

SUNPOWER CORP
Form 10-Q
August 08, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 29, 2008

OR

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

For the transition period from _____ to _____

Commission file number 000-51593

SunPower Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

94-3008969
(I.R.S. Employer
Identification No.)

3939 North First Street, San Jose, California 95134
(Address of Principal Executive Offices and Zip Code)

(408) 240-5500
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 "smaller reporting

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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 a smaller reporting company)

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

The total number of outstanding shares of the registrant’s class A common stock as of August 1, 2008 was 40,542,667.
The total number of outstanding shares of the registrant’s class B common stock as of August 1, 2008 was 44,533,287.

SunPower Corporation

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

SunPower Corporation

Condensed Consolidated Balance Sheets
(In thousands, except share data)
(unaudited)

| | June 29, 2008 | December 30, 2007 |
|----------------------------------------------------|---------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 189,542 | \$ 285,214 |
| Restricted cash, current portion | 38,322 | — |
| Short-term investments | 37,233 | 105,453 |
| Accounts receivable, net | 249,459 | 138,250 |
| Costs and estimated earnings in excess of billings | 50,784 | 39,136 |
| Inventories | 200,268 | 140,504 |
| Deferred project costs | 23,067 | 8,316 |
| Advances to suppliers, current portion | 62,078 | 52,277 |
| Prepaid expenses and other current assets | 61,044 | 33,110 |
| Total current assets | 911,797 | 802,260 |
| Restricted cash, net of current portion | 45,516 | 67,887 |
| Long-term investments | 25,086 | 29,050 |
| Property, plant and equipment, net | 451,969 | 377,994 |
| Goodwill | 195,930 | 184,684 |
| Intangible assets, net | 45,623 | 50,946 |
| Advances to suppliers, net of current portion | 96,400 | 108,943 |
| Other long-term assets | 55,642 | 31,974 |
| Total assets | \$ 1,827,963 | \$ 1,653,738 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 187,847 | \$ 119,869 |
| Accounts payable to Cypress | 5,409 | 4,854 |
| Accrued liabilities | 101,989 | 79,434 |
| Billings in excess of costs and estimated earnings | 33,074 | 69,900 |
| Customer advances, current portion | 15,340 | 9,250 |
| Convertible debt | 200,000 | 425,000 |
| Total current liabilities | 543,659 | 708,307 |
| Convertible debt | 225,000 | — |
| Deferred tax liability | 9,285 | 6,213 |
| Customer advances, net of current portion | 59,665 | 60,153 |
| Other long-term liabilities | 22,176 | 14,975 |
| Total liabilities | 859,785 | 789,648 |
| Commitments and Contingencies (Note 8) | | |
| Stockholders' Equity: | | |

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| | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------|--------------|
| Preferred stock, \$0.001 par value, 10,042,490 shares authorized; none issued and outstanding | | |
| Common stock, \$0.001 par value, 375,000,000 shares authorized: 85,533,004 and 84,803,006 shares issued; 85,365,521 and 84,710,244 shares outstanding, at June 29, 2008 and December 30, 2007, respectively | 85 | 85 |
| Additional paid-in capital | 935,028 | 883,033 |
| Accumulated other comprehensive income | 20,684 | 5,762 |
| Accumulated earnings (deficit) | 18,550 | (22,815) |
| | 974,347 | 866,065 |
| Less: shares of common stock held in treasury, at cost; 167,483 and 112,762 shares at June 29, 2008 and December 30, 2007, respectively | (6,169) | (1,975) |
| Total stockholders' equity | 968,178 | 864,090 |
| Total liabilities and stockholders' equity | \$ 1,827,963 | \$ 1,653,738 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SunPower Corporation

Condensed Consolidated Statements of Operations
(In thousands, except per share data)
(unaudited)

| | Three Months Ended | | Six Months Ended | |
|-----------------------------------------------|--------------------|-----------------|------------------|-----------------|
| | June 29, 2008 | July 1, 2007 | June 29, 2008 | July 1, 2007 |
| Revenue: | | | | |
| Systems | \$ 270,593 | \$ 104,037 | \$ 449,444 | \$ 182,532 |
| Components | 112,158 | 69,729 | 207,008 | 133,581 |
| Total revenue | 382,751 | 173,766 | 656,452 | 316,113 |
| Costs and expenses: | | | | |
| Cost of systems revenue | 209,137 | 91,518 | 352,350 | 153,984 |
| Cost of components revenue | 80,584 | 52,456 | 157,752 | 99,912 |
| Research and development | 4,813 | 2,821 | 9,455 | 5,757 |
| Sales, general and administrative | 43,208 | 26,109 | 77,066 | 48,480 |
| Purchased in-process research and development | — | — | — | 9,575 |
| Impairment of acquisition-related intangibles | — | 14,068 | — | 14,068 |
| Total costs and expenses | 337,742 | 186,972 | 596,623 | 331,776 |
| Operating income (loss) | 45,009 | (13,206) | 59,829 | (15,663) |
| Other income (expense): | | | | |
| Interest income | 2,289 | 2,196 | 6,436 | 4,180 |
| Interest expense | (1,411) | (1,085) | (2,875) | (2,204) |
| Other, net | (2,240) | (517) | (1,953) | (243) |
| Other income (expense), net | (1,362) | 594 | 1,608 | 1,733 |
| Income (loss) before income taxes | 43,647 | (12,612) | 61,437 | (13,930) |
| Income tax provision (benefit) | 15,039 | (7,267) | 20,072 | (9,825) |
| Net income (loss) | \$ 28,608 | \$ (5,345) | \$ 41,365 | \$ (4,105) |
| Net income (loss) per share: | | | | |
| Basic | \$ 0.36 | \$ (0.07) | \$ 0.52 | \$ (0.06) |
| Diluted | \$ 0.34 | \$ (0.07) | \$ 0.49 | \$ (0.06) |
| Weighted-average shares: | | | | |
| Basic | 79,412 | 75,123 | 79,188 | 74,428 |
| Diluted | 84,036 | 75,123 | 83,848 | 74,428 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SunPower Corporation

Condensed Consolidated Statements of Cash Flows
(In thousands)
(unaudited)

| | Six Months Ended | |
|---------------------------------------------------------------------------------------------|------------------|---------------------------|
| | June 29, 2008 | July 1, 2007 Note 1 |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 41,365 | \$ (4,105) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Depreciation | 21,971 | 11,486 |
| Impairment of long-lived assets | 5,489 | — |
| Amortization of intangible assets | 8,351 | 14,551 |
| Impairment of acquisition-related intangibles | — | 14,068 |
| Amortization of debt issuance costs | 972 | 479 |
| Stock-based compensation | 33,115 | 23,833 |
| Purchased in-process research and development | — | 9,575 |
| Share in net income of joint venture | (1,874) | — |
| Excess tax benefits from stock-based award activity | (14,639) | — |
| Deferred income taxes and other tax liabilities | 20,734 | (10,568) |
| Changes in operating assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable | (103,132) | (215) |
| Costs and estimated earnings in excess of billings | (10,144) | (14,323) |
| Inventories | (53,048) | (49,438) |
| Prepaid expenses and other assets | (25,032) | (3,893) |
| Deferred project costs | (14,751) | 990 |
| Advances to suppliers | 3,641 | (15,586) |
| Accounts payable and other accrued liabilities | 81,811 | 17,910 |
| Accounts payable to Cypress | 555 | 2,993 |
| Billings in excess of costs and estimated earnings | (38,886) | 11,503 |
| Customer advances | 4,130 | (10,163) |
| Net cash used in operating activities | (39,372) | (903) |
| Cash flows from investing activities: | | |
| Decrease (increase) in restricted cash | (15,951) | 4,711 |
| Purchases of property, plant and equipment | (95,078) | (107,585) |
| Purchases of available-for-sale securities | (50,970) | (25,555) |
| Proceeds from sales or maturities of available-for-sale securities | 121,921 | 16,496 |
| Cash paid for acquisition, net of cash acquired | (13,484) | (98,645) |
| Cash paid for investments in joint ventures and other private companies | (22,625) | — |
| Net cash used in investing activities | (76,187) | (210,578) |
| Cash flows from financing activities: | | |
| Proceeds from exercises of stock options | 2,335 | 4,969 |
| Excess tax benefits from stock-based award activity | 14,639 | — |
| Purchases of stock for tax withholding obligations on vested restricted stock | (4,194) | — |
| Proceeds from issuance of convertible debt | — | 200,000 |

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| | | |
|----------------------------------------------------------------------------------------------------------|------------|------------|
| Convertible debt issuance costs | — | (6,030) |
| Principal payments on line of credit and notes payable | — | (3,563) |
| Net cash provided by financing activities | 12,780 | 195,376 |
| Effect of exchange rate changes on cash and cash equivalents | 7,107 | 861 |
| Net decrease in cash and cash equivalents | (95,672) | (15,244) |
| Cash and cash equivalents at beginning of period | 285,214 | 165,596 |
| Cash and cash equivalents at end of period | \$ 189,542 | \$ 150,352 |
| Non-cash transactions: | | |
| Additions to property, plant and equipment acquired under accounts payable and other accrued liabilities | \$ 3,838 | \$ 3,741 |
| Change in goodwill relating to adjustments to acquired net assets | 231 | 1,689 |
| Issuance of common stock for purchase acquisition | — | 111,266 |
| Stock options assumed in relation to acquisition | — | 21,280 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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SunPower Corporation

Notes to Condensed Consolidated Financial Statements
(unaudited)

Note 1. THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

SunPower Corporation (together with its subsidiaries, the “Company” or “SunPower”), a majority-owned subsidiary of Cypress Semiconductor Corporation (“Cypress”), was originally incorporated in the State of California on April 24, 1985. In October 1988, the Company organized as a business venture to commercialize high-efficiency solar cell technologies. The Company designs, manufactures and markets high-performance solar electric power technologies. The Company’s solar cells and solar panels are manufactured using proprietary processes and technologies based on more than 15 years of research and development. The Company’s solar power products are sold through its components and systems business segments.

On November 10, 2005, the Company reincorporated in Delaware and filed an amendment to its certificate of incorporation to effect a 1-for-2 reverse stock split of the Company’s outstanding and authorized shares of common stock. All share and per share figures presented herein have been adjusted to reflect the reverse stock split.

In November 2005, the Company raised net proceeds of \$145.6 million in an initial public offering (the “IPO”) of 8.8 million shares of class A common stock at a price of \$18.00 per share. In June 2006, the Company completed a follow-on public offering of 7.0 million shares of its class A common stock, at a per share price of \$29.50, and received net proceeds of \$197.4 million. In July 2007, the Company completed a follow-on public offering of 2.7 million shares of its class A common stock, at a discounted per share price of \$64.50, and received net proceeds of \$167.4 million.

In February 2007, the Company issued \$200.0 million in principal amount of its 1.25% senior convertible debentures to Lehman Brothers Inc. (“Lehman Brothers”) and lent 2.9 million shares of its class A common stock to an affiliate of Lehman Brothers. Net proceeds from the issuance of senior convertible debentures in February 2007 were \$194.0 million. The Company did not receive any proceeds from the 2.9 million lent shares of its class A common stock, but received a nominal lending fee (see Note 10). In July 2007, the Company issued \$225.0 million in principal amount of its 0.75% senior convertible debentures to Credit Suisse Securities (USA) LLC (“Credit Suisse”) and lent 1.8 million shares of its class A common stock to an affiliate of Credit Suisse. Net proceeds from the issuance of senior convertible debentures in July 2007 were \$220.1 million. The Company did not receive any proceeds from the 1.8 million lent shares of class A common stock, but received a nominal lending fee (see Note 10).

In January 2007, the Company completed the acquisition of PowerLight Corporation (“PowerLight”), a privately-held company which developed, engineered, manufactured and delivered large-scale solar power systems for residential, commercial, government and utility customers worldwide. These activities are now performed by the Company’s systems business segment. As a result of the acquisition, PowerLight became an indirect wholly-owned subsidiary of the Company. In June 2007, the Company changed PowerLight’s name to SunPower Corporation, Systems (“SP Systems”), to capitalize on SunPower’s name recognition.

