Spansion Inc.
Form 10-K
February 27, 2007
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
**For the fiscal year ended December 31, 2006**

**OR**

**¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
**For the transition period from to**

**Commission File Number 000-51666**

# SPANSION INC.

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

| **Delaware** | **20-3898239** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

**915 DeGuigne Drive**

**P.O. Box 3453**

**Sunnyvale, CA 94088**

**(408) 962-2500**

**(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)**

**Securities registered pursuant to Section 12(b) of the Act:**

**None**

**Securities registered pursuant to Section 12(g) of the Act:**

| **(Title of each class)** | **(Name of each exchange on which registered)** |
|---|---|
| Class A Common Stock, $0.001 Par Value Per Share | NASDAQ Global Select Market |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

**Note** Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The aggregate market value of Common Stock held by non-affiliates of the registrant (based upon the closing sale price on the NASDAQ Global Select Market on February 21, 2007) was approximately $759,716,882. Shares held by each executive officer, director and by each person who owns 10 percent or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of each of the registrant s classes of common stock as of the close of business on February 21, 2007:

| **Class** | **Number of Shares** |
|---|---|
| Class A Common Stock, $0.001 par value | 134,674,603 |
| Class B Common Stock, $0.001 par value | 1 |
| Class C Common Stock, $0.001 par value | 1 |

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated into Part III hereof.

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**Spansion Inc.**

**FORM 10-K**

**For The Fiscal Year Ended December 31, 2006**

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**PART I**

**ITEM 1. BUSINESS**

**Cautionary Statement Regarding Forward-Looking Statements**

*The statements in this report include forward-looking statements. These statements relate to future events or our future financial performance. Forward-looking statements may include words such as may, will, should, expect, plan, intend, anticipate, believe, estimate, predict, potential or continue or other wording indicating future results or expectations. Forward-looking statements are subject to risks and uncertainties, and actual events or results may differ materially. Factors that could cause our actual results to differ materially include, but are not limited to, those discussed under Risk Factors in this report and the following factors:*

*our ability to successfully introduce our next generation products to market in a timely manner;*

*our ability to effectively and timely achieve volume production of our next generation products;*

*our ability to accelerate our product development cycle;*

*our ability to penetrate further the integrated category of the Flash memory market with our high density products and expand the number of customers in emerging markets;*

*our ability to successfully develop and transition to the latest technologies;*

*our ability to finance, construct and equip SP1 and have 300-millimeter Flash memory wafer manufacturing capacity in fiscal 2008;*

*our ability to implement successfully our cost reduction efforts;*

*our ability to control our operating expenses, particularly our marketing, general and administrative costs;*

*our ability to design and implement new enterprise-wide information systems in a timely and cost-effective manner;*

*our ability to develop our MirrorBit ORNAND and MirrorBit Quad architectures, introduce new products based on these architectures, and to achieve customer acceptance of these products, particularly among mobile phone OEMs;*

*our ability to develop systems-level solutions that provide value to customers of our products;*

*our ability to enter new markets not traditionally served by Flash memory, for example, integrating logic functions within high density arrays of Flash memory;*

*our ability to negotiate successfully patent and other intellectual property licenses and patent cross-licenses and acquire additional patents; and*

*our ability to complete the sale of our JV1 and JV2 facilities to Fujitsu and to transition to Fujitsu s provision of foundry services at these facilities.*

*We undertake no obligation to revise or update any forward-looking statements to reflect any event or circumstance that arises after the date of this report, or to conform such statements to actual results or changes in our expectations.*

**Our Company**

We are one of the largest Flash memory providers and the largest company in the world exclusively dedicated to designing, developing, manufacturing, marketing and selling Flash memory solutions, a critical semiconductor element of nearly every electronic product and one of the fastest growing segments of the

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semiconductor industry. Our Flash memory is integrated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, personal computers and PC peripherals. Our Flash memory solutions are incorporated in products from original equipment manufacturers, or OEMs, in each of these markets, including all of the top ten mobile phone OEMs, all of the top ten consumer electronics OEMs and all of the top ten automotive electronics OEMs. We operate four Flash memory wafer fabrication facilities, or fabs, four assembly and test sites and a development fab, known as our Submicron Development Center, or SDC. We are headquartered in Sunnyvale, California.

We were originally organized as a Flash memory manufacturing venture of AMD and Fujitsu in 1993 named Fujitsu AMD Semiconductor Limited, or FASL. The primary function of FASL was to manufacture and sell Flash memory wafers to AMD and Fujitsu, who in turn converted the Flash memory wafers into finished Flash memory products and sold them to their customers. AMD and Fujitsu were also responsible for all research and development and marketing activities and provided FASL with various support and administrative services.

By 2003, AMD and Fujitsu desired to expand the operations of FASL to: achieve economies of scale; add additional Flash memory wafer fabrication capacity; include assembly, test, mark and pack operations; include research and development capabilities and include various marketing and administrative functions. To accomplish these goals, in 2003, AMD and Fujitsu reorganized our business as a Flash memory company called FASL LLC, later renamed Spansion LLC, by integrating the manufacturing venture with other Flash memory assets of AMD and Fujitsu. Since this reorganization, until the beginning of the second quarter of fiscal 2006, we manufactured and sold finished Flash memory devices to customers worldwide through our two sole distributors, AMD and Fujitsu. Since the beginning of the second quarter of fiscal 2006, we have sold our products directly to our customers, including customers not served solely by Fujitsu. Fujitsu acts as our sole distributor in Japan and also as a nonexclusive distributor throughout the rest of the world, other than Europe and the Americas with limited exceptions. We were reorganized from Spansion LLC into Spansion Inc., a Delaware corporation, in connection with our initial public offering in December 2005.

Our mailing address and executive offices are located at 915 DeGuigne Drive, Sunnyvale, California 94088, and our telephone number is (408) 962-2500. References in this report to Spansion, we, us, our, or the Company shall mean Spansion Inc. and our consolidated subsidiari unless the context indicates otherwise.

We post on the Investor Relations page of our Web site, *www.spansion.com*, a link to our filings with the SEC, our Code of Ethics for our Chief Executive Officer, Chief Financial Officer, Corporate Controller and other senior finance executives, our Code of Conduct, which applies to all directors and all our employees, and the charters of our Audit, Compensation and Nominating and Corporate Governance committees. Our filings with the SEC are posted as soon as reasonably practical after they are filed electronically with the SEC. You can also obtain copies of these documents by writing to us at: Corporate Secretary, Spansion Inc., 915 DeGuigne Drive, Sunnyvale, California 94088, or emailing us at: *Corporate.Secretary@spansion.com*. These documents and filings are provided free of charge.

