of our auction-rate securities are backed by pools of student loans guaranteed by the Federal Family Education Loan Program (FFELP), and all were rated Aaa/AAA. To date we have collected all interest payable on all of our auction-rate securities in accordance with their terms at each auction date. As of June 29, 2008, we recorded approximately \$13.4 million of unrealized loss of such securities. We have classified our investments in auction rate securities as current assets because we expect that we will be able to sell these securities and have the proceeds available for use in our operations within the next twelve months through a future successful auction or sale to a buyer outside the auction process, or through a redemption by which issuers establish a different form of financing to replace these securities.

Given the current adverse economic conditions in the Flash memory industry and our own liquidity position, we continue to focus on cash management improvement and identifying and taking actions to enhance our liquidity position. These actions could include selling assets to third parties, establishing manufacturing and technology partnerships or re-timing or eliminating certain capital spending or research and development projects. We believe that with these actions and cash management improvement our anticipated cash flows from operations and current cash balances, our existing credit facilities and available external financing will be sufficient to fund working capital requirements, capital investments, debt service and operations and to meet our cash needs for at least the next twelve months. Our liquidity declined in the first half of fiscal 2008 and could further decline in the second half of fiscal 2008. Current credit market conditions and any adverse change in our credit rating may make external financing difficult to obtain in

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light of overall credit market conditions combined with the ratings of our outstanding debt securities. Any external financing that we are able to obtain may be at interest rates that are substantially higher than the rates on our outstanding debt securities. Our ability to fund our cash needs over the short and long term will depend on our ability to generate cash from operations, which is subject to general economic, financial, competitive and other factors, such as those discussed in Part II, Item 1A Risk Factors, many of which are beyond our control. Should we require additional funding, such as to satisfy our short-term and long-term debt obligations when due or to make additional capital investments, we may need to raise the required additional funds through additional bank borrowings or public or private sales of debt or equity securities. Credit market conditions will affect our ability to access the capital market and/or the cost of financing. We cannot assure you that such funding will be available in needed quantities or on terms favorable to us, if at all.

**Off-Balance-Sheet Arrangements**

During the normal course of business, we make certain indemnities and commitments under which we may be required to make payments in relation to certain transactions. These indemnities include non-infringement of patents and intellectual property indemnities to our customers in connection with the delivery, design, manufacture and sale of our products, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to other parties to certain acquisition agreements. The duration of these indemnities and commitments varies, and in certain cases, is indefinite. We believe that substantially all of our indemnities and commitments provide for limitations on the maximum potential future payments we could be obligated to make. However, we are unable to estimate the maximum amount of liability related to our indemnities and commitments because such liabilities are contingent upon the occurrence of events which are not reasonably determinable. Management believes that any liability for these indemnities and commitments would not be material to our accompanying consolidated financial statements.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Reference is made to Part II, Item 7A, Quantitative and Qualitative Disclosures about Market Risk in our Annual Report on Form 10-K for the fiscal year ended December 30, 2007. We experienced no significant changes in market risk during the first six months of fiscal 2008 except as follows: subsequent to February 2008, all of our investments in auction rate securities failed to be traded in auctions (see Note 12 of the Notes to Condensed Consolidated Financial Statements), and during the first three months of fiscal 2008, the U.S. dollar continued to weaken against the Japanese yen, which was partially offset by the strengthening of U.S dollar against Japanese yen during the second quarter of fiscal 2008. The cumulative translation adjustment balance increased by approximately \$30.3 million during the first six months of fiscal 2008. This increase was primarily due to the translation of net assets of our subsidiary in Japan, denominated in that entity's functional currency, the Japanese yen, into our reporting currency, the U.S. dollar. However, this translation adjustment does not affect our earnings or cash flows as it is recorded as a component of stockholders' equity in our balance sheet. As foreign currency exchange rates fluctuate relative to the U.S. dollar, we expect to continue to incur foreign currency translation adjustments, which will either increase or decrease our total stockholders' equity balance and which may be material. In addition, we cannot give any assurance as to the effect of future changes in foreign currency rates on our consolidated financial position, results of operations or cash flows.

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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) are effective at the reasonable assurance level to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes to Internal Control over Financial Reporting**

There were no changes to our internal control over financial reporting identified in connection with our management's evaluation that occurred during the second quarter of fiscal 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS*****Tessera v. Spansion LLC, et al.***

On October 7, 2005, Tessera, Inc. filed a complaint, Civil Action No. 05-04063, for alleged patent infringement against Advanced Micro Devices ( AMD ) and Spansion LLC in the United States District Court for the Northern District of California under the patent laws of the United States of America, 35 U.S.C. section 1, *et seq.*, including 35 U.S.C. section 271. The complaint alleges that Spansion LLC's Ball Grid Array ( BGA ) and multichip packages infringe the following Tessera patents: United States Patent No. 5,679,977, United States Patent No. 5,852,326, United States Patent No. 6,433,419 and United States Patent No. 6,465,893. On December 16, 2005, Tessera filed a First Amended Complaint adding Spansion, Inc. and Spansion Technology Inc. as defendants. On January 31, 2006, Tessera filed a Second Amended Complaint adding Advanced Semiconductor Engineering, Inc., Chipmos Technologies, Inc., Chipmos U.S.A., Inc., Silicon Precision Industries Co., Ltd., Siliconware USA, Inc., STMicroelectronics N.V., STMicroelectronics, Inc., Stats Chippac Ltd., Stats Chippac, Inc., and Stats Chippac (BVI) Limited as defendants. The Second Amended Complaint alleges that Spansion LLC's BGA and multichip packages infringe the four Tessera patents identified above. The Second Amended Complaint further alleges that the newly named defendants are in breach of a Tessera license agreement, and that Silicon Precision Industries Co., Ltd. is infringing a fifth Tessera patent, United States Patent No. 6,133,627. The Second Amended Complaint seeks unspecified damages, injunctive relief, a trebling of damages for alleged willful conduct and attorneys' fees (the Tessera District Court Action ). On February 9, 2006, Spansion filed an answer to the Second Amended Complaint and asserted counterclaims against Tessera. On April 18, 2006, U.S. District Court Judge Claudia Wilken issued a Case Management Order that set a trial date of January 28, 2008. On March 13, 2007, Judge Wilken issued an order vacating the trial date. On April 12, 2007, Judge Wilken issued an order referring case management scheduling issues to a Special Master, and directing that the court will appoint an expert in the case to testify on the ultimate merits of the technical issues relating to infringement and patent validity. On April 26, 2007, Spansion, STMicroelectronics and AMD filed a motion to stay the Tessera District Court Action pending resolution of an International Trade Commission Investigation that is described below. On May 24, 2007, Judge Wilken issued an order staying the Tessera District Court Action until final resolution of the ITC action.

We believe that we have meritorious defenses against Tessera's claims and we intend to defend the lawsuit vigorously.

***Tessera ITC Investigation***

On April 17, 2007 Tessera, Inc. filed a complaint under section 337 of the Tariff Act of 1930, 19 U.S.C. § 1337, in the United States International Trade Commission ( ITC ) against respondents ATI Technologies, Inc., Freescale Semiconductor, Inc., Motorola, Inc., Qualcomm, Inc., Spansion Inc., Spansion LLC and STMicroelectronics N.V. Tessera claims that face up and stacked-chip small format laminate Ball Grid Array ( BGA ) packages, including the Spansion 5185941F60 chip assembly, infringe certain specified claims of United States Patent Nos. 5,852,326 and 6,433,419 ( Asserted Patents ). The complaint requests that the ITC institute an investigation into the matter. The complaint seeks a permanent exclusion order pursuant to section 337(d) of the Tariff Act of 1930, as amended, excluding from entry into the United States

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all semiconductor chips with small format laminate BGA semiconductor packaging that infringe any of the Asserted Patents, and all products containing such infringing small format laminate BGA semiconductor packaged chips. The complaint also seeks a permanent cease and desist order pursuant to section 337(f) of the Tariff Act of 1930, as amended, directing respondents with respect to their domestic inventories to cease and desist from marketing, advertising, demonstrating, sampling, warehousing inventory for distribution, offering for sale, selling, distributing, licensing, or using any semiconductor chips with small format laminate BGA semiconductor packaging that infringe any of the Asserted Patents, and/or products containing such semiconductor chips. On May 15, 2007, the ITC instituted an investigation pursuant to 19 U.S.C. § 1337, entitled *In the Matter of Certain Semiconductor Chips with Minimized Chip Package Size and Products Containing Same*, Inv. No. 337-TA-605, identifying ATI Technologies, ULC, Freescale Semiconductor, Inc., Motorola, Inc., Spansion Inc., Spansion LLC and STMicroelectronics N.V. ( Respondents ) as respondents. On June 8, 2007, Respondents filed a motion to stay the ITC investigation pending reexamination of the Asserted Patents by the U.S. Patent and Trademark Office. On July 11, 2007, Administrative Law Judge Carl C. Charneski set an Initial Determination date of May 21, 2008 and a target date for completion of the ITC Investigation of August 21, 2008. On October 17, 2007, the ITC investigation was reassigned to Administrative Law Judge Theodore Essex, who set a hearing for February 25, 2008. On February 26, 2008, Judge Essex issued an Initial Determination granting respondents' motion for a stay of the ITC investigation pending completion of the re-examination of the Asserted Patents by the U.S. Patent and Trademark Office. On March 4, 2008, Tessera filed, with the International Trade Commission, a Petition for Review of the Initial Determination Ordering Stay. On March 27, 2008, the ITC issued an order reversing Judge Essex's Initial Determination, and denying respondents' motion for a stay of the ITC investigation pending reexamination of the Asserted Patents. On July 14, 2008 Judge Essex held an evidentiary hearing at which complainant Tessera and respondents ATI, Freescale, Motorola, Spansion, STMicroelectronics and Qualcomm presented their respective evidence. The hearing concluded on July 18, 2008. Judge Essex is expected to issue an Initial Determination on or before October 21, 2008.

We believe that we have meritorious defenses against Tessera's claims and we intend to defend this proceeding vigorously.

***LSI, Agere v. Spansion, Inc., et al.***

On April 18, 2008, LSI Corporation and Agere Systems, Inc. filed a complaint, Civil Action No. 2 - 08 CV -165, in the United States District Court for the Eastern District of Texas, against defendants United Microelectronics Corporation, Integrated Device Technology, Inc., AMIC Technology Corporation, Elpida Memory, Inc., Freescale Semiconductor, Inc., Grace Semiconductor Manufacturing Corporation, Microchip Technology, Inc., Micromas Semiconductor Holding, AG, National Semiconductor Corporation, Nanya Technology Corporation, NXP B.V., ON Semiconductor Corporation, Powerchip Semiconductor Corporation, ProMOS Technologies, Inc., Spansion, Inc., STMicroelectronics NV and Vanguard International Semiconductor Corporation. The complaint alleges that certain Spansion Flash products, including Spanion's 4 Mb CMOS 3.0 Volt-only Simultaneous Read/Write Flash Memory and 1 G MirrorBit NOR Flash products, infringe at least claim 1 of U.S. Patent No. 5,227, 335 (the Asserted Patent). The complaint seeks a declaration that Spansion infringes the Asserted Patent, permanent injunctive relief and unspecified reasonable royalty and other damages, a trebling of damages for alleged willful conduct and attorney's fees.

