

SOLECTRON CORP  
Form 10-Q  
April 05, 2006

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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 February 24, 2006**
- 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 1-11098**

**SOLECTRON CORPORATION**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**94-2447045**

*(I.R.S. Employer  
Identification Number)*

**847 Gibraltar Drive  
Milpitas, California 95035**

*(Address of principal executive offices including zip code)*

**(408) 957-8500**

*(Registrant's telephone number, including area code)*

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 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

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At March 30, 2006, 914,430,596 shares of Common Stock of the Registrant were outstanding (including approximately 20.5 million shares of Solectron Global Services Canada, Inc., which are exchangeable on a one-to-one basis for the Registrant's common stock)

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**SOLECTRON CORPORATION**

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	<b>February 28 2006</b>	<b>August 31 2005</b>
	<b>(Unaudited)</b>	
	<b>(In millions)</b>	
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and short-term investments*	\$ 1,526.8	\$ 1,722.3
Accounts receivable, net	1,177.7	1,180.7
Inventories	1,346.1	1,108.5
Prepaid expenses and other current assets	233.2	211.4
Total current assets	4,283.8	4,222.9
Property and equipment, net	681.7	666.3
Goodwill	147.6	148.8
Other assets	221.8	219.8
Total assets	\$ 5,334.9	\$ 5,257.8
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Short-term debt	\$ 228.5	\$ 165.7
Accounts payable	1,430.3	1,371.2
Accrued employee compensation	143.3	167.0
Accrued expenses and other current liabilities	472.1	509.6
Total current liabilities	2,274.2	2,213.5
Long-term debt	628.0	540.9
Other long-term liabilities	79.6	59.2
Total liabilities	\$ 2,981.8	\$ 2,813.6
Commitments and contingencies		
Stockholders' equity:		
Common stock	1.0	1.0
Additional paid-in capital	7,619.6	7,774.1

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Accumulated deficit	(5,152.1)	(5,206.5)
Accumulated other comprehensive loss	(115.4)	(124.4)
Total stockholders' equity	2,353.1	2,444.2
Total liabilities and stockholders' equity	\$ 5,334.9	\$ 5,257.8

\* Includes \$31.2 million and \$13.2 million of restricted cash balances as of February 28, 2006 and August 31, 2005, respectively, and \$15.0 million and \$26.3 million of short term investments as of February 28, 2006 and August 31, 2005, respectively.

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Three Months Ended February 28</b>		<b>Six Months Ended February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In millions, except per share data)</b>		<b>(In millions, except per share data)</b>	
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Net sales	\$ 2,499.6	\$ 2,756.0	\$ 4,956.0	\$ 5,446.6
Cost of sales	2,370.6	2,598.1	4,701.4	5,133.2
Gross profit	129.0	157.9	254.6	313.4
Operating expenses:				
Selling, general and administrative	104.3	104.7	211.7	200.3
Restructuring and impairment costs	5.6	43.2	6.5	43.9
Operating income	19.1	10.0	36.4	69.2
Interest income	12.3	9.1	24.4	14.9
Interest expense	(6.9)	(16.7)	(13.6)	(33.0)
Other (expense) income net	(1.9)	1.1		5.8
Operating income from continuing operations before income taxes	22.6	3.5	47.2	56.9
Income tax expense	5.5	6.6	9.9	12.5
Income (loss) from continuing operations	\$ 17.1	\$ (3.1)	\$ 37.3	\$ 44.4
Discontinued operations:				
Income from discontinued operations	\$ 13.3	\$ 0.9	\$ 17.1	\$ 13.3
Income tax expense				1.7
Income from discontinued operations	13.3	0.9	17.1	11.6
Net income (loss)	\$ 30.4	\$ (2.2)	\$ 54.4	\$ 56.0
Basic net income (loss) per share				
Continuing operations	\$ 0.02	\$ (0.00)	\$ 0.04	\$ 0.05
Discontinued operations	0.01	0.00	0.02	0.01
Basic net income (loss) per share	\$ 0.03	\$ (0.00)	\$ 0.06	\$ 0.06
Diluted net income (loss) per share				
Continuing operations	\$ 0.02	\$ (0.00)	\$ 0.04	\$ 0.05
Discontinued operations	0.01	0.00	0.02	0.01

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Diluted net income (loss) per share	\$	0.03	\$	(0.00)	\$	0.06	\$	0.06
Shares used to compute basic net income per share		908.8		977.1		917.3		966.7
Shares used to compute diluted net income per share		909.7		977.1		918.1		970.6

See accompanying notes to condensed consolidated financial statements.



Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>Three Months Ended February 28</b>		<b>Six Months Ended February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
	<b>(In millions)</b>		<b>(In millions)</b>	
	<b>(Unaudited)</b>		<b>(Unaudited)</b>	
Net income (loss)	\$ 30.4	\$ (2.2)	\$ 54.4	\$ 56.0
Other comprehensive income:				
Foreign currency translation adjustments, net	8.6	17.6	9.0	25.8
Comprehensive income	\$ 39.0	\$ 15.4	\$ 63.4	\$ 81.8

Accumulated unrealized foreign currency translation losses were \$105.2 million at February 28, 2006 and \$114.2 million at August 31, 2005. Foreign currency translation adjustments consist of adjustments to consolidate subsidiaries that use the local currency as their functional currency and transaction gains and losses related to intercompany dollar-denominated debt that is not expected to be repaid in the foreseeable future.

See accompanying notes to condensed consolidated financial statements.

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**SOLECTRON CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Six Months Ended February</b>	
	<b>28</b>	
	<b>2006</b>	<b>2005</b>
	<b>(In millions)</b>	
	<b>(Unaudited)</b>	
		<b>(Revised)</b>
Cash flows from operating activities:		
Net income	\$ 54.4	\$ 56.0
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Earnings from discontinued operations	(17.1)	(11.6)
Depreciation and amortization	87.5	101.3
Impairment of property, equipment and other long-term assets, net	10.4	40.8
Gain on disposal of property and equipment	(0.1)	(0.1)
Stock based compensation	10.2	1.5
Changes in operating assets and liabilities:		
Accounts receivable, net of allowance	4.5	161.3
Inventories	(237.4)	213.9
Prepaid expenses and other current assets	(27.4)	14.9
Accounts payable	59.0	(55.5)
Accrued expenses and other current liabilities	(14.0)	(45.9)
Net cash (used in) provided by operating activities of continuing operations	(70.0)	476.6
Net cash used in operating activities of discontinued operations	(8.2)	(5.9)
Net cash (used in) provided by operating activities	(78.2)	470.7
Cash flows from investing activities:		
Sale of available for sale securities	11.3	
Change in restricted cash and cash equivalents	(18.0)	(2.9)
Settlement of receivable related to synthetic lease		19.9
Capital expenditures	(109.7)	(66.1)
Proceeds from sale of property and equipment	4.4	9.3
Proceeds from sale of investments		16.0
Dispositions and receipts from discontinued operations	8.9	7.1
Net cash used in investing activities of continuing operations	(103.1)	(16.7)
Net cash provided by investing activities of discontinued operations	17.1	13.0
Net cash used in investing activities	(86.0)	(3.7)
Cash flows from financing activities:		
Net proceeds (repayment) of bank lines of credit and other debt arrangements	0.8	(16.5)

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Proceeds from issuance of debt, net	147.4	
Lyon repurchase	(2.0)	(0.5)
Common stock repurchase	(180.4)	(1.4)
Net proceeds from issuance of common stock		64.3
Net proceeds from stock issued under option and employee purchase plans	5.1	8.1
Net cash (used in) provided by financing activities of continuing operations	(29.1)	54.0
Net cash used in financing activities of discontinued operations	(8.9)	(7.1)
Net cash (used in) provided by financing activities	(38.0)	46.9
Effect of exchange rate changes on cash and cash equivalents		10.7
Net increase (decrease) in cash and cash equivalents	(202.2)	524.6
Cash and cash equivalents of continuing operations at beginning of period	1,682.8	1,412.7
Cash and cash equivalents of discontinued operations at beginning of period		
Total cash and cash equivalents at beginning of period	1,682.8	1,412.7
Cash and cash equivalents continuing operations at end of period	\$ 1,480.6	\$ 1,937.3
Cash and cash equivalents discontinued operations at end of period		
Total cash and cash equivalents at end of period	\$ 1,480.6	\$ 1,937.3

See accompanying notes to condensed consolidated financial statements.