For financial information about geographic areas and for segment information with respect to sales and operating results, refer to the information set forth in Note 15 of our consolidated financial statements, beginning on page 99, below.

For a discussion of the risk factors related to our business operations, please see the sections entitled, Cautionary Statement Regarding Forward-Looking Statements, above, and the Risk Factors set forth under Item 1A below.

For fiscal 2006, our net sales were approximately $2.6 billion and our net loss was approximately $148 million, reflecting a growth in net sales of approximately 29 percent and a reduction in net loss by approximately 51 percent over fiscal 2005 net sales of approximately $2.0 billion and net loss of approximately $304 million. According to market research firm iSuppli, in the first nine months of 2006, we were the largest supplier of NOR

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Flash memory, responsible for approximately 30 percent of all NOR Flash memory sales, which made us one of the largest suppliers for the overall Flash memory market, with a 12 percent market share, based on net sales. In 2005, based on iSuppli data, we were the second largest supplier of NOR Flash memory, responsible for approximately 26 percent of all NOR Flash memory sales, and we were one of the largest suppliers for the overall Flash memory market, with an 11 percent market share, based on end sales of our products.

**Our Industry**

Consumers are increasingly demanding access to digital content through sophisticated communications equipment, consumer electronic products and automotive electronics. People now expect to instantly access, store and interact with multimedia content, including photos, music, video and text files using such products as mobile phones, digital cameras, DVD players, digital HDTVs, set top boxes, or STBs, MP3 players, video players and automotive electronics such as navigation systems. The primary semiconductor component used to store and access this kind of digital content is Flash memory, and as a result, Flash memory has become one of the most critical components of electronic products. Most electronic products use Flash memory to store important program instructions, known as code, as well as multimedia or other digital content, known as data. Code storage allows the basic operating instructions, operating system software or program code to be retained, which allows an electronic product to function, while data storage allows digital content, such as multimedia files, to be retained. There are two major architectures of Flash memory in the market today: NOR Flash memory, which is used for code and data storage in mobile phones and primarily for code storage in consumer electronics, and NAND Flash memory, which is primarily used for data storage in removable memory applications, such as Flash memory cards and USB drives, and is increasingly being used in some high-end mobile phones and embedded applications such as MP3 players.

The Flash memory market can be divided into two major categories based on application: the integrated category, which includes wireless and embedded applications, and the removable storage category. Within the integrated category, portable, battery-powered communications applications are referred to as wireless and all other applications, such as consumer, industrial, telecommunications and automotive electronics, are referred to as embedded. Within the removable storage category, applications include Flash memory cards and USB drives. Based on iSuppli data, the wireless portion of the integrated category, which primarily consists of mobile phones, represented the largest market for NOR Flash memory in fiscal 2006.

We focus primarily on the integrated category of the Flash memory market, including the wireless and embedded portions. Our products designed for code storage applications are based on NOR Flash memory architecture and utilize either traditional floating gate technology or our MirrorBit technology. Our products designed for data storage applications are based on MirrorBit ORNAND and MirrorBit Quad architectures and also utilize our MirrorBit technology. Floating gate is the conventional technology that is used by most Flash memory companies today. MirrorBit technology is our proprietary technology that takes a fundamentally different approach from floating gate technology, with lower overall manufacturing costs and higher yields.

Sales in the wireless portion of the integrated category represented a majority of our sales in fiscal 2005 and fiscal 2006, and sales in the embedded portion of the integrated category represented the balance of our sales. We do not, at this time, sell any products in the removable storage category. Sales of MirrorBit technology-based products increased from approximately 23 percent of our total net sales in fiscal 2005 to approximately 50 percent in fiscal 2006. The remainder of our sales has been based on floating gate technology.

**Products**

Our current product portfolio ranges from 1 megabit to 1 gigabit with a breadth of interfaces and features. While historically our products have been based on floating gate technology, the majority of our new product designs use MirrorBit technology. Our products have traditionally been designed to support code, or combined code and data storage applications and serve the wireless and/or embedded portions of the integrated category of the Flash memory market.

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***Technology***

Flash memory technology refers to the structure of an individual memory cell or transistor. Our products are based on two technologies, single-bit-per-cell floating gate technology and two- or more-bit-per-cell MirrorBit technology. In September 2006 we introduced MirrorBit Quad, the industry s first four-bit-cell technology and announced products based on this technology in January 2007.

We successfully began production of our products based on 90-nanometer MirrorBit process technology in 2006 for both MirrorBit NOR and MirrorBit ORNAND products. We also announced samples of 65-nanometer MirrorBit ORNAND products in January of 2007 with plans for production in the third quarter of 2007. In addition we plan to manufacture MirrorBit products on 45-nanometer process technology in 2008.

***Floating Gate Technology.*** Floating gate is the conventional memory cell technology that is utilized by most Flash memory companies today for both NOR and NAND products. A memory cell comprises a transistor having a source, a drain and a control gate to regulate the current flow between the source and the drain, thereby defining whether the memory cell stores a 0 bit or a 1 bit by storing charge in the cell storage medium. Floating gate is a memory cell technology in which the floating gate is a conductive storage medium between the control gate and the source and drain. It is referred to as a floating gate as it is electrically isolated or floating from the rest of the cell to ensure that stored charge does not leak away resulting in memory loss. We have created innovations in floating gate that have become industry standards, such as negative gate erase, single power supply and embedded programming algorithms, and we continue to hold a leading position in the Flash memory market with our products based on floating gate technology. Our products using floating gate technology are typically used for code storage in applications requiring very high read speeds, extreme temperatures and harsh environments such as automotive applications and for the majority of low density applications.

***MirrorBit Technology.*** To achieve two bits per cell, and most recently four bits per cell, we developed MirrorBit technology. MirrorBit technology stores two distinct charges in a single memory cell, with each charge equivalent to one bit of data thereby at least doubling the density, or storage capacity, of each memory cell and enabling higher density products. This is made possible because MirrorBit technology stores charge in a nonconductive storage medium, silicon nitride, which eliminates the need for a floating gate, contrary to the conductive storage medium used by floating gate technology. While electrons stored in a particular location of a MirrorBit nitride cell stay in place, those stored in a floating gate diffuse, preventing the storage of more than one charge.