We believe that we have meritorious defenses against LSI's and Agere's claims and we intend to defend the lawsuit vigorously.



**Table of Contents*****LSI, Agere ITC Investigation***

On April 18, 2008, LSI Corporation and Agere Systems, Inc. (collectively "Complainants") filed a complaint under section 337 of the Tariff Act of 1930, 19 U.S.C. § 1337, in the United States International Trade Commission against respondents United Microelectronics Corporation, Integrated Device Technology, Inc., AMIC Technology Corporation, Elpida Memory, Inc., Freescale Semiconductor, Inc., Grace Semiconductor Manufacturing Corporation, Microchip Technology, Inc., Micromas Semiconductor Holding, AG, National Semiconductor Corporation, Nanya Technology Corporation, NXP B.V., ON Semiconductor Corporation, Powerchip Semiconductor Corporation, ProMOS Technologies, Inc., Spansion, Inc., STMicroelectronics NV and Vanguard International Semiconductor Corporation. The complaint alleges that certain Spansion Flash products, including Spanison's 4 Mb CMOS 3.0 Volt-only Simultaneous Read/Write Flash Memory and 1 G MirrorBit NOR Flash products, infringe at least claim 1 of U.S. Patent No. 5,227,335 (the "Asserted Patent"). The complaint identifies, under the heading "Related Litigations," other lawsuits involving the Asserted Patent, including *Agere Systems, Inc. v Atmel Corporation*, Civil Action No. 2:02-CV-864 (E.D. Pa.). The complaint requests that the International Trade Commission institute an investigation into the matter. The complainant seeks a permanent exclusion order pursuant to section 337(d) of the Tariff Act of 1930, as amended, excluding from entry into the United States all semiconductor IC devices and products containing same, made by a method that infringes one or more claims of the Asserted Patent. The complainant also seeks a permanent cease and desist order pursuant to section 337(1) of the Tariff Act of 1930, as amended, directing respondents to cease and desist from importing, selling, offering for sale, using, demonstrating, promoting, marketing, and/or advertising in the United States, or otherwise transferring outside the United States for sale in the United States, semiconductor IC devices and products containing same made by a method that infringes one or more claims of the Asserted Patent.

We believe that we have meritorious defenses against LSI's and Agere's claims and we intend to defend this proceeding vigorously.

***Fast Memory Erase LLC v. Spansion Inc., et al.***

On June 9, 2008, Fast Memory Erase LLC filed a complaint in the U.S. District Court for the Northern District of Texas alleging patent infringement against Spansion Inc., Spansion LLC, Intel Corp., Numonyx B.V., Numonyx, Inc., Nokia Corp., Nokia Inc., Sony Ericsson Mobile Communications AB, Sony Ericsson Mobile Communications (USA), Inc., and Motorola, Inc. The case is styled, *Fast Memory Erase, LLC v. Spansion Inc., Spansion LLC, et al.*, Case No. 3:08-cv-00977-M (N.D. Tex.). Fast Memory Erase's complaint alleges that Spansion's NOR Flash products using floating gate technology infringe one or more claims of U.S. Patent No. 6,236,608 (the "608 patent"). Fast Memory Erase has also asserted U.S. Patent No. 6,303,959 (the "959 patent") in its complaint against the products of other defendants, namely Intel and Numonyx, but it has not asserted the 959 patent against any Spansion products. Spansion is currently scheduled to answer, move, or otherwise respond to the complaint on or before August 20, 2008.

We believe that we have meritorious defenses against Fast Memory Erase's claims and we intend to defend this proceeding vigorously.

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### **ITEM 1A. RISK FACTORS**

*Investing in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this annual report. If any of the following risks occur, our business could be materially harmed, and our financial condition and results of operations could be materially and adversely affected. As a result, the price of our common stock could decline, and you could lose all or part of your investment.*

*The demand for our products depends in large part on continued growth in the industries into which they are sold. A decline in the markets served by any of these industries, or a decline in demand for Flash memory products in these industries, would have a material adverse effect on our results of operations.*

Sales of our Flash memory products are dependent upon consumer demand for mobile phones, consumer electronics such as set top boxes and DVD players, automotive electronics, and industrial electronics such as networking equipment, personal computers and personal computer peripheral equipment such as printers. Sales of our products are also dependent upon the inclusion of increasing amounts of Flash memory content in some of these products.

In the first half of fiscal 2008 sales of our products were evenly divided between wireless applications, such as mobile phones, and embedded applications, such as gaming, set top boxes, DVD players, automotive and industrial electronics. This represented a shift from fiscal 2007 and fiscal 2006 when sales to wireless Flash memory customers accounted for a majority of our sales. If our sales begin to be more heavily weighted in a declining category of products, if demand for mobile phones or products in the embedded portion of the integrated category of the Flash memory market decline, or if our sales are below industry analysts' expectations, our business would be materially adversely affected. Also, if the functionality of successive generations of such products does not require increasing Flash memory density or if such products no longer require Flash memory due to alternative technologies or otherwise, our operating results would be materially adversely affected.

*Our business has been characterized by an average selling price that declines over time, which can negatively affect our results of operations.*

As a semiconductor manufacturing company, our financial results are primarily dependent upon the difference between our average selling price and our costs. Generally, we endeavor to maintain or increase our average selling price while lowering our costs, improving our product mix, and selling more units. Historically, however, the average selling price of our products has decreased during the products' lives, and we expect this trend to continue. When our average selling price declines, our net sales and gross margins also decline unless we are able to compensate by selling more units, reducing our manufacturing costs or introducing and selling new, higher margin products with higher densities and/or advanced features. If the average selling price for our products continues to decline, our operating results could be materially adversely affected.

Moreover, during downturns, periods of extremely intense competition, or the presence of oversupply in the industry, the average selling price for our products has declined at a high rate over relatively short time periods as compared to historical rates of decline. For example, during the second quarter of fiscal 2007, our average selling price decreased by approximately 11 percent compared with the first quarter of fiscal 2007, a decrease that was greater than expected, due to unanticipated intense competitive pricing environments in the Flash memory market. We are unable to predict average selling prices for any future periods and may experience

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unanticipated, sharp declines in average selling prices for our products. When such pricing declines occur, we may not be able to mitigate the effects by selling more or higher margin units, or by reducing our manufacturing costs. In such circumstances, our operating results could be materially adversely affected.

*The Flash memory market is highly cyclical and has experienced severe downturns that have materially adversely affected, and may in the future materially adversely affect, our business.*

The Flash memory market is highly cyclical and has experienced severe downturns, often as a result of wide fluctuations in supply and demand, constant and rapid technological change, continuous new product introductions and price erosion. Our financial performance has been, and may in the future be, adversely affected by these downturns. We have incurred substantial losses in past downturns, due principally to:

substantial declines in average selling prices, particularly due to competitive pressures and an imbalance in product supply and demand;

a decline in demand for end-user products that incorporate our products; and

lower than expected demand in the distribution channels such as by mobile phone OEMs.

For example, during the first quarter of fiscal 2007, our business was adversely affected by a seasonal drop in unit shipments, and during the first nine months of fiscal 2007, our business was adversely affected by a greater than average decline in our average selling price as a result of intense competitive pressures. Our historical financial information does not necessarily indicate what our results of operations, financial condition or cash flows will be in the future. If our net sales decline in the future, or if these or other similar conditions continue or occur again in the future, we would likely be materially adversely affected.

*Our forecasts of customer demand for our products may be inaccurate, which could result in excess inventory and cause us to record write-downs that would adversely affect our gross margins.*

We rely on our ability to forecast inventory and production mix in order to meet customer demand and produce requisite amounts of our products in order to fill current orders and future orders. To forecast demand and value inventory, management considers, among other factors, the inventory on hand, competitiveness of product offerings, market conditions and product life cycles. Historically, we have generally used a six-month demand forecast in assessing the salability of inventory on hand and did not value inventory in excess of six months of forecasted demand. During the second quarter of fiscal 2008, however, we built and valued certain inventory to meet estimated customer demand as much as twelve months into the future. Consequently, we are now valuing the inventory beyond our historical six-month demand forecast.

If we anticipate future demand or market conditions to be less favorable than our previous projections, inventory write-downs may be required and would be reflected in cost of sales in the period the write-down is made. This would have a negative impact on our gross margin in that period. While we believe our understanding of the end markets we serve provides us with the ability to make reliable forecasts, as we begin to forecast customer demand beyond six-months, we may be unable to forecast accurately. If we inaccurately forecast customer demand, it could result in excess or obsolete inventory that would reduce our profit margins, which would materially adversely affect us.

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*Any future business combinations, divestitures, acquisitions or mergers expose us to risks, including the risk that we may not be able to successfully integrate these businesses or achieve expected operating synergies.*

We periodically consider strategic transactions. We evaluate acquisitions, divestitures, joint ventures, alliances or co-production programs as opportunities arise and we may be engaged in varying levels of negotiations with third parties at any time. We may not be able to effect transactions with strategic alliance, divestiture, acquisition or co-production program candidates on commercially reasonable terms, or at all. If we enter into these transactions, we also may not realize the benefits we anticipate. Moreover, the integration of companies that have previously been operated separately involves a number of risks. Consummating any acquisitions, divestitures, joint ventures, alliances or co-production programs could result in the incurrance of additional transaction-related expenses, as well as unforeseen contingent liabilities, which could materially adversely affect us.

*Financial market conditions may impede access to or increase the cost of financing operations and investments.*

The recent changes in U.S. and global financial and equity markets, including market disruptions and tightening of the credit markets, may make it more difficult for us to obtain financing for our operations or investments or increase the cost of obtaining financing. In addition, our borrowing costs can be affected by short and long-term debt ratings assigned by independent rating agencies which are based, in significant part, on our performance as measured by credit metrics such as interest coverage and leverage ratios. A decrease in these ratings could increase our cost of borrowing or make it more difficult for us to obtain financing, which would materially adversely affect us.