Cypress made a significant investment in the Company in 2002. On November 9, 2004, Cypress completed a reverse triangular merger with the Company in which all of the outstanding minority equity interest of SunPower was retired, effectively giving Cypress 100% ownership of all of the Company’s then outstanding shares of capital stock but

leaving its unexercised warrants and options outstanding. After completion of the Company's IPO in November 2005, Cypress held, in the aggregate, approximately 52.0 million shares of class B common stock. On May 4, 2007, Cypress completed the sale of 7.5 million shares of the Company's class B common stock in an offering pursuant to Rule 144 of the Securities Act. Such shares converted to 7.5 million shares of class A common stock upon the sale. As of June 29, 2008, Cypress owned approximately 44.5 million shares of the Company's class B common stock, which represented approximately 55% of the total outstanding shares of the Company's common stock, or approximately 52% of such shares on a fully diluted basis after taking into account outstanding stock options (or 49% of such shares on a fully diluted basis after taking into account outstanding stock options and shares loaned to underwriters of the Company's convertible indebtedness), and 90% of the voting power of the Company's total outstanding common stock.

The condensed consolidated financial statements include purchases of goods and services from Cypress, including wafers, employee benefits and other Cypress corporate services and infrastructure costs. The expenses allocations have been determined based on a method that Cypress and the Company consider to be a reasonable reflection of the utilization of services provided or the benefit received by the Company. See Note 2 for additional information on the transactions with Cypress.

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The Company is subject to a number of risks and uncertainties including, but not limited to, an industry-wide shortage of polysilicon, potential downward pressure on product pricing as new polysilicon manufacturers begin operating and the worldwide supply of solar cells and panels increases, the possible reduction or elimination of government and economic incentives that encourage industry growth, the challenges of achieving our goal to reduce costs of installed solar systems by 50% by 2012 to maintain competitiveness, the continued availability of third-party financing for the Company's customers, difficulties in maintaining or increasing the Company's growth rate and managing such growth, and accurately predicting warranty claims.

Summary of Significant Accounting Policies

Fiscal Years

The Company reports on a fiscal-year basis and ends its quarters on the Sunday closest to the end of the applicable calendar quarter, except in a 53-week fiscal year, in which case the additional week falls into the fourth quarter of that fiscal year. Both fiscal 2008 and 2007 consist of 52 weeks. The second quarter of fiscal 2008 ended on June 29, 2008 and the second quarter of fiscal 2007 ended on July 1, 2007.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. The year-end Condensed Consolidated Balance Sheets data was derived from audited financial statements. Accordingly, these financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 30, 2007.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates in these financial statements include the "percentage-of-completion" revenue recognition method for construction projects, allowances for doubtful accounts receivable and sales returns, inventory write-downs, estimates for future cash flows and economic useful lives of property, plant and equipment, asset impairments, valuation of auction rate securities, certain accrued liabilities including accrued warranty reserves and income taxes and tax valuation allowances. Actual results could differ from those estimates.

In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, which the Company believes are necessary for a fair statement of the Company's financial position as of June 29, 2008 and its results of operations for the three and six months ended June 29, 2008 and July 1, 2007 and its cash flows for the six months ended June 29, 2008 and July 1, 2007. These condensed consolidated financial statements are not necessarily indicative of the results to be expected for the entire year.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles in the United States ("U.S. GAAP"), and expands disclosures about fair value instruments. This statement does not require any new fair value measurements; rather, it applies other accounting pronouncements that require or permit fair value

measurements. The provisions of this statement are to be applied prospectively at the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative effect adjustment to the opening balance of retained earnings. The provisions of SFAS No. 157 were effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB released FASB Staff Position FAS 157-b—Effective Date of FASB Statement No. 157, delaying the effective date of SFAS No. 157 for one year for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The Company does not presently hold any financial assets or financial liabilities that would require recognition under SFAS No. 157 other than available-for-sale investments and foreign currency derivatives. With the exception of investments and foreign currency derivatives held, this deferral makes SFAS No. 157 effective for the Company beginning in the first quarter of fiscal 2009. The adoption of the relevant provisions under SFAS No. 157 in the first quarter of fiscal 2008 did not have a material impact on the Company's financial position or results of operations (see Note 5). The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 157 on measurement of fair value of its nonfinancial assets, including goodwill, and nonfinancial liabilities.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159"), which provides companies an option to report selected financial assets and liabilities at fair value. SFAS No. 159 requires companies to provide information helping financial statement users to understand the effect of a company's choice to use fair value on its earnings, as well as to display the fair value of the assets and liabilities a company has chosen to use fair value

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for on the face of the balance sheet. Additionally, SFAS No. 159 establishes presentation and disclosure requirements designed to simplify comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The statement was effective for fiscal years beginning after November 15, 2007 and was adopted by the Company in the first quarter of fiscal 2008. The Company did not elect the fair value option for any of its financial assets or liabilities, and therefore, the adoption of SFAS No. 159 had no impact on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"), which replaces SFAS No. 141, "Business Combinations" ("SFAS No. 141"). SFAS No. 141(R) will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in-process research and development and restructuring costs. In addition, under SFAS No. 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008 and will be adopted by the Company for any purchase business combinations consummated subsequent to December 28, 2008.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements — an amendment of Accounting Research Bulletin No. 51" ("SFAS No. 160"), which will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 160 on its financial position and results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities — an amendment of SFAS No. 133" ("SFAS No. 161"), which expands the disclosure requirements for derivative instruments and hedging activities. SFAS No. 161 specifically requires entities to provide enhanced disclosures addressing the following: (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations; and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 161 on its financial position, results of operations and disclosures.

In April 2008, the FASB issued FASB Staff Position ("FSP") FAS 142-3, "Determination of Useful Life of Intangible Assets" ("FSP FAS 142-3"), which amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142, "Goodwill and Other Intangible Assets." FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of FSP FAS 142-3 on its financial position and results of operations.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"), which identifies the sources of accounting principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP. This Statement is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles." The Company currently adheres to the hierarchy of U.S. GAAP as presented in SFAS No. 162, and does not expect its adoption will have a material impact on its financial position, results of operations and disclosures.

In May 2008, the FASB issued FSP APB 14-1, which clarifies the accounting for convertible debt instruments that may be settled in cash upon conversion. FSP APB 14-1 significantly impacts the accounting for instruments commonly referred to as Instruments B, Instruments C and Instruments X from Emerging Issue Task Force (“EITF”) Issue No. 90-19, “Convertible Bonds with Issuer Option to Settle for Cash upon Conversion,” and any other convertible debt instruments that allow settlement in any combination of cash and shares at the issuer’s option. The new guidance requires the issuer to separately account for the liability and equity components of the instrument in a manner that reflects interest expense equal to the issuer’s non-convertible debt borrowing rate. FSP APB 14-1 is effective for fiscal years and interim periods beginning after December 15, 2008, and retrospective application will be required for all periods presented. The new guidance may have a significant impact on the Company’s outstanding convertible debt balance of \$425.0 million, potentially resulting in significantly higher non-cash interest expense on our convertible debt (see Note 10). The Company is currently evaluating the potential impact of the new guidance on its results of operations and financial condition.

Revision of Statement of Cash Flow Presentation Related to Purchases of Property, Plant and Equipment

The Company has corrected its Condensed Consolidated Statements of Cash Flows for the six months ended July 1, 2007 to exclude the impact of purchases of property, plant and equipment that remain unpaid and as such are included in “accounts payable and other accrued liabilities” at the end of the reporting period. Historically, changes in “accounts payable and other

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accrued liabilities” related to such purchases were included in cash flows from operations, while the investing activity caption "Purchase of property, plant and equipment" included these purchases. As these unpaid purchases do not reflect cash transactions, the Company has revised its cash flow presentations to exclude them. The correction resulted in a decrease to the previously reported amount of cash used for operating activities of \$3.7 million in the six months ended July 1, 2007, resulting from a reduction in the amount of cash used from the change in accounts payable and other accrued liabilities in that period. The corresponding correction in the investing section was to increase cash used for investing activities by \$3.7 million in the six months ended July 1, 2007, as a result of the increase in the amount of cash used for purchases of property, plant and equipment in that period. These corrections had no impact on previously reported results of operations, working capital or stockholders' equity of the Company. The Company concluded that these corrections were not material to any of its previously issued condensed consolidated financial statements, based on SEC Staff Accounting Bulletin No. 99-Materiality.

Note 2. TRANSACTIONS WITH CYPRESS

Purchases of Imaging and Infrared Detector Products from Cypress

The Company purchased fabricated semiconductor wafers from Cypress at intercompany prices consistent with Cypress' internal transfer pricing methodology. In December 2007, Cypress announced the planned closure of its Texas wafer fabrication facility that manufactured the Company's imaging and infrared detector products. The planned closure is expected to be completed in the fourth quarter of fiscal 2008. The Company evaluated its alternatives relating to the future plans for this business and decided to wind-down its activities related to the imaging detector product line in the first quarter of fiscal 2008. Accordingly, in the three-months ended March 30, 2008, cost of revenue included a \$2.2 million impairment charge to long-lived assets primarily related to manufacturing equipment located in the Texas wafer fabrication facility. The Company did not purchase wafers from Cypress in the three months ended June 29, 2008. Wafer purchases totaled \$0.6 million for the six months ended June 29, 2008 and \$1.6 million and \$3.1 million for the three and six months ended July 1, 2007, respectively.

Administrative Services Provided by Cypress

Cypress has seconded employees and consultants to the Company for different time periods for which the Company pays their fully-burdened compensation. In addition, Cypress personnel render services to the Company to assist with administrative functions such as employee benefits and other Cypress corporate services and infrastructure. Cypress bills the Company for a portion of the Cypress employees' fully-burdened compensation. In the case of the Philippines subsidiary, which entered into a services agreement for such secondments and other consulting services in January 2005, the Company pays the fully burdened compensation plus 10%. The amounts that the Company has recorded as general and administrative expenses in the accompanying statements of operations for these services was approximately \$1.6 million and \$2.1 million for the three and six months ended June 29, 2008, respectively, and \$0.4 million and \$0.8 million for the three and six months ended July 1, 2007, respectively.

Leased Facility in the Philippines

In 2003, the Company and Cypress reached an understanding that the Company would build out and occupy a building owned by Cypress for its solar cell manufacturing facility in the Philippines. The Company entered into a lease agreement for this facility and a sublease for the land under which the Company paid Cypress at a rate equal to the cost to Cypress for that facility (including taxes, insurance, repairs and improvements). Under the lease agreement, the Company had the right to purchase the facility and assume the lease for the land from Cypress at any time at Cypress' original purchase price of approximately \$8.0 million, plus interest computed on a variable index starting on the date of purchase by Cypress until the sale to the Company, unless such purchase option was exercised after a change of control of the Company, in which case the purchase price would be at a market rate, as reasonably

determined by Cypress. Rent expense paid to Cypress for this building and land was not material for the three months ended June 29, 2008 and July 1, 2007. Rent expense paid to Cypress for this building and land was approximately \$0.1 million in each of the six months ended June 29, 2008 and July 1, 2007. In May 2008, the Company exercised its right to purchase the facility from Cypress and assumed the lease for the land from an unaffiliated third party for a total purchase price of \$9.5 million. The lease for the land expires in May 2048 and is renewable for an additional 25 years.

Leased Headquarters Facility in San Jose, California

In May 2006, the Company entered into a lease agreement for its 43,732 square foot headquarters, which is located in a building owned by Cypress in San Jose, California, for \$6.0 million over the five-year term of the lease. In December 2006 and July 2007, the Company amended the lease agreement, increasing the rentable square footage and the total lease obligations to 51,228 and \$6.9 million, respectively, over the five-year term of the lease. In the event Cypress decides to sell the building, the Company has the right of first refusal to purchase the building at a fair market price which will be based on comparable sales in the area. Rent expense paid to Cypress for this facility was approximately \$0.4 million and \$0.7 million for the three and six months ended June 29, 2008, respectively, and \$0.3 million and \$0.6 million for the three and six months ended July 1, 2007, respectively.