MirrorBit technology is the foundation for expanding our product roadmap with enhanced capabilities. For example, in September 2006 we demonstrated technology with the ability to store four bits per cell, which we refer to as MirrorBit Quad and in January 2007 we announced a family of products based on MirrorBit Quad technology. MirrorBit Quad, as with our two-bit-per-cell MirrorBit technology, stores charges in two distinct locations in a non-conducting nitride storage medium but the quantity of each charge is variable to produce the equivalent of two bits of data in each location for a total of four bits per cell. Furthermore, MirrorBit technology has the ability to efficiently integrate logic functions within high-density arrays of Flash memory which will enable us to create new types of Flash memory products not available on the market today, such as our HD-SIM product that is designed to integrate high performance processors and significant security capabilities. Also, we have leveraged our MirrorBit technology to expand our Flash memory offering into new areas such as serial interface Flash memory known as Serial Peripheral Interface, or SPI. We believe that these Flash memory innovations made possible by MirrorBit technology will enable us to expand our opportunity in the Flash memory market.

***Architecture***

Flash memory architecture may be defined as the connection of cells in a memory array with circuits that give access to and manage these cells for read, write and erase operations. Traditionally, customers requiring fast

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read performance and superior reliability have chosen a NOR architecture for program code storage as well as for combined code and data storage purposes. Flash memory customers requiring higher densities, faster write speeds and lower costs mostly for removable data storage applications have typically chosen a NAND architecture. Our products have historically implemented a NOR architecture and therefore have fast random and sequential read, fast random write and high reliability. We do not currently have products based on NAND architecture. We have instead developed a new architecture called ORNAND based on our MirrorBit technology that will draw from among some of the best attributes of both NOR and NAND architectures. We began commercial shipments of MirrorBit ORNAND-based products to customers in the second quarter of fiscal 2006.

***Wireless Products***

Our products for wireless applications, particularly for mobile phones, offer a combination of low power consumption with fast performance and competitive cost structure for a wide range of customer platforms and wireless applications with different interface requirements. Key wireless products include the following:

***PL Family.*** The PL product family, with a 3-volt interface, is used for a broad range of mobile phones, from entry level, basic audio-only handsets to audio and data capable phones with higher resolution color displays. The PL family, which includes products based on floating gate and MirrorBit technology, combines a high speed page mode 3-volt interface, Simultaneous Read/Write capability and Advanced Sector Protection at 32- to 256-megabit densities for code-optimized requirements. PL products can be combined with third-party SRAM or pSRAM die to achieve Flash memory densities up to 512 megabits in a single MCP.

***WS and NS Families.*** The WS and NS product families, with a 1.8 volt interface, are optimized for higher-end mobile phones with capabilities such as complex ring tones, enhanced color displays, higher resolution cameras and larger internal storage for multimedia content including music, videos and pictures. The WS and NS families, which include products based on floating gate and MirrorBit technology, combine a high performance burst-mode 1.8-volt interface operating at up to 108 MHz, with Simultaneous Read/Write and Advanced Sector Protection features at 64- to 512-megabit densities for code and data requirements. WS and NS products can also be combined with third-party SRAM, pSRAM or DRAM die in a single MCP that meets both code and data storage needs.

***GL Family.*** The GL product family, with a 1.8-volt and/or 3-volt interface, enables code and data applications in low-end, mid-range and higher-end mobile phones. The GL product family, which is manufactured using MirrorBit technology, includes a page-mode interface at 32-megabit to 512-megabit densities for wireless applications providing a single scalable platform for code and data applications. GL products can be combined with third-party SRAM and pSRAM die in a single MCP that meets both code and data storage needs.

***MS Family.*** The MS family, which includes 512-megabit and 1-gigabit density devices with a 1.8-volt interface, enables enhanced data applications in higher-end mobile phones. The MS family, which is manufactured using ORNAND architecture based on MirrorBit technology, has faster write speeds than NOR products and includes an interface similar to floating gate NAND. MS products, on their own or together with code-optimized Flash memory products such as those from the WS and NS families, can be combined with third-party low-power DRAM die to achieve Flash memory densities of up to 2 gigabits in a single MCP that meets both code and data storage needs. We began commercial shipments of our first product in the MS family in the second quarter of fiscal 2006.

***Embedded Products***

We offer a variety of general purpose as well as highly optimized products to serve the diverse needs of the embedded portion of the integrated category. Key embedded products include the following:

***AL and GL Families.*** The AL and GL product families address applications where high reliability coupled with low cost are important, including consumer, networking and telecommunications. The AL product family

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offers densities as low as 4 megabits, supports a simpler feature set and provides a standard interface for value-focused applications, such as DVD players. The GL product family offers densities up to 1 gigabit in production and includes a page-mode interface and Advanced Sector Protection to support high performance consumer applications, such as high-end STBs and digital video recorders, or DVRs. MirrorBit technology is utilized for the GL family, while both MirrorBit and floating gate technology are utilized for the AL family.

***CD Family.*** The CD product family addresses automotive engine and transmission control applications, which require high reliability and feature rich, high performance solutions operating over wide temperature ranges. The CD product family combines a high performance burst-mode 2.5-volt interface, with Simultaneous Read/Write and Advanced Sector Protection at 16- and 32-megabit densities. Because engine and transmission control units must withstand extreme temperatures, this family operates at up to 145°C and is available in a fully tested die-only solution for incorporation into special customer modules. We use our floating gate technology to meet the extreme operating temperature range and very high reliability requirements of automotive Flash memory customers.

***FL Family.*** The FL product family addresses the need for continued cost reduction in applications such as personal computers and PC peripherals, for example in hard disk drives and graphics cards and in consumer applications such as DVD players and home networking. The FL family utilizes our MirrorBit technology and a Serial Peripheral Interface (SPI) with a low pin count package to provide optimal low cost solutions at densities from 4 to 64 megabits.

**Development Platforms**

We provide development tools and subsystems to customers of our Flash memory products that help them easily and quickly design Flash devices into their integrated products. We assist these customers in prototyping their designs with our Flash memory devices by providing the necessary hardware development tools and platforms for design, development, verification, evaluation and programming. Our goal is to streamline and simplify the design and development cycle by providing consistent and comprehensive tools to support the design and development process, from initial system bring-up to final product deployment.