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**SOLECTRON CORPORATION AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements  
(Unaudited)**

**NOTE 1 Basis of Presentation and Recent Accounting Pronouncements**

***Basis of Presentation***

The accompanying financial data as of February 28, 2006 and for the three and six months ended February 28, 2006 and 2005 has been prepared by Solectron, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The August 31, 2005 condensed consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles. However, Solectron believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in Solectron's Annual Report on Form 10-K for the fiscal year ended August 31, 2005.

Solectron's second quarters of fiscal 2006 and 2005 ended on February 24, 2006 and February 25, 2005, respectively. Solectron's fiscal year 2005 ended on August 26, 2005. For clarity of presentation, Solectron has indicated its second quarter as having ended on February 28 and its fiscal year as having ended on August 31.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair consolidated statement of financial position as of February 28, 2006, the results of operations, comprehensive income and cash flows for the six months ended February 28, 2006 and 2005 have been made. The consolidated results of operations for the three and six months ended February 28, 2006 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Research and Development Expenses***

Selling, general and administrative expense includes \$7.8 million and \$15.7 million of research and development expenses for the three and six months ended February 28, 2006, respectively, and \$8.4 million and \$15.2 million for the three and six months ended February 28, 2005, respectively.

***Restricted Cash***

During the first quarter of fiscal 2006, Solectron elected to put in place a line of credit for the issuance of standby letters of credit. The letters of credit are principally related to self-insurance for workers compensation liability coverage. These standby letters of credit were previously issued under Solectron's revolving credit facility. Solectron opted to post cash collateral totaling 105% of the standby letter of credit balances in order to reduce annual issuance commissions of the standby letters of credit. Total cash collateral of \$18 million at February 28, 2006, is classified as

restricted cash and cash equivalents in the condensed consolidated balance sheets. Solectron also has \$13.2 million of restricted cash in connection with its synthetic leases. See also Note 8 Commitments and Contingencies for a discussion of these synthetic leases.

***Recent Accounting Pronouncements***

In March 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations, as an interpretation of FASB Statement No. 143, Accounting for Asset Retirement Obligations (FASB No. 143). This

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interpretation clarifies that the term conditional asset retirement obligation as used in FASB No. 143, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainly exists about the timing and/or method of settlement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. This interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company is currently assessing the impact of the adoption of FIN 47.

***Reclassifications***

Certain amounts from prior periods have been reclassified to conform to the current period presentation.

**NOTE 2 Revision of Statement of Cash Flows**

Solectron has revised its statements of cash flows for the six months ended February 28, 2006 and February 28, 2005, respectively, to present cash flows related to discontinued operations consistent with the requirements of Financial Accounting Standards Board ( FASB ) Statement No. 95, Statement of Cash Flows . This revision includes beginning the indirect method of determining cash flows from operating activities with net income (loss) rather than net income (loss) from continuing operations. In addition, the operating, financing and investing cash flows of discontinued operations have been separately presented within the body of the statements of cash flows which in prior periods were reported on a consolidated basis as a single amount. Solectron intends to utilize this revised presentation in all future annual and quarterly filings. The following table presents revised summary cash flow information for each of the three most recently completed fiscal years.

	<b>Years Ended August 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(Revised)</b>	<b>(In millions) (Revised)</b>	<b>(Revised)</b>
Cash flows from operating activities:			
Net income (loss)	\$ 3.4	\$ (177.4)	\$ (3,452.6)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:			
(Earnings) loss from discontinued operations	(13.9)	(85.0)	443.7
Depreciation and amortization	193.3	276.3	330.3
Loss (gain) on retirement of debt and interest rate swaps	45.6	72.1	(39.4)
Deferred tax charge	11.9	(12.0)	528.9
Impairment of goodwill and intangible assets		47.5	1,792.0
Loss on disposal and impairment of property and equipment, net	46.6	60.2	157.5
Other			(5.2)



**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

	<b>Years Ended August 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(Revised)</b>	<b>(In millions) (Revised)</b>	<b>(Revised)</b>
<b>Changes in operating assets and liabilities:</b>			
Accounts receivable, net of allowance	362.9	(144.3)	123.4
Inventories	348.5	(134.1)	420.4
Prepaid expenses and other assets	11.0	6.8	106.9
Accounts payable	(53.6)	150.3	(132.0)
Accrued expenses and other current liabilities	(8.4)	(69.0)	7.1
Net cash provided by (used in) operating activities of continuing operations	947.3	(8.6)	281.0
Net cash provided by operating activities of discontinued operations	22.4	2.9	109.4
Net cash provided by (used in) operating activities	969.7	(5.7)	390.4
<b>Cash flows from investing activities:</b>			
Change in restricted cash and cash equivalents	4.3	44.5	169.8
Sales and maturities of short-term investments	2.5	27.5	252.5
Purchases of short-term investments	(28.8)		(56.1)
Settlement of loan receivable related to synthetic lease	31.4		
Acquisitions, net of cash acquired	(42.2)		(49.3)
Divestitures			
Capital expenditures	(150.4)	(149.6)	(124.6)
Proceeds from sale of property and equipment	32.1	68.9	60.1
Dispositions and receipts from discontinued operations	38.9	505.6	84.1
Supply agreement and other		0.2	48.3
Net cash (used in) provided by investing activities of continuing operations	(112.2)	497.1	384.8
Net cash provided by (used in) investing activities of discontinued operations	16.5	466.3	(112.2)
Net cash (used in) provided by investing activities	(95.7)	963.4	272.6