*If our expense reduction efforts are not effective, our business could be materially adversely affected.*

We incurred net losses in each of the first and second quarters of fiscal 2008, and fiscal years 2007, 2006 and 2005 of approximately \$104.4 million, \$118.5 million, \$263.5 million, \$147.8 million and \$304.1 million. As a result, we are continuing to undertake actions in an effort to significantly reduce our expenses. These actions include: (i) accelerating the transfer of positions to more cost effective regions including China and Malaysia; (ii) establishing strategic partnerships in technology development and manufacturing; and (iii) reducing approximately 500 regular and contract positions globally. We cannot assure you that we will be able to achieve anticipated expense reductions. If our expense reduction efforts are unsuccessful, our operating results and business may be materially adversely affected.

*We have lost rights to key intellectual property arrangements because we are no longer a beneficiary of AMD's patent cross-license agreements and other licenses, which creates a greatly increased risk of patent or other intellectual property infringement claims against us.*

As a subsidiary of Advanced Micro Devices, Inc. (AMD) until our initial public offering in December 2005, we were the beneficiary of AMD's intellectual property arrangements with third parties, including patent cross-license agreements with other major semiconductor companies such as Intel, Motorola and IBM, and licenses from third parties for technology incorporated in our products and software used to operate our business. As a result of the conversion of the outstanding shares of Class D common stock into shares of Class A common stock in November 2006, we ceased to be a beneficiary under most of the remainder of these license agreements. As a result, we may be subject to claims that we are infringing intellectual property rights of third

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parties through the manufacture and sale of our products and the operation of our business. Therefore, absent negotiating our own license agreements with the third parties who own such intellectual property, we will be vulnerable to claims by such parties that our products or operations infringe such parties' patents or other intellectual property rights.

We may attempt to negotiate our own agreements and arrangements with third parties for intellectual property and technology that are important to our business, including the intellectual property that we previously had access to through our relationship with AMD. We may also attempt to acquire new patents as our success in negotiating patent cross-license agreements with other industry participants will depend in large part upon the strength of our patent portfolio relative to that of the third party with which we are negotiating. If such third-party benefits from an existing patent cross-license agreement with AMD or Fujitsu Limited (Fujitsu), in many cases such third party will retain the rights that it has under that agreement, including rights to utilize the patents that AMD and Fujitsu transferred to us in connection with our reorganization as Spansion LLC in June 2003. In many cases, third parties also retain such rights to utilize any patents that have been issued to us or acquired by us between the dates of our reorganization in 2003 and our initial public offering in 2005 or, in some cases, between the dates of our reorganization in 2003 and the conversion of the Class D common stock in 2006. Our negotiating position may therefore be impaired, because the other party will already be entitled to utilize a large number of our patents, while we will no longer have the right to utilize that party's patents. As a result, we may be unable to obtain access to the other party's patent portfolio on favorable terms or at all. Similarly, with respect to licenses from third parties for technology incorporated in our products or software used to operate our business, we may not be able to negotiate prices with these third parties on terms as favorable to us as those previously available to us because we are no longer able to take advantage of AMD's size and purchasing power. These parties, and other third parties with whom AMD had no prior intellectual property arrangement, may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted. Such litigation could be extremely expensive and time consuming. We cannot assure you that such litigation would be avoided or successfully concluded. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture or sale of some or all of our products, would have a material adverse effect on us.

***A significant market shift to NAND architecture would materially adversely affect us.***

Flash memory products are generally based on either NOR or NAND architecture. To date, our Flash memory products have been based on NOR architecture which are typically produced at a higher cost-per-bit than NAND-based products. We do not currently manufacture products based on NAND architecture. We have developed our MirrorBit ORNAND, MirrorBit Quad and MirrorBit Eclipse architectures to address certain portions of the integrated category of the Flash memory market served by NAND-based products, but we cannot be certain that our MirrorBit ORNAND-, Quad- or Eclipse- based products will satisfactorily address those market needs.

In each of the last five years from 2003 to 2007, industry sales of NAND-based Flash memory products grew at a higher rate than sales of NOR-based Flash memory products, resulting in NAND vendors in aggregate gaining a greater share of the overall Flash memory market and NOR vendors in aggregate losing overall market share. In 2007, according to iSuppli, total sales for the Flash memory market reached approximately \$21.5 billion, of which approximately 35 percent was classified as sales of NOR-based Flash memory products and approximately 65 percent was classified as sales of NAND-based Flash memory products. iSuppli estimates that sales of NAND-based Flash memory products grew by approximately 13 percent

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from 2006 to 2007 and will grow at a seven percent compound annual growth rate from 2007 to 2012, while sales of NOR-based Flash memory products declined by approximately two percent from 2006 to 2007 and will decline by approximately eight percent compound annual rate from 2007 to 2012. We expect the Flash memory market trend of decreasing market share for NOR-based Flash memory products relative to NAND-based Flash memory products to continue in the foreseeable future.

Moreover, the removable storage category of the Flash memory market, which is predominantly served by floating gate NAND vendors, is expected to constitute a significant portion of the Flash memory market for the foreseeable future. As mobile phones and other consumer electronics become more advanced, they will require higher density Flash memory to meet the increased data storage requirements associated with music downloads, photos and videos. Because storage requirements will increase to accommodate data-intensive applications, OEMs may increasingly choose higher density floating gate NAND-based Flash memory products over MirrorBit NOR-, ORNAND-, Quad- or Eclipse-based Flash memory products for their applications. If this occurs and OEMs continue to prefer the attributes and characteristics of floating gate NAND-based products over those of MirrorBit NOR-, ORNAND-, Quad- or Eclipse-based products for their applications, we may be materially and adversely affected. Moreover, some of our competitors are able to manufacture floating gate NAND-based Flash memory products on 300-millimeter wafers produced in much larger capacity fabs than our SPI fab or may choose to utilize more advanced manufacturing process technologies than we use today to offer products competitive to ours at a lower cost. If floating gate NAND vendors continue to increase their share of the Flash memory market, our market share may decrease, which would materially adversely affect us.

In addition, even if products based on NAND architecture are unsuccessful in displacing products based on NOR architecture, the average selling price for our products may be adversely affected by a significant decline in the price for NAND-based products. Such a decline may result in downward price pressure in the overall Flash memory market affecting the price we can obtain for our NOR-based products, which would adversely affect us. We believe such downward pricing pressure was a factor in the significant declines in the average selling price in the first half of 2007. If the prices for NAND products do not improve, or continue to decline, we may be materially adversely affected.

***If we cannot generate sufficient operating cash flows and obtain external financing, we may be unable to make all of our planned capital expenditures.***

Our business is dependent upon the continued development of advanced technologies that utilize smaller lithography and process nodes. However, our ability to fund the capital expenditures necessary for transitioning to advanced technologies depends on generating sufficient cash flows from operations and the continued availability of external financing. We expect our total capital expenditures for fiscal 2008 to be less than \$500.0 million. Our capital expenditures, together with ongoing operating expenses, will be a substantial drain on our cash flows and may decrease our cash balances. The timing and amount of our capital requirements cannot be precisely determined at this time and will depend on a number of factors, including demand for our products, product mix, changes in industry conditions and market competition.

We may assess markets for external financing opportunities, including debt and equity. Such financing may not be available when needed or, if available, may not be available on satisfactory terms. Moreover, the funds availability under our existing \$175.0 million senior secured revolving credit facility may be adversely affected by our financial condition, results of operations and incurrence or maintenance of additional debt, such as our 11.25% Senior Notes

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due 2016 and our 2.25% Exchangeable Senior Secured Debentures. Also, no further funds are available under the Spansion Japan 2007 Credit Facility, which provided funding based on capital deliveries to SP1, our Flash memory manufacturing facility in Aizu-Wakamatsu, Japan. Finally, any equity financing may not be desirable because of resulting dilution to our stockholders. Our inability to obtain needed financing or to generate sufficient cash from operations may require us to abandon projects or curtail capital expenditures. If we cannot generate sufficient operating cash flows or obtain external financing, we may be delayed in transitioning, or we may not be able to transition at all, to advanced technologies needed for future manufacturing capacity. If this occurs, we could be materially adversely affected.

***We cannot be certain that our substantial investments in research and development will lead to timely improvements in technology or that we will have sufficient resources to invest in the level of research and development that is required to remain competitive.***

We make substantial investments in research and development for design, process technologies and production in an effort to design and manufacture advanced Flash memory products. For example, in the six months ended June 29, 2008 and fiscal years 2007 and 2006, our research and development expenses were approximately \$228.6 million, \$436.8 million and \$342.0 million, respectively, or approximately 18, 17 and 13 percent, respectively, of our net sales.

Currently, we are developing new non-volatile memory process technologies, including 45-nanometer process technologies and researching more advanced process technologies. Our Submicron Development Center facility is developing manufacturing process technologies on 300-millimeter wafers. We cannot assure you that we will have sufficient resources to maintain the level of investment in research and development that is required for us to remain competitive, which could materially adversely affect us. Further, we cannot assure you that our investments in research and development will result in increased sales or competitive advantage, which could adversely affect our operating results.

***We have a substantial amount of, and continue to incur, indebtedness which could adversely affect our financial position.***

We currently have and will continue to have for the foreseeable future, a substantial amount of indebtedness. Our indebtedness has increased over time and may increase in the future. At the time of our initial public offering in December 2005, our aggregate principal amount of outstanding debt was approximately \$760.0 million. As of June 29, 2008, we had an aggregate principal amount of approximately \$1.6 billion in outstanding debt. In order to advance our business with new technologies, like other semiconductor manufacturers, we are required to make sizable capital investment in facilities and equipment. If cash flow from operations is not sufficient to meet capital requirements, we may need to incur additional indebtedness.

Our substantial indebtedness may:

require us to use a substantial portion of our cash flows from operations to make debt service payments;

make it difficult for us to satisfy our financial obligations;

limit our ability to use our cash flows, use our available financings to the fullest extent possible, or obtain additional financing for future working capital, capital expenditures, acquisitions or other general corporate purposes;

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limit our flexibility to plan for, or react to, changes in our business and industry;

place us at a competitive disadvantage compared to our less leveraged competitors; and

increase our vulnerability to the impact of adverse economic and industry conditions.

***We are currently party to and intend to enter into debt arrangements in the future, each of which may subject us to restrictive covenants which could limit our ability to operate our business.***

We are party to a \$175.0 million senior secured revolving credit facility that imposes various restrictions and covenants on us that limits our ability to:

enter into any mergers, consolidations or sales of property, or sales of inventory, equipment and assets except in the ordinary course of business;

make any distributions except for distributions from Spansion LLC to us in specified circumstances;

make investments, except for the purchase of inventory, equipment and intellectual property in the ordinary course of business, unless we meet minimum liquidity requirements consisting of availability under the revolving credit facility and domestic cash of at least \$200.0 million, provided, however, that investments are limited to no more than a total of \$50.0 million while the reduced minimum liquidity requirement is in place;

incur additional debt, enter into capital leases and, in limited cases, make loans to subsidiaries;

engage in transactions with affiliates unless the transactions are in the normal course of business, negotiated at arms-length and disclosed to the agent for the lenders;

incur any new liens except for equipment leases and loans; and

prepay any debt, except that debt of foreign subsidiaries may be prepaid by the applicable foreign subsidiary and we may prepay any debt as long as after such repayment we meet minimum liquidity requirements consisting of availability under the revolving credit facility plus domestic cash of at least \$250.0 million.