For example, our Productivity, Adaptive Communication & Entertainment, or PACE development platform offers customers of our Flash memory products the benefit of utilizing our products on fully functional cell phone and PDA platforms running with multiple operating systems and with a variety of popular baseband and CPU chipsets. We believe this reference platform can remove significant design overhead and complexity from product development cycles. Additionally, PACE allows the ability to provide system tuning and optimization before final product release. PACE is used in generating benchmarks, creating reference designs, debugging software, integrating new hardware platforms and systems and prototyping next generation wireless architectures.

Together with our key partners, we created the Platform Independent Storage Module or PISMO memory interface standard. PISMO is used to create standard memory modules recommended for development platforms and we offer comprehensive support of our Flash memory products on PISMO modules. PISMO modules enable our partners and customers to significantly reduce system development and debugging time and the PISMO standard is supported by a large number of system and chipset companies. PISMO allows design and system validation of memory combinations before any Multi Chip Package or MCP is produced, allowing system design and software development to start while the final product is being manufactured. Together with our partners, we offer a comprehensive set of personal computer and embedded development environments based on PISMO.

Other examples of our development tools include Spansion USB Programmer, or SUP, and a variety of devices models. SUP is a portable Flash programmer system used to program and verify our Flash memory devices. The SUP provides basic programming and verification functions in addition to the ability to exercise our advanced Flash memory features and enhancements all through the USB port of any personal computer or laptop. Verilog, VHDL and IBIS models are also available for many of our products.

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**Sales and Marketing**

We market and sell our products worldwide under the Spansion trademark. Since the beginning of the second quarter of fiscal 2006, we have sold our products directly to our customers, including customers not served solely by Fujitsu. Fujitsu acts as our sole distributor in Japan and also as a nonexclusive distributor throughout the rest of the world, other than Europe and the Americas with limited exceptions.

We market our products through a variety of direct and indirect channels. For wireless Flash memory customers, we focus on direct relationships with many of the top mobile phone OEMs worldwide. We supplement this effort with programs designed to support design-in of our products on reference designs, which are typically used by a broad base of wireless providers when choosing Flash memory solutions. These reference designs are produced by complementary silicon providers, such as baseband processor or controller vendors, or other independent companies. We have ongoing marketing efforts in place targeted at reference design houses to choose our Flash memory products for their reference designs. For embedded Flash memory customers, we focus our marketing efforts on providers of complementary silicon to ensure our products interoperate effectively with the most widely used components in various embedded applications.

Our marketing activities targeting customers, reference design houses and our potential partners include a combination of direct marketing activities such as trade shows, events and marketing collateral and indirect activities such as public relations and other marketing communications activities.

**Customers**

We serve our customers worldwide directly or through our distributors, including Fujitsu, who buy products from us and resell them to their customers, either directly or through third-party distributors of Fujitsu. Customers for our products consist of OEMs, original design manufacturers or ODMs and contract manufacturers. For fiscal 2006, fiscal 2005 and fiscal 2004, AMD accounted for approximately 13 percent, 56 percent and 54 percent of our net sales, and Fujitsu accounted for approximately 36 percent, 44 percent and 46 percent of our net sales. AMD s sales force responsible for selling our products was transferred to us in the second quarter of fiscal 2005. In the second quarter of fiscal 2006, we began to sell directly to customers previously served by AMD. Among those customers, Nokia Corporation accounted for approximately 12 percent of our net sales in fiscal 2006. We continue to use Fujitsu as our sole distributor in Japan and as a nonexclusive distributor throughout the rest of the world, other than Europe and the Americas with limited exceptions.

***Original Equipment Manufacturers***

OEMs consist primarily of foreign and domestic manufacturers of mobile phones, consumer electronics, automotive electronics and networking equipment companies, selected regional accounts and customers in other target applications.

***Third-Party Distributors***

Our third-party distributors typically resell to OEMs, ODMs and contract manufacturers. Sales through our direct distributors are typically made pursuant to agreements that provide return rights for discontinued products or for products that are not more than twelve months older than their manufacturing date code. In addition, some of our agreements with distributors may contain standard stock rotation provisions permitting limited levels of product returns. Our distribution agreement with Fujitsu grants limited stock rotation rights to Fujitsu and allows Fujitsu to provide similar limited rights to some of its distributors. However, to date, Fujitsu has not extended these rights to its distributors.

We generally warrant that products sold to our customers and our distributors will, at the time of shipment, be free from defects in workmanship and materials and conform to our approved specifications. Subject to specific exceptions, we offer a one-year limited warranty.

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**Research and Development**

Research and development is critical to our success and is focused on process, product and system level development. We conduct our product and system engineering activities primarily in Sunnyvale, California and in Kawasaki, Japan with additional design and development engineering teams located in the United States, Europe and Asia. Our primary development focus is on MirrorBit products for the integrated category of the Flash memory market. We conduct our process development primarily at our SDC facility located in Sunnyvale, California, our Fab 25 facility located in Austin, Texas and our facilities in Aizu-Wakamatsu, Japan. Currently, we are developing new non-volatile memory process technologies and have announced first samples of 65-nanometer process technology and plans for development of 45-nanometer technology. In February 2007 we stopped further development of manufacturing processes on 200-millimeter at our SDC facility with all future development at the SDC now focused on 300-millimeter wafer technology at 65-nanometer process technology and beyond.

We also participate in alliances or other arrangements with external partners in the area of product technology and systems solutions to reduce the cost of development for ourselves and our Flash memory customers. Furthermore, these relationships with external partners enable us to broaden our product offerings and accelerate access to new technologies.

Our research and development expenses for fiscal 2006, fiscal 2005 and fiscal 2004 were $348 million, $296 million and $281 million, respectively. For more information, see Management s Discussion and Analysis of Financial Condition and Results of Operations.

**Manufacturing**

We own and operate eight manufacturing facilities, of which four, Fab 25, JV1, JV2 and JV3, are wafer fabrication facilities and four are assembly and test facilities. We are beginning to equip a new wafer fabrication facility in Aizu-Wakamatsu, Japan (SP1), in which we expect to produce 300-millimeter wafers at 65- and 45-nanometer process technologies. We also have an agreement with Taiwan Semiconductor Manufacturing Company Limited to augment our internal production capacity for our 110- and 90-nanometer MirrorBit process technologies. On September 28, 2006, we agreed to sell the JV1 and JV2 wafer fabrication facilities and certain equipment, assets and inventory located at these facilities to Fujitsu for approximately $150 million plus the value of the inventory at the time of closing (the JV1/JV2 Transaction ). Fujitsu has agreed to provide foundry services for the manufacture of our products at JV1 and JV2. We expect to close this sale in the second quarter of fiscal 2007. For more information, see Management s and Discussion and Analysis of Financial Condition and Results of Operations Other Financial Matters JV1/JV2 Transaction.