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2005 Separation and Service Agreements

In October 2005, the Company entered into a series of separation and services agreements with Cypress. Among these agreements are a master separation agreement, a sublease of the land and a lease for the building in the Philippines (see above); a three-year wafer manufacturing agreement for detector products at inter-company pricing; a three-year master transition services agreement under which Cypress would allow the Company to continue to utilize services provided by Cypress such as corporate accounting, legal, tax, information technology, human resources and treasury administration at Cypress' cost; an asset lease under which Cypress leased certain manufacturing assets from the Company; an employee matters agreement under which the Company's employees would be allowed to continue to participate in certain Cypress health insurance and other employee benefits plans; an indemnification and insurance matters agreement; an investor rights agreement; and a tax sharing agreement. All of these agreements, except the tax sharing agreement and the manufacturing asset lease agreement, became effective at the time of completion of the Company's IPO in November 2005. Since the Company's IPO, the Company has hired and continues to hire additional personnel to perform services previously provided by Cypress in preparation of the expiration of the three-year master transition services agreement.

Master Separation Agreement

In October 2005, the Company entered into a master separation agreement containing the framework with respect to the Company's separation from Cypress. The master separation agreement provides for the execution of various ancillary agreements that further specify the terms of the separation.

Master Transition Services Agreement

The Company has also entered into a master transition services agreement which would govern the provisions of services provided by Cypress, such as: financial services; human resources; legal matters; training programs; and information technology.

For a period of three years following the Company's November 2005 IPO or earlier if a change of control of the Company occurs, Cypress would provide these services and the Company would pay Cypress for services provided to the Company, at Cypress' cost (which, for purposes of the master transition services agreement, will mean an appropriate allocation of Cypress' full salary and benefits costs associated with such individuals as well as any out-of-pocket expenses that Cypress incurs in connection with providing the Company those services) or at the rate negotiated with Cypress. Cypress will have the ability to deny requests for services under this agreement if, among other things, the provisions of such services creates a conflict of interest, causes an adverse consequence to Cypress, requires Cypress to retain additional employees or other resources or the provision of such services become impracticable as a result or cause outside of the control of Cypress. In addition, Cypress will incur no liability in connection with the provision of these services. The master transition services agreement also contains provides indemnities by the Company for the benefit of Cypress.

Lease for Manufacturing Assets

In 2005 the Company entered into a lease with Cypress under which Cypress leased from the Company certain manufacturing assets owned by the Company and located in Cypress' Texas manufacturing facility. The term of the lease was 27 months, and it expired on December 31, 2007. Under this lease, Cypress reimbursed the Company approximately \$0.7 million representing the net book value of the assets divided by the life of the leasehold improvements.

Employee Matters Agreement

In October 2005, the Company entered into an employee matters agreement with Cypress to allocate assets, liabilities and responsibilities relating to its current and former U.S. and international employees and its participation in the employee benefits plans that Cypress currently sponsors and maintains.

The Company's eligible employees generally will remain able to participate in Cypress' benefit plans, as they may change from time to time. The Company will be responsible for all liabilities incurred with respect to the Cypress plans by the Company as a participating company in such plans. The Company intends to have its own benefit plans established by the time its employees are no longer eligible to participate in Cypress' benefit plans. Once the Company has established its own benefit plans, the Company will have the ability to modify or terminate each plan in accordance with the terms of those plans and its policies. It is the Company's intent that employees not receive duplicate benefits as a result of participation in its benefit plans and the corresponding Cypress benefit plans.

All of the Company's eligible employees will be able to continue to participate in Cypress' health plans, life insurance and other benefit plans as they may change from time to time, until the earliest of, (1) a change of control of the Company occurs, which includes such time as Cypress ceases to own at least a majority of the aggregate number of shares of all classes of our common stock then outstanding, (2) such time as the Company's status as a participating company under the Cypress plans is not permitted by a Cypress plan or by applicable law, (3) such time as Cypress determines in its reasonable judgment that its status as

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a participating company under the Cypress plans has or will adversely affect Cypress, or its employees, directors, officers, agents, affiliates or its representatives, or (4) such earlier date as the Company and Cypress mutually agree. The Company's employees are precluded from participating in Cypress' stock option plans and stock purchase plans.

In July 2008, the Company transferred all accounts in the Cypress 401(k) Plan held by the Company's employees to its recently established SunPower 401(k) Savings Plan.

Indemnification and Insurance Matters Agreement

The Company will indemnify Cypress and its affiliates, agents, successors and assigns from all liabilities arising from environmental conditions: existing on, under, about or in the vicinity of any of the Company's facilities, or arising out of operations occurring at any of the Company's facilities, including its California facilities, whether prior to or after the separation; existing on, under, about or in the vicinity of the Philippines facility which the Company occupies, or arising out of operations occurring at such facility, whether prior to or after the separation, to the extent that those liabilities were caused by the Company; arising out of hazardous materials found on, under or about any landfill, waste, storage, transfer or recycling site and resulting from hazardous materials stored, treated, recycled, disposed or otherwise handled by any of the Company's operations or the Company's California and Philippines facilities prior to the separation; and arising out of the construction activity conducted by or on behalf of us at Cypress' Texas facility.

The indemnification and insurance matters agreement and the master transition services agreement also contains provisions governing the Company's insurance coverage, which shall be under the Cypress insurance policies (other than our directors and officers insurance and insurance for our systems segment business, for which the Company intends to obtain its own separate policies) until the earliest of (1) a change of control of the Company occurs, which includes such time as Cypress ceases to own at least a majority of the aggregate number of shares of all classes of the Company's common stock then outstanding, (2) the date on which Cypress' insurance carriers do not permit the Company to remain on Cypress policies, (3) the date on which Cypress' cost of insurance under any particular insurance policy increases, directly or indirectly, due to the Company's inclusion or participation in such policy, (4) the date on which the Company's coverage under the Cypress policies causes a real or potential conflict of interest or hardship for Cypress, as determined solely by Cypress or (5) the date on which Cypress and the Company mutually agree to terminate this arrangement. Prior to that time, Cypress will maintain insurance policies on the Company's behalf, and the Company shall reimburse Cypress for expenses related to insurance coverage during this period. The Company will work with Cypress to secure additional insurance if desired and cost effective.

Investor Rights Agreement

The Company has entered into an investor rights agreement with Cypress providing for specified (1) registration and other rights relating to the Company's shares of the Company's common stock, (2) information and inspection rights, (3) coordination of auditing practices and (4) approval rights with respect to certain transactions.

Tax Sharing Agreement

The Company has entered into a tax sharing agreement with Cypress providing for each of the party's obligations concerning various tax liabilities. The tax sharing agreement is structured such that Cypress will pay all federal, state, local and foreign taxes that are calculated on a consolidated or combined basis (while being a member of Cypress' consolidated or combined group pursuant to federal, state, local and foreign tax law). The Company's portion of such tax liability or benefit will be determined based upon its separate return tax liability as defined under the tax sharing agreement. Such liability or benefit will be based on a pro forma calculation as if the Company were filing a separate income tax return in each jurisdiction, rather than on a combined or consolidated basis with Cypress subject to adjustments as set forth in the tax sharing agreement.

After the date the Company ceases to be a member of Cypress' consolidated group for federal income tax purposes and most state income tax purposes, as and to the extent that the Company becomes entitled to utilize on the Company's separate tax returns portions of those credit or loss carryforwards existing as of such date, the Company will distribute to Cypress the tax effect, estimated to be 40% for federal income tax purposes, of the amount of such tax loss carryforwards so utilized, and the amount of any credit carryforwards so utilized. The Company will distribute these amounts to Cypress in cash or in the Company's shares, at the Company's option. As of December 30, 2007, the Company has \$44.0 million of federal net operating loss carryforwards and approximately \$73.5 million of California net operating loss carryforwards meaning that such potential future payments to Cypress, which would be made over a period of several years, would therefore aggregate approximately \$19.1 million.

The majority of these net operating loss carryforwards were created by employee stock transactions. Because there is uncertainty as to the realizability of these loss carryforwards, the portion created by employee stock transactions are not reflected on the Company's Condensed Consolidated Balance Sheets.

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Upon completion of its follow-on public offering of common stock in June 2006, the Company is no longer considered to be a member of Cypress' consolidated group for federal income tax purposes. Accordingly, the Company will be subject to the obligations payable to Cypress for any federal income tax credit or loss carryforwards utilized in its federal tax returns in subsequent periods, as explained in the preceding paragraph.

The Company will continue to be jointly and severally liable for any tax liability as governed under federal, state and local law during all periods in which it is deemed to be a member of the Cypress consolidated or combined group. Accordingly, although the tax sharing agreement allocates tax liabilities between Cypress and all its consolidated subsidiaries, for any period in which the Company is included in Cypress' consolidated group, the Company could be liable in the event that any federal tax liability was incurred, but not discharged, by any other member of the group.

Subject to certain caveats, Cypress has obtained a ruling from the Internal Revenue Service ("IRS") to the effect that a distribution by Cypress of the Company's class B common stock to Cypress stockholders will qualify as a tax-free distribution under Section 355 of the Internal Revenue Code (the "Code"). Despite such ruling, the distribution may nonetheless be taxable to Cypress under Section 355(e) of the Code if 50% or more of the Company's voting power or economic value is acquired as part of a plan or series of related transactions that includes the distribution of the Company's stock. The tax sharing agreement includes the Company's obligation to indemnify Cypress for any liability incurred as a result of issuances or dispositions of the Company's stock after the distribution, other than liability attributable to certain dispositions of the Company's stock by Cypress, that cause Cypress' distribution of shares of the Company's stock to its stockholders to be taxable to Cypress under Section 355(e) of the Code.

The tax sharing agreement further provides for cooperation with respect to tax matters, the exchange of information and the retention of records which may affect the income tax liability of either party. Disputes arising between Cypress and the Company relating to matters covered by the tax sharing agreement are subject to resolution through specific dispute resolution provisions contained in the agreement.

Note 3. BUSINESS COMBINATION, GOODWILL AND INTANGIBLE ASSETS

Business Combination

On January 8, 2008, the Company completed the acquisition of Solar Solutions, a solar systems integration and product distribution company based in Faenza, Italy. Solar Solutions was a division of Combigas S.r.l., a petroleum products trading firm. Active since 2002, Solar Solutions distributes components such as solar panels and inverters, and offers turnkey solar power systems and standard system kits via a network of dealers throughout Italy. Prior to the acquisition, Solar Solutions had been a customer of the Company since fiscal 2006. As a result of the acquisition, Solar Solutions became a wholly-owned subsidiary of the Company. In connection with the acquisition, the Company changed Solar Solutions' name to SunPower Italia S.r.l. ("SunPower Italia"). The acquisition of SunPower Italia was not material to the Company's financial position or results of operations.

Goodwill

The following table presents the changes in the carrying amount of goodwill under the Company's reportable business segments:

| (In thousands) | Components Business Segment | Systems Business Segment | Total |
|-------------------------|-----------------------------------|--------------------------------|------------|
| As of December 30, 2007 | \$ 2,883 | \$ 181,801 | \$ 184,684 |
| Goodwill acquired | 10,284 | — | 10,284 |

| | | | | |
|---------------------|----|--------|------------|------------|
| Adjustments | | 962 | — | 962 |
| As of June 29, 2008 | \$ | 14,129 | \$ 181,801 | \$ 195,930 |

Changes to goodwill during the six months ended June 29, 2008 resulted from the acquisition of SunPower Italia. Approximately \$10.3 million had been allocated to goodwill within the components segment, which represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets of SunPower Italia. SunPower Italia is a Euro functional currency subsidiary, therefore, the Company records a translation adjustment for the revaluation of the subsidiary's goodwill and intangible assets into U.S. dollar. As of June 29, 2008, the cumulative translation adjustment increased the balance of goodwill by \$0.8 million. Also during the six months ended June 29, 2008, the Company recorded an adjustment to increase goodwill by \$0.2 million to adjust the value of acquired investments.