In addition, the indentures governing Spansion LLC's \$250.0 million principal amount of 11.25% Senior Notes due 2016 and Spansion LLC's \$625.0 million aggregate principal amount of Senior Secured Floating Rate Notes due 2013 impose substantially similar restrictions and covenants on us which could limit our ability to respond to market conditions, make capital investments or take advantage of business opportunities. Also, certain of our credit facilities in Japan impose on-going requirements on us and the breach of such requirements could result in a default of the credit facilities.

In the future, we will likely incur additional indebtedness through arrangements such as credit agreements or term loans that may also impose similar restrictions and covenants. These restrictions and covenants limit, and any future covenants and restrictions likely will limit, our ability to respond to market conditions, to make capital investments or to take advantage of business opportunities. Any debt arrangements we enter into would likely require us to make regular interest payments, which would adversely affect our results of operations.





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As of June 29, 2008, we were in compliance with the financial covenants under our debt instruments. However, we cannot assure you that in the future we will be able to satisfy the provisions, covenants, financial tests and ratios of our debt instruments, which can be affected by events beyond our control. If we fail to comply with such provisions, covenants, financial tests and ratios, or if we disagree with our lenders about whether or not we are in compliance, we cannot assure you that we will be able to obtain waivers for any future failures to comply with our financial covenants or any other terms of the debt instruments. We also may not be able to obtain amendments which will prevent a failure to comply in the future. A breach of any of the provisions, covenants, financial tests or ratios under our debt instruments could result in a default under the applicable agreement, which in turn could trigger cross-defaults under our other debt instruments, any of which would materially adversely affect us.

***If we are unable to timely and efficiently expand our manufacturing capacity to increase 300-millimeter wafer capacity at SP1, and achieve a competitive wafer cost for SP1 output, our business and financial results could be materially adversely affected.***

We have expanded our manufacturing capacity to produce 300-millimeter wafers at SP1. In fiscal 2006, we commenced a plan to spend approximately \$1.2 billion over three years to construct and equip SP1 for production of 65-nanometer process technology on 300-millimeter wafers, and we expect to sample 45-nanometer process technology on 300-millimeter wafer capacity in late 2008. In order for SP1 to produce wafers at a competitive cost, we must achieve suitable economies of scale which we anticipate will require additional capital expenditures at SP1 to reach our planned manufacturing capacity. Financing may not be available when needed or, if available, may not be available on satisfactory terms. If we do not achieve our desired capacity at the anticipated cost, or if we cannot obtain suitable financing, we could be materially adversely affected.

The timing for expanding our 300-millimeter capacity in SP1 will also depend in part on our ability to execute our plan for equipping the facility and other factors that may be beyond our control, such as delivery schedules for the required machinery and equipment and construction schedules. If we are unable to timely and efficiently ramp production on 300-millimeter wafers, we will not achieve anticipated cost savings associated with this technology and our gross margins could decline. Even if we are successful in expanding this capacity, if the demand for our products is not sufficient to support the additional capacity when it becomes available, we could be materially and adversely affected.

***The loss of a significant customer or a reduction in demand for our Flash memory products from a significant customer could have a material adverse effect on us.***

We serve our customers worldwide directly through our sales force and indirectly through our distributors, who purchase products from us and sell them to customers, either directly or through their distributors. Our customers consist of OEMs, ODMs and contract manufacturers. In the second quarter of fiscal 2008, and fiscal years 2007, 2006 and 2005, the five largest of these customers accounted for a significant portion of end sales of our products. If one of these customers stopped purchasing our Flash memory products, or if one of these customers were to materially reduce its demand for our products, we could be materially adversely affected. For example, in the third quarter of fiscal 2007 we were materially adversely affected by the reduced customer demand in Japan for some of our custom high density Flash memory solutions.

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Our business strategy is to continue to maintain and increase our market share, diversify our customer base in the integrated category of the Flash memory market, and enter new markets enabled by our MirrorBit technology. We cannot assure you that we will be successful in implementing this strategy, and if we are unsuccessful, we could be materially adversely affected. If we fail to successfully diversify our customer base and we lose a significant customer or suffer a reduction in demand from a significant customer, our business may be materially adversely affected.

***If we fail to successfully develop, introduce and commercialize new products and technologies or to accelerate our product development cycle, we may be materially adversely affected.***

Our success depends to a significant extent on the development, qualification, production, introduction and acceptance of new product designs and improvements that provide value to Flash memory customers. Our ability to develop and qualify new products and related technologies to meet evolving industry requirements at prices acceptable to our customers and on a timely basis affects our competitiveness in our target markets. If we are delayed in developing or qualifying new products or technologies, we could be materially adversely affected.

***Competitors may introduce new memory or other technologies that may make our Flash memory products uncompetitive or obsolete.***

Our competitors are working on a number of new technologies, including FRAM, MRAM, polymer, charge trapping and phase-change based memory technologies. Some of our competitors have announced plans to bring to market products based on phase-change based memory technology in 2009. If such products are successfully developed and commercialized as a viable alternative to MirrorBit or floating gate Flash memory, these other products could pose a competitive threat to a number of Flash memory companies, including us. In addition, some of Saifun's licensees and customers are our competitors or work with our competitors and have licensed Flash memory intellectual property associated with NROM technology from Saifun. Use of this NROM intellectual property or use of independently developed charge trapping Flash memory technology by our competitors, if successfully developed and commercialized, may allow these competitors to develop Flash memory technology that may compete with our proprietary MirrorBit technology.

***If we fail to successfully develop products based on our new MirrorBit ORNAND, MirrorBit Eclipse, MirrorBit Quad or MirrorBit ORNAND2 architectures, or if there is a lack of market acceptance of these products, our future operating results would be materially adversely affected.***

We are attempting to position ourselves to address the increasing demand for data optimized Flash memory by offering higher density, lower cost and more versatile products based on our new MirrorBit ORNAND, MirrorBit Quad, MirrorBit Eclipse and MirrorBit ORNAND2 architectures. The success of these architectures requires that we timely and cost effectively develop, manufacture and market products based on these architectures that are competitive with floating gate NAND-based Flash memory solutions. While we have made some progress on developing and commercializing products based on these architectures, we may not be able to continue to do so in accordance with our product development plans or at a rate required for us to remain competitive. If we fail to continue to develop and commercialize products based on these architectures on a timely basis, our future operating results would be materially adversely affected. Furthermore, if market acceptance of products based on our MirrorBit architectures occurs at a slower rate than we anticipate, our ability to compete will be reduced, and we would be materially adversely affected. If we do not achieve market acceptance of these architectures or subsequent MirrorBit products, our future operating results would be materially adversely affected.

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*If we fail to successfully develop new applications and markets for our products our future operating results would be materially adversely affected.*

We are developing new applications and opportunities for our products beyond our traditional customer base and in some cases plan to deploy our Flash memory solutions beyond current Flash memory markets. We expect these new applications to grow future revenue, future margin or a combination of both. However, some of these opportunities require that we are successful in creating, marketing, gaining customer acceptance of and deploying these new system architectures into a customer base where we do not have a historic business relationship and where our solution is required to replace established and proven solutions. In some cases our solutions rely on third parties to contribute a significant and necessary component of the solution without which the solution is nonviable. For example during the second quarter of fiscal 2008 we announced plans to introduce a Spansion EcoRAM product that is designed to replace conventional DRAM in certain types of servers that support Internet search capability in data centers. Our expectation is that this solution will be capable of delivering a significant reduction in operator costs enabling us to achieve significant increased revenue and margins based on the value of these reduced operator costs to our customer base. If we are unsuccessful in our attempts to bring this product to market, experience significant delays in generating sales, fail to establish the value of this solution or face competition from third parties or incumbent suppliers that result in lower margins than expected, then our future operating results would be materially adversely affected.

*Industry overcapacity could require us to take actions which could have a material adverse effect on us.*

Semiconductor companies with their own manufacturing facilities and specialist semiconductor foundries, which are subcontractors that manufacture semiconductors designed by others, have added significant capacity in recent years and are expected to continue to do so. In the past, capacity additions sometimes exceeded demand requirements leading to oversupply situations and downturns in the industry. Fluctuations in the growth rate of industry capacity relative to the growth rate in demand for Flash memory products contribute to cyclicalities in the Flash memory market, which may in the future negatively impact our average selling price and materially adversely affect us.

It is difficult to predict future growth or decline in the markets we serve, making it very difficult to estimate requirements for production capacity. If our target markets do not grow as we anticipate, we may under-utilize our manufacturing capacity. This may result in write-downs or write-offs of inventories and losses on products the demand for which is lower than we anticipate. In addition, during periods of industry overcapacity, customers do not generally 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.

Many of our costs are fixed. Additionally, pursuant to some of our subcontractor and foundry arrangements with third parties we may incur and pay penalties, according to which we have agreed to pay for a certain amount of product even if we do not accept delivery of all of such amount. Accordingly, during periods in which we under-utilize our manufacturing capacity as a result of reduced demand for some of our products, our costs cannot be reduced in proportion to the reduced revenues for such periods. When this occurs, our operating results are materially adversely affected.

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### ***Our customers' ability to change booked orders may lead to excess inventory.***

Because our manufacturing processes require long lead times, we use indicators such as booking rates in conjunction with other business metrics, to schedule production in our fabrication facilities. Consequently, when customers change orders booked by us, our planned manufacturing capacity may be greater or less than actual demand, resulting in less than optimal inventory levels. When this occurs, we adjust our production levels but such adjustments may not prevent our production of excess inventory in environments when bookings are strong. As a result, our business may be materially adversely affected.

### ***Intense competition in the Flash memory market could materially adversely affect us.***

Our principal NOR Flash memory competitors are Numonyx B.V. and Samsung Electronics Co., Ltd. Additional significant NOR Flash memory competitors include Silicon Storage Technology, Inc., Macronix International Co., Ltd., Toshiba Corporation and Sharp Electronics Corp.

We increasingly compete with NAND Flash memory manufacturers where NAND Flash memory has the ability to replace NOR Flash memory in customer applications and as we develop data storage solutions based on our MirrorBit ORNAND, MirrorBit Quad, MirrorBit Eclipse and MirrorBit ORNAND2 architectures for the integrated category and select portions of the removable category of the Flash memory market. Our principal NAND Flash memory competitors include Samsung Electronics Co., Ltd, Toshiba Corporation, Hynix Semiconductor Inc. and Numonyx. In the future our principal NAND Flash memory competitors may include Intel Corporation, Micron Technology, Inc., IM Flash Technology LLC, the joint venture between Intel and Micron Technology, Inc. and SanDisk Corporation.