**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

	<b>Years Ended August 31</b>		
	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>(Revised)</b>	<b>(In millions) (Revised)</b>	<b>(Revised)</b>
Cash flows from financing activities:			
Proceeds used for ACES early settlement		(63.3)	
Net repayment of bank lines of credit and other debt arrangements	(23.8)	(50.5)	(85.0)
Proceeds from issuance of ACES and Senior Notes		436.5	
Payments made to redeem ACES and Senior Notes	(544.7)		
Net (costs) proceeds to settle interest rate swap	(8.2)	6.0	
Repurchase of LYONS		(950.2)	(967.5)
Common stock repurchase	(71.0)		
Net proceeds from issuance of common stock	77.7	111.1	7.8
Other			28.4
Net cash used in financing activities of continuing operations	(570.0)	(510.4)	(1,016.3)
Net cash used in financing activities of discontinued operations	(38.9)	(507.4)	(6.3)
Net cash used in financing activities	(608.9)	(1,017.8)	(1,022.6)
Effect of exchange rate changes on cash and cash equivalents	5.0	14.7	35.8
Net increase (decrease) in cash and cash equivalents	270.1	(45.4)	(323.8)
Cash and cash equivalents of continuing operations at beginning of period	1,412.7	1,425.3	1,742.9
Cash and cash equivalents of discontinued operations at beginning of period		32.8	39.0
Total cash and cash equivalents at beginning of period	1,412.7	1,458.1	1,781.9
Cash and cash equivalents of continuing operations at end of period	1,682.8	1,412.7	1,425.3
Cash and cash equivalents of discontinued operations at end of period			32.8
Total cash and cash equivalents at end of period	\$ 1,682.8	\$ 1,412.7	\$ 1,458.1
<b>SUPPLEMENTAL DISCLOSURES</b>			
Cash paid (received) during the period:			
Income taxes	\$ 14.7	\$ 6.6	\$ (199.6)
Interest	\$ 59.0	\$ 100.8	\$ 133.4
Non-cash investing and financing activities:			
Early settlement of ACES for stock	\$	\$ 1,006.6	\$
Accrued stock repurchase	\$ 11.2	\$	\$

**NOTE 3 Stock-Based Compensation**

Effective September 1, 2005, Solectron began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123-R, *Share-Based Payment*, ( SFAS 123R ) as interpreted by SEC Staff Accounting Bulletin No. 107. Prior to September 1, 2005, the Company accounted for stock options according to the provisions of Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value. Solectron adopted the modified prospective transition method provided for under SFAS 123R, and consequently has not

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retroactively adjusted results from prior periods. Under this transition method, compensation cost associated with stock options now includes 1) quarterly amortization related to the remaining unvested portion of all stock option awards granted prior to September 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) quarterly amortization related to all stock option awards granted subsequent to September 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. In addition, Solectron records expense over the offering period and the vesting term, respectively, in connection with 1) shares issued under its employee stock purchase plan and 2) restricted stock and discounted stock options. The compensation expense for stock based compensation awards includes an estimate for forfeitures and is recognized over the expected term of the options using the straight-line method. As a result of the adoption of SFAS 123R, Solectron's earnings from continuing operations before income taxes, earnings from continuing operations, and net earnings for the three-month and six-month period ended February 28, 2006, were \$3.8 million and \$7.6 million lower respectively, than under Solectron's previous accounting method for share-based compensation. Basic and diluted net earnings per common share for the quarter ended February 28, 2006, were not impacted by the change in accounting method. Prior to our adoption of SFAS 123R, benefits of tax deductions in excess of recognized compensation costs were reported as operating cash flows. SFAS 123R requires that they be recorded as a financing cash inflow rather than as a reduction of taxes paid. For the quarter ended February 28, 2006, no excess tax benefits were generated from option exercises. The Company evaluated the need to record a cumulative effect adjustment for estimated forfeitures upon the adoption of SFAS 123R and determined the amount to be immaterial. The company is in the process of computing the excess tax benefits in additional paid-in capital as of the date of adoption of SFAS 123R. This analysis is not expected to result in a material change to Solectron's financial statements.

Total stock compensation expense for the three months ended February 28, 2006, of \$5.4 million was included in cost of sales and selling, general and administrative expense in the amounts of \$1.8 million and \$3.6 million, respectively. Total stock compensation expense for the six months ended February 28, 2006, of \$10.2 million was included in cost of sales and selling, general and administrative expense in the amounts of \$3.6 million and \$6.6 million, respectively. Total stock compensation expense for the three months and six months ended February 28, 2005, of \$0.6 million and \$1.5 million, respectively, was included in selling, general, and administrative expense.

For stock options granted prior to the adoption of SFAS 123R, if compensation expense for the Company's various stock option plans had been determined based upon estimated fair values at the grant dates in accordance with SFAS 123, the Company's pro forma net income (loss), and basic and diluted income (loss) per share would have been as follows:

	<b>Three Months Ended February 28, 2005</b>		<b>Six Months Ended February 28, 2005</b>	
Net income (loss):				
As reported	\$	(2.2)	\$	56.0
Fair value-based expense, net of tax	\$	(43.1)	\$	(52.3)
Pro forma	\$	(45.3)	\$	3.7

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Net income (loss) per common share:

Basic

As reported	\$	(0.00)	\$	0.06
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Pro Forma	\$	(0.05)	\$	0.00
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Diluted

As reported	\$	(0.00)	\$	0.06
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Pro Forma	\$	(0.05)	\$	0.00
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**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)*****Stock Options***

Solectron's stock option plans provide for grants of options to employees to purchase common stock at the fair market value of such shares on the grant date. The options vest monthly over a four-year period beginning on the grant date. The term of the options is seven years for options granted between January 12, 1994 and September 20, 2001, and ten years for options granted thereafter. Options assumed under past acquisitions generally vest over periods ranging from immediately to five years from the original grant date and have terms ranging from two to ten years.

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected life of options is based on observed historical exercise patterns. Groups of employees that have similar historical exercise patterns have been considered separately for valuation purposes. The expected volatility of stock options is based upon equal weightings of the historical volatility of Solectron stock and, for fiscal periods in which there is sufficient trading volume in options on Solectron's stock, the implied volatility of traded options on Solectron stock having a life of more than six months. The expected volatility of Employee Share Purchase Plan shares is based on the implied volatility of traded options on the Company's stock in periods in which there is sufficient trading volume in those options. Otherwise, historical volatility is utilized. The risk free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that Solectron has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

<b>Stock Options</b>	<b>Three Months Ended February</b>		<b>Six Months Ended</b>	
	<b>28</b>		<b>February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Expected volatility	59%	69%	52%-59%	70%
Dividends Yield	zero	zero	zero	zero
Expected life	4.32 years	3.9 years	4.32 years to 4.91 years	3.9 years
Risk-free rate	4.35%	3.54%	4.26% to 4.35%	3.43%

<b>Employee Stock Purchase Plan</b>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>February 28</b>		<b>February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Weighted-average volatility	30%	39%	30%-44%	40%
Dividends Yield	zero	zero	zero	zero
Expected life	6 months	6 months	6 months	6 months
Risk-free rate	4.43%	2.68%	3.94%-4.43%	2.50%

The Company has recorded \$2.8 million and \$5.9 million of compensation expenses relative to stock options (other than discounted stock options) for the three-month and six-month periods ended February 28, 2006 in accordance with SFAS 123R. As of February 28, 2006, there was \$21.2 million of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average period of 1.4 years.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

A summary of stock option activity under the plans for the three-months and six-months ended February 28, 2006 is presented as follows:

	Shares (In millions)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In millions)
Balance, September 1, 2005	50.9	\$ 9.75		
Granted	1.1	\$ 3.77		
Cancelled	(2.8)	\$ 10.60		
Balance, November 30, 2005	49.2	\$ 9.57	6.86	
Exercisable, November 30, 2005	37.5	\$ 11.34	6.21	
Balance, November 30, 2005	49.2	\$ 9.57	6.86	
Granted	1.1	\$ 3.74		
Cancelled	(2.3)	\$ 10.18		
Balance, February 28, 2006	48.0	\$ 9.41	6.67	\$ 0.70
Exercisable, February 28, 2006	36.8	\$ 11.09	6.02	\$ 0.60

The weighted-average fair value of stock options granted during the three months and six months ended February 28, 2006, was \$1.90 and \$1.88, respectively. The total intrinsic value of stock options exercised during the three months and six months ended February 28, 2006, was \$.03 million and \$.03 million, respectively.

