Spansion Inc.
Form 10-Q
November 07, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 28, 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)

Delaware	**20-3898239**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**
915 DeGuigne Drive	
Sunnyvale, California	**94088**
(Address of principal executive offices)	**(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 x 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 the definitions of large accelerated filer, accelerated filer and small reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of the close of business on November 5, 2008:

Class	**Number of Shares**
Class A Common Stock, $0.001 par value	161,069,430

Table of Contents

Table of Contents

INDEX

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)

	Three Months Ended		Nine Months Ended	
	Sep. 28 2008	Sep. 30 2007	Sep. 28 2008	Sep. 30 2007
Net sales	$ 474,170	$ 408,605	$ 1,300,621	$ 1,197,270
Net sales to related parties	156,690	202,464	513,231	650,742
Total net sales	630,860	611,069	1,813,852	1,848,012
Expenses:				
Cost of sales *(Note 7)*	544,273	499,758	1,523,654	1,538,761
Research and development *(Note 7)*	106,845	111,248	335,469	324,139
Sales, general and administrative *(Note 7)*	64,094	59,192	197,122	179,379
In-process research and development *(Note 3)*			10,800	
Restructuring charges *(Note 13)*	1,377		11,299	
Operating loss	(85,729)	(59,129)	(264,492)	(194,267)
Other income (expense):				
Other than temporary impairment on marketable securities	(14,518)		(14,518)	
Loss on early extinguishment of debt				(3,435)
Interest and other income (expense), net	1,432	6,835	7,347	30,873
Interest expense	(24,853)	(23,628)	(73,507)	(65,316)
Other income (expense), net	(37,939)	(16,793)	(80,678)	(37,878)
Loss before income taxes	(123,668)	(75,922)	(345,170)	(232,145)
Income tax (provision) benefit	(9,583)	4,320	(7,195)	18,163
Net loss	$ (133,251)	$ (71,602)	$ (352,365)	$ (213,982)
Net loss per common share:				
Basic and diluted	$ (0.83)	$ (0.53)	$ (2.30)	$ (1.59)
Shares used in per share calculation:				
Basic and diluted	160,687	135,049	153,216	134,805

See accompanying notes

3

Table of Contents

Spansion Inc.

Condensed Consolidated Balance Sheets

(in thousands)

	Sep. 28 2008 (Unaudited)	Dec. 30 2007 (*)
Assets		
Current assets:		
Cash and cash equivalents	$ 152,107	$ 199,092
Marketable securities	107,382	216,650
Trade accounts receivable, net	249,363	181,443
Trade accounts receivable from related parties, net (*Note 7*)	127,796	186,646
Other receivables	8,881	
Other receivables from related parties *(Note 7)*	7,024	11,873
Inventories:		
Raw materials	24,271	31,877
Work-in-process	485,289	421,765
Finished goods	105,157	130,227
Total inventories	614,717	583,869
Deferred income taxes	13,976	26,607
Prepaid expenses and other current assets	48,903	46,452
Total current assets	1,330,149	1,452,632
Property, plant and equipment, net	2,308,480	2,271,964
Deferred income taxes	43,240	29,957
Acquisition related intangible assets, net *(Note 3)*	57,761	
Goodwill *(Note 3)*	18,506	
Other assets	81,771	61,092
Total assets	$ 3,839,907	$ 3,815,645
Liabilities and Stockholders Equity		
Current liabilities:		
Notes payable to banks under revolving loans	$ 130,411	$
Accounts payable	545,374	489,163
Accounts payable to related parties (*Note 7*)	46,046	56,929
Accrued compensation and benefits	76,960	60,778
Accrued liabilities to related parties (*Note 7*)	5,617	9,666
Other accrued liabilities	88,001	88,006
Income taxes payable	608	13,818
Deferred income on shipments	52,826	39,957
Current portion of long-term debt	104,191	68,705
Current portion of long-term obligations under capital leases	42,640	33,092
Total current liabilities	1,092,674	860,114
Deferred income taxes	4,260	186
Long-term debt, less current portion	1,233,477	1,258,616
Long-term obligations under capital leases, less current portion	44,769	40,920
Other long-term liabilities	22,429	23,361
Commitments and contingencies		

Stockholders equity	1,442,298	1,632,448
Total liabilities and stockholders equity	$ 3,839,907	$ 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)