The Flash memory market is characterized by intense competition. The basis of competition is cost, selling price, performance, quality, customer relationships and ability to provide value-added solutions. In particular, in the past, our competitors have aggressively priced their products, which resulted in a decreased average selling price for our products in the first half of fiscal 2007 and adversely impacted our results of operations. Some of our competitors, including Samsung, Toshiba and Sharp, are more diversified than we are and may be able to sustain lower operating margins in their Flash memory business based on the profitability of their other, non-Flash memory businesses. In addition, recent capital investments by competitors have resulted in substantial industry manufacturing capacity, which may further contribute to a competitive pricing environment. Some of our competitors are able to manufacture floating gate NAND-based Flash memory products on 300-millimeter wafers produced in much larger capacity fabs than our SP1 fab or may choose to utilize more advanced manufacturing process technologies than we use today to offer products competitive to ours at a lower cost. Moreover, products based on our MirrorBit ORNAND-, MirrorBit Quad-, MirrorBit Eclipse- and MirrorBit ORNAND2-based architectures may not have the price, performance, quality and other features necessary to compete successfully for these applications.

We expect competition in the market for Flash memory devices to intensify as existing manufacturers introduce new products, new manufacturers enter the market, industry-wide production capacity increases and competitors aggressively price their Flash memory products to increase market share. The competition we face may also intensify if our competitors increase their focus on the Flash memory products, or segments of the Flash memory markets, that generate a significant portion of our net sales.

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Competition also may increase if NOR memory vendors merge, if NAND memory vendors acquire NOR businesses or other NAND businesses, or if our competitors otherwise consolidate their operations. Furthermore, we face increasing competition from NAND Flash memory vendors in some portions of the integrated Flash memory market.

To compete successfully, we must decrease our manufacturing costs and develop, introduce and sell products at competitive prices that meet the increasing demand for greater Flash memory content in mobile phones, consumer electronics, automotive and other applications. If we are unable to compete effectively, we could be materially adversely affected.

### ***Manufacturing capacity constraints may adversely affect us.***

There may be situations in which our manufacturing capacity is inadequate to meet the demand for some of our products. We continue to depend on foundry, subcontractor and similar arrangements with third parties to meet demand. Our arrangements with third-party suppliers do not necessarily include capacity guarantees. If a third-party manufacturer on which we rely does not have the capacity to deliver an adequate amount of product to meet actual demand, we may not be able to obtain the manufacturing capacity, either in our own facilities or through other third-party arrangements, to meet such demand. During fiscal 2006, demand for certain of our products exceeded the available supply. As a result, we were unable to meet the demand of some of our customers for these products. This adversely impacted our relationships with these customers, and comparable situations in the future could cause harm to our reputation in the marketplace, cause these customers to move future business to our competitors or cause us to make financial concessions to our customers. Any of these occurrences could have a material adverse effect on us. Also, in the third and fourth quarters of fiscal 2006, we experienced capacity constraints for final test and assembly of some of our products. While we have worked internally and with subcontractors to increase capacity to meet anticipated demand, we cannot assure you that we will not experience similar constraints in the future. These capacity constraints limit our ability to respond to rapid and short-term surges or changes in demand for our products. If we are unable to obtain sufficient manufacturing capacity to meet anticipated demand, either in our own facilities or through foundry, subcontractor or similar arrangements with third parties, or if we are unable to obtain foundry services at competitive rates, our business may be materially adversely affected.

### ***Our reliance on third-party manufacturers entails risks that could materially adversely affect us.***

We have in the past and plan in the future to obtain foundry services from other companies. Foundry services suppliers including Fujitsu (as a result of the sale of our JV1/JV2 manufacturing facilities in April 2007) and Semiconductor Manufacturing International Corporation from which we may obtain foundry services in the future. We also use independent contractors to perform some of the assembly, testing and packaging of our products. Third-party manufacturers are often under no obligation to provide us with any specified minimum quantity of product. We depend on these manufacturers to allocate to us a portion of their manufacturing capacity sufficient to meet our needs, to produce products of acceptable quality and at acceptable manufacturing yields and to deliver those products to us on a timely basis at acceptable prices. We cannot assure you that these manufacturers will be able to meet our near-term or long-term manufacturing requirements and may not be able to attain qualification from our customers.

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These manufacturers also make products for other companies, including certain of our competitors, and/or for themselves and could choose to prioritize capacity for themselves or other customers beyond any minimum guaranteed amounts, reduce deliveries to us or, in the absence of price guarantees, increase the prices they charge us on short notice, such that we may not be able to pass cost increases on to our customers. Because it could take several quarters or more to establish a relationship with a new manufacturing partner, we may be unable to secure an alternative supply for specific products in a short timeframe or at all at an acceptable cost to satisfy our production requirements. In addition, we may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. Other risks associated with our increased dependence on third-party manufacturers include: their ability to adapt to our proprietary technology, reduced control over delivery schedules, quality assurance, manufacturing yields and cost, lack of capacity in periods of excess demand, misappropriation of our intellectual property, reduced ability to manage inventory and parts and risks associated with operating in foreign countries. If we are unable to secure sufficient or reliable suppliers of wafers or obtain the necessary assembling, testing and packaging services, our ability to meet customer demand for our products may be adversely affected, which could have a material adverse effect on us.

*Unless we maintain manufacturing efficiency, we may not become profitable and our future profitability could be materially adversely affected.*

The Flash memory industry is characterized by rapid technological changes. For example, new manufacturing process technologies using smaller feature sizes and offering better performance characteristics are generally introduced every one to two years. The introduction of new manufacturing process technologies allows us to increase the functionality of our products while at the same time optimizing performance parameters, decreasing power consumption and/or increasing storage capacity. In addition, the reduction of feature sizes enables us to produce smaller chips offering the same functionality and thereby considerably reduces the costs per bit. In order to remain competitive, it is essential that we secure the capabilities to develop and qualify new manufacturing process technologies. For example, our leading Flash memory products must be manufactured at 65-nanometer and more advanced process technologies and on 300-millimeter wafers. If we are delayed in transitioning to these technologies and other future technologies, we could be materially adversely affected.

Manufacturing our products involves highly complex processes that require advanced equipment. Our manufacturing efficiency is an important factor in our profitability, and we cannot be sure that we will be able to maintain or increase our manufacturing efficiency to the same extent as our competitors. For example, we continuously modify our manufacturing processes in an effort to improve yields and product performance and decrease costs. We are continuing to transition products to 90-nanometer and 65-nanometer process technology for the manufacture of some of our products. During periods when we are implementing new process technologies, manufacturing facilities may not be fully productive. We may fail to achieve acceptable yields or may experience product delivery delays as a result of, among other things, capacity constraints, delays in the development of new process technologies, changes in our process technologies, upgrades or expansion of existing facilities, impurities or other difficulties in the manufacturing process. Any of these occurrences could adversely impact our relationships with customers, cause harm to our reputation in the marketplace, cause customers to move future business to our competitors or cause us to make financial concessions to our customers. For example, in the third quarter of fiscal 2006, we had lower than expected yields on 12,000 raw wafers and, as a result, we were unable to meet the demand of some of our customers, including in Japan, and our revenue and gross margins were adversely affected.

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Improving our manufacturing efficiency in future periods is dependent on our ability to:

develop advanced process technologies and advanced products that utilize those technologies;

successfully transition to 65-nanometer and more advanced process technologies;

continue to reduce test times;

ramp product and process technology improvements rapidly and effectively to commercial volumes across our facilities;

achieve acceptable levels of manufacturing wafer output and yields, which may decrease as we implement more advanced technologies; and

maintain our quality controls and rely upon the quality and process controls of our suppliers.

***We may experience manufacturing disruptions if suppliers interrupt supply or increase prices for raw materials.***

Our ability to maintain manufacturing efficiency and to control our manufacturing costs depends upon obtaining adequate supplies of quality raw materials on a timely basis. A number of materials are available only from a limited number of suppliers, or only from a limited number of suppliers in a particular region. In addition, we purchase raw materials such as gold which prices on the world markets have fluctuated significantly during recent periods. Although we believe supplies for raw materials we currently need are adequate, shortages could occur due to interruption of supply or increased demand in the industry. In addition, the costs of certain materials, such as gold, may increase due to market pressures and such cost increases may adversely impact our gross margin. Although we work closely with our suppliers to avoid these types of shortages, there can be no assurances that we will not encounter problems in the future. If we are unable to obtain adequate supplies of raw materials in a timely manner or if there were significant increases in the costs of raw materials or problems with the quality of raw materials, we may be materially adversely affected.

***If we cannot adequately protect our technology or other intellectual property in the United States and abroad, through patents, copyrights, trade secrets, trademarks and other measures, we may lose a competitive advantage and incur significant expenses.***

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. However, we cannot assure you that we will be able to adequately protect our technology or other intellectual property from third-party infringement or from misappropriation in the United States and abroad. Any patent owned or licensed by us or issued to us could be challenged, invalidated or circumvented or rights granted under these patents or licenses may not provide a competitive advantage to us. Furthermore, patent applications that we file may not result in issuance of a patent or, if a patent is issued, the patent may not be issued in a form that is advantageous to us. Despite our efforts to protect our intellectual property rights, others may independently develop similar products, duplicate our products or design around our patents and other intellectual property rights. In addition, it is difficult to monitor compliance with, and enforce, our intellectual property on a worldwide basis in a cost-effective manner. Foreign laws may provide less intellectual property protection than afforded in the United States. If we cannot adequately protect our technology or other intellectual property rights in the United States and abroad, we may be materially adversely affected.



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***We are party to intellectual property litigation and may become party to other intellectual property claims or litigation that could cause us to incur substantial costs or pay substantial damages or prohibit us from selling our products.***

We provide indemnities relating to non-infringement of patents and other intellectual property indemnities to certain of our customers in connection with the delivery, design, manufacture and sale of our products. From time to time, we may be notified, or third parties may bring actions against us based on allegations, that we are infringing the intellectual property rights of others. If any such claims are asserted against us, we may seek to obtain a license under the third party's intellectual property rights. We cannot assure you that we will be able to obtain all of the necessary licenses on satisfactory terms, if at all. In the event that we cannot obtain a license, these parties may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted, which could result in our having to stop the sale of some of our products, increase the costs of selling some of our products, or cause damage to our reputation. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture and sale of some or all of our products, would have a material adverse effect on us. We could decide, in the alternative, to redesign our products or to resort to litigation to challenge or defend such claims, either of which could be expensive and time-consuming and may have a material adverse effect on us.