The locations of our wafer fabrication facilities, the process technologies employed and the approximate clean room square footage are described in the table below.

***Wafer Fabrication Facilities***

| Name/Location | Wafer Size (diameter in millimeters) | Process Technology (in nanometers) | Approximate Clean Room Square Footage |
|---|---|---|---|
| Austin, Texas | | | |
| Fab 25 | 200 | 65 to 110 | 120,000 |
| Aizu-Wakamatsu, Japan | | | |
| JV1* | 200 | 200 to 320 | 70,000 |
| JV2* | 200 | 200 to 230 | 91,000 |
| JV3 | 200 | 110 to 170 | 118,000 |

* We have agreed to sell JV1 and JV2 to Fujitsu. Under the terms of the related asset purchase agreement, the JV1/JV2 Transaction is scheduled to close in the second quarter of fiscal 2007.

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The following table describes the location and approximate clean room square footage of our assembly and test facilities.

***Assembly and Test Facilities***

| Location | Approximate Clean Room Square Footage |
|---|---|
| Bangkok, Thailand | 78,000 |
| Kuala Lumpur, Malaysia | 71,300 |
| Penang, Malaysia | 71,000 |
| Suzhou, China | 30,250 |

Our manufacturing processes require many raw materials, such as silicon wafers, mold compound, substrates and various chemicals and gases, and the necessary equipment for manufacturing. We obtain these materials and equipment from a large number of suppliers located throughout the world.

**Environmental Matters**

Many of our facilities are located on properties or in areas with a long history of industrial activity. Prior to our reorganization in June 2003, environmental audits were conducted for each of our manufacturing facilities. The audits described various conditions customary of facilities in our industry and, in particular, noted historical soil and groundwater contamination at our Sunnyvale, California facility arising from the leakage of chlorinated solvent storage tanks that previously had been located on this property. This property is listed on the U.S. Environmental Protection Agency s Superfund National Priorities List. AMD, as the former owner of the property, is investigating and remediating this contamination.

In connection with our June 2003 reorganization, each of AMD and Fujitsu agreed to indemnify us against losses arising out of the presence or release, prior to June 30, 2003, of hazardous substances at or from these and other sites they each contributed to us. Conversely, our subsidiary agreed to indemnify each of AMD and Fujitsu from and against liabilities arising out of events or circumstances occurring after June 30, 2003, in connection with the operation of our business. We also share some permits and facilities with AMD and Fujitsu. For example, our Aizu-Wakamatsu manufacturing facilities are located adjacent to other manufacturing facilities of Fujitsu. AMD and Fujitsu, on the one hand, and we, on the other, agreed to indemnify the other against liability arising from permit violations attributable to our respective activities. To the extent AMD and Fujitsu cannot meet their obligations under any of their indemnity agreements, or material environmental conditions arise, we may be required to incur costs to address these matters, which could have a material adverse effect on us.

We have made and will continue to make capital and other expenditures to comply with environmental laws, but we do not expect compliance with environmental requirements to result in material expenditures in the foreseeable future. Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time factors that could alter the current outlook. See Risk Factors We are subject to a variety of environmental laws that could result in liabilities.

**Competition**

Our principal competitors are Intel Corporation, Samsung Electronics Co., Ltd., STMicroelectronics, Silicon Storage Technology, Inc., Macronix International Co., Ltd., Toshiba Corporation, Sharp Electronics Corp., Renesas Technology Corp., Micron Technology, Inc. and Hynix Semiconductor Inc. In the future, our principal competitors may also include SanDisk Corporation and IM Flash Technology LLC, the joint venture between Intel and Micron Technology, Inc.

We expect competition in the market for Flash memory devices to intensify as existing manufacturers introduce new products, new manufacturers enter the market, industry-wide production capacity increases and

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

We believe Flash memory providers must also possess the following attributes to remain competitive:

- strong relationships with OEMs, ODMs and contract manufacturers that are acknowledged leaders within their respective industries;
- strong market focus to identify emerging Flash memory applications;
- leadership in research and development;
- flexibility in manufacturing capacity and utilization so as to take advantage of industry conditions through market cycles;
- access to the financial resources needed to maintain a highly competitive technological position;
- the ability to establish and sustain strategic relationships and alliances with key industry participants; and
- rapid time to market for new products, measured by the time elapsed from first conception of a new product to its commercialization.

Competitors are working on a number of new technologies, including FRAM, MRAM, polymer and phase-change based memory technologies. If successfully developed and commercialized as a viable alternative to Flash memory, these or other technologies could pose a competitive threat to a number of Flash memory companies, including us. In addition, we and some of our competitors have licensed Flash memory intellectual property associated with NROM technology from a third party. Use of this NROM intellectual property may allow these competitors to develop Flash memory technology that may compete with MirrorBit technology. To compete successfully, we must decrease our manufacturing costs and develop, introduce and sell products at competitive prices to meet the increasing demand for greater Flash memory content in mobile phones, consumer electronics, automotive and other applications.

Some of our competitors, including Intel, Samsung, STMicroelectronics, Toshiba, Sharp and Renesas, are more broadly diversified than we are and may be able to sustain lower operating margins in their Flash memory business based on profitability of their other, non-Flash memory businesses, allowing them to offer their Flash memory products at prices with which it is difficult for us to compete.

**Employees**

As of December 31, 2006, we had approximately 9,465 employees. Some employees of our wholly owned Japanese subsidiary, Spansion Japan, are represented by a company union.

**Backlog**

We generally manufacture and market standard lines of products. Consequently, a significant portion of our sales are made from inventory on a current basis. Sales are made primarily pursuant to purchase orders for current delivery or agreements covering purchases over a period of time. These orders or agreements may be revised or canceled without penalty. Generally, in light of current industry practice and experience, we do not believe that backlog information is necessarily indicative of actual sales for any succeeding period.

**Intellectual Property and Licensing**

We rely on a combination of protections provided by contracts, including confidentiality and non-disclosure agreements, copyrights, patents, trademarks and common law rights, such as trade secrets, to protect our

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intellectual property. Our U.S. patents are potentially valid and enforceable for either 17 years from the date they were issued or 20 years from the date they were filed. Accordingly, some of our existing patents will only survive for a few more years while others will survive for approximately another 15 years. We do not believe that the expiration of any specific patent will have a material adverse effect on us. In addition, the duration of our valid and enforceable trademarks is indefinite.