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In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," ("SFAS No. 142"), goodwill will not be amortized but instead will be tested for impairment at least annually, or more frequently if certain indicators are present. The Company conducts its annual impairment test of goodwill as of the Sunday closest to the end of the third calendar quarter of each year. Based on its last impairment test as of September 30, 2007, the Company determined there was no impairment. There were no events or circumstances from that date through June 29, 2008 indicating that an interim assessment was necessary. In the event that management determines that the value of goodwill has become impaired, the Company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made.

Intangible Assets

The following tables present details of the Company's acquired identifiable intangible assets:

| (In thousands) | Gross | Accumulated Amortization | Net |
|----------------------------------|-----------|-----------------------------|-----------|
| As of June 29, 2008 | | | |
| Patents and purchased technology | \$ 51,398 | \$ (25,976) | \$ 25,422 |
| Tradenames | 2,215 | (1,244) | 971 |
| Backlog | 11,787 | (11,787) | — |
| Customer relationships and other | 25,612 | (6,382) | 19,230 |
| | \$ 91,012 | \$ (45,389) | \$ 45,623 |
| As of December 30, 2007 | | | |
| Patents and purchased technology | \$ 51,398 | \$ (20,630) | \$ 30,768 |
| Tradenames | 1,603 | (808) | 795 |
| Backlog | 11,787 | (11,460) | 327 |
| Customer relationships and other | 23,193 | (4,137) | 19,056 |
| | \$ 87,981 | \$ (37,035) | \$ 50,946 |

In connection with the acquisition of SunPower Italia, the Company recorded \$2.7 million of intangible assets and \$0.2 million of cumulative translation adjustment for acquired intangibles in the six months ended June 29, 2008. In connection with the acquisition of SP Systems, the Company recorded \$79.5 million of intangible assets in the first quarter of fiscal 2007, of which \$15.5 million was related to the PowerLight tradename. The determination of the fair value and useful life of the tradename was based on the Company's strategy of continuing to market its systems products and services under the PowerLight brand. Based on the Company's change in branding strategy and changing PowerLight's name to SunPower Corporation, Systems, during the quarter ended July 1, 2007, the Company recognized an impairment charge of \$14.1 million, which represented the net book value of the PowerLight tradename.

All of our acquired identifiable intangible assets are subject to amortization. Aggregate amortization expense for intangible assets totaled \$4.0 million and \$8.4 million for the three and six months ended June 29, 2008, respectively, and \$7.7 million and \$14.6 million for the three and six months ended July 1, 2007, respectively. As of June 29, 2008, the estimated future amortization expense related to intangible assets is as follows (in thousands):

| | |
|-----------------------------|----------|
| 2008 (remaining six months) | \$ 8,041 |
| 2009 | 15,461 |
| 2010 | 13,948 |
| 2011 | 4,152 |
| 2012 | 3,916 |

| | |
|------------|-----------|
| Thereafter | 105 |
| | \$ 45,623 |

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Note 4. BALANCE SHEET COMPONENTS

| (In thousands) | June 29, 2008 | December 30, 2007 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|----------------------|
| Costs and estimated earnings in excess of billings on contracts in progress and billings in excess of costs and estimated earnings on contracts in progress consists of the following: | | |
| Costs and estimated earnings in excess of billings on contracts in progress | \$ 50,784 | \$ 39,136 |
| Billings in excess of costs and estimated earnings on contracts in progress | 33,074 | 69,900 |
| | \$ 17,710 | \$ (30,764) |
| Contracts in progress: | | |
| Costs incurred to date | \$ 824,289 | \$ 481,340 |
| Estimated earnings to date | 269,201 | 145,643 |
| Contract revenue earned to date | 1,093,490 | 626,983 |
| Less: Billings to date, including earned incentive rebates | (1,075,780) | (657,747) |
| | \$ 17,710 | \$ (30,764) |
| Inventories: | | |
| Raw materials(1) | \$ 98,534 | \$ 89,604 |
| Work-in-process | 3,972 | 2,027 |
| Finished goods | 97,762 | 48,873 |
| | \$ 200,268 | \$ 140,504 |
| (1) In addition to polysilicon and other raw materials for solar cell manufacturing, raw materials includes solar panels purchased from third-party vendors and installation materials for systems projects. | | |
| Prepaid expenses and other current assets: | | |
| VAT receivables, current portion | \$ 25,308 | \$ 7,266 |
| Deferred tax assets, current portion | 8,438 | 8,437 |
| Other receivables | 16,458 | 9,946 |
| Other prepaid expenses | 10,840 | 7,461 |
| | \$ 61,044 | \$ 33,110 |
| Property, plant and equipment, net: | | |
| Land and buildings | \$ 8,923 | \$ 7,482 |
| Manufacturing equipment | 237,457 | 194,963 |
| Manufacturing equipment held for sale(2) | 768 | — |
| Computer equipment | 14,676 | 12,399 |
| Furniture and fixtures | 3,920 | 2,648 |
| Leasehold improvements | 130,425 | 113,801 |
| Construction-in-process (manufacturing facility in the Philippines) | 127,178 | 99,945 |
| | 523,347 | 431,238 |
| Less: Accumulated depreciation(3) | (71,378) | (53,244) |
| | \$ 451,969 | \$ 377,994 |

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| (In thousands) | June 29, 2008 | December 30, 2007 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|----------------------|
| (2) During the three months ended March 30, 2008, certain manufacturing equipment with a net book value of \$4.1 million were replaced with new processes. The Company determined that the expected realizable value for the resale of such manufacturing equipment is \$0.8 million, therefore, the Company incurred an impairment charge of \$3.3 million in the first quarter of fiscal 2008. | | |
| (3) Total depreciation expense was \$11.9 million and \$22.0 million for the three and six months ended June 29, 2008, respectively, and \$5.9 million and \$11.5 million for the three and six months ended July 1, 2007, respectively. | | |

Other long-term assets:

| | | |
|----------------------------------------|-----------|-----------|
| VAT receivable, net of current portion | \$ 15,422 | \$ 24,269 |
| Investments in joint ventures | 14,803 | 5,304 |
| Note receivable(4) | 10,000 | — |
| Other | 15,417 | 2,401 |
| | \$ 55,642 | \$ 31,974 |

(4) In June 2008, the Company loaned \$10.0 million to a third-party private company pursuant to a three-year interest-bearing note receivable that is convertible into equity at the Company's option.

Accrued liabilities:

| | | |
|---------------------------------------------|------------|-----------|
| VAT payables | \$ 28,592 | \$ 18,138 |
| Employee compensation and employee benefits | 14,858 | 15,338 |
| Income taxes payable | 15,316 | 11,106 |
| Warranty reserves | 13,393 | 10,502 |
| Foreign exchange derivative liability | 11,261 | 8,920 |
| Other | 18,569 | 15,430 |
| | \$ 101,989 | \$ 79,434 |

Note 5. INVESTMENTS

On December 31, 2007, the Company adopted SFAS No. 157, which refines the definition of fair value, provides a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy assigns the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities ("Level 1") and the lowest priority to unobservable inputs ("Level 3"). Level 2 measurements are inputs that are observable for assets or liabilities, either directly or indirectly, other than quoted prices included within Level 1. The following table presents information about the Company's available-for-sale securities measured at fair value on a recurring basis as of June 29, 2008 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value in accordance with the provisions of SFAS No. 157:

| (In thousands) | Quoted Prices in Active Markets for Identical Instruments | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance as of June 29, 2008 |
|----------------|-----------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|--------------------------------------|
| | | | | |

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(Level 1)

| Asset | | | | | |
|-------------------------------------|----|---------|--------|--------|------------|
| Money market funds | \$ | 160,108 | \$ | — | \$ 160,108 |
| Corporate securities | | — | 33,244 | 25,086 | 58,330 |
| Commercial paper | | — | 23,989 | — | 23,989 |
| Total available-for-sale securities | \$ | 160,108 | \$ | 57,233 | \$ 242,427 |

Available-for-sale securities utilizing Level 3 inputs to determine fair value are comprised of auction rate securities which are bought and sold in the marketplace through a bidding process sometimes referred to as a “Dutch auction,” and which are classified as short-term investments or long-term investments and carried at their market values. After the initial issuance of the auction rate securities, the interest rate on the securities resets periodically, at intervals set at the time of issuance (e.g., every seven, twenty-eight, or thirty-five days; every six-months; etc.), based on the market demand at the reset period. The “stated” or

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“contractual” maturities for these securities generally are between 20 to 30 years. The Company classifies auction rate securities as available-for-sale securities under SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (“SFAS No. 115”).

At June 29, 2008, the Company had \$25.1 million invested in auction rate securities as compared to \$50.8 million invested in auction rate securities at December 30, 2007. These auction rate securities are typically over collateralized and secured by pools of student loans originated under the Federal Family Education Loan Program (“FFELP”) that are guaranteed by the U.S. Department of Education, and insured. In addition, all auction rate securities held are rated by one or more of the Nationally Recognized Statistical Rating Organizations (“NRSRO”) as triple-A. Beginning in February 2008, the auction rate securities market experienced a significant increase in the number of failed auctions, resulting from a lack of liquidity, which occurs when sell orders exceed buy orders, and does not necessarily signify a default by the issuer.

As of August 8, 2008, all of the Company’s auction rate securities invested in at June 29, 2008 had failed to clear at auctions. For failed auctions, the Company continues to earn interest on these investments at the maximum contractual rate as the issuer is obligated under contractual terms to pay penalty rates should auctions fail. Historically, failed auctions have rarely occurred, however, such failures could continue to occur in the future. In the event the Company needs to access these funds, the Company will not be able to do so until a future auction is successful, the issuer redeems the securities, a buyer is found outside of the auction process or the securities mature. Accordingly, auction rate securities at June 29, 2008 and December 30, 2007 that were not sold in a subsequent period totaling \$25.1 million and \$29.1 million, respectively, are classified as long-term investments on the Condensed Consolidated Balance Sheets, because they are not expected to be used to fund current operations and consistent with the stated contractual maturities of the securities.

The Company determined that use of a valuation model was the best available technique for measuring the fair value of its auction rate securities. The Company used an income approach valuation model to estimate the price that would be received to sell its securities in an orderly transaction between market participants ("exit price") as of June 29, 2008. The exit price was derived as the weighted average present value of expected cash flows over various periods of illiquidity, using a risk adjusted discount rate that was based on the credit risk and liquidity risk of the securities.

While the valuation model was based on both Level 2 (credit quality and interest rates) and Level 3 inputs, the Company determined that the Level 3 inputs were the most significant to the overall fair value measurement, particularly the estimates of risk adjusted discount rates and ranges of expected periods of illiquidity. The valuation model also reflected the Company's intention to hold its auction rate securities until they can be liquidated in a market that facilitates orderly transactions. The following key assumptions were used in the valuation model:

- 5 years to liquidity;
- continued receipt of contractual interest which provides a premium spread for failed auctions; and
- discount rates ranging from 3.8% to 5.9%, which incorporate a spread for both credit and liquidity risk.