	Nine Months Ended	
	Sep. 28 2008	**Sep. 30 2007**
Cash Flows from Operating Activities:		
Net loss	$ (352,365)	$ (213,982)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	468,440	387,709
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	525	1,693
Benefit for deferred income taxes	(792)	(43,537)
Net gain on sale and disposal of property, plant and equipment, net	(19,910)	(21,946)
Other than temporary impairment on marketable securities	14,518	
Gain on sale of marketable securities	(621)	
Compensation recognized under employee stock plans	15,493	12,084
Amortization of premium on floating rate notes and discount on senior subordinated and senior notes, net	1,693	1,745
Changes in operating assets and liabilities:		
Decrease in trade account receivables from related parties	55,874	26,796
Increase in other receivables from related parties	(1,639)	(6,177)
(Increase) decrease in trade account receivables and other receivables	(55,467)	27,700
Increase in inventories	(30,848)	(76,558)
Decrease (increase) in prepaid expenses and other current assets	1,121	(28,019)
Decrease in other assets	(3,735)	(1,361)
(Decrease) increase in accounts payable and accrued liabilities to related parties	(113,085)	34,938
Increase in accounts payable and accrued liabilities	163,330	75,981
Increase (decrease) in accrued compensation and benefits	16,182	(965)
(Decrease) increase in income taxes payable	(13,210)	18,984
Increase in deferred income on shipments	12,752	1,365
Net cash provided by operating activities	169,055	201,895
Cash Flows from Investing Activities:		
Proceeds from sale of property, plant and equipment	6,333	188,525
Purchases of property, plant and equipment	(396,697)	(964,666)
Proceeds from maturity and sale of marketable securities	133,695	679,900
Purchases of marketable securities	(36,950)	(822,075)
Loan made to an investee	(4,125)	
Cash proceeds from Saifun acquisition	733	
Net cash used in investing activities	(297,011)	(918,316)
Cash Flows from Financing Activities:		
Proceeds from borrowings, net of issuance costs	250,559	810,840
Payments on debt and capital lease obligations	(162,278)	(580,004)
Proceeds from issuance of common stock, net of offering costs		60

Net cash provided by financing activities	88,281	230,896
Effect of exchange rate changes on cash and cash equivalents	(7,310)	(13,323)
Net (decrease) increase in cash and cash equivalents	(46,985)	(498,848)
Cash and cash equivalents at the beginning of period	199,092	759,794
Cash and cash equivalents at end of period	$ 152,107	$ 260,946
Non-cash investing and financing activities:		
Equipment capital leases	$ 50,474	$
Issuance of common stock and stock options to acquire Saifun	108,898	

See accompanying notes

Table of Contents

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, Middle East, 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, data center servers, 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 semiconductor solutions.

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 September 28, 2008 and September 30, 2007 both consisted of 13 weeks. The nine months ended September 28, 2008 and September 30, 2007 both consisted of 39 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.

Table of Contents

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

Financial Statements Reclassifications

Certain prior period amounts in the condensed 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, beginning in 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 has 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 $18.5 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.

Table of Contents

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 related to the Company s marketable securities.

New Accounting Pronouncements

In February 2008, the FASB issued FASB Staff Position (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 affect an

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

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 on its derivatives disclosures upon adopting Statement 161.

In May 2008, the FASB issued FSP APB 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 14-1 on its consolidated financial statements.

In April 2008, the FASB issued FSP FAS 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 FASB Statement No. 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.

In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active which clarifies the application of Statement 157 when the market for a financial asset is inactive. Specifically, FSP FAS 157-3 clarifies how (1) management s internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance in FSP FAS 157-3 is effective immediately and the Company has adopted its provisions with respect to its financial assets as of September 28, 2008.

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 nine months ended September 28, 2008.

Table of Contents

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

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 non-volatile Flash memory based products including products that integrate Flash memory with logic as well as dedicated standalone Flash memory device. The Company believes that the acquisition of Saifun expands its product portfolio and enables its entry into the technology licensing business.

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 $117.0 million and is comprised of:

	In millions
22.7 million shares of Class A common stock	$ 98.4
Fair value of vested options issued	10.5
Acquisition related transaction costs	8.1
Total purchase price	**$ 117.0**

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. 04-1, 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:

	In millions
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	18.5
Total purchase price	**$ 117.0**

As of September 28, 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.