AMD and Fujitsu have each contributed to us various intellectual property rights pursuant to an Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement. Under this agreement, we became owners, or joint owners with each of Fujitsu and AMD, of certain patents, patent applications, trademarks, and other intellectual property rights and technology. AMD and Fujitsu reserved rights, on a royalty-free basis, to practice the contributed patents and to license these patents to their affiliates and successors-in-interest to their semiconductor groups. AMD and Fujitsu each have the right to use the jointly-owned intellectual property for their own internal purposes and to license such intellectual property to others to the extent consistent with their non-competition obligations to us. Subject to our confidentiality obligations to third parties, and only for so long as AMD s and Fujitsu s ownership interests in us remain above specific minimum levels, we are obligated to identify any of our technology to each of AMD and Fujitsu, and to provide copies of and training with respect to that technology to them. In addition, we have granted a non-exclusive, perpetual, irrevocable, fully paid and royalty-free license of our rights in that technology to each of AMD and Fujitsu.

AMD may grant licenses under our patents, provided that these licenses are of no broader scope than, and are subject to the same terms and conditions that apply to, any license of AMD s patents granted in connection with such license, and the recipient of such license grants to us a license of similar scope under its patents.

In connection with our reorganization in June 2003, we entered into separate patent cross-license agreements with each of AMD and Fujitsu in which we granted to AMD or Fujitsu, as applicable, and AMD or Fujitsu, as applicable, each granted to us, non-exclusive licenses under certain patents and patent applications of their semiconductor groups to make, have made, use, sell, offer to sell, lease, import and otherwise dispose of specific semiconductor-related products anywhere in the world. The patents and patent applications that are licensed are those with an effective filing date prior to the termination of our patent cross-license agreements. Each agreement will automatically terminate on the later of June 30, 2013 or the date AMD or Fujitsu, whichever is the other party to the agreement, sells its entire equity interest in us. Each agreement may be terminated by a party on a change in control of the other party or its semiconductor group. The licenses to patents under license at the time of the termination will survive until the last such patent expires.

Under each agreement, in cases where there is a change of control of us or the other party (AMD or Fujitsu, or each of their semiconductor groups, as applicable), the other party shall have the right to terminate the agreement (or to invoke the provisions described in this paragraph if the agreement had been previously terminated) by giving 30 days written notice within 90 days after receiving notice of the change of control. If so terminated, the rights, licenses and immunities granted under the agreement will continue solely with respect to those licensed patents that are entitled to an effective filing date that is on or before, and are licensed as of, the date of such change of control, and will continue until the expiration of the last to expire of such licensed patents. Moreover, with respect to circuit patents, which are patents (other than process patents) covering elements relating to electrical signals to achieve a particular function, the rights, licenses and immunities granted to the party undergoing the change of control are limited solely to:

each existing and pending product of such party as of the date of change of control;

each existing and pending product of the acquiring third party of such party as of the date of change of control that would have been in direct competition with products described in (i) above; and

successor products of products described in (i) and (ii) above provided such successor product is based substantially on the same technology.

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We will continue to make royalty payments associated with licenses that survive the termination of the cross-license agreement. In fiscal 2006 and fiscal 2005, we incurred royalty expenses of approximately $6 million and $14 million to each of AMD and Fujitsu under their respective patent cross-license agreements. In fiscal 2004, we incurred royalty expenses in the amount of approximately $18 million to each of AMD and Fujitsu under these agreements. The royalty rate we pay to each of AMD and Fujitsu under our patent cross-license agreements with them was reduced from one percent of net sales of our products to 0.5 percent on October 1, 2005, and was further reduced to 0.3 percent on December 21, 2005. Following the conversion of our Class D common stock into Class A common stock immediately prior to the completion of our secondary stock offering in November 2006, the royalty rate was further reduced to 0.15 percent and will further reduce to zero percent in November 2008.

As a subsidiary of AMD up until our initial public offering, we were the beneficiary of AMD s intellectual property arrangements with third parties, including patent cross-license agreements with other major semiconductor companies such as Intel, Motorola and IBM, and licenses from third parties for technology incorporated in our products and software used to operate our business. Since the completion of our initial public offering in December 2005, we are no longer a beneficiary under a number of these agreements. Furthermore, upon the conversion of the outstanding shares of Class D common stock into shares of Class A common stock immediately prior to the completion of our secondary stock offering in November 2006, we lost all rights as a beneficiary under most of these license agreements. As a result, we may be subject to claims that we are infringing intellectual property rights of third parties through the manufacture and sale of our products and the operation of our business. Therefore, absent negotiating our own license agreements with the third parties who own such intellectual property, we will be vulnerable to claims by such parties that our products or operations infringe such parties patents or other intellectual property rights.

Under our Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement with AMD and Fujitsu that we executed in December 2005, AMD agreed to enforce its applicable patents to minimize, to the extent reasonably possible, any of our losses incurred as a result of the infringement of third-party patents, provided that the details of the manner in which AMD enforces its patents, including which of its patents AMD enforces, is left to AMD s reasonable discretion. However, as a result of the conversion of the Class D common stock immediately prior to the completion of our secondary stock offering in November 2006, AMD is no longer obligated to provide us this benefit. We will continue to attempt to negotiate our own agreements and arrangements with third parties for intellectual property and technology that is important to our business, including the intellectual property that we previously had access to through our relationship with AMD. We will also attempt to acquire new patents as our success in negotiating patent cross-license agreements with other industry participants will depend in large part upon the strength of our patent portfolio relative to that of the third party with which we are negotiating. If the third-party benefits from an existing patent cross-license agreement with AMD, in many cases it will retain the rights that it has under that agreement even after we cease to be an AMD subsidiary, including rights to utilize the patents that AMD and Fujitsu transferred to us in connection with our reorganization as Spansion LLC in June 2003 and in connection with our initial public offering. In many cases, any such third party will also retain such rights to utilize any patents that have been issued to us or acquired by us subsequent to our reorganization and prior to our no longer being a subsidiary of AMD. Our negotiating position will therefore be impaired, because the other party will already be entitled to utilize a large number, or even all, of our patents, while we will no longer have the right to utilize that party s patents. As a result, we may be unable to obtain access to the other party s patent portfolio on favorable terms or at all. Similarly, with respect to licenses from third parties for technology incorporated in our products or software used to operate our business, we may not be able to negotiate prices with these third parties on terms as favorable to us as those available when we were a subsidiary of AMD because we are not able to take advantage of AMD s size and purchasing power. These parties, and other third parties with whom AMD had no prior intellectual property arrangement, may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted. Such litigation could be extremely expensive and time-consuming. We cannot assure you that such litigation would be avoided or successfully

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concluded. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture or sale of some or all of our products, would have a material adverse effect on us.