Based on these assumptions, the Company estimated that the auction rate securities would be valued at approximately 96% of their stated par value, representing a decline in value of approximately \$1.0 million. The following table provides a summary of changes in fair value of the Company’s available-for-sale securities utilizing Level 3 inputs as of June 29, 2008:

| | |
|----------------|-------------------------------|
| | Auction Rate Securities |
| (In thousands) | |

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| | | |
|--------------------------------------------------------|----|----------|
| Balance at December 31, 2007 | \$ | — |
| Transfers from Level 2 to Level 3 | | 29,050 |
| Purchases of auction rate securities | | 10,000 |
| Unrealized loss included in other comprehensive income | | (1,445) |
| Balance at March 30, 2008 | | 37,605 |
| Sales of auction rate securities | | (13,000) |
| Unrealized gain included in other comprehensive income | | 481 |
| Balance at June 29, 2008 | \$ | 25,086 |

In the second quarter of fiscal 2008, the Company sold auction rate securities with a carrying value of \$12.5 million for their stated par value of \$13.0 million. The

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following table summarizes the fair value and gross unrealized losses of the Company's available-for-sale securities, aggregated by type of investment instrument and length of time that individual securities have been in a continuous unrealized loss position:

| (In thousands) | Less than 12 Months | | As of June 29, 2008 12 Months or Greater | | Total | |
|----------------------|---------------------|-------------------|---------------------------------------------|-------------------|------------|-------------------|
| | Gross | | Gross | | Gross | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate securities | \$ 48,283 | \$ (1,054) | \$ — | \$ — | \$ 48,283 | \$ (1,054) |

| (In thousands) | Less than 12 Months | | As of December 30, 2007 12 Months or Greater | | Total | |
|----------------------|---------------------|-------------------|-------------------------------------------------|-------------------|------------|-------------------|
| | Gross | | Gross | | Gross | |
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate securities | \$ 25,536 | \$ (50) | \$ — | \$ — | \$ 25,536 | \$ (50) |
| Commercial paper | 24,002 | (2) | — | — | 24,002 | (2) |
| | \$ 49,538 | \$ (52) | \$ — | \$ — | \$ 49,538 | \$ (52) |

Of the \$1.1 million gross unrealized losses of the Company's corporate securities, \$1.0 million resulted from the decline in the estimated fair value of auction rate securities primarily due to their lack of liquidity. The decline in fair value for the remaining available-for-sale securities was primarily related to changes in interest rates. The Company has concluded that no other-than-temporary impairment losses occurred in the six months ended June 29, 2008 because the lack of liquidity in the market for auction rate securities and changes in interest rates are considered temporary in nature for which the Company has recorded an unrealized loss within comprehensive income (loss), a component of stockholders' equity. The Company has the ability and intent to hold these securities until a recovery of fair value. In addition, the Company evaluated the near-term prospects of the available-for-sale securities in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time, the Company did not consider these investments to be other-than-temporarily impaired. If it is determined that the fair value of these securities is other-than-temporarily impaired, the Company would record a loss in its Condensed Consolidated Statements of Operations in the future, which could be material.

The classification and contractual maturities of available-for-sale securities is as follows:

| (In thousands) | June 29, 2008 | December 30, 2007 |
|-------------------------------|------------------|----------------------|
| Included in: | | |
| Cash equivalents | \$ 96,270 | \$ 249,582 |
| Short-term restricted cash(1) | 38,322 | — |
| Short-term investments | 37,233 | 105,453 |
| Long-term restricted cash(1) | 45,516 | 67,887 |
| Long-term investments | 25,086 | 29,050 |
| | \$ 242,427 | \$ 451,972 |
| Contractual maturities: | | |
| Due in less than one year | \$ 171,826 | \$ 396,228 |
| Due from one to two years (2) | 2,382 | 4,994 |
| Due from two to 30 years | 68,219 | 50,750 |

\$ 242,427 \$ 451,972

- (1) The Company provided security in the form of cash collateralized bank standby letters of credit for advance payments received from customers.
- (2) The Company classifies all available-for-sale securities that are intended to be available for use in current operations as short-term investments.

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Note 6. ADVANCES TO SUPPLIERS

The Company has entered into agreements with various polysilicon, ingot, wafer, solar cells and solar module vendors and manufacturers. These agreements specify future quantities and pricing of products to be supplied by the vendors for periods up to 12 years. Certain agreements also provide for penalties or forfeiture of advanced deposits in the event the Company terminates the arrangements (see Note 8). Under certain of these agreements, the Company is required to make prepayments to the vendors over the terms of the arrangements. As of June 29, 2008, advances to suppliers totaled \$158.5 million, the current portion of which is \$62.1 million.

The Company's future prepayment obligations related to these agreements as of June 29, 2008 are as follows (in thousands):

| | |
|-----------------------------|------------|
| 2008 (remaining six months) | \$ 56,040 |
| 2009 | 78,006 |
| 2010 | 59,642 |
| 2011 | 19,792 |
| | \$ 213,480 |

On June 30, 2008, the Company paid an advance of \$5.6 million in accordance with the terms of an existing supply agreement.

Note 7. STOCK-BASED COMPENSATION

During the preparation of its condensed consolidated financial statements for the six months ended June 29, 2008, the Company identified errors in its financial statements related to the year ended December 30, 2007, which resulted in \$1.3 million overstatement of stock-based compensation expense. The Company corrected these errors in its condensed consolidated financial statements for the six months ended June 29, 2008, which resulted in a \$1.3 million credit to income before income taxes and net income. The out-of-period effect is not expected to be material to estimated full-year 2008 results, and, accordingly has been recognized in accordance with APB 28, Interim Financial Reporting, paragraph 29 as the error is not material to any financial statements of prior periods.

The following table summarizes the consolidated stock-based compensation expense, by type of awards:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|-------------------------------------------------------------|--------------------|-----------------|------------------|-----------------|
| | June 29, 2008 | July 1, 2007 | June 29, 2008 | July 1, 2007 |
| Employee stock options | \$ 1,014 | \$ 4,847 | \$ 2,201 | \$ 9,593 |
| Restricted stock | 10,229 | 3,266 | 18,130 | 4,520 |
| Shares and options released from re-vesting restrictions | 7,627 | 5,306 | 13,633 | 10,028 |
| Change in stock-based compensation capitalized in inventory | (263) | (189) | (849) | (308) |
| Total stock-based compensation expense | \$ 18,607 | \$ 13,230 | \$ 33,115 | \$ 23,833 |

In connection with the acquisition of SP Systems on January 10, 2007, 1.1 million shares of the Company's class A common stock and 0.5 million stock options issued to employees of SP Systems, which were valued at \$60.4 million, are subject to certain transfer restrictions and a repurchase option held by the Company. The Company is recognizing expense as the re-vesting restrictions of these shares lapse over the two-year period beginning on the date of acquisition. The value of shares released from such re-vesting restrictions are included in stock-based compensation expense in the table above.

The following table summarizes the consolidated stock-based compensation expense by line items in the Condensed Consolidated Statements of Operations:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|------------------------------------------------------------|--------------------|-----------------|------------------|-----------------|
| | June 29, 2008 | July 1, 2007 | June 29, 2008 | July 1, 2007 |
| Cost of systems revenue | \$ 2,239 | \$ 2,189 | \$ 4,750 | \$ 4,186 |
| Cost of components revenue | 2,890 | 1,009 | 4,093 | 1,262 |
| Research and development | 972 | 348 | 1,783 | 849 |
| Sales, general and administrative | 12,506 | 9,684 | 22,489 | 17,536 |
| Total stock-based compensation expense before income taxes | 18,607 | 13,230 | 33,115 | 23,833 |
| Tax effect on stock-based compensation expense | — | — | — | — |
| Total stock-based compensation expense after income taxes | \$ 18,607 | \$ 13,230 | \$ 33,115 | \$ 23,833 |

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Consolidated net cash proceeds from the issuance of shares in connection with exercises of stock options under the Company's employee stock plans were \$1.2 million and \$2.3 million for the three and six months ended June 29, 2008, respectively, and \$3.0 million and \$5.0 million for the three and six months ended July 1, 2007, respectively. The Company recognized an income tax benefit from stock option exercises of \$10.2 million and \$14.6 million for the three and six months ended June 29, 2008, respectively. No income tax benefit was realized from stock option exercises during the three and six months ended July 1, 2007. As required, the Company presents excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

The following table summarizes the unrecognized stock-based compensation cost by type of awards:

| (In thousands, except years) | As of June 29, 2008 | Weighted-Average Amortization Period (in years) |
|--------------------------------------------------|---------------------------|-------------------------------------------------------|
| Stock options | \$ 10,365 | 2.7 |
| Restricted stock | 103,227 | 3.0 |
| Shares subject to re-vesting restrictions | 15,423 | 0.5 |
| Total unrecognized stock-based compensation cost | \$ 129,015 | |

For stock options issued prior to the adoption of SFAS No. 123(revised 2004), "Share-Based Payment" ("SFAS No. 123(R)") and for performance based awards, the Company recognizes its stock-based compensation cost using the graded amortization method. For all other awards, stock-based compensation cost is recognized on a straight-line basis. Additionally, the Company issues new shares upon exercises of options by employees.

Valuation Assumptions

The Company estimates the fair value of its stock-based awards using the Black-Scholes valuation model (the "Black-Scholes model"). The determination of fair value of share-based payment awards on the date of grant using the Black-Scholes model is affected by the stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

Assumptions used in the determination of fair value of share-based payment awards using the Black-Scholes model were as follows:

| | Three Months Ended July 1, 2007 | Six Months Ended July 1, 2007 |
|-------------------------|---------------------------------------|-------------------------------------|
| Stock Option Plans: | | |
| Expected term | 6.5 years | 6.5 years |
| Risk-free interest rate | 4.56% | 4.62% |
| Volatility | 90% | 70.3% |
| Dividend yield | 0% | 0% |

No stock options were granted in the six months ended June 29, 2008.

For the Three and Six Months Ended July 1, 2007:

The Company utilized the simplified method under the provisions of Staff Accounting Bulletin No. 107 ("SAB No. 107") for estimating expected term, instead of its historical exercise data. The Company elected not to base the

expected term on historical data because of the significant difference in its status before and after the effective date of SFAS No. 123(R). The Company was a privately-held company until its IPO, and the only available liquidation event for option holders was Cypress's buyout of minority interests in November 2004. At all other times, optionees could not cash out on their vested options. From the time of the Company's IPO in November 2005 through May 2006 when lock-up restrictions expired, a majority of the optionees were unable to exercise and sell vested options.

Because of the limited history of its stock trading publicly, the Company does not believe that its historical volatility would be representative of the expected volatility for its equity awards. Accordingly, the Company has chosen to use the historical volatility rates for a publicly-traded U.S.-based direct competitor as the basis for calculating the volatility for its granted options.

The interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Since the Company does not pay and does not expect to pay dividends, the expected dividend yield is zero.

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Equity Incentive Programs

Second Amended and Restated 2005 SunPower Corporation Stock Incentive Plan:

In May 2008, the Company's stockholders approved an increase of 1.7 million shares and an automatic annual increase beginning in fiscal 2009 in the number of shares available for grant under the Company's Second Amended and Restated 2005 SunPower Corporation Stock Incentive Plan under which the Company may issue incentive or non-statutory stock options, restricted stock awards, restricted stock units, or stock appreciation rights to directors, employees and consultants. The majority of shares issued are net of the minimum statutory withholding requirements that the Company pays on behalf of its employees. During the three and six months ended June 29, 2008, the Company withheld approximately 15,000 shares and 52,000 shares, respectively, to satisfy \$0.9 million and \$4.2 million, respectively, of employees' tax obligations. The Company paid this amount in cash to the appropriate taxing authorities. Shares withheld are treated as common stock repurchases for accounting and disclosure purposes and reduce the number of shares outstanding upon vesting.