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 balances of acquisition related intangible assets as of September 28, 2008 were as follows:

(In millions)	Gross Assets	Accumulated Amortization	Net Book Value	Weighted Average Amortization in Months
Existing technology	$ 42.8	$ (3.8)	$ 39.0	72
Customer relationships	18.0	(1.4)	$ 16.6	84
Trademarks and trade names	1.4	(0.2)	$ 1.2	48
Non competition agreement	1.3	(0.3)	$ 1.0	24
Goodwill	18.5		$ 18.5	
TOTAL	$ 82.0	$ (5.7)	$ 76.3	

The amortization expenses for the three and nine months ended September 28, 2008 were as follows:

(In millions)	Three Months Ended Sept. 28, 2008	Nine Months Ended Sept. 28, 2008
Existing technology	$ 1.8	$ 3.8
Customer relationships	0.6	1.4
Trademarks and trade names	0.1	0.2
Non competition agreement	0.2	0.3
Total	$ 2.7	$ 5.7

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 September 28, 2008 is as follows:

	In millions
Fiscal Year	
2008 (3 months)	$ 2.7
2009	10.7
2010	10.2
2011	10.1
2012	9.8
2013	9.7
Thereafter	4.6
Total	**$ 57.8**

Pro Forma Information

The following unaudited pro forma consolidated financial information gives effect to the Saifun acquisition as if it had occurred at the beginning of the fiscal periods presented. The pro forma consolidated financial 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.

	Nine Months Ended	
	Sep. 28, 2008	Sep. 30, 2007
	(in thousands, except per share amounts)	
Total net sales	$ 1,816,382	$ 1,861,909
Net loss	$ (357,914)	$ (224,448)
Basic and diluted net loss per common share	$ (2.24)	$ (1.43)

4. Stock-Based Compensation

Saifun Semiconductors Ltd. Employee Share Option Plans (Saifun Option Plans)

The Company assumed all outstanding option shares under the Saifun 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.

13

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

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 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 [1]	12,126,424
Shares available under the 2005 Plan [2]	506,413
Stock options granted through September 28, 2008, net of cancelled stock options	(6,754,003)
RSU awards granted through September 28, 2008, net of cancelled RSU awards	(2,010,496)
Shares available for grant under the 2007 Plan and Saifun 2003 Plan	3,868,338

(1) 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.

(2) 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 nine months ended September 28, 2008 and September 30, 2007:

	Three Months Ended		Nine Months Ended	
	Sep. 28, 2008	Sep. 30, 2007	Sep. 28, 2008	Sep. 30, 2007
	(in thousands)			
Cost of sales	$ 1,350	$ 1,387	$ 3,854	$ 3,442
Research and development	1,699	1,202	4,522	3,268
Sales, general and administrative	2,505	2,153	7,117	5,374

Stock-based compensation expense before income taxes	5,554	4,742	15,493	12,084
Income tax benefit [1]				
Stock-based compensation expense after income taxes [1]	$ 5,554	$ 4,742	$ 15,493	$ 12,084

(1) 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)

No stock options were granted in the three months ended September 28, 2008 under either the Spansion Plans or Saifun Option Plans. The weighted average fair value of the Company s stock options granted in the three months ended September 30, 2007 under Spansion Plans was $3.68 per share. The weighted average fair value of the Company s stock options granted in the nine months ended September 28, 2008 and September 30, 2007 under Spansion Plans and Saifun Option Plans was $1.89 and $4.80 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:

	Three Months Ended		Nine Months Ended	
	Sep. 28, 2008	Sep. 30, 2007	Sep. 28, 2008	Sep. 30, 2007
Expected volatility	54.13%	45.32%	48.66%	48.50%
Risk-free interest rate	3.06%	4.12%	2.67%	4.73%
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 September 28, 2008, the total unrecognized compensation cost related to unvested stock options and RSU awards under Spansion Plans and Saifun Option Plans was approximately $43.9 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2012.

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 Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options:				
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 [(1)]	6,806,119	$ 1.48		
Cancelled	(376,210)	$ 6.77		
Exercised	(13,034)	$ 0.09		
Outstanding as of September 28, 2008	9,953,843	$ 4.85	6.67	$ 6,428
Exercisable as of September 28, 2008	2,491,577	$ 8.27	4.88	$ 1,174

(1) The number of options granted in the nine months ended September 28, 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 $1.64 as of September 26, 2008, which was the last trading day prior to September 28, 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 activities and related information for the period presented:

	Number of Shares	Weighted-Average Grant-date Fair Value
Restricted Stock Units:		
Unvested as of December 31, 2006	2,923,615	$ 12.33
Granted	1,680,532	$ 10.35
Cancelled	(303,430)	$ 11.95
Vested	(1,147,291)	$ 12.27

Unvested as of December 30, 2007	3,153,426	$	11.33
Granted	1,884,455	$	2.97
Cancelled	(313,158)	$	9.06
Vested	(1,079,333)	$	11.51
Unvested as of September 28, 2008	3,645,390	$	7.15

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.