As of December 31, 2006, we had 1,171 U.S. patents and 428 foreign patents as well as 580 patent applications pending in the United States. In some cases, we have filed corresponding applications in foreign jurisdictions. We expect to file future patent applications in both the United States and abroad on significant inventions, as we deem appropriate. In addition, under our cross-license agreement with AMD, AMD granted us the right to use a substantial number of patents that AMD owns. Similarly, under our cross-license agreement with Fujitsu, Fujitsu also granted us the right to use a substantial number of patents that Fujitsu owns.

## ITEM 1A. RISK FACTORS

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

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

Sales of our Flash memory products are dependent to a large degree upon consumer demand for mobile phones. In fiscal 2006, wireless customers, which primarily consist of mobile phone original equipment manufacturers, or OEMs, represented the largest market for NOR Flash memory. The market research firm iSuppli projects that wireless handset NOR Flash memory will represent approximately 70 percent of all NOR Flash memory sales in 2007, excluding commercial die. In fiscal 2006 and fiscal 2005, sales to wireless Flash memory customers drove a majority of our sales.

Similarly, sales of our products targeting embedded Flash memory customers are dependent upon demand for consumer electronics such as set top boxes, or STBs, and DVD players, automotive electronics, industrial electronics such as networking equipment, personal computers and PC peripheral equipment such as printers. Sales of our products are also dependent upon the inclusion of increasing amounts of Flash memory content in some of these products. In fiscal 2006 and fiscal 2005, sales to embedded Flash memory customers drove a significant portion of our sales.

If demand for mobile phones or products in the embedded portion of the integrated category of the Flash memory market, or the Flash memory content of these products, is below our expectations, if the functionality of successive generations of such products does not require increasing Flash memory density or if such products no longer require Flash memory due to alternative technologies or otherwise, we would be materially adversely affected.

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

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

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

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

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

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

During 2004, industry sales of NAND-based Flash memory products grew at a higher rate than sales of NOR-based Flash memory products, resulting in NAND vendors in aggregate gaining a greater share of the overall Flash memory market and NOR vendors in aggregate losing overall market share. This trend continued in 2005 and 2006 when sales of NAND-based Flash memory products represented a majority of the Flash memory products sold in the overall Flash memory market. In 2005, according to iSuppli, total sales for the Flash memory market reached approximately $18.6 billion, of which approximately 42 percent was classified as sales of NOR-based Flash memory products and approximately 58 percent was classified as sales of NAND-based Flash memory products. For the first nine months of 2006, according to iSuppli, total sales for the Flash memory market reached approximately $15.3 billion, of which approximately 41 percent was classified as sales of NOR-based Flash memory products and approximately 59 percent was classified as sales of NAND-based Flash memory products. We expect the trend of decreasing market share for NOR-based Flash memory products to continue in the future. iSuppli estimates that sales of NAND-based Flash memory products grew by approximately 62 percent from 2004 to 2005 and will grow at a 17 percent compound annual growth rate from 2005 to 2010, while sales of NOR-based Flash memory products declined by approximately 15 percent from 2004 to 2005 and will grow at a seven and a half percent compound annual growth rate from 2005 to 2010.

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

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

Our competitors are working on a number of new technologies, including FRAM, MRAM, polymer and phase-change based memory technologies. If successfully developed and commercialized as a viable alternative to Flash memory, these or other technologies could pose a competitive threat to a number of Flash memory companies, including us. In addition, we and some of our competitors have licensed Flash memory intellectual property associated with NROM technology from a third party. Use of this NROM intellectual property may allow these competitors to develop Flash memory technology that may compete with MirrorBit technology.

***If we fail to successfully develop products based on our MirrorBit NOR, or new MirrorBit ORNAND or MirrorBit Quad architectures, or if there is a lack of market acceptance of these products, our future operating results would be materially adversely affected.***

We are positioning ourselves to address the increasing demand for higher density data optimized Flash memory by offering products based on our new MirrorBit ORNAND and MirrorBit Quad architectures. The success of these architectures requires that we timely and cost effectively develop, manufacture and market products based on these architectures that are competitive with floating gate NAND-based Flash memory products. We began commercial shipments of MirrorBit ORNAND-based products in the second quarter of fiscal 2006 and announced MirrorBit Quad-based family of products in January 2007. However, if we fail to develop and commercialize these products and additional products based on these architectures on a timely basis, our future operating results would be materially adversely affected. Furthermore, if market acceptance of products based on our MirrorBit technology occurs at a slower rate than we anticipate, our ability to compete will be reduced, and we would be materially adversely affected. If we do not achieve market acceptance of these products or subsequent MirrorBit products, our future operating results would be materially adversely affected.

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

Sales of our products are dependent to a large extent on demand for mobile phones. Historically, a small number of wireless Flash memory customers have driven a substantial portion of our net sales. If one of these customers decided to stop buying our Flash memory products, or if one of these customers were materially to reduce its operations or its demand for our products, we could be materially adversely affected. For example, in the fourth quarter of fiscal 2006 we were materially adversely affected by the reduced demand by certain customers for our custom high density NOR-based Flash memory solutions used in mid-range wireless handsets.

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***We have a substantial amount of indebtedness which could adversely affect our financial position.***

We currently have and will continue to have for the foreseeable future, a substantial amount of indebtedness. As of December 31, 2006, we had an aggregate principal amount of approximately $1,118 million in outstanding debt.

Our substantial indebtedness may:

- require us to use a substantial portion of our cash flows from operations to make debt service payments;
- make it difficult for us to satisfy our financial obligations;
- limit our ability to use our cash flows or obtain additional financing for future working capital, capital expenditures, acquisitions or other general corporate purposes;
- limit our flexibility to plan for, or react to, changes in our business and industry;
- place us at a competitive disadvantage compared to our less leveraged competitors; and
- increase our vulnerability to the impact of adverse economic and industry conditions.