The following table summarizes the Company's stock option activities:

| | Shares (in thousands) | Weighted- Average Exercise Price Per Share |
|-------------------------------------|--------------------------|-----------------------------------------------------|
| Outstanding as of December 30, 2007 | 3,701 | \$ 5.44 |
| Granted | — | — |
| Exercised | (703) | 3.32 |
| Forfeited | (32) | 7.86 |
| Outstanding as of June 29, 2008 | 2,966 | 5.92 |
| Exercisable as of June 29, 2008 | 1,329 | 4.22 |

The following table summarizes the Company's non-vested stock options and restricted stock activities thereafter:

| | Stock Options | | Restricted Stock Awards and Units | |
|-------------------------------------|--------------------------|-----------------------------------------------------|--------------------------------------|------------------------------------------------------------|
| | Shares (in thousands) | Weighted- Average Exercise Price Per Share | Shares (in thousands) | Weighted- Average Grant Date Fair Value Per Share |
| Outstanding as of December 30, 2007 | 2,454 | \$ 6.29 | 1,174 | \$ 68.74 |
| Granted | — | — | 579 | 79.48 |
| Vested(1) | (786) | 4.13 | (195) | 56.33 |
| Forfeited | (31) | 7.45 | (30) | 79.70 |
| Outstanding as of June 29, 2008 | 1,637 | 7.30 | 1,528 | 78.58 |

(1) Restricted stock awards and units vested includes shares withheld on behalf of employees to satisfy the minimum statutory tax withholding requirements.

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Information regarding the Company's outstanding stock options as of June 29, 2008 follows:

| Range of Exercise Price | Options Outstanding | | | | Options Exercisable | | | |
|-------------------------|--------------------------|----------------------------------------------------|-------------------------------------------------|---------------------------------------------------|--------------------------|----------------------------------------------------|-------------------------------------------------|---------------------------------------------------|
| | Shares (in thousands) | Weighted-Average Contractual Life (in years) | Weighted-Average Exercise Price per Share | Aggregate Intrinsic Value (in thousands) | Shares (in thousands) | Weighted-Average Contractual Life (in years) | Weighted-Average Exercise Price per Share | Aggregate Intrinsic Value (in thousands) |
| \$ 0.04—0.75 | 465 | 3.64 | \$ 0.31 | \$ 33,667 | 260 | 4.61 | \$ 0.49 | \$ 18,801 |
| 0.88—2.66 | 191 | 6.40 | 2.09 | 13,487 | 58 | 6.04 | 1.99 | 4,084 |
| 3.30—4.95 | 1,661 | 6.37 | 3.33 | 115,258 | 851 | 6.40 | 3.32 | 59,089 |
| 7.00—16.20 | 327 | 7.17 | 8.51 | 21,011 | 100 | 7.18 | 8.75 | 6,401 |
| 17.00—62.51 | 322 | 8.02 | 27.03 | 14,711 | 60 | 7.93 | 27.84 | 2,680 |
| | 2,966 | | | \$ 198,134 | 1,329 | | | \$ 91,055 |

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on the Company's closing stock price of \$72.71 at June 29, 2008, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable was 1.3 million shares as of June 29, 2008.

Stock Unit Plan:

As of June 29, 2008, the Company has granted approximately 236,000 stock units to 2,200 employees in the Philippines at an average unit price of \$39.80 in relation to its 2005 Stock Unit Plan, under which participants are awarded the right to receive cash payments from the Company in an amount equal to the appreciation in the Company's common stock between the award date and the date the employee redeems the award. A maximum of 300,000 stock units may be subject to stock unit awards granted under the 2005 Stock Unit Plan. Pursuant to a voluntary exchange offer that concluded in November 2007, approximately 53,000 stock units were exchanged for approximately 32,000 restricted stock units issued under the Company's Second Amended and Restated 2005 SunPower Corporation Stock Incentive Plan. The Company conducted a second voluntary exchange offer that concluded in May 2008, in which approximately 109,000 stock units were exchanged for approximately 50,000 restricted stock units issued under the Company's Second Amended and Restated 2005 SunPower Corporation Stock Incentive Plan. For the three and six months ended June 29, 2008, total compensation expense associated with the 2005 Stock Unit Plan was zero as compared to \$0.4 million and \$0.8 million in the three and six months ended July 1, 2007, respectively.

Note 8. COMMITMENTS AND CONTINGENCIES**Operating Lease Commitments**

The Company leases its San Jose, California facility under a non-cancelable operating lease from Cypress, which expires in April 2011 (see Note 2). The lease requires the Company to pay property taxes, insurance and certain other costs. In addition, the Company leases its Richmond, California facility under a non-cancelable operating lease from an unaffiliated third party, which expires in September 2018. In December 2005, the Company entered into a 5-year operating lease from an unaffiliated third party for a solar panel assembly facility in the Philippines. The Company also has various lease arrangements, including its European headquarters located in Geneva, Switzerland under a lease that expires in September 2012, as well as sales and support offices in Southern California, New Jersey, Germany, Spain, Italy and South Korea, all of which are leased from unaffiliated third parties. Future minimum obligations

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under all non-cancelable operating leases as of June 29, 2008 are as follows (in thousands):

| | | |
|-----------------------------|----|--------|
| 2008 (remaining six months) | \$ | 2,547 |
| 2009 | | 5,144 |
| 2010 | | 4,839 |
| 2011 | | 3,547 |
| 2012 | | 3,140 |
| Thereafter | | 24,651 |
| | \$ | 43,868 |

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Rent expense, including the rent paid to Cypress for the San Jose, California facility and the solar cell manufacturing facility in the Philippines (see Note 2), was \$1.6 million and \$3.5 million for the three and six months ended June 29, 2008, respectively, and \$0.8 million and \$1.4 million for the three and six months ended July 1, 2007, respectively.

Purchase Commitments

The Company purchases raw materials for inventory, services and manufacturing equipment from a variety of vendors. During the normal course of business, in order to manage manufacturing lead times and help assure adequate supply, the Company enters into agreements with contract manufacturers and suppliers that either allow them to procure goods and services based upon specifications defined by the Company, or that establish parameters defining the Company's requirements. In certain instances, these agreements allow the Company the option to cancel, reschedule or adjust the Company's requirements based on its business needs prior to firm orders being placed. Consequently, only a portion of the Company's recorded purchase commitments arising from these agreements are firm, non-cancelable and unconditional commitments.

The Company also has agreements with several suppliers, including joint ventures, for the procurement of polysilicon, ingots, wafers, solar cells and solar panels which specify future quantities and pricing of products to be supplied by the vendors for periods up to 12 years and provide for certain consequences, such as forfeiture of advanced deposits and liquidated damages relating to previous purchases, in the event that the Company terminates the arrangements (see Note 6).

At June 29, 2008, total obligations related to such supplier agreements was \$3.5 billion and non-cancelable purchase orders related to equipment and building improvements totaled approximately \$155.2 million. In addition, the Company has entered into agreements to purchase solar renewable energy certificates ("SRECs") from solar installation owners in New Jersey. The Company primarily sells SRECs to entities that must either retire a certain volume of SRECs each year or face much higher alternative compliance payments. At June 29, 2008, total obligations related to future purchases of SRECs was \$2.7 million.

Future minimum obligations under supplier agreements, non-cancelable purchase orders and SRECs as of June 29, 2008 are as follows (in thousands):

| | |
|-----------------------------|--------------|
| 2008 (remaining six months) | \$ 302,461 |
| 2009 | 431,894 |
| 2010 | 534,751 |
| 2011 | 543,726 |
| 2012 | 344,639 |
| Thereafter | 1,532,215 |
| | \$ 3,689,686 |

Joint Ventures

Woongjin Energy Co., Ltd ("Woongjin Energy")

In the third quarter of fiscal 2006, the Company entered into an agreement with Woongjin Coway Co., Ltd. ("Woongjin"), a provider of environmental products located in Korea, to form Woongjin Energy, a joint venture to manufacture monocrystalline silicon ingots. Under the joint venture, the Company and Woongjin have funded the joint venture through capital investments. In addition, Woongjin Energy obtained a \$33.0 million loan originally guaranteed by Woongjin. The Company supplies polysilicon and technology required for the silicon ingot manufacturing to the joint venture, and the Company procures the manufactured silicon ingots from the joint venture

under a five-year agreement. Woongjin Energy began manufacturing in the third quarter of fiscal 2007. For the three and six months ended June 29, 2008, the Company paid \$9.2 million and \$15.0 million, respectively, to Woongjin Energy for manufacturing polysilicon into silicon ingots. As of June 29, 2008 and December 30, 2007, \$4.0 million and \$2.4 million, respectively, remained due and payable to Woongjin Energy.

In October 2007, the Company entered into an agreement with Woongjin and Woongjin Holdings Co., Ltd. (“Woongjin Holdings”), whereby Woongjin transferred its equity investment held in Woongjin Energy to Woongjin Holdings and Woongjin Holdings assumed all rights and obligations formerly owned by Woongjin under the joint venture agreement described above, including the \$33.0 million loan guarantee. In January 2008, the Company and Woongjin Holdings provided Woongjin Energy with additional funding through capital investments in which the Company invested an additional \$5.4 million in the joint venture.

As of June 29, 2008, the Company had an \$11.7 million investment in the joint venture on its Condensed Consolidated Balance Sheets which consisted of a 27.4% equity investment valued at \$8.4 million and a \$3.3 million convertible note that is convertible at the Company’s option into an additional 12.6% equity ownership in the joint venture. As of December 30, 2007, the Company had a \$4.4 million investment in the joint venture on its Condensed Consolidated Balance Sheets which consisted of a 19.9% equity investment valued at \$1.1 million and a \$3.3 million convertible note that is convertible at the Company’s option into an additional 20.1% equity ownership in the joint venture. The Company accounts for this investment in Woongjin Energy using the equity method of accounting, in which the entire investment is classified as “Other long-term assets” in the Condensed

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Consolidated Balance Sheets and the Company's share of Woongjin Energy's income totaling \$1.3 million and \$1.9 million for the three and six months ended June 29, 2008, respectively, and none in each of the three and six months ended July 1, 2007, is included in "Other, net" in the Condensed Consolidated Statements of Operations. Neither party has contractual obligations to provide any additional funding to the joint venture.

In the first half of fiscal 2008, the Company conducted other related-party transactions with Woongjin Energy. For the three and six months ended June 29, 2008, the Company recognized zero and \$0.6 million, respectively, in components revenue related to the sale of solar modules. As of June 29, 2008 and December 30, 2007, zero and \$3.2 million, respectively, remained due and receivable from Woongjin Energy related to the sale of solar modules.

First Philec Solar Corporation ("First Philec Solar")

In October 2007, the Company entered into an agreement with First Philippine Electric Corporation ("First Philec") to form First Philec Solar, a joint venture to provide wafer slicing services of silicon ingots to the Company. The Company and First Philec have funded the joint venture through capital investments. The Company supplies silicon ingots and technology required for the slicing of silicon to the joint venture, and the Company procures the silicon wafers from the joint venture under a five-year wafering supply and sales agreement. This joint venture is located in the Philippines and became operational in the second quarter of fiscal 2008.

As of June 29, 2008, the Company had a \$3.1 million investment in the joint venture on its Condensed Consolidated Balance Sheets which consisted of a 20.6% equity investment. As of December 30, 2007, the Company had a \$0.9 million investment in the joint venture on its Condensed Consolidated Balance Sheets which consisted of a 16.9% equity investment. The Company accounts for this investment using the equity method of accounting, in which the entire investment is classified as "Other long-term assets" in the Condensed Consolidated Balance Sheets.

The Company periodically evaluates the qualitative and quantitative attributes of the joint ventures to determine whether the joint ventures need to be consolidated into the Company's financial statements in accordance with FSP FASB Interpretation No. 46 "Consolidation of Variable Interest Entities" ("FSP FIN 46(R)").