At February 28, 2006, an aggregate of 60.9 million shares were authorized for future issuance under our stock plans, which cover stock options, Employee Stock Purchase Plans, Restricted Stock Awards and Discounted Stock Options. A total of 49.9 million shares of common stock were available for grant under Solectron's stock option plans as of February 28, 2006. Awards that expire or are cancelled without delivery of shares generally become available for issuance under the plans.

An initial option is granted to each new outside member of Solectron's Board of Directors to purchase 20,000 shares of common stock at the fair value on the date of the grant. On December 1 of each year, each outside member is granted an additional option to purchase 20,000 shares of common stock at the fair market value on such date. These options vest over one year and have a term of seven years.

***Employee Stock Purchase Plan***

Under Solectron's Employee Stock Purchase Plan, employees meeting specific employment qualifications are eligible to participate and can purchase shares semi-annually through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement or end of the offering period. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation. We have treated the Employee Stock Purchase Plan as a compensatory plan. The Company has recorded compensation expense relative to the Purchase Plan in the three-month and six-month periods ended February 28, 2006 of \$1 million and \$1.7 million, respectively.

***Restricted Stock Awards and Discounted Stock Options***

During fiscal 2003, Solectron issued restricted stock awards of 1.4 million shares of common stock to certain eligible executives at a purchase price of \$0.001 per share. These restricted shares are not transferable until fully vested and are subject to the Company Repurchase Option for all unvested shares upon certain early termination events and also subject to accelerated vesting in certain circumstances. Compensation expense computed under the



**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

fair value method for the three and six months ended February 28, 2006, is being amortized over the vesting period and was \$0.1 million and \$0.2 million, respectively. Compensation expense computed under the intrinsic value method for the three and six months ended February 28, 2005, is being amortized over the vesting period and was \$0.3 million and \$0.9 million, respectively.

During fiscal 2005 and 2004, Solectron also issued discounted stock options of 1.5 million and 0.7 million shares, respectively, to certain eligible executives and employees at a price below the market value on the day of the stock option grant. During the six month period ended February 28, 2006, an additional 4.2 million discounted options were granted to certain eligible employees. Compensation expense under the fair value method for the three months and six months ended February 28, 2006, is being amortized over the vesting period and was \$1.5 million and \$2.3 million, respectively. Compensation expense under the intrinsic value method for the three months and six months ended February 28, 2005, was \$0.3 million and \$0.5 million, respectively. For compensation expense purposes, the intrinsic value of restricted stock awards and discounted stock options equals the fair market value of these awards.

The weighted-average fair value of the discounted stock options granted in the three-month and six-month period ended February 28, 2006 was \$3.73 and \$3.79, respectively. At February 28, 2006, unrecognized costs related to restricted stock awards and discounted stock options totaled approximately \$19.4 million and is expected to be recognized over a weighted average period of 2.8 years. The total fair value of restricted stock and discounted stock options vested was zero during the three months and six months ended February 28, 2006.

*Pro Forma Net Loss and Assumptions for Fiscal Years 2005 and 2004*

The table below sets out the pro forma amounts of net loss and net loss per share that would have resulted for fiscal years 2005 and 2004, if Solectron accounted for its employee stock plans under the fair value recognition provisions of SFAS No. 123.

	<b>Fiscal 2005</b>	<b>Fiscal 2004</b>
	<b>(In millions, except per-share data)</b>	
Net income (loss) as reported	\$ 3.4	\$ (177.4)
Stock-based employee compensation expense determined under fair value method, net of related tax effects	(58.7)	(60.5)
Pro forma net loss	\$ (55.3)	\$ (237.9)
Net loss per share		
Basic and diluted as reported	\$ 0.00	\$ (0.20)
Basic and diluted pro forma	\$ (0.06)	\$ (0.27)

Stock based employee compensation expense determined under the fair value method, net of related tax effects, included zero and \$6.5 million of expense relating to discontinued operations during fiscal years 2005 and 2004,

respectively.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

For purposes of computing pro forma net loss, the fair value of each option grant and employee stock purchase plan purchase right was estimated on the date of grant using the Black-Scholes option pricing model. The assumptions used to value the option grants and purchase rights are stated below.

	<b>Fiscal 2005</b>	<b>Fiscal 2004</b>
<b>Stock Options</b>		
Expected life of options	4.5 years	3.9 years
Volatility	57%	75%
Risk-free interest rate	3.79%	2.30% to 3.06%
Dividend yield	zero	zero
<b>Employee Stock Purchase Plan</b>		
Expected life of purchase right	6 months	6 months
Volatility	37%	77%
Risk-free interest rate	2.90%	1.00% to 1.70%
Dividend yield	zero	zero

**NOTE 4 Stock Repurchase**

On July 22, 2005, Solectron's board of directors authorized a \$250 million stock repurchase program. During the first fiscal quarter of 2006, Solectron repurchased and retired 46.6 million shares of its common stock at an average price of \$3.87 for approximately \$180.4 million. In October 2005, Solectron completed the stock repurchase program. Solectron repurchased and retired a total of 63.6 million shares for approximately \$250.0 million under this program. On November 1, 2005, Solectron announced that the Company's Board of Directors had approved a new stock repurchase program whereby the Company is authorized to repurchase up to an additional \$250 million of the Company's common stock. Solectron commenced this second \$250 million repurchase program at the end of the quarter ended February 28, 2006. However, no repurchase transactions were settled during the quarter.

**NOTE 5 Inventories**

Inventories related to continuing operations as of February 28, 2006 and August 31, 2005, consisted of the following (in millions):

	<b>February 28 2006</b>	<b>August 31 2005</b>
Raw materials	\$ 985.2	\$ 771.0
Work-in-process	168.7	152.8
Finished goods	192.2	184.7

Total	\$	1,346.1	\$	1,108.5
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**NOTE 6 Accounts Receivable, Net**

Accounts receivable, net related to continuing operations as of February 28, 2006 and August 31, 2005 consisted of the following (in millions):

		<b>February 28 2006</b>	<b>August 31 2005</b>
Accounts Receivable	\$	1,194.1	\$ 1,203.0
Less: Allowance for doubtful accounts		16.4	22.3
Accounts Receivable, net	\$	1,177.7	\$ 1,180.7

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 7 Property and Equipment, Net**

Property and equipment, net related to continuing operations as of February 28, 2006 and August 31, 2005 consisted of the following (in millions):

	<b>February 28 2006</b>	<b>August 31 2005</b>
Original Cost	\$ 1,843.0	\$ 1,818.3
Less: Accumulated depreciation	1,161.3	1,152.0
Total	\$ 681.7	\$ 666.3

**NOTE 8 Commitments and Contingencies***Synthetic Leases*

Solectron has synthetic lease agreements relating to three manufacturing sites. The synthetic leases have expiration dates in August 2007. At the end of the lease terms, Solectron has an option, subject to certain conditions, to purchase or to cause a third party to purchase the facilities subject to the synthetic leases for the Termination Value, which approximates the lessor's original cost for each facility, or may market the property to a third party at a different price. Solectron is entitled to any proceeds from a sale of the properties to third parties in excess of the Termination Value and is liable to the lessor for any shortfall not to exceed 85% of the Termination Value. Solectron has provided loans to the lessor equaling approximately 85% of the Termination Value for each synthetic lease. These loans are repayable solely from the sale of the properties to third parties in the future, are subordinated to the amounts payable to the lessor at the end of the synthetic leases, and may be credited against the Termination Values payable if Solectron purchases the properties. The approximate aggregate Termination Values and loan amounts were \$87.7 million and \$74.5 million, respectively, as of February 28, 2006.