For example, Tessera, Inc., LSI Corporation, Agere Systems, Inc. and Fast Memory Erase LLC filed lawsuits against us alleging that we have infringed certain of their respective patents. Tessera, LSI and Agere have sought to enjoin such alleged infringements, to recover an unspecified amount of damages, and to bar our importation and sale of allegedly infringing products. In addition, Fujitsu has informed us that Texas Instruments has asserted that a number of our products infringe some of Texas Instruments' patents. Fujitsu has also informed us that it expects us to defend and indemnify Fujitsu against Texas Instruments' claims. Fujitsu has provided us with formal notice that they believe we have a duty to defend or indemnify Fujitsu under the terms of our distribution agreement. Since then, we and Fujitsu have been discussing the issues raised by this notice, and if Fujitsu were to terminate our distribution agreement, we could be materially adversely affected. Defending these alleged infringement claims and similar claims could be extremely expensive and time-consuming and an award of damages or an injunction could have a material adverse effect on us. We cannot assure you that litigation related to the intellectual property rights of ours or others can be avoided or will be successfully concluded.

***We may not realize the expected value of Saifun's NROM technology.***

We expect that licensees of Saifun's NROM technology will continue to implement and expand their uses of the technology. If such licensees fail to successfully implement the NROM technology in a timely manner or in a large number of their products, the value of NROM technology could be diminished. Moreover, if leading Flash memory semiconductor manufacturers adopt and achieve success with other technologies or incorporate Saifun's NROM technology but fail to achieve success with its products, the value of the NROM technology could be adversely affected.

In addition, we cannot assure you that Saifun's patents, including those covering NROM technology, would not be challenged, invalidated or circumvented, or that rights granted under these patents will provide a competitive advantage to us. If Saifun's patents are ultimately challenged, invalidated or circumvented, we may be materially adversely affected.

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*We may not realize all or any of our anticipated benefits from the Saifun acquisition because of integration and other challenges.*

Achieving the expected benefits of the Saifun acquisition will depend on the timely and efficient integration of our and Saifun's technology, operations, business culture and personnel. This will be particularly challenging due to the fact that Saifun was headquartered in Israel and we are headquartered in California. The integration may not be completed as quickly as anticipated, and if we fail to effectively integrate the companies or the integration takes longer than expected, we may not achieve the expected benefits of the acquisition. The challenges involved in this integration include, among others:

retaining the licensees and customers of both companies, including licensees and customers of Saifun who may compete with us;

retaining the main sources of supply of both companies;

incorporating Saifun's technology into our current and future technology and product lines;

integrating Saifun's sales force into our worldwide sales network;

demonstrating to Saifun's licensees and customers that the acquisition will not result in adverse changes in pricing, customer service standards or support;

coordinating research and development activities to enhance introduction of new products and technologies;

integrating Saifun's internal control over financial reporting with our internal control over financial reporting;

migrating Saifun to our information systems;

integrating Saifun's engineering operations with ours;

persuading the employees of both companies that the companies' business cultures are compatible;

maintaining employee morale and retaining key employees;

ensuring there are no delays in releasing new products and technologies to market; and

coordinating geographically separate organizations.

This integration effort is international in scope, complex, time consuming and expensive, and may disrupt the respective businesses or result in the loss of licensees, customers or key employees or the diversion of the attention of management. In addition, the integration process may strain our financial and managerial controls and reporting systems and procedures. This may result in the diversion of management and financial resources from our core business objectives. There can be no assurance that we will successfully integrate Saifun into our business or that we



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will realize the anticipated benefits of the acquisition. If we do not realize the anticipated benefits of the acquisition, or if charges and other accounting changes resulting from the acquisition adversely affect our earnings, the acquisition could result in a reduction of our per-share earnings as compared to the per-share earnings that would have been achieved by us if the acquisition had not occurred. Also, if Saifun shareholders promptly sell the Spansion Class A common stock received in the transaction, such sales could cause a decline in the market price of our common stock.

***Our inability to design and implement new enterprise-wide information systems in a timely and cost-effective manner could materially adversely affect us.***

We are continuing to design and implement our own enterprise-wide information systems. These systems have been designed to automate more fully our business processes and affect most of our functional areas including sales, finance, procurement, inventory control, collections, order processing and manufacturing. In connection with the implementation of these information systems, we may experience functional and performance problems, including problems relating to the information systems response time and data integrity. In addition, resolution of any such problems could entail significant additional costs. We cannot assure you that we will be able to implement these information systems successfully or on a timely basis and in a cost-effective manner or that these information systems will not fail or prove to be unsuitable for our needs. Our inability to implement or resolve problems with these information systems in a timely and cost-effective manner could materially adversely affect us.

***If essential equipment or adequate supplies of satisfactory materials are not available to manufacture our products, we could be materially adversely affected.***

Our manufacturing operations depend upon obtaining deliveries of equipment and adequate supplies of materials on a timely basis. We purchase equipment and materials from a number of suppliers. From time to time, suppliers may extend lead times, limit supply to us or increase prices due to capacity constraints or other factors. Because the equipment that we purchase is complex, it is difficult for us to substitute one supplier for another or one piece of equipment for another. Some raw materials we use in the manufacture of our products are available from a limited number of suppliers. Our manufacturing operations also depend upon the quality and usability of the materials we use in our products, including raw materials and wafers we receive from our suppliers. For example, in the third quarter of fiscal 2006, we had lower than expected yields on 12,000 raw wafers received from one of our suppliers and our revenue and gross margins were adversely affected. If the materials we receive from our suppliers do not meet our manufacturing requirements or product specifications, we may be materially adversely affected.

We also rely on purchasing commercial memory die such as DRAMs from third-party suppliers to incorporate these die into multi-chip package, or MCP, products. The availability of these third-party purchased commercial die is subject to market availability, and the process technology roadmaps and manufacturing capacities of our vendors. In addition, some of our major suppliers, including Samsung, are also our competitors. Interruption of supply from a competitor that is a supplier or otherwise or increased demand in the industry could cause shortages and price increases in various essential materials. If we are unable to procure these materials, or if the materials we receive from our suppliers do not meet our production requirements or product specifications, we may have to reduce our manufacturing operations or our manufacturing yields may be adversely affected. Such a reduction and yield issues have in the past and could in the future have a material adverse effect on us.

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***Our inability to continue to attract, retain and motivate qualified personnel could impact our business.***

Our future success depends upon the continued service of numerous qualified engineering, manufacturing, marketing, sales and executive personnel. We cannot assure you that our equity incentive plan or our employee benefit plans will be effective in motivating or retaining our employees or attracting new employees. Competition for qualified employees among companies that rely heavily on engineering and technology is intense, and the loss of key employees or executive personnel or an inability to attract, retain and motivate additional highly skilled employees could materially adversely affect us.

***Costs related to defective products could have a material adverse effect on us.***

One or more of our products may be found to be defective after the product has been shipped to customers in volume. The cost of product replacements or product returns may be substantial, and our reputation with our customers would be damaged. In addition, we could incur substantial costs to implement modifications to fix defects. Any of these problems could materially adversely affect us.

***Uncertainties involving the ordering of our products could materially adversely affect us.***

Flash memory suppliers compete in part on the basis of their ability to deliver products to end customers on short lead times and it is common for prevailing lead times in the market to be shorter than the minimum manufacturing cycle time. To deliver products with competitive lead times, we must maintain a buffer stock of product to fulfill customer orders. Because our buffer stock must be produced before customer orders are received, our production levels are based on forecasts of customer demand. Generally, we sell our products pursuant to individual purchase orders from our direct customers, distributors and our distributors' customers. Generally, these customers and distributors may cancel their orders for standard products thirty days prior to shipment without incurring a significant penalty.

Customer demand for our products may be difficult to predict because such customers may change their inventory practices on short notice for any reason or they may cancel or defer product orders. Inaccurate forecasts of customer demand or cancellation or deferral of product orders could result in excess or obsolete inventory, which could result in write-downs of inventory. Because market conditions are uncertain, we could be materially adversely affected if we are unable to accurately predict demand for our products.

***Our investments in marketable debt securities are subject to risks which may cause losses and affect the liquidity of these investments.***

Our cash, cash equivalents and marketable securities as of June 29, 2008 totaled approximately \$348.9 million and consisted of cash, money market funds and commercial paper of approximately \$240.4 million and marketable securities of approximately \$108.5 million. Our marketable securities which we classify as short term assets, consisted solely of student loan backed auction rate securities. These marketable securities are subject to general credit, liquidity, market risks and interest rate fluctuations that have affected various sectors of the financial markets and caused overall tightening of the credit markets. Although we temporarily impaired the fair value of these marketable securities, we cannot assure you that the market risks associated with our investment portfolio will not in the future have a permanent negative adverse effect on our results of operations, liquidity and financial condition.

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As of June 29, 2008, our marketable securities portfolio consisted solely of approximately \$108.5 million of AAA/Aaa securities with auction reset features (auction rate securities) whose underlying assets are student loans and are substantially backed by the U.S. government Federal Family Education Loan Program. Since the end of fiscal 2007, we were unsuccessful in liquidating our marketable securities portfolio. Although our auction rate securities are sponsored by the U.S. government and are currently rated AAA/Aaa, our ability to liquidate these investments in the near term may be limited. We may be required to wait until market stability is restored for these instruments or until the final maturity of the underlying notes (up to thirty years) to realize our investments' recorded value. We cannot assure you that auctions on our auction rate securities holdings will succeed in the near future. Any delays in liquidating these securities in the future could have a material adverse effect on us. Refer to the "Liquidity and Capital Resources" section of Management's Discussion and Analysis of Financial Condition and Results of Operations.

If uncertainties in the credit and capital markets continue, these markets deteriorate further or there are any ratings downgrades on any auction rate securities we hold, we may be required to reclassify these investments from short-term to long-term investments. In addition, if the failed auctions or any downgrades are deemed to cause an "other than temporary impairment" of our auction rate securities, we may be required to re-value the auction rate securities at some amount below par. Any re-valuation of auction rate securities that are other than temporarily impaired will flow through our operations statement and affect our earnings.

***Unfavorable currency exchange rate fluctuations could adversely affect us.***

As a result of our foreign operations, we have sales, expenses, assets and liabilities that are denominated in Japanese yen and other foreign currencies. For example,

some of our manufacturing costs are denominated in Japanese yen, Chinese renminbi, and other foreign currencies such as the Thai baht and Malaysian ringgit;

sales of our products to Fujitsu are denominated in both US dollars and Japanese yen; and

some fixed asset purchases are denominated in Japanese yen and European Union euros.

Consequently, movements in exchange rates could cause our net sales and expenses to fluctuate, affecting our profitability and cash flows. We use foreign currency forward contracts to reduce our exposure to foreign currency exchange rate fluctuations. The objective of these contracts is to reduce the impact of foreign currency exchange rate movements on our operating results and on the cost of capital asset acquisitions. We do not use these contracts for speculative or trading purposes. We cannot assure you that these activities will be successful in reducing our foreign currency exchange rate exposure. Failure to do so could have a material adverse effect on us.