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

For the three and nine months ended September 28, 2008, the Company excluded approximately 25.3 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 nine months ended September 30, 2007, the Company excluded approximately 18.9 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:

	Three Months Ended		Nine Months Ended	
	Sep. 28, 2008	Sep. 30, 2007	Sep. 28, 2008	Sep. 30, 2007
	(in thousands)			
Net loss	$ (133,251)	$ (71,602)	$ (352,365)	$ (213,982)
Net change in pension plan, net of taxes	155	99	(442)	293
Pension curtailment loss				2,010
Net change in cumulative translation adjustment	3,452	47,497	33,779	28,038
Net change in unrealized losses on marketable securities, net of $0 taxes	12,242		(515)	
Total comprehensive loss	$ (117,402)	$ (24,006)	$ (319,543)	$ (183,641)

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 nine months ended September 30, 2007 and as of December 30, 2007:

	Three Months Ended Sep. 30, 2007	Nine Months Ended Sep. 30, 2007
Cost of sales:		
Royalties to AMD	$ 797	$ 2,352
Service fees to AMD[1]:		
Cost of sales	$ 15	$ (1,100)
Research and development	(2)	177
Sales, general and administrative	142	356
Service fees to AMD	$ 156	$ (566)

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

	Dec. 30, 2007 (in thousands)
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. 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 (the sale of the Company s two wafer fabrication facilities located in Aizu-Wakamatsu, Japan) which occurred in the second quarter of fiscal 2007. 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.

Effective September 29, 2008, Fujitsu transferred its one share of Class C Common Stock to the Company. As a result of the transfer, Fujitsu no longer has a right to appoint any directors to the Company s Board of Directors.

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		Nine Months Ended	
	Sep. 28, 2008	Sep. 30, 2007	Sep. 28, 2008	Sep. 30, 2007
	(in thousands)			
Net sales to Fujitsu	$ 156,690	$ 202,464	$ 513,232	$ 650,742
Cost of sales:				
Royalties to Fujitsu	$ 883	$ 797	$ 2,451	$ 2,352
Other purchases of goods and services from Fujitsu and rental expense to Fujitsu	19,580	15,744	59,905	59,645
Subcontract manufacturing and commercial die purchases from Fujitsu	1,693	2,725	6,856	17,602
Wafer purchases, processing and sort services from Fujitsu [(1)]	56,588	63,274	186,329	122,236
Net gain recognized on sale of assets to Fujitsu on April 2, 2007 [(1)]	(8,192)	(10,278)	(25,238)	(19,845)
Reimbursement on costs of employees seconded to Fujitsu [(1)]	(7,454)	(6,351)	(21,483)	(12,319)
Pension curtailment loss [(1)]				2,010
Equipment rental income from Fujitsu [(1)]	(819)	(1,884)	(2,790)	(3,914)
Administrative services income from Fujitsu [(1)]	(93)	(325)	(1,180)	(615)
	$ 62,186	$ 63,701	$ 204,850	$ 167,151
Service fees to Fujitsu:				
Cost of sales	$ 9	$ 77	$ 28	$ 660
Research and development		324	10	923
Sales, general and administrative	148	26	453	733
Service fees to Fujitsu	$ 157	$ 427	$ 491	$ 2,316

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

	Sep. 28, 2008	Dec. 30, 2007
	(in thousands)	
Trade accounts receivable from Fujitsu	$ 127,796	$ 183,670
Other receivables from Fujitsu	$ 7,024	$ 5,385
Accounts payable to Fujitsu	$ 46,046	$ 53,332
Royalties payable to Fujitsu	$ 914	$ 1,629
Accrued liabilities to Fujitsu	$ 4,703	$ 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 nine months ended September 28, 2008 and September 30, 2007 are as follows:

	Three Months Ended		Nine Months Ended	
	Sep. 28 2008	Sep. 30 2007	Sep. 28 2008	Sep. 30 2007
	(in thousands)			
Balance, beginning of period	$ 1,489	$ 1,600	$ 1,305	$ 1,350
Provision for warranties issued	4,274	1,095	11,296	3,579
Settlements	(3,912)	(446)	(11,232)	(1,554)
Changes in liability for pre-existing warranties during the period, including expirations	(362)	(649)	120	(1,775)
Balance, end of period	$ 1,489	$ 1,600	$ 1,489	$ 1,600

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:

	Sep. 28, 2008	Dec. 30, 2007
	(in thousands)	
Debt obligations:		
Spansion China Bank Enterprise Cooperation Loan Facility	$	$ 5,405
Senior Notes	232,425	230,628
Spansion Penang Loan	560	2,028
Exchangeable Senior Subordinated Debentures	207,000	207,000
Spansion Japan 2007 Credit Facility	272,031	256,503
Senior Secured Floating Rate Notes	625,652	625,757
Senior Secured Revolving Credit Facility	55,000	
Spansion Japan 2007 Revolving Credit Facility	75,411	
Obligations under capital leases	87,409	74,012
Total debt and capital lease obligations	1,555,488	1,401,333
Less: current portion	277,242	101,797
Long-term debt and capital lease obligations, less current portion	$ 1,278,246	$ 1,299,536

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

New Debt and Capital Lease Obligations and Activities for the nine months ended September 28, 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 September 28, 2008) under this facility. The drawdown period expired on March 31, 2008. The Company began to make quarterly principal installments in the second quarter of fiscal 2008. As of September 28, 2008, the total outstanding balance under this facility is 28.9 billion yen (approximately $272.0 million). The amount bears interest at approximately 2.8 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 a principal amount of $6.0 million and accrued interest under this facility. In September 2008, the Company borrowed an additional amount of $11 million under this facility. As of September 28, 2008, the total outstanding balance under this credit facility was $55.0 million. This amount bears interest at approximately 4.6 percent to 5.0 percent as of September 28, 2008.

This credit facility provides a total borrowing capacity of $175.0 million and the Company may carry an outstanding balance of up to that amount, subject to certain borrowing base calculations derived from accounts receivable. 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 September 28, 2008, the Company has not met the minimum EBITDA requirement. As such, after deducting the $35 million of availability required, the Company had approximately $38.4 million available under this facility as of September 28, 2008. This credit facility will expire on September 19, 2010.

Spansion Japan 2007 Revolving Credit Facility

During the quarter ended March 30, 2008, Spansion Japan borrowed 8 billion yen approximately $75.4 million as of September 28, 2008) under this credit facility. During the quarter ended June 29, 2008, the Company borrowed an additional 1 billion yen (approximately $9.4 million as of September 28, 2008). In September 2008, the Company repaid a principal amount of 1 billion yen (approximately $9.3 million as of the date of repayment) under this facility. As of September 28, 2008, the outstanding balance under this facility is 8 billion yen (approximately $75.4 million). This amount bears interest at approximately 1.2 percent as of September 28, 2008. Spansion Japan had approximately 5.3 billion yen (approximately $50.0 million) available under this facility as of September 28, 2008. This facility will expire on December 28, 2009 and is extendable at each anniversary with an extension fee 0.2% of the commitment amount.

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 September 28, 2008). The borrowings must be used for working capital purposes. The interest rate for each drawdown denominated in RMB is a floating rate that

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

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 September 28, 2008, the Company had not borrowed any amounts under this credit facility.

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 income tax expenses of $9.6 million in the three months ended September 28, 2008 as compared to $4.3 million of income tax benefit in the three months ended September 30, 2007. The income tax expense recorded in the three months ended September 28, 2008 was primarily related to tax provision in profitable foreign locations, of which $9.9 million was associated with profits in Japan. The income tax expense of $9.9 million associated with Japan is due to a $3.1 million reduction in income tax payable and a $13.0 million reduction in deferred tax assets. The income tax benefit recorded in the three months ended September 30, 2007 was primarily due to a decrease in the valuation allowance associated with deferred tax assets of the Company s Japanese subsidiary, 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 income tax expenses of $7.2 million in the nine months ended September 28, 2008 as compared to $18.2 million of income tax benefit in the nine months ended September 30, 2007. The income tax expense recorded in the nine months ended September 28, 2008 was primarily related to a tax provision of $4.5 million associated with profits in Japan, and by tax provisions in other profitable foreign locations of $2.7 million. The income tax benefit recorded in the nine months ended September 30, 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 September 28, 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 September 28, 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 nine months ended September 28, 2008 and September 30, 2007:

	Three Months Ended		Nine Months Ended	
	Sep. 28, 2008	Sep. 30, 2007	Sep. 28, 2008	Sep. 30, 2007
	(in thousands)			
Service cost	$ 1,592	$ 909	$ 4,863	$ 3,547
Interest cost	444	273	1,357	1,064
Expected return on plan assets	(983)	(596)	(3,001)	(2,325)
Amortization of prior service cost	156	102	472	2,307
Total net periodic pension expense	$ 1,209	$ 688	$ 3,691	$ 4,593

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 nine months ended September 30, 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 September 28, 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	$ 89	$	$	$ 89
Auction rate securities			107	$ 107
Total cash equivalents and marketable securities	$ 89	$	$ 107	$ 196

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 nine months ended September 28, 2008:

	Three Months Ended Sep. 28, 2008 (in millions)	
Beginning balance as of June 30, 2008	$	109
Other than temporary impairment		(2)
Ending fair value as of September 28, 2008	$	107

	Nine Months Ended Sep. 28, 2008 (in millions)	
Beginning balance as of December 31, 2007	$	
Transfer in		122
Other than temporary impairment		(15)
Ending fair value as of September 28, 2008	$	107

Marketable Securities

The Company s marketable securities at September 28, 2008 consist of $107.4 million of auction rate securities (ARS) valued at fair value which are backed by student loans and substantially all of which 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 September 28, 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 analysis to determine the fair values as of September 28, 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 (3.76% as of September 28, 2008) adjusted by 125 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 125 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 3.48% per annum. The projected interest income is based on a trailing 12-month average 91-day T-bill rate at 2.28% as of September 28, 2008 plus 120 bps, which is the average annual yield of the Company s ARS assuming auctions continue to fail.

The Company s analysis indicated the fair value of its ARS investments was approximately $107.4 million, as compared to a face value of approximately $121.9 million as of September 28, 2008. The impairment in value, or $14.5 million, was considered to be other than temporary, and accordingly, was recorded as an impairment charge in the condensed consolidated statement of operations during the three months ended September 28, 2008.

In making the determination that the impairment was other than temporary, the Company considered (i) the current market liquidity for ARS, particularly student loan backed ARS, (ii) the long-term maturities of the loan portfolios underlying each ARS owned by the Company which typically range from 24 to 39 years, and (iii) the intent of the Company to hold its ARS investments until sufficient liquidity returns to the auction rate market to enable the sale of these securities or until the investments mature.

The Company continues to monitor the market for auction rate securities as well as the individual ARS investments it owns. The Company may be required to record additional losses in future periods if the fair value of its ARS deteriorates further.

The Company has classified its investments in ARS as current assets as it 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 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.

Table of Contents

Spansion Inc.

Notes to Condensed Consolidated Financial Statements-Continued

(Unaudited)

In October 2008, the Company received an offer to participate in an auction rate securities settlement from UBS, its broker, providing the Company the right, but not the obligation, to sell to UBS up to 100 percent of its auction rate securities at par, which was approximately $121.9 million as of September 28, 2008, commencing June 30, 2010. In addition, accepting this offer will allow the Company, pursuant to a no net cost revolving credit facility, to borrow up to 75 percent of the market value, as determined by the broker, of these securities. The credit facility will remain outstanding until the ARS are purchased by UBS commencing June 30, 2010, or sooner, to the extent UBS exercises its rights to call some or all of the ARS. However, certain provisions in the Company s debt instruments may not allow the Company to make use of this borrowing provision. The Company is currently evaluating the offer.

The Company s right to sell the ARS to UBS commencing June 30, 2010 represents a put option (i.e. right to sell) for a payment equal to the par value of the ARS. As the put option is non-transferable and cannot be attached to the ARS if they are sold to another entity other than UBS, it represents a freestanding instrument between the Company and UBS and which is separate from the ARS, which represents an investment security between the Company and the ARS Issuer. Therefore, in the accounting period in which the Company signs the auction rate securities settlement agreement with UBS, the Company will account for the put option as an asset, measured at its fair value, with the resultant gain recognized in earnings.

13. Restructuring Charges

In the second quarter of fiscal 2008, as part of its 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.

Restructuring charges for the three and nine months ended September 28, 2008 were as follows:

&nb