NorSun AS ("NorSun")

In January 2008, the Company entered into an Option Agreement with NorSun pursuant to which the Company will deliver cash advance payments to NorSun for the purchase of polysilicon under a long-term polysilicon supply agreement with NorSun, which NorSun will use to partly fund its portion of the equity investment in the joint venture with Swicorp Jousour Company and Chemical Development Company for the construction of a new polysilicon manufacturing facility in Saudi Arabia. The Company will provide a letter of credit or deposit funds in an escrow account to secure NorSun's right to such advance payments. NorSun will initially hold a fifty percent equity interest in the joint venture. Under the terms of the Option Agreement, the Company may exercise a call option and apply the advance payments to purchase half, subject to certain adjustments, of NorSun's fifty percent equity interest in the joint venture. The Company may exercise its option at any time until six months following the commercial operation of the Saudi Arabian polysilicon manufacturing facility. The Option Agreement also provides NorSun an option to put half, subject to certain adjustments, of its fifty percent equity interest in the joint venture to the Company. NorSun's option is exercisable commencing July 1, 2009 through six months following commercial operation of the polysilicon manufacturing facility. The Company accounts for the put and call options as one instrument, which will be measured at fair value at each reporting period. The changes in the fair value of the combined option will be recorded as other income in the Condensed Consolidated Statements of Operations. The fair value of the combined option at June 29, 2008 was not material.

Product Warranties

The Company warrants or guarantees the performance of the solar panels that the Company manufactures at certain levels of power output for extended periods, usually 25 years. It also warrants that the solar cells will be free from defects for at least ten years. In addition, it passes through to customers long-term warranties from the original equipment manufacturers of certain system components. Warranties of 20 to 25 years from solar panel suppliers are standard, while inverters typically carry two-, five- or ten-year warranties. The Company maintains warranty reserves to cover potential liabilities that could result from these guarantees. The Company's potential liability is generally in the form of product replacement or repair. Warranty reserves are based on the Company's best estimate of such liabilities and are recognized as a cost of revenue. The Company continuously monitors product returns for warranty failures and maintains a reserve for the related warranty expenses based on historical experience of similar products as well as various other assumptions that are considered reasonable under the circumstances.

The Company generally warrants or guarantees systems installed for a period of five to ten years. The Company's estimated warranty cost for each project is accrued and the related costs are charged against the warranty accrual when incurred. It is not possible to predict the maximum potential amount of future warranty-related expenses under these or similar contracts due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular contract. Historically, warranty costs related to contracts have been within the range of management's expectations.

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Provisions for warranty reserves charged to cost of revenue were \$4.9 million and \$9.8 million for the three and six months ended June 29, 2008, respectively, and \$1.4 million and \$5.6 million during the three and six months ended July 1, 2007, respectively. Activity within accrued warranty for the three and six months ended June 29, 2008 and July 1, 2007 is summarized as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|---------------------------------------------------|--------------------|-----------------|------------------|-----------------|
| | June 29, 2008 | July 1, 2007 | June 29, 2008 | July 1, 2007 |
| Balance at the beginning of the period | \$ 19,517 | \$ 13,560 | \$ 17,194 | \$ 3,446 |
| SP Systems accrued balance at date of acquisition | — | — | — | 6,542 |
| Accruals for warranties issued during the period | 4,941 | 1,441 | 9,840 | 5,588 |
| Warranty claims made during the period | (1,937) | (687) | (4,513) | (1,262) |
| Balance at the end of the period | \$ 22,521 | \$ 14,314 | \$ 22,521 | \$ 14,314 |

The accrued warranty balance at June 29, 2008 and December 30, 2007 includes \$9.1 million and \$6.7 million, respectively, of accrued costs primarily related to servicing the Company's obligations under long-term maintenance contracts entered into under the systems segment and the balance is included in "Other long-term liabilities" in the Condensed Consolidated Balance Sheets.

FIN 48 Uncertain Tax Positions

As of June 29, 2008 and December 30, 2007, total liabilities associated with FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, and Related Implementation Issues," ("FIN 48"), uncertain tax positions were \$5.7 million and \$4.1 million, respectively, and are included in "Other long-term liabilities" on our Condensed Consolidated Balance Sheets at June 29, 2008 and December 30, 2007, respectively, as they are not expected to be paid within the next twelve months. Due to the complexity and uncertainty associated with our tax positions, the Company cannot make a reasonably reliable estimate of the period in which cash settlement will be made for our liabilities associated with uncertain tax positions in "Other long-term liabilities."

Royalty Obligations

As of January 10, 2007, the Company assumed certain royalty obligations related to existing agreements entered into by PowerLight before the date of acquisition. In September 2002, PowerLight entered into a Technology Assignment and Services Agreement and other ancillary agreements, subsequently amended in December 2005, with Jefferson Shingleton and MaxTracker Services, LLC, a New York limited liability company controlled by Mr. Shingleton. Under the agreements, the PowerTracker®, now referred to as SunPower™ Tracker, was acquired through an assignment and acquisition of the patents associated with the product from Mr. Shingleton and the Company is obligated to pay Mr. Shingleton royalties on the tracker systems that it sells. In addition, several of the systems segment's government awards require the Company to pay royalties based on specified formulas related to sales of products developed or enhanced from such government awards. The Company incurred royalty expense totaling \$0.4 million and \$1.0 million for the three and six months ended June 29, 2008, respectively, and \$0.6 million and \$1.3 million during the three and six months ended July 1, 2007, respectively, which were charged to cost of systems revenue. As of June 29, 2008 and December 30, 2007, the Company's royalty liabilities totaled \$0.3 million.

Indemnifications

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in connection with contracts and license agreements or the sale of assets, under which the Company customarily agrees to hold the other party harmless against losses

arising from a breach of warranties, representations and covenants related to such matters as title to assets sold, negligent acts, damage to property, validity of certain intellectual property rights, non-infringement of third-party rights and certain tax related matters. In each of these circumstances, payment by the Company is typically subject to the other party making a claim to the Company pursuant to the procedures specified in the particular contract. These procedures usually allow the Company to challenge the other party's claims or, in case of breach of intellectual property representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, the Company's obligations under these agreements may be limited in terms of activity (typically to replace or correct the products or terminate the agreement with a refund to the other party), duration and/or amounts. In some instances, the Company may have recourse against third parties and/or insurance covering certain payments made by the Company.

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Legal Matters

From time to time the Company is a party to litigation matters and claims that are normal in the course of its operations. While the Company believes that the ultimate outcome of these matters will not have a material adverse effect on the Company, the outcome of these matters is not determinable and negative outcomes may adversely affect the Company's financial position, liquidity or results of operations.

Note 9. LINE OF CREDIT

In July 2007, the Company entered into a credit agreement with Wells Fargo and has entered into amendments to the credit agreement from time to time. As of June 29, 2008, the credit agreement provides for a \$50.0 million unsecured revolving credit line, with a \$50.0 million unsecured letter of credit subfeature, and a separate \$150.0 million secured letter of credit facility. The Company may borrow up to \$50.0 million and request that Wells Fargo issue up to \$50.0 million in letters of credit under the unsecured letter of credit subfeature through April 4, 2009. Letters of credit issued under the subfeature reduce the Company's borrowing capacity under the revolving credit line. The Company may request that Wells Fargo issue up to \$150.0 million in letters of credit under the secured letter of credit facility through July 31, 2012. As detailed in the agreement, the Company will pay interest on outstanding borrowings and a fee for outstanding letters of credit. At any time, the Company can prepay outstanding loans. All borrowings must be repaid by April 4, 2009, and all letters of credit issued under the unsecured letter of credit subfeature expire on or before April 4, 2009 unless the Company provides by such date collateral in the form of cash or cash equivalents in the aggregate amount available to be drawn under letters of credit outstanding at such time. All letters of credit issued under the secured letter of credit facility expire no later than July 31, 2012. The Company concurrently entered into a security agreement with Wells Fargo, granting a security interest in a securities account and deposit account to secure its obligations in connection with any letters of credit that might be issued under the credit agreement. In connection with the credit agreement, SunPower North America, Inc., a wholly-owned subsidiary of the Company, SP Systems, an indirect wholly-owned subsidiary of the Company, and SunPower Systems SA, another indirect wholly-owned subsidiary of the Company, entered into an associated continuing guaranty with Wells Fargo. The terms of the credit agreement include certain conditions to borrowings, representations and covenants, and events of default customary for financing transactions of this type.

As of June 29, 2008 and December 30, 2007, 6 letters of credit totaling \$41.5 million and 4 letters of credit totaling \$32.0 million, respectively, were issued by Wells Fargo under the unsecured letter of credit subfeature. In addition, 22 letters of credit totaling \$63.8 million and 8 letters of credit totaling \$47.9 million, were issued by Wells Fargo under the secured letter of credit facility as of June 29, 2008 and December 30, 2007, respectively. On June 29, 2008 and December 30, 2007, cash available to be borrowed under the unsecured revolving credit line was \$8.5 million and \$18.0 million, respectively, and includes letter of credit capacities available to be issued by Wells Fargo under the unsecured letter of credit subfeature of \$8.5 million and \$8.0 million, respectively. Letters of credit available under the secured letter of credit facility at June 29, 2008 and December 30, 2007 totaled \$86.2 million and \$2.1 million, respectively.

Note 10. SENIOR CONVERTIBLE DEBENTURES AND SHARE LENDING ARRANGEMENTS

February 2007 and July 2007 Debt Issuance

In February 2007, the Company issued \$200.0 million in principal amount of its 1.25% senior convertible debentures. Interest on the February 2007 debentures is payable on February 15 and August 15 of each year, commencing August 15, 2007. The February 2007 debentures will mature on February 15, 2027. Holders may require the Company to repurchase all or a portion of their February 2007 debentures on each of February 15, 2012, February 15, 2017 and February 15, 2022, or if the Company experiences certain types of corporate transactions constituting a fundamental

change. In addition, the Company may redeem some or all of the February 2007 debentures on or after February 15, 2012. The February 2007 debentures are initially convertible, subject to certain conditions, into cash up to the lesser of the principal amount or the conversion value. If the conversion value is greater than \$1,000, then the excess conversion value will be convertible into common stock. The initial effective conversion price of the February 2007 debentures is approximately \$56.75 per share, which represented a premium of 27.5% to the closing price of the Company's common stock on the date of issuance. The applicable conversion rate will be subject to customary adjustments in certain circumstances.

In July 2007, the Company issued \$225.0 million in principal amount of its 0.75% senior convertible debentures. Interest on the July 2007 debentures is payable on February 1 and August 1 of each year, commencing February 1, 2008. The July 2007 debentures will mature on August 1, 2027. Holders may require the Company to repurchase all or a portion of their July 2007 debentures on each of August 1, 2010, August 1, 2015, August 1, 2020, and August 1, 2025, or if the Company is involved in certain types of corporate transactions constituting a fundamental change. In addition, the Company may redeem some or all of the July 2007 debentures on or after August 1, 2010. The July 2007 debentures are initially convertible, subject to certain conditions, into cash up to the lesser of the principal amount or the conversion value. If the conversion value is greater than \$1,000, then the excess conversion value will be convertible into cash, common stock or a combination of cash and common stock, at the Company's election. The initial effective conversion price of the February 2007 debentures is approximately \$82.24 per share, which represented a premium of 27.5% to the closing price of the Company's common stock on the date of issuance. The applicable conversion rate will be subject to customary adjustments in certain circumstances.

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The February 2007 debentures and July 2007 debentures are senior, unsecured obligations of the Company, ranking equally with all existing and future senior unsecured indebtedness of the Company. The February 2007 debentures and July 2007 debentures are effectively subordinated to the Company's secured indebtedness to the extent of the value of the related collateral and structurally subordinated to indebtedness and other liabilities of the Company's subsidiaries. The February 2007 debentures and July 2007 debentures do not contain any covenants or sinking fund requirements.