In addition, cash collateral of \$13.2 million, an amount equal to the difference between the aggregate Termination Values and the loan amounts, is pledged as collateral. Each synthetic lease agreement contains various affirmative covenants. A default under a lease, including violation of these covenants, may accelerate the termination date of the arrangement. Solectron was in compliance with all applicable covenants as of February 28, 2006. Monthly lease payments are generally based on the Termination Value and 30-day LIBOR index (4.57% as of February 28, 2006) plus an interest-rate margin, which may vary depending upon Solectron's Moody's Investors Services and Standard and Poor's ratings, and are allocated between the lessor and Solectron based on the proportion of the loan amount to the Termination Value for each synthetic lease.

During fiscal 2004, Solectron determined that it is probable that the expected fair value of the properties under the synthetic lease agreements will be less than the Termination Value at the end of the lease terms by approximately \$13.5 million. The \$13.5 million is being accreted over the remaining lease terms. As of February 28, 2006, Solectron

had accreted \$7.3 million.

Solectron accounts for these synthetic lease arrangements as operating leases in accordance with SFAS No. 13, Accounting for Leases, as amended. Solectron's loans to the lessor and cash collateral are included in other assets and restricted cash and cash equivalents, respectively, in the consolidated balance sheets.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)*****Future Minimum Lease Obligations***

Future minimum payments for operating lease obligations related to facilities in use, including the synthetic leases discussed above, are as follows (in millions):

	Total	Short-Term	Payments Due by Period						
			Q3 07-Q4 07	FY08	FY09	FY10	FY11	Thereafter	
				(In millions)					
Operating lease	\$ 142.1	\$ 34.2	\$ 20.2	\$ 21.3	\$ 16.4	\$ 14.5	\$ 13.5	\$ 22.0	

***Legal Proceedings***

Solectron is from time to time involved in various litigation and legal matters, including the one described below.

Solectron has settled the previously reported shareholder class action lawsuit entitled *Abrams v. Solectron Corporation et al.*, Case No. C-03-0986 CRB, filed in the United States District Court for the Northern District of California, on terms not considered to be material to Solectron. Court approval of the settlement terms was obtained on March 3, 2006.

**NOTE 9 Segment Information and Geographic Information**

SFAS No. 131 Disclosure about Segments of an Enterprise and Related Information established standards for reporting information about operating segments in annual consolidated financial statements and requires selected information about operating segments in interim financial reports issued to stockholders. It also established standards for related disclosures about products and services, geographic areas and major customers. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance.

Solectron's chief operating decision maker is the Chief Executive Officer. The Chief Executive Officer evaluates financial information on a company-wide basis for purposes of making decisions and assessing financial performance. Accordingly, Solectron has one operating segment.

Geographic net sales are attributable to the country in which the product is manufactured. Geographic information for continuing operations as of and for the periods presented is as follows (in millions):

Three Months Ended		Six Months Ended	
February 28		February 28	
2006	2005	2006	2005

Geographic net sales:				
United States	\$ 808.5	\$ 828.8	\$ 1,605.2	\$ 1,615.2
Other North and Latin America	385.6	448.0	743.6	921.7
Europe	288.8	381.2	602.7	815.3
Malaysia	515.3	514.7	1,012.1	951.2
China	279.1	349.5	538.6	689.6
Other Asia Pacific	222.3	233.8	453.8	453.6
	\$ 2,499.6	\$ 2,756.0	\$ 4,956.0	\$ 5,446.6



**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

	<b>February 28 2006</b>	<b>August 31 2005</b>
Long-lived assets:		
United States	\$ 299.7	\$ 314.3
Other North and Latin America	165.7	165.7
Europe	130.7	138.0
Asia Pacific	299.7	275.8
	<b>\$ 895.8</b>	<b>\$ 893.8</b>

Certain customers accounted for 10% or more of our net sales. The following table includes these customers and the percentage of net sales attributed to them:

	<b>Three Months Ended February 28</b>		<b>Six Months Ended February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Cisco Systems	18.1%	17.0%	17.4%	15.6%
Nortel Networks	11.7%	10.7%	11.0%	10.5%

Solectron has concentrations of credit risk due to sales to the customers listed above as well as to Solectron's other significant customers. No customer accounted for 10% or more of total accounts receivable at February 28, 2006.

**NOTE 10 Long-Term Debt*****8.00% Senior Subordinated Notes due 2016***

On February 14, 2006, Solectron's wholly owned subsidiary Solectron Global Finance Ltd ( Solectron Global Finance ) issued \$150 million of senior subordinated notes to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The notes are unconditionally guaranteed by Solectron on a senior subordinated basis, and will mature on March 15, 2016, and bear interest at the rate of 8% annually. Cash interest payments on the notes will be made semiannually in arrears on March 15 and September 15 of each year, beginning on September 15, 2006. The notes will be redeemable, in whole or in part, at any time on or after March 15, 2011 at specified redemption prices plus accrued and unpaid interest. Prior to March 15, 2011, subject to certain outstanding principal amount and redemption timing conditions, Solectron Global Finance will have the option to redeem the notes, in whole or in part at a price equal to the greater of 100% or the make-whole premium plus accrued and unpaid interest. In addition, subject to certain conditions, prior to March 15, 2009, Solectron Global Finance or Solectron may redeem up to 35% of the aggregate principal amount of notes with the net proceeds of a public common stock offering by Solectron at a redemption price of 108% of the principal amount of the notes, plus any accrued and unpaid interest to the redemption date. Solectron used the net proceeds from the offering, together with cash on hand, to repay its 7.375% Senior Notes

on March 1, 2006.

***0.5% Convertible Senior Notes due 2034***

On February 17, 2004, Solectron issued \$450 million of convertible senior notes (the *Original Notes* ), to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The *Original Notes* are unsecured and unsubordinated indebtedness of Solectron and will mature on February 15, 2034.

On February 10, 2005, Solectron completed an exchange offer with respect to the *Original Notes* for an equal amount of its newly issued 0.5% convertible senior notes, Series B due 2034 (the *New Notes* ) and cash. Solectron accepted for exchange \$447.3 million aggregate principal amount of outstanding notes, representing approximately 99.4% of the total outstanding notes. Upon conversion of the *New Notes*, Solectron will deliver \$1,000 in cash for

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**SOLECTRON CORPORATION AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Continued)**

the principal amount, and at its election, either common stock or cash, for the conversion value above the principal amount. Holders electing to convert upon a change of control, prior to February 15, 2011, unless the consideration consists of at least 90% in the form of listed shares (excluding cash payments for fractional shares and cash payments made pursuant to dissenters' appraisal rights), shall be eligible for an increase in the conversion rate in accordance to the terms of the New Notes.