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

We are party to a $175 million senior secured revolving credit facility that imposes various restrictions and covenants on us that limits our ability to:

- enter into any mergers, consolidations or sales of property, or sales of inventory, equipment and assets except in the ordinary course of business;
- make any distributions except for distributions from Spansion LLC to us in specified circumstances;
- make investments, except for the purchase of inventory, equipment and intellectual property in the ordinary course of business, unless we meet minimum liquidity requirements consisting of availability under the revolving credit facility and domestic cash of at least $200 million, provided, however, that investments are limited to no more than a total of $50 million while the reduced minimum liquidity requirement is in place;
- incur additional debt, enter into capital leases and, in limited cases, make loans to subsidiaries;
- engage in transactions with affiliates unless the transactions are in the normal course of business, negotiated at arms-length and disclosed to the agent for the lenders;

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

prepay any debt, except that debt of foreign subsidiaries may be prepaid by the applicable foreign subsidiary and we may prepay any debt as long as after such repayment we meet minimum liquidity requirements consisting of availability under the revolving credit facility plus domestic cash of at least $250 million.

In addition, our $500 million senior secured term loan facility and the indenture governing Spansion LLC s $250 million principal amount of 11.25% Senior Notes due 2016 impose substantially similar restrictions and covenants on us which could limit our ability to respond to market conditions, make capital investments or take advantage of business opportunities. Moreover, the Senior Notes bear a higher rate of interest than our bank debt, which will adversely affect our results of operations.

In the future, we will likely incur additional indebtedness through arrangements such as credit agreements or term loans that may also impose similar restrictions and covenants. These restrictions and covenants limit, and any future covenants and restrictions likely will limit, our ability to respond to market conditions, to make capital

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investments or to take advantage of business opportunities. Any debt arrangements we enter into would likely require us to make regular interest payments, which would adversely affect our results of operations.

As of December 31, 2006, we were in compliance with the financial covenants under our debt instruments. However, we cannot assure you that in the future we will be able to satisfy the covenants, financial tests and ratios of our debt instruments, which can be affected by events beyond our control. For example, as of December 25, 2005, Spansion Japan was not in compliance with certain financial covenants under its debt instruments but obtained waivers from the other parties. A breach of any of the covenants, financial tests or ratios under our debt instruments could result in a default under the applicable agreement, which in turn could trigger cross-defaults under our other debt instruments, any of which would materially adversely affect us.

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

Our ability to fund anticipated capital expenditures depends on generating sufficient cash flows from operations and the availability of external financing. We expect our total capital expenditures for fiscal 2007 to be approximately $1.0 billion. Our capital expenditures, together with ongoing operating expenses, will be a substantial drain on our cash flows and may decrease our cash balances. The timing and amount of our capital requirements cannot be precisely determined at this time and will depend on a number of factors, including demand for our products, product mix, changes in industry conditions and market competition.

We may assess markets for external financing opportunities, including debt and equity. Such financing may not be available when needed or, if available, may not be available on satisfactory terms. Any equity financing would cause dilution to our stockholders. Our inability to obtain needed financing or to generate sufficient cash from operations may require us to abandon projects or curtail capital expenditures. If we cannot generate sufficient operating cash flows or obtain external financing, we may be delayed in achieving, or may not achieve, needed manufacturing capacity, and we could be materially adversely affected.

***If we are unable to timely and efficiently expand our manufacturing capacity to implement 300-millimeter wafer capacity at SP1, our business, results of operations or financial condition could be materially adversely affected.***

We intend to expand our manufacturing capacity to produce approximately 15,000 to 20,000 300-millimeter wafers per month at our planned flash memory manufacturing facility in Aizu-Wakamatsu, Japan, which we refer to as SP1. Our goal is to have 65-nanometer process technology on 300-millimeter wafer capacity in place in late 2007, and 45-nanometer process technology on 300-millimeter wafer capacity in place in early fiscal 2008. In fiscal 2006 we commenced a plan to spend approximately $1.2 billion over three years to construct and equip our planned flash memory manufacturing facility in Aizu-Wakamatsu, Japan, which we refer to as SP1. However, the actual cost and capacity achieved will vary depending on various factors, including available financing and future product demand. Financing for the construction of and equipment for SP1 may not be available when needed or, if available, may not be available on satisfactory terms. If we do not achieve our desired capacity at the anticipated cost, or if we cannot obtain suitable financing, we may be delayed in achieving, or may not achieve, such capacity, and we could be materially adversely affected.

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

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

We incurred a net loss in each of fiscal 2006, 2005 and 2004 of approximately $148 million, $304 million and $20 million, respectively. As a result, we continue to undertake actions in an effort to significantly reduce our expenses. These actions include and have included streamlining operations, continuing to align manufacturing utilization to our level of demand, controlling increasing testing costs and working with AMD and Fujitsu to reduce costs under our service agreements with them. We cannot assure you that we will be able to achieve anticipated cost reductions. If our cost reduction efforts are unsuccessful, we may be materially adversely affected.

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

Our success depends to a significant extent on the development, qualification, production, introduction and acceptance of new product designs and improvements that provide value to Flash memory customers. We must also be able to accomplish this process at a faster pace than we currently do. For example, we introduced products on 90-nanometer process technology in 2006 and plan to be in production on 65-nanometer process technology in 2007 and in production on 45-nanometer process technology in 2008. Our ability to develop and qualify new products and related technologies to meet evolving industry requirements, at prices acceptable to our customers and on a timely basis are significant factors in determining our competitiveness in our target markets. If we are delayed in developing or qualifying new products or technologies, we could be materially adversely affected. For example, during the second half of fiscal 2004 and the first quarter of fiscal 2005, we experienced a delay in qualifying and introducing a new Flash memory product based on our MirrorBit technology for wireless Flash memory customers. The delay, which was due to our having to re-design the product in order to achieve higher performance specifications under all temperature conditions, contributed to lower than anticipated net sales during the second half of fiscal 2004 and the first six months of fiscal 2005 and caused us to lose market share. We began delivering a version of this product in the first quarter of fiscal 2005, and we began delivering our new, higher performance version of the product by the end of the second quarter of fiscal 2005. In addition, we continue to transition certain of our products from floating gate technology to MirrorBit technology. If we experience any substantial difficulty with this transition, we will be materially adversely affected.

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

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

- substantial declines in average selling prices, particularly due to aggressive pricing by competitors and an imbalance in product supply and demand;
- a decline in demand for end-user products that incorporate our products; and
- less than expected demand in the distribution channels such as by mobile phone OEMs in China.

For example, our net sales in fiscal 2005 decreased from fiscal 2004. Similarly, our net sales in the second half of fiscal 2004 decreased significantly compared to the first half of fiscal 2004