As of December 30, 2007, the closing price of the Company's class A common stock equaled or exceeded 125% of the \$56.75 per share initial effective conversion price governing the February 2007 debentures and the closing price of the Company's class A common stock equaled or exceeded 125% of the \$82.24 per share initial effective conversion price governing the July 2007 debentures, for 20 out of 30 consecutive trading days ending on December 30, 2007, thus satisfying the market price conversion trigger pursuant to the terms of the debentures. As of the first trading day of the first quarter in fiscal 2008, holders of the February 2007 debentures and July 2007 debentures were able to exercise their right to convert the debentures any day in that fiscal quarter. Therefore, since holders of the February 2007 debentures and July 2007 debentures were able to exercise their right to convert the debentures in the first quarter of fiscal 2008, the Company classified the \$425.0 million in aggregate convertible debt as short-term debt in its Condensed Consolidated Balance Sheets as of December 30, 2007. In addition, the Company wrote off \$8.2 million and \$1.0 million of unamortized debt issuance costs in the fourth fiscal quarter of 2007 and first fiscal quarter of 2008, respectively. No holders of the February 2007 debentures and July 2007 debentures exercised their right to convert the debentures in the first quarter of fiscal 2008.

For the quarter ended June 29, 2008, the closing price of the Company's class A common stock equaled or exceeded 125% of the \$56.75 per share initial effective conversion price governing the February 2007 debentures for 20 out of 30 consecutive trading days ending on June 29, 2008, thus satisfying the market price conversion trigger pursuant to the terms of the February 2007 debentures. As of the first trading day of the third quarter in fiscal 2008, holders of the February 2007 debentures are able to exercise their right to convert the debentures any day in that fiscal quarter. Therefore, since holders of the February 2007 debentures are able to exercise their right to convert the debentures in the third quarter of fiscal 2008, the Company classified the \$200.0 million in aggregate convertible debt as short-term debt in its Condensed Consolidated Balance Sheets as of June 29, 2008.

Because the closing stock price did not equal or exceed 125% of the initial effective conversion price governing the July 2007 debentures for 20 out of 30 consecutive trading days during the quarter ended June 29, 2008, holders of the debentures did not have the right to convert the debentures, based on the market price conversion trigger, any day in the third fiscal quarter beginning on June 30, 2008. Accordingly, the Company classified the \$225.0 million in aggregate convertible debt as long-term debt in its Condensed Consolidated Balance Sheets as of June 29, 2008. This test is repeated each fiscal quarter, therefore, if the market price conversion trigger is satisfied in a subsequent quarter, the debentures may again be re-classified as short-term debt.

As of June 29, 2008, the estimated fair value of the February 2007 debentures and July 2007 debentures was approximately \$283.0 million and \$261.9 million, respectively, based on quoted market prices. As of December 30, 2007, the estimated fair value of the February 2007 debentures and July 2007 debentures was approximately \$465.6 million and \$366.3 million, respectively, based on quoted market prices. The fair market value of the senior convertible debentures is expected to increase as interest rates fall and/or as the market price of our class A common stock increases. Conversely, the fair market value of the senior convertible debentures is expected to decrease as interest rates rise and/or as the market price of our class A common stock falls.

February 2007 Amended and Restated Share Lending Arrangement and July 2007 Share Lending Arrangement

Concurrent with the offering of the February 2007 debentures, the Company lent 2.9 million shares of its class A common stock, all of which are being borrowed by an affiliate of Lehman Brothers Inc. ("LBIE"), one of the

underwriters of the February 2007 debentures. The lent shares are to be used to facilitate the establishment by investors in the February 2007 debentures and July 2007 debentures of hedged positions in the Company's class A common stock. Under the share lending agreement, LBIE has the ability to offer any of the 1.0 million shares that remain in LBIE's possession to facilitate hedging arrangements for subsequent purchasers of both the February 2007 debentures and July 2007 debentures and, with the Company's consent, purchasers of securities the Company may issue in the future. Concurrent with the offering of the July 2007 debentures, the Company also lent 1.8 million shares of its class A common stock, all of which are being borrowed by an affiliate of Credit Suisse Securities (USA) LLC ("CSI"), one of the underwriters of the July 2007 debentures. The Company did not receive any proceeds from these offerings of class A common stock, but received a nominal lending fee of \$0.001 per share for each share of common stock that is loaned pursuant to the share lending agreements described below.

Share loans under the share lending agreement will terminate and the borrowed shares must be returned to the Company under the following circumstances: (i) LBIE and CSI may terminate all or any portion of a loan at any time; (ii) the Company may terminate any or all of the outstanding loans upon a default by LBIE and CSI under the share lending agreement, including a breach by LBIE and CSI of any of its representations and warranties, covenants or agreements under the share lending agreement, or the bankruptcy of LBIE and CSI; or (iii) if the Company enters into a merger or similar business combination transaction with an unaffiliated third party (as defined in the agreement). In addition, CSI has agreed to return to the Company any borrowed shares in its possession on the date anticipated to be five business days before the closing of certain merger or similar business combinations described in the share lending agreement. Except in limited circumstances, any such shares returned to the Company cannot be re-borrowed.

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Any shares loaned to LBIE and CSI will be issued and outstanding for corporate law purposes and, accordingly, the holders of the borrowed shares will have all of the rights of a holder of the Company's outstanding shares, including the right to vote the shares on all matters submitted to a vote of the Company's stockholders and the right to receive any dividends or other distributions that the Company may pay or make on its outstanding shares of class A common stock.

While the share lending agreement does not require cash payment upon return of the shares, physical settlement is required (i.e., the loaned shares must be returned at the end of the arrangement). In view of this and the contractual undertakings of LBIE and CSI in the share lending agreement, which have the effect of substantially eliminating the economic dilution that otherwise would result from the issuance of the borrowed shares, the borrowed shares are not considered outstanding for the purpose of computing and reporting earnings per share. Notwithstanding the foregoing, the shares will nonetheless be issued and outstanding and will be eligible for trading on The Nasdaq Global Market.

Note 11. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income (loss) includes unrealized gains and losses on the Company's available-for-sale investments, foreign currency derivatives designated as cash flow hedges and cumulative translation adjustments. The components of comprehensive income (loss), net of tax, were as follows:

| (In thousands) | Three Months Ended | | Six Months Ended | |
|---------------------------------------------------|--------------------|-----------------|------------------|-----------------|
| | June 29, 2008 | July 1, 2007 | June 29, 2008 | July 1, 2007 |
| Net income (loss) | \$ 28,608 | \$ (5,345) | \$ 41,365 | \$ (4,105) |
| Other comprehensive income (loss): | | | | |
| Cumulative translation adjustment | 1,924 | 1,561 | 12,329 | 1,897 |
| Unrealized gain (loss) on investments, net of tax | 469 | — | (1,002) | 4 |
| Unrealized gain (loss) on derivatives, net of tax | 5,051 | 349 | 3,595 | 800 |
| Total comprehensive income (loss) | \$ 36,052 | \$ (3,435) | \$ 56,287 | \$ (1,404) |

Note 12. FOREIGN CURRENCY DERIVATIVES

The Company has non-U.S. subsidiaries that operate and sell the Company's products in various global markets, primarily in Europe. As a result, the Company is exposed to risks associated with changes in foreign currency exchange rates. It is the Company's policy to use various hedge instruments to manage the exposures associated with purchases of foreign sourced equipment, net asset or liability positions of its subsidiaries and forecasted revenues and expenses. The Company does not enter into foreign currency derivative financial instruments for speculative or trading purposes.

The Company calculates the fair value of its forward contracts based on market volatilities, spot rates and interest differentials from published sources. The following table presents information about the Company's hedge instruments measured at fair value on a recurring basis as of June 29, 2008 and indicates the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value in accordance with the provisions of SFAS No. 157:

| (In thousands) | Significant Other Observable Inputs |
|----------------|----------------------------------------------|
|----------------|----------------------------------------------|

| | (Level 2) |
|---------------------------------------------|-----------|
| Asset | |
| Foreign currency forward exchange contracts | \$ 586 |
| Liability | |
| Foreign currency forward exchange contracts | \$ 11,261 |

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), the Company accounts for its hedges of forecasted foreign currency revenue and cost of revenue as cash flow hedges and hedges of firmly committed purchase contracts denominated in foreign currency as fair value hedges.

Cash Flow Hedges: Hedges of forecasted foreign currency denominated revenues are designated as cash flow hedges and changes in fair value of the effective portion of hedge contracts are recorded in accumulated other comprehensive income in stockholders' equity in the Condensed Consolidated Balance Sheets. Amounts deferred in accumulated other comprehensive income are reclassified to other, net in the Condensed Consolidated Statements of Operations in the periods in which the hedged exposure impacts earnings. The effective portion of unrealized losses recorded in accumulated other comprehensive income, net

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of tax, were losses of \$0.3 million and \$1.3 million for the six months ended June 29, 2008 and July 1, 2007, respectively. As of June 29, 2008 and December 30, 2007, the Company had outstanding cash flow hedge forward contracts with an aggregate notional value of \$6.9 million and \$140.1 million, respectively. The maturity dates of the outstanding contracts do not extend beyond July 2008. At June 29, 2008, the Company discontinued a portion of an existing cash flow hedge of foreign currency revenue when it determined that it was probable the original forecasted transaction would not occur by the end of the originally specified time period. The amount of derivative loss, \$0.8 million, was reclassified from accumulated other comprehensive income to other, net in the Condensed Consolidated Statements of Operations as a result of the discontinuance of the cash flow hedge.

Fair Value Hedges: On occasion, the Company commits to purchase equipment in foreign currency, predominantly Euros. When these purchases are hedged and qualify as firm commitments under SFAS No. 133, they are designated as fair value hedges and changes in the fair value of the firm commitment derivative contract are recognized in the Condensed Consolidated Statements of Operations. Under fair value hedge treatment, the changes in the firm commitment on a spot to spot basis are recorded in property, plant and equipment, net, in the Condensed Consolidated Balance Sheets and in other, net, in the Condensed Consolidated Statements of Operations. As of June 29, 2008 and December 30, 2007, the Company had no outstanding fair value hedges.

Both cash flow hedges and fair value hedges are tested for effectiveness each period on a spot to spot basis using the dollar-offset method. Both the excluded time value and any ineffectiveness, which were not significant for all periods, are recorded in other, net.

In addition, the Company began hedging the net balance sheet effect of foreign currency denominated assets and liabilities in 2005 primarily for intercompany transactions, receivables from customers, prepayments to suppliers and advances received from customers. The Company records its hedges of foreign currency denominated monetary assets and liabilities at fair value with the related gains or losses recorded in other, net. The gains or losses on these contracts are substantially offset by transaction gains or losses on the underlying balances being hedged. As of June 29, 2008 and December 30, 2007, the Company held forward contracts with an aggregate notional value of \$160.9 million and \$62.7 million, respectively, to hedge the risks associated with foreign currency denominated assets and liabilities.

Note 13. INCOME TAXES

The Company's effective rate of income tax provision was 34% and 33% for the three and six months ended June 29, 2008, respectively, and the effective rate of income tax benefit was 58% and 71% for the three and six months ended July 1, 2007, respectively. The tax provision for the three and six months ended June 29, 2008 was primarily attributable to the consumption of non-stock net operating loss carryforwards, net of foreign income taxes in profitable jurisdictions where the tax rates are less than the U.S. statutory rate. The tax benefit for the three and six months ended July 1, 2007 was primarily the result of recognition of deferred tax assets to the extent of deferred tax liabilities created by the acquisition of SP Systems, net of foreign income taxes in profitable jurisdictions where the tax rates are less than the U.S. statutory rate.

Unrecognized Tax Benefits

On January 1, 2007, the Company adopted the provisions for FIN 48, which is an interpretation of SFAS No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues. FIN 48 contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including

resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement.

The total amount of unrecognized tax benefits recorded in the Condensed Consolidated Balance Sheets at the date of adoption was approximately \$1.1 million, which, if recognized, would affect the Company's effective tax rate. The additional amount of unrecognized tax benefits accrued during the year ended December 30, 2007 was \$3.1 million. A reconciliation of the beginning and ending amount of unrecognized tax benefits for the six months ended June 29, 2008 is as follows:

| (In thousands) | June 29, 2008 |
|----------------------------------------------------------------|------------------|
| Balance at December 30, 2007 | \$ 4,172 |
| Additions based on tax positions related to the current period | 1,569 |
| Balance at June 29, 2008 | \$ |