

Spansion Inc.  
Form 10-Q  
November 07, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-Q**

(Mark One)

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

For the quarterly period ended 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)

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<p><b>Delaware</b> (State or other jurisdiction of incorporation or organization)</p> <p><b>915 DeGuigne Drive</b></p> <p><b>Sunnyvale, California</b> (Address of principal executive offices)</p>	<p><b>20-3898239</b> (I.R.S. Employer Identification No.)</p> <p><b>94088</b> (Zip Code)</p> <p><b>Registrant's telephone number, including area code: (408) 962-2500</b></p>
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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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       Accelerated filer       Non-accelerated filer       Smaller reporting company   
(Do not check if smaller reporting company)

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

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

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

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>Sep. 28</b>	<b>Sep. 30</b>	<b>Sep. 28</b>	<b>Sep. 30</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
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
<b>Total net sales</b>	<b>630,860</b>	<b>611,069</b>	<b>1,813,852</b>	<b>1,848,012</b>
Expenses:				
Cost of sales <i>(Note 7)</i>	544,273	499,758	1,523,654	1,538,761
Research and development <i>(Note 7)</i>	106,845	111,248	335,469	324,139
Sales, general and administrative <i>(Note 7)</i>	64,094	59,192	197,122	179,379
In-process research and development <i>(Note 3)</i>			10,800	
Restructuring charges <i>(Note 13)</i>	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
<b>Net loss</b>	<b>\$ (133,251)</b>	<b>\$ (71,602)</b>	<b>\$ (352,365)</b>	<b>\$ (213,982)</b>
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



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

(in thousands)

	Sep. 28 2008 (Unaudited)	Dec. 30 2007 (*)
<b>Assets</b>		
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
<b>Liabilities and Stockholders Equity</b>		
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		

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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)**

	<b>Nine Months Ended</b>	
	<b>Sep. 28</b>	<b>Sep. 30</b>
	<b>2008</b>	<b>2007</b>
<b>Cash Flows from Operating Activities:</b>		
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
<b>Net cash provided by operating activities</b>	<b>169,055</b>	<b>201,895</b>
<b>Cash Flows from Investing Activities:</b>		
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	
<b>Net cash used in investing activities</b>	<b>(297,011)</b>	<b>(918,316)</b>
<b>Cash Flows from Financing Activities:</b>		
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



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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
<b>Non-cash investing and financing activities:</b>		
Equipment capital leases	\$ 50,474	\$
Issuance of common stock and stock options to acquire Saifun	108,898	

**See accompanying notes**

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**Spansion Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Description of Business**

Spansion Inc. (the Company) is a semiconductor manufacturer headquartered in Sunnyvale, California, with research and development, manufacturing and assembly operations in the United States, 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.

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**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.

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**Spansion Inc.**

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

**(Unaudited)**

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

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

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

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**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:

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

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

In accordance with EITF Issue No. 04-1, *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:

	<b>In millions</b>
Net tangible assets acquired	\$ 24.2
Existing technology	42.8
In process research and development	10.8
Non-competition agreement	1.3
Customer relationships	18.0
Trade name	1.4
Goodwill	18.5
<b>Total purchase price</b>	<b>\$ 117.0</b>

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.



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

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

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

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

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

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

The 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	
<b>TOTAL</b>	<b>\$ 82.0</b>	<b>\$ (5.7)</b>	<b>\$ 76.3</b>	

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
<b>Total</b>	<b>\$ 2.7</b>	<b>\$ 5.7</b>

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Estimated future amortization expense related to acquisition related intangible assets as of September 28, 2008 is as follows:

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

**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.

	<b>Nine Months Ended</b>	
	<b>Sep. 28, 2008</b>	<b>Sep. 30, 2007</b>
	<b>(in thousands, except per share amounts)</b>	
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.



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For options granted under the Saifun Option Plans, the exercise period may not exceed 10 years from the date of grant. Options are granted with an exercise price equal to the market price of the stock at the date of grant or at a lower price as may be determined by the compensation committee of the board of directors at the date of grant. Prior to the Acquisition, option awards vested over a period of up to five years; restricted stock unit and option awards granted after the Acquisition will vest over a period of up to four years. Awards granted under any of the Saifun Option Plans from the inception of the Saifun 2003 Plan through the Acquisition that are forfeited or cancelled revert to the Saifun 2003 Plan reserve. Future awards granted under the Saifun 2003 Plan that are forfeited or cancelled will also revert to that plan's reserve.

**Shares Available to Grant**

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

Number of shares available for grant:	
Shares reserved for grant <sup>(1)</sup>	12,126,424
Shares available under the 2005 Plan <sup>(2)</sup>	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

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

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

**Valuation and Expense Information**

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

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Stock-based compensation expense before income taxes	5,554	4,742	15,493	12,084
Income tax benefit <sup>(1)</sup>				
Stock-based compensation expense after income taxes <sup>(1)</sup>	\$ 5,554	\$ 4,742	\$ 15,493	\$ 12,084

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

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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:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>Sep. 28,</b>	<b>Sep. 30,</b>	<b>Sep. 28,</b>	<b>Sep. 30,</b>
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
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.

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

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

	Number of Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
<b>Options:</b>				
Outstanding as of December 31, 2006	2,134,906	\$ 12.63	6.08	\$ 4,761
Granted	1,770,062	\$ 10.39		
Cancelled	(363,000)	\$ 12.45		
Exercised	(5,000)	\$ 12.00		
Outstanding as of December 30, 2007	3,536,968	\$ 11.53	5.66	\$
Granted <sup>(1)</sup>	6,806,119	\$ 1.48		
Cancelled	(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

<sup>(1)</sup> 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
<b>Restricted Stock Units:</b>		
Unvested as of December 31, 2006	2,923,615	\$ 12.33
Granted	1,680,532	\$ 10.35
Cancelled	(303,430)	\$ 11.95
Vested	(1,147,291)	\$ 12.27

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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.



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**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:

<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
<b>Sep. 28, 2008</b>	<b>Sep. 30, 2007</b>	<b>Sep. 28, 2008</b>	<b>Sep. 30, 2007</b>