On or after February 20, 2011, Solectron will have the option to redeem all or a portion of the convertible notes that have not been previously purchased, repurchased or converted, at 100% of the principal amount of the convertible notes to be redeemed plus accrued and unpaid interest and liquidated damages owed, if any, up to, but excluding, the date of the purchase. Holders of the convertible notes may require Solectron to purchase all or a portion of the convertible notes for cash on each of February 15, 2011, 2014, 2019, 2024, and 2029 at a price equal to 100% of the principal amount of the convertible notes to be repurchased plus accrued and unpaid interest, up to, but excluding, the date of repurchase. Holders will have the option, subject to certain conditions, to require Solectron to repurchase any convertible notes held by such holder in the event of a change in control, as defined, at a price of 100% of the principal amount of the convertible notes plus accrued and unpaid interest up to, but excluding, the date of repurchase. The convertible notes are convertible into shares of common stock of Solectron at any time prior to maturity, subject to the terms of the notes.

After the exchange offer was complete, there were approximately \$2.7 million aggregate principal amount of Original Notes outstanding. Interest on both the Original Notes and the New Notes (together, the convertible notes) will be paid on February 15 and on August 15 of each year. The conversion rate for the convertible notes is 103.4468 per \$1,000 principal amount. As of February 28, 2006, the aggregate carrying amount of the convertible notes of \$450.0 million was classified as long-term debt.

***7.375% Senior Notes***

In February 1996, Solectron issued \$150 million aggregate principal amount of unsubordinated notes. These notes are in denominations and have a maturity value of \$1,000 each and are due on March 1, 2006. Interest is payable semiannually at a rate of 7.375% per annum. The notes may not be redeemed prior to maturity. As of February 28, 2006, the carrying amount of the notes of \$150.0 million was classified as short-term debt. These notes were redeemed at maturity on March 1, 2006.

***Adjustable Conversion-Rate Equity Securities (ACES)***

On August 31, 2004, there were 2.6 million ACES units remaining. Each ACES unit has a stated amount of \$25.00 and consisted of (a) a contract requiring the holder to purchase, for \$25.00, a number of shares of Solectron common stock (subject to certain anti-dilution adjustments); and (b) a \$25 principal amount of 7.97% subordinated debenture due November 2006.

On November 15, 2004, Solectron issued 6.6 million shares of its common stock at a settlement rate of 2.5484 shares per ACES unit as defined above. Solectron received cash proceeds of \$64.3 million which resulted in a corresponding increase in additional paid in capital. The equity component of the ACES has been settled. Accordingly, the remaining obligation of the original ACES is the 7.97% subordinated debentures.

As of February 28, 2006, the 7.97% subordinated debentures due November 2006 had a carrying value of \$64.3 million and were classified as short-term debt.

***Liquid Yield Option Notes (LYONs<sup>tm</sup>)***

On February 28, 2006, Solectron had \$8.6 million aggregate accreted value of LYONs<sup>tm</sup> outstanding with an interest rate of 2.75%. These notes are unsecured and unsubordinated indebtedness of Solectron. Solectron will pay no interest prior to maturity. Each note has a yield of 2.75% with a maturity value of \$1,000 on May 8, 2020. Each note is convertible at any time by the holder to common shares at a conversion rate of 12.3309 shares per note.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

Holders will be able to require Solectron to purchase all or a portion of their notes on May 8, 2010, at a price of \$761.00 per note. Solectron, at its option, may redeem all or a portion of the notes at any time on or after May 20, 2004. As of February 28, 2006, the accreted value of the 2.75% LYONs™ is classified as long-term debt.

On February 28, 2006, Solectron had \$1.1 million aggregate accreted value of LYONs™ outstanding with an interest rate of 3.25%. These notes are unsecured and unsubordinated indebtedness of Solectron. Solectron will pay no interest prior to maturity. Each note has a yield of 3.25% with a maturity value of \$1,000 on November 20, 2020. Each note is convertible at any time by the holder to common shares at a conversion rate of 11.7862 shares per note. Holders will be able to require Solectron to purchase all or a portion of their notes on November 20, 2010, at a price of \$724.42 per note. Solectron, at its option, may redeem all or a portion of the notes at any time on or after May 20, 2004. As of February 28, 2006, the accreted value of the 3.25% LYONs™ is classified as long-term debt.

**NOTE 11 Derivative Instruments**

Solectron enters into foreign exchange forward contracts intended to reduce the short-term impact of foreign currency fluctuations on foreign currency receivables, investments, payables and indebtedness. The gains and losses on the foreign exchange forward contracts are intended to largely offset the transaction gains and losses on the foreign currency receivables, investments, payables, and indebtedness recognized in operating results. Solectron does not enter into foreign exchange forward contracts for speculative purposes. Solectron's foreign exchange forward contracts related to current assets and liabilities are generally three months or less in original maturity.

As of February 28, 2006, Solectron had outstanding foreign exchange forward contracts with a total notional amount of approximately \$391.0 million.

For all derivative transactions, Solectron is exposed to counterparty credit risk to the extent that the counterparties may not be able to meet their obligations towards Solectron. To manage the counterparty risk, Solectron limits its derivative transactions to those with major financial institutions. Solectron does not expect to experience any material adverse financial consequences as a result of default by Solectron's counterparties.

Financial instruments that potentially subject Solectron to concentrations of credit risk consist of cash, cash equivalents and trade accounts receivable. Concentrations of credit risk in accounts receivable resulting from sales to major customers are discussed in Note 9, Segment Information and Geographic Information .

**NOTE 12 Goodwill and Intangible Assets**

Goodwill information is as follows (in millions):

	<b>Goodwill</b>
Balance at August 31, 2005	\$ 148.80
Adjustments	(1.20)
Balance at February 28, 2006	\$ 147.60



**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

Solectron's intangible assets are classified as other assets on the condensed consolidated balance sheets and categorized into three main classes: supply agreements, intellectual property and contractual and non-contractual customer relationships obtained in asset purchases or business combinations. The following table summarizes the intangible asset balance at February 28, 2006 and August 31, 2005 (in millions):

	<b>Supply Agreements</b>	<b>Intellectual Property Agreements</b>	<b>Customer Relationships and Other</b>	<b>Total</b>
February 28, 2006				
Gross amount	\$ 89.5	\$ 61.0	\$ 98.9	\$ 249.4
Accumulated amortization	(85.9)	(57.1)	(88.9)	(231.9)
Carrying value	\$ 3.6	\$ 3.9	\$ 10.0	\$ 17.5
August 31, 2005				
Gross amount	\$ 91.9	\$ 61.0	\$ 98.9	\$ 251.8
Accumulated amortization	(86.7)	(56.2)	(84.1)	(227.0)
Carrying value	\$ 5.2	\$ 4.8	\$ 14.8	\$ 24.8

During the six months ended February 28, 2006, Solectron recorded a \$2.4 million impairment of an intangible asset in connection with the termination of a customer relationship for which an intangible asset had been established. A \$.5 million gain on sale of fully depreciated equipment to this former customer has been reported as a component of restructuring and impairment costs

Amortization expense for the three months and six months ended February 28, 2006 was approximately \$1.7 million and \$3.9 million, respectively. Annual amortization expense for these intangibles over the next five years would be approximately \$4.6 million, \$4.2 million, \$3.9 million, \$2.9 million and \$1.2 million.