***Worldwide economic and political conditions may adversely affect demand for our products.***

We operate in more than ten countries and we derive a majority of our net sales outside the United States. Worldwide economic conditions may adversely affect demand for our products. Because our sales are primarily to customers purchasing Flash memory that addresses the wireless and embedded applications, our business depends on the overall economic conditions and the economic and business conditions within our customers' industries. Our business also may be affected by general economic factors in other countries that are beyond our control, such as downturns in economic activity worldwide, in a specific country or region. A weakening of the worldwide economy or the demand for our customers' products may cause a decrease in demand for our products, which could materially adversely affect us.

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Our consolidated financial results could also be significantly and adversely affected by geopolitical concerns and world events, such as wars and terrorist attacks. Our revenues and financial results have been and could be negatively affected to the extent geopolitical concerns continue and similar events occur or are anticipated to occur. In particular, consequences of military action in the Middle East have in the past, and may in the future, adversely affect demand for our products and our relationship with various third parties with which we collaborate. In addition, terrorist attacks may negatively affect our operations, directly or indirectly, and such attacks or related armed conflicts may directly impact our physical facilities or those of our suppliers or customers. Furthermore, these attacks may make travel and the transportation of our products more difficult and more expensive, which could materially adversely affect us.

The United States has been and may continue to be involved in armed conflicts that could have a further impact on our sales and our supply chain. Political and economic instability in some regions of the world may also result and could negatively impact our business. The consequences of armed conflicts are unpredictable, and we may not be able to foresee events that could have a material adverse effect on us. More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. economy and worldwide financial markets. Any of these occurrences could have a material adverse effect on us.

***Our operations in foreign countries are subject to political and economic risks, which could have a material adverse effect on us.***

The majority of our wafer fabrication capacity is located in Japan and nearly all final test and assembly of our products is performed at our facilities in China, Malaysia and Thailand and by third parties in Taiwan and Japan. In addition, we have international sales operations and, as part of our business strategy, we are continuing to seek to expand our product sales in high growth markets. The political and economic risks associated with our sales to, and operations in, foreign countries include:

expropriation;

changes in political or economic conditions;

changes in tax laws, trade protection measures and import or export licensing requirements;

difficulties in protecting our intellectual property;

difficulties in achieving headcount reductions;

changes in foreign currency exchange rates;

restrictions on transfers of funds and other assets of our subsidiaries between jurisdictions;

changes in freight and interest rates;

disruption in air transportation between the United States and our overseas facilities; and

loss or modification of exemptions for taxes and tariffs.





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Our subsidiary, Saifun, conducts business in Israel, which is affected and surrounded by unstable political, economic and military conditions. We cannot predict the effect of continued or increased violence in Lebanon or Gaza, or the effect of military action elsewhere in the Middle East. Continued armed conflicts or political instability in the region would harm business conditions and could adversely affect the combined company's results of operations. Furthermore, several countries continue to restrict or ban business with Israel and Israeli companies. These restrictive laws and policies may limit the combined company's ability to make sales in those countries, and, as a global company, may limit our own ability to efficiently administer our worldwide resources.

Any conflict or uncertainty in the countries in which we operate, including public health or safety concerns, natural disasters or general economic factors, could have a material adverse effect on our business. Any of the above risks, should they occur, could have a material adverse effect on us.

*We are subject to a variety of environmental laws that could result in liabilities.*

Our properties and many aspects of our business operations are subject to various domestic and international environmental laws and regulations, including those relating to materials used in our products and manufacturing processes; chemical use and handling; waste minimization; discharge of pollutants into the environment; the treatment, transport, storage and disposal of solid and hazardous wastes; and remediation of contamination. Certain of these laws and regulations require us to obtain permits for our operations, including permits related to the discharge of air pollutants and wastewater. From time to time, our facilities are subject to investigation by governmental regulators. Environmental compliance obligations and liability risks are inherent in many of our manufacturing and other activities. Any failure to comply with applicable environmental laws, regulations or permits may subject us to a range of consequences, including fines, suspension of production, alteration of manufacturing processes, sales limitations, and criminal and civil liabilities or other sanctions. We could also be held liable for any and all consequences arising out of exposure to hazardous materials used, stored, released, disposed of by us or located at or under our facilities, or for other environmental or natural resource damage.

Certain environmental laws, including the U.S. Comprehensive, Environmental Response, Compensation and Liability Act of 1980, or the Superfund Act, impose joint and several liability on current and previous owners or operators of real property for the cost of removal or remediation of hazardous substances and costs related to damages to natural resources. Liability can attach even if the owner or operator did not know of, or was not responsible for, the release of such hazardous substances. These environmental laws also can result in liability for persons, like us, who arrange for hazardous substances to be sent to disposal or treatment facilities, in the event such facilities are found to be contaminated. Such persons can be responsible for cleanup costs at a disposal or treatment facility, even if they never owned or operated the contaminated facility. One property where we currently conduct research and development operations is listed on the U.S. Environmental Protection Agency's Superfund National Priorities List. However, other parties currently are responsible for all investigation, cleanup and remediation activities. Although we have not been named a responsible party at this site, if we were so named, costs associated with the cleanup of the site could have material adverse effect upon us.

We have not been named a responsible party at any Superfund or other contaminated site. If we were ever so named, costs associated with the cleanup of the site could be material. Additionally, contamination that has not yet been identified could exist at one or more of our facilities, and identification of such contamination could have a material adverse effect on us.

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Our business is subject to complex and dynamic environmental regulatory schemes. While we have budgeted for reasonably foreseeable environmental expenditures, we cannot assure you that environmental laws will not change or become more stringent in the future. Future environmental regulations could require us to procure expensive pollution abatement or remediation equipment; to modify product designs; or to incur other expenses associated with compliance with such regulations. For example, the European Union and China recently began imposing stricter requirements regarding reduced lead content in semiconductor packaging. Therefore, we cannot assure you that our costs of complying with current and future environmental and health and safety laws, or liabilities arising from past or future releases of, or exposure to, hazardous substances, will not have a material adverse effect on our business.

***Our business, worldwide operations and the operations of our suppliers could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses.***

Our worldwide operations and business could be subject to natural disasters and other business disruptions, such as a world health crisis, fire, earthquake, tsunami, volcano eruption, flood, hurricane, power loss, power shortage, telecommunications failure or similar events, which could harm our future revenue and financial condition and increase our costs and expenses. For example, during the first quarter of fiscal 2008, our business was adversely affected by severe weather conditions in China which caused us to experience decreased demand for our products in that region. In addition, our corporate headquarters are located near major earthquake fault lines in California, and one of our two wafer fabrication facilities, as well as our new 300-millimeter wafer fabrication facility, SP1, are located near major earthquake fault lines in Japan. Also, our assembly and test facilities located in China, Malaysia and Thailand may be affected by tsunamis. In the event of a major earthquake or tsunami, we could experience loss of life of our employees, destruction of facilities or other business interruptions. If such business disruptions result in cancellations of customer orders or contribute to a general decrease in economic activity or demand for our products, or directly impact our marketing, manufacturing, financial, and logistics functions, our results of operations and financial condition could be materially adversely affected.

Furthermore, the operations of our suppliers could be subject to natural disasters and other business disruptions, which could cause shortages and price increases in various essential materials, such as liquid hydrogen, which are required to manufacture our products or commercial memory die such as DRAMs for incorporation into our MCP products. If we are unable to procure an adequate supply of materials that are required for us to manufacture our products, or if the operations of our other suppliers of such materials are affected by an event that causes a significant business disruption, then we may have to reduce our manufacturing operations. Such a reduction could in the future have a material adverse effect on us.

***We may be delayed or prevented from taking actions that require the consent of Fujitsu, whose interests may differ from or conflict with our interests or those of our other stockholders, which could decrease the value of your shares.***

Our bylaws provide that for so long as Fujitsu maintains an aggregate ownership interest in us of at least 10 percent, we will not be able to amend our certificate of incorporation or bylaws or effect any resolution to wind up Spansion Inc. or any other subsidiary without their prior consent.

We cannot assure you that the interests of Fujitsu will be aligned with our interests or those of our other stockholders with respect to such decisions. As a result, we may be unable to take steps that we believe are desirable and in the best interests of our stockholders. In addition, these consent rights could make an acquisition of us more difficult, even if the acquisition may be considered beneficial by some stockholders.

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***Fujitsu has the right to elect one member to our board of directors.***

Fujitsu is one of our largest stockholders and continues to have the right to elect one member to our board of directors. Upon the recommendation of the Nominating and Corporate Governance Committee, the Board of Directors nominated, and Fujitsu has agreed to elect, an independent director to serve in Fujitsu's board seat. Fujitsu's ability to elect a director is subject to reduction based on the amount of our common stock that they own and this right terminates when their ownership in us falls below 10 percent.

Our independent director elected by Fujitsu may be replaced by Fujitsu at any time at Fujitsu's discretion. In the event that Fujitsu replaces such independent director with a person who is simultaneously serving as an officer of Fujitsu, a conflict of interest may arise. Any individual who serves as our director and also as an officer of Fujitsu has a duty of care and loyalty to us when acting in his or her capacity as our director and a duty of care and loyalty to Fujitsu when acting in his or her capacity as Fujitsu's officer or director. However, our certificate of incorporation provides that in the event a director or officer of our company who is also a director or officer of Fujitsu acquires knowledge of a potential business opportunity that may be deemed a corporate opportunity of our company and Fujitsu, such opportunity will belong to Fujitsu, as applicable, unless it has been expressly offered to such director or officer in writing solely in his or her capacity as a director or officer of our company.

***Third parties may seek to hold us responsible for liabilities of AMD and Fujitsu that we did not assume in our agreements.***

Under our agreements with AMD and Fujitsu, we agreed to assume liabilities related to our business after June 30, 2003, and liabilities related to our business prior to June 30, 2003 if such liabilities were reflected as accruals or reserves on the AMD and Fujitsu contributed balance sheets. Our assumed liabilities include claims made with respect to Flash memory products sold after June 30, 2003, even if such products were manufactured prior to June 30, 2003, and warranty claims with respect to products sold prior to June 30, 2003 to the extent such warranty claims were reflected as accruals or reserves on the AMD and Fujitsu contributed balance sheets. The allocation of assets and liabilities between AMD, Fujitsu and us may not reflect the allocation that would have been reached between unaffiliated parties and may be less favorable to us as a result. Third parties may seek to hold us responsible for AMD's and Fujitsu's retained liabilities. If our losses for AMD's and Fujitsu's retained liabilities were significant and we were ultimately held liable for them, we cannot assure you that we would be able to recover the full amount of our losses.