**NOTE 13 Discontinued Operations**

During the fourth quarter of fiscal 2003 and the first quarter of fiscal 2004, as a result of a full review of its portfolio of businesses, Solectron committed to a plan to divest a number of business operations that are outside its core competencies. The companies which we have divested and that are included in discontinued operations are Dy 4 Systems Inc., Kavlico Corporation, Solectron's MicroTechnology division, SMART Modular Technologies Inc., Stream International Inc., Solectron's 63% interest in US Robotics Corporation, and Force Computers, Inc.

These businesses each qualify as a discontinued operation component of Solectron under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Solectron has reported the results of operations and consolidated financial position of these businesses in discontinued operations within the consolidated statements of

operations and the balance sheets for all periods presented.



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The results from discontinued operations were as follows (in millions):

	<b>Three Months</b>		<b>Six Months</b>	
	<b>Ended</b>		<b>Ended</b>	
	<b>February 28</b>		<b>February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net sales	\$	\$	\$	\$ 15.2
Cost of sales				14.1
Gross profit				1.1
Operating income net	(6.5)	(0.9)	(8.2)	(11.3)
Operating income (loss)	6.5	0.9	8.2	12.4
Interest income net				
Other income net	6.8		8.9	0.9
Income before income taxes	13.3	0.9	17.1	13.3
Income tax expense				1.7
Income from discontinued operations, net of tax	\$ 13.3	\$ 0.9	\$ 17.1	\$ 11.6

During fiscal 2004, Solectron completed the sale of six of its discontinued operations. During the first quarter of fiscal 2005, Solectron completed the sale of its MicroTechnology division, the final discontinued operation, for cash proceeds of \$30.0 million resulting in a \$10.1 million pre-tax gain which is included in operating income net for the quarter ended November 30, 2004. As a result of this disposition, Solectron transferred approximately \$28.3 million from accumulated foreign currency translation gains, included in accumulated other comprehensive losses within Stockholder's Equity and recognized that amount as part of the pre-tax gain. The sales agreement for this divestiture provided for a possible adjustment to the proceeds and gain based upon final settlement of Microtechnology's working capital at closing. During the second quarter of fiscal 2006, the working capital adjustment pursuant to the sales agreement was resolved, resulting in a gain of \$9.4 million.

During the first quarter of fiscal 2005, Solectron increased the net loss on disposal of those discontinued operations by approximately \$0.5 million resulting from a few insignificant adjustments pursuant to the terms of the disposal transaction. During the second quarter of fiscal 2005, Solectron sold a building that was subject to a synthetic lease agreement. The synthetic lease agreement was associated with a discontinued operation that has been sold. As a result of the transaction, Solectron recorded a gain of approximately \$0.9 million in operating income net as disclosed above.

During the first quarter of fiscal 2006, Solectron recorded a \$2.1 million gain on sale of assets of discontinued operations having no remaining book value and \$1.7 million associated with the favorable resolution of certain contingencies. During the second quarter of fiscal 2006, Solectron recorded a \$2.1 million gain on the sale of assets formerly associated with a discontinued operation and \$1.8 million associated with the favorable resolution of certain contingencies.

The sale agreements for the divestitures contain certain indemnification provisions pursuant to which Solectron may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. In aggregate, Solectron is contingently liable for up to \$94.8 million for a period of 12 to 24 months subsequent to the completion of the sale. As of February 28, 2006, there were no significant liabilities recorded under these indemnification obligations. Additionally, Solectron may be required to indemnify a buyer for environmental remediation costs for a period up to 10 years and not to exceed \$13 million. Solectron maintains an insurance policy to cover environmental remediation liabilities in excess of reserves previously established upon the acquisition of these properties. Solectron did not record any environmental charges upon disposition of these properties.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 14 Restructuring and Impairment**

Over the past few years, Solectron has recorded restructuring and impairment costs as it rationalized operations in light of customer demand declines and the economic downturn. The measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, was largely intended to align Solectron's capacity and infrastructure to anticipated customer demand and transition our operations to lower cost regions. The restructuring and impairment costs include employee severance and benefit costs, costs related to leased facilities abandoned and subleased, impairment of owned facilities no longer used by Solectron which will be disposed, costs related to leased equipment that has been abandoned, and impairment of owned equipment that will be disposed. For owned facilities and equipment, the impairment loss recognized was based on the fair value less costs to sell, with fair value estimated based on existing market prices for similar assets. Severance and benefit costs are recorded in accordance with SFAS No. 112, *Employer's Accounting for Postemployment Benefits*, as Solectron has concluded that it had a substantive severance plan. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the estimated lease loss accrued for leased facilities abandoned and subleased after December 31, 2002 represents the fair value of the lease liability as measured by the present value of future lease payments subsequent to abandonment less the present value of any estimated sublease income. For those facilities abandoned and subleased before January 1, 2003, as part of restructuring activities under EITF Issue No. 94-3, the estimated lease loss represents payments subsequent to abandonment less any estimated sublease income. In order to estimate future sublease income, we work with real estate brokers to estimate the length of time until we can sublease a facility and the amount of rent we can expect to receive. Estimates of expected sublease income could change based on factors that affect our ability to sublease those facilities such as general economic conditions and the real estate market, among others. At each reporting date, the Company evaluates its accruals for exit costs and employee separation costs to ensure the accruals are still appropriate. In certain circumstances, accruals are no longer required because of efficiencies in carrying out the plans or because employees previously identified for separation resigned from the Company and did not receive severance or were redeployed due to circumstances not foreseen when the original plans were initiated. The Company reverses accruals through the income statement line item where the original charges were recorded when it is determined that they are no longer required.

See also Note 12, *Goodwill and Intangible Assets*, for discussion of intangible asset impairment charges.

***Overview of Restructuring Plans******Fiscal Year 2005 Restructuring Plan***

During fiscal year 2005, in response to a decline in revenues from fiscal year 2004 levels, we reviewed our cost structure and geographic footprint and determined that cost savings could be realized by moving certain activities from high-cost facilities in Europe and North America to facilities in low cost geographies. This restructuring plan as amended will result in restructuring charges of approximately \$55 million to \$65 million, and includes the following measures:

Closing our facilities in Hillsboro, Oregon; Winnipeg, Canada; Lincoln, California; Turnhout, Belgium; and Munich, Germany.

Eliminating approximately 2,400 positions at (1) the facilities being closed; (2) our facilities in Bordeaux, France; Dunfermline, Scotland; Mexico; Brazil; and other facilities; and (3) within our material procurement and sales organizations in Europe and North America. These actions included the elimination of certain positions, the migration of certain functional activities to facilities in low cost geographies, and the outsourcing of certain activities.

Impair certain long-lived assets (primarily building and leasehold improvement) in connection with the facilities being vacated and equipment made obsolete to the extent that we would be unable to recover their carrying value upon sales to third parties.

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**SOLECTRON CORPORATION AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Continued)**

Cumulative restructuring costs recorded under this plan as of February 28, 2006 were \$54.4 million. As of February 28, 2006, we have reduced our workforce by 2,000 personnel in connection with this plan and expect to reduce headcount by an additional 400 personnel prior to the completion of this plan. We expect to substantially complete this restructuring plan by the end of fiscal 2006.

***Fiscal Year 2004 Restructuring Plan***

In the fourth quarter of fiscal 2004, in order to drive savings in its human resources and information technology functions, as well as reduce labor costs in certain high cost facilities, Solectron committed to a plan to eliminate approximately 2,100 full-time positions primarily in Europe and North America, consolidate certain facilities, and impair certain long-lived assets.

This plan was expected to result in total restructuring charges of \$20.0 million. Through February 28, 2006, Solectron had recorded restructuring charges of approximately \$25.6 million related to this plan. This amount consisted of \$11.2 million of severance charges, \$10.2 million relating to the impairment of certain long-lived assets, and \$4.2 million of facility lease obligation and other expenses. The facility lease obligation currently expires in 2011. We expect to substantially complete this restructuring plan by the end of fiscal 2006.

***Legacy Restructuring Plans***

From 2001 through 2003, a significant economic downturn adversely impacted Solectron's business, resulting in a decline in revenues from \$17.4 billion in fiscal year 2001 to \$9.8 billion in fiscal year 2003. In response to these trends, Solectron initiated a series of restructuring measures to align its capacity and infrastructure with anticipated customer demand. These actions included significant reductions in the Company's workforce, the closure and consolidation of facilities, and the impairment of certain long-lived assets. These restructuring activities are substantially complete as of February 28, 2006, as the remaining accrual is almost entirely attributable to ongoing facility lease obligations, which are currently leased through 2014. However, we expect to incur restructuring costs as we continue to sell restructured long-lived assets and revise previous estimates in connection with these plans. Revisions to estimates will primarily be due to changes in assumptions used for the facility lease loss accrual.

***Three and six months ended February 28, 2006 and 2005***

Solectron continued to incur expected restructuring charges in the first and second quarter of fiscal 2006 in accordance with previously announced plans. The employee severance and benefit costs included in the restructuring charges recorded in the first and second quarters of fiscal 2006 primarily arose from the 2005 Restructuring Plan described above. Solectron also recorded a \$1.6 million impairment of tangible assets relating to a consolidated subsidiary during the second quarter of fiscal 2006.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

The following table summarizes restructuring charges included in the accompanying condensed consolidated statements of operations (in millions):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>		<b>Nature</b>
	<b>February 28</b>		<b>February 28</b>		
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>	
Loss on disposal of and impairment of equipment and facilities, net	\$ 5.1	\$ 38.5	\$ 8.5	\$ 39.7	non-cash
Intangible asset impairment charge, net			1.9		non-cash
Total impairment of equipment, facilities and intangibles	5.1	38.5	10.4	39.7	non-cash
Severance and benefit costs	(2.8)	2.9	(9.9)	3.3	cash
Net adjustment to facility lease loss accrual	2.1	1.9	4.5	0.9	cash
Net adjustment to equipment lease loss accrual	0.1	(0.2)	0.1	(0.1)	cash
Other exit costs	1.1	0.1	1.4	0.1	cash
Total cash restructuring	0.5	4.7	(3.9)	4.2	cash
Total cash and non-cash restructuring	\$ 5.6	\$ 43.2	\$ 6.5	\$ 43.9	

***Restructuring Accrual***

The following table summarizes the restructuring accrual balance for continuing operations as of February 28, 2006 (in millions). The amounts presented include remaining obligations under both the 2005 Restructuring Plan and prior plans.

	<b>Severance and Benefits</b>	<b>Leased Facilities &amp; Equipment</b>	<b>Other Exit Costs</b>	<b>Total</b>
Balance of accrual at August 31, 2005	\$ 44.9	\$ 32.7	\$ 0.1	\$ 77.7
Provision	1.6	2.8	0.4	4.8
Q1-FY06 Provision Adjustments	(8.7)	(0.4)	(0.1)	(9.2)
Q1-FY06 Cash Payments	(5.2)	(5.2)	(0.4)	(10.8)
Foreign Exchange Adjustment	(0.9)	(0.1)		(1.0)

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Balance of accrual at November 30, 2005	31.7	29.8	61.5
Provision	2.1	2.2	5.5
Q2-FY06 Provision Adjustments	(5.0)		(5.0)
Q2-FY06 Cash Payments	(13.3)	(4.9)	(19.4)
Foreign Exchange Adjustment	0.2	0.1	0.3
Balance of accrual at February 28, 2006	\$ 15.7	\$ 27.2	\$ 42.9

Accruals related to restructuring activities were recorded in accrued expenses in the accompanying condensed consolidated balance sheets. Solectron expects to pay amounts related to severance and benefits in the next year. The remaining balance, primarily consisting of lease commitment costs on facilities, is expected to be paid out through 2014.

**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)*****Restructuring Activity by Plan***

The restructuring and impairment charges incurred by restructuring plan during the six month period ended February 28, 2006, were as follows:

	<b>Fiscal 2005 Plan</b>	<b>Fiscal 2004 Plan</b>	<b>Legacy Plans</b>	<b>Total</b>
Balance at August 31, 2005	\$ 40.2	\$ 5.2	\$ 32.3	\$ 77.7
Provision	2.4	0.2	2.2	4.8
Provision adjustments	(7.2)	(1.4)	(0.6)	(9.2)
Cash payments	(5.3)	(0.7)	(4.8)	(10.8)
Foreign Exchange Adjustment	(0.8)		(0.2)	(1.0)
Balance at November 30, 2005	\$ 29.3	\$ 3.3	\$ 28.9	\$ 61.5
Q1FY2006 loss on disposal of and impairment of equipment and facilities, net	\$ 1.3	\$ 2.0	\$ 0.1	\$ 3.4
Provision	3.9	0.7	0.9	5.5
Provision adjustments	(5.0)			(5.0)
Cash payments	(14.8)	(0.4)	(4.2)	(19.4)
Foreign Exchange Adjustment	0.2		0.1	0.3
Balance at February 28, 2006	\$ 13.6	\$ 3.6	\$ 25.7	\$ 42.9
Q2FY2006 loss on disposal of and impairment of equipment and facilities, net	\$ 2.0	\$	\$ 1.5	\$ 3.5

**NOTE 15 Net Income (Loss) Per Share Calculation**

Basic net income (loss) per share is computed using the weighted average number of common shares outstanding during the period.

The computation of diluted net income (loss) per share calculates the effect of dilutive securities on weighted average shares. Dilutive securities include options to purchase common stock and shares issuable upon conversion of Solectron's LYONs and ACES.



**Table of Contents****SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)**

Net income (loss) per share data were computed as follows (in millions, except per share amounts):

	<b>Three Months Ended February 28</b>		<b>Six Months Ended February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Basic earnings per share:				
Net income	\$ 30.4	\$ (2.2)	\$ 54.4	\$ 56.0
Shares used in computation:				
Weighted average ordinary shares outstanding	908.8	977.1	917.3	966.7
Basic earnings per share	\$ 0.03	\$ (0.00)	\$ 0.06	\$ 0.06
Diluted earnings per share:				
Net income	\$ 30.4	\$ (2.2)	\$ 54.4	\$ 56.0
Shares used in computation:				
Weighted average ordinary shares outstanding	908.8	977.1	917.3	966.7
Employee stock options	.2		.2	3.9
Restricted Stock	0.7		0.6	
Shares issuable upon conversion of LYONs				
Shares issuable upon conversion of ACES				
Weighted average number of shares	909.7	977.1	918.1	970.6
Diluted earnings per share	\$ 0.03	\$ (0.00)	\$ 0.06	\$ 0.06

The following table summarizes the weighted average dilutive securities that were excluded from the above computation of diluted earnings per share because their inclusion would have an anti-dilutive effect (in millions):

	<b>Three Months Ended February 28</b>		<b>Six Months Ended February 28</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Dilutive securities:				
Employee stock options	40.2	28.6	30.8	