***We rely on Fujitsu to be our largest distributor in Japan.***

We currently rely on Fujitsu to act as the largest distributor of our products to customers in Japan, which was one of our most important geographic markets in fiscal 2006 and in fiscal 2007. Under our distribution agreement with Fujitsu, Fujitsu has agreed to use its best efforts to promote the sale of our products in Japan and to other customers served by Fujitsu. In the event that we reasonably determine that Fujitsu's sales performance in Japan and to those customers served by Fujitsu is not satisfactory based on specified criteria, then we have the right to require Fujitsu to propose and implement an agreed-upon corrective action plan. If we reasonably believe that the corrective action plan is inadequate, we can take steps to remedy deficiencies ourselves through means that include appointing another distributor as a supplementary distributor to sell

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products in Japan and to customers served by Fujitsu. Pursuing these actions would be costly and disruptive to the sales of our products in Japan. If Fujitsu's sales performance in Japan is unsatisfactory or if we are unable to successfully maintain our distribution agreement and relationship with Fujitsu, as a result of its seeking indemnity from us in respect of certain infringement claims made by Texas Instruments or otherwise, and we can not timely find a suitable supplementary distributor, we could be materially adversely affected.

On December 28, 2007, we entered into an amendment to our distribution agreement with Fujitsu which provides, among other terms, that Fujitsu no longer has territorial exclusivity in Japan, that the distribution agreement will expire on September 30, 2008, and that effective April 1, 2008 we may enter into distribution agreements with Fujitsu's sub-distributors in Japan. We also agreed to negotiate in good faith a successor distribution agreement with Fujitsu Electronics, Inc., or such other semiconductor sales group affiliate of Fujitsu. If Fujitsu, Fujitsu Electronics, Inc., or another semiconductor sales group affiliate of Fujitsu unexpectedly or abruptly terminates its distribution agreement with us, or otherwise ceases its support of our customers in Japan, we would be required to rely on a relationship with another distributor or establish our own local sales organization and support functions. Although we are currently establishing a sales organization and infrastructure in Japan, we cannot be certain that we will be successful in selling our products to customers currently served by Fujitsu or new customers. If customers currently served by Fujitsu, or potential new customers, refuse to purchase our products directly from us or from another distributor, our sales in Japan may decline, and we could be materially adversely affected.

***AMD and Fujitsu may continue to use all of our intellectual property and the intellectual property they have transferred to us.***

In connection with our reorganization as Spansion LLC in June 2003, AMD and Fujitsu transferred approximately 400 patents and patent applications to us. In addition, AMD and Fujitsu contributed additional patents to us at the time of our initial public offering. However, both AMD and Fujitsu have retained the rights to use any patents contributed to us for an unlimited period of time. In addition, under their respective patent cross-license agreements with us, AMD and Fujitsu have also obtained licenses to our present and future patents with effective filing dates prior to the later of June 30, 2013, or such date on which they have transferred all of their shares in us, although the scope of patents under license can be impacted by a change in control of the parties or their semiconductor groups. These licenses continue until the last to expire of the patents under license expires and provide AMD and Fujitsu with licenses to all of our present and future patents in existence through such cross-license termination date. Furthermore, we entered into an Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement with AMD and Fujitsu in connection with our reorganization as Spansion Inc. in December 2005. Pursuant to that agreement, subject to our confidentiality obligations to third parties, and only for so long as AMD's and Fujitsu's ownership interests in us remain above specific minimum levels, we are obligated to identify any of our technology to each of AMD and Fujitsu, and to provide copies of and training with respect to that technology to them. In addition, pursuant to this agreement we have granted a non-exclusive, perpetual, irrevocable fully paid and royalty-free license of our rights, other than patent and trademark rights, in that technology to each of AMD and Fujitsu.

Under our non-competition agreement, both AMD and Fujitsu have agreed that they will not directly or indirectly engage in a business, and have agreed to divest any acquired business, that manufactures or supplies standalone semiconductor devices (including single chip, multiple chip or system devices) containing certain Flash memory, which is the business in which we primarily compete. With respect to each of AMD and Fujitsu, this non-competition restriction

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will last until the earlier of (i) two years from the date such stockholder's ownership in us falls to or below five percent, or (ii) the dissolution of our company. After that time, should they ever decide to re-enter the Flash memory business, AMD or Fujitsu could use our present and future patents and technologies licensed by us to AMD and Fujitsu under the cross licenses and our Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement to compete against us. If either AMD or Fujitsu were to compete with us, we could be materially adversely affected.

***Our stock price may be volatile, and stockholders may lose all or part of their investment.***

The market price of shares of our common stock has been volatile and may in the future be subject to wide fluctuations in response to many risk factors listed in this section, and others beyond our control, including:

actual or anticipated changes in our operating results;

changes in financial estimates by securities analysts;

fluctuations in the valuation of companies perceived to be comparable to us;

announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives; and

stock price and volume fluctuations attributable to inconsistent trading volume levels or other factors.

Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of shares of our common stock. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could materially adversely affect us.

***If securities or industry analysts or rating agencies publish negative reports about our business, the price and trading volume of our securities could decline.***

The trading market for our securities depends, in part, on the research reports and ratings that securities or industry analysts or ratings agencies publish about us, our business and the Flash memory market in general. For example, in March 2008 Moody's Investors Service lowered the corporate family and long-term debt ratings of Spansion LLC, our wholly owned operating subsidiary, which affected approximately \$875 million of our rated debt. We do not have any control over these analysts or agencies. If one or more of the analysts or agencies who cover us downgrades us or our securities, the price of our securities may decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause the price of our securities or trading volume to decline.

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***We currently do not intend to pay dividends on our common stock and, consequently, our stockholders' only opportunity to achieve a return on their investment is through appreciation in the price of our common stock.***

We currently do not plan to pay dividends on shares of our common stock in the foreseeable future and are currently prohibited from doing so in specific circumstances under agreements governing our borrowing arrangements. The terms of our senior secured revolving credit facility limit our ability to pay cash dividends on any shares of our common stock. Furthermore, if we are in default under this credit facility, our ability to pay cash dividends will be limited in the absence of a waiver of that default or an amendment to that facility. Similar prohibitions are applicable under the indenture governing the outstanding notes issued by Spansion LLC. In addition, because we are a holding company, our ability to pay cash dividends on shares of our common stock may be limited by restrictions on our ability to obtain sufficient funds through dividends from our subsidiaries, including the restrictions under the indenture governing the notes. Our common stock will rank junior as to payment of dividends to any series of preferred stock that we may issue in the future. Generally, unless full dividends including any cumulative dividends still owing on all outstanding shares of any preferred stock have been paid, no dividends will be declared or paid on our common stock. Consequently, your only opportunity to achieve a return on your investment in our company will be if the market price of our common stock appreciates.

***Any future issuance of our preferred stock could adversely affect holders of our common stock.***

Our board of directors is authorized to issue shares of preferred stock without any action on the part of our stockholders. Our board of directors also has the power, without stockholder approval, to set the terms of any such series of shares of preferred stock that may be issued, including voting rights, dividend rights and preferences over our common stock with respect to dividends or if we liquidate, dissolve or wind up our business and other terms. If we issue preferred stock in the future that has preference over our common stock with respect to the payment of dividends or upon our liquidation, dissolution or winding up of our affairs, or if we issue preferred stock with voting rights that dilute the voting power of our common stock, the rights of holders of our common stock or the market price of our common stock could be adversely affected.

***The use of our net operating loss carryforwards may be limited.***

If we conduct an offering of our common stock, we may experience an ownership change as defined in the Internal Revenue Code such that our ability to utilize our federal net operating loss carryforwards of approximately \$594 million as of December 31, 2007 may be limited under certain provisions of the Internal Revenue Code. As a result, we may incur greater tax liabilities than we would in the absence of such a limitation and any increased liabilities could materially adversely affect us.

***Provisions in our corporate governance documents as well as Delaware law may delay or prevent an acquisition of us that stockholders may consider favorable, which could decrease the value of your shares.***

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These provisions include restrictions on the ability of our stockholders to remove directors, a classified board of directors and limitations on action by our stockholders by written consent. In addition, our board of directors has the right to issue preferred stock without stockholder approval, which could be used to make an acquisition of us more difficult. Although we believe

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these provisions protect our stockholders from coercive or otherwise unfair takeover tactics and thereby provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our board of directors, these provisions apply even if the offer may be considered beneficial by some stockholders.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Our 2008 Annual Meeting of Stockholders was held on May 27, 2008 in East Palo Alto, California. Of the 158,323,770 shares of Class A common stock and 1 share of Class B common stock outstanding as of the record date, 84 percent of Class A common stock, and 100 percent of Class B common stock were present or represented by proxy at the meeting. The results of the voting on the matters submitted to the stockholders are as follows:

1. To elect two Class A directors to serve until the 2011 Annual Meeting of Stockholders or until their successor is duly elected and qualified.

| Name               | Votes For   | Votes Withheld |
|--------------------|-------------|----------------|
| Bertrand F. Cambou | 127,283,857 | 6,096,557      |
| David E. Roberson  | 127,295,041 | 6,085,373      |

2. To elect one Class C director to serve until the 2011 Annual Meeting of Stockholders or until his successor is duly elected and qualified.

| Name            | Votes For | Votes Withheld |
|-----------------|-----------|----------------|
| Gilles Delfassy | 1         | 0              |

3. To ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the current fiscal year.

| Votes For   | Votes Against | Votes Abstaining | Broker Non-Vote |
|-------------|---------------|------------------|-----------------|
| 133,311,641 | 55,766        | 13,008           | 0               |

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**ITEM 6. EXHIBITS**

| <b>Exhibit Number</b> | <b>Description of Exhibits</b>   |
|-----------------------|--|
| 10.37(a)              | Amendment No. 1 to the Amended and Restated Foundry Agreement, effective March 21, 2008 and entered into as of June 19, 2008, by and among Spansion Japan Limited, Spansion Inc., Spansion Technology, Inc. and Spansion LLC, in their capacities as guarantors of Spansion Japan Limited, and Fujitsu Limited and its assignee, Fujitsu Microelectronics Limited. |
| 10.37(b)              | Waiver of Payment Terms, dated June 30, 2008, by Fujitsu Microelectronics Limited, and agreed to by Spansion Inc., Spansion Technology, Inc., Spansion LLC and Spansion Japan Limited.   |
| 31.1                  | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2                  | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1*                 | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 32.2*                 | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |

\* Exhibits 32.1 and 32.2 are being furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liability of that section, nor shall such exhibits be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as otherwise specifically stated in such filing.



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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SPANSION INC.

Date: August 8, 2008

By: /s/ Dario Sacomani  
Dario Sacomani

Executive Vice President and

Chief Financial Officer

(Principal Financial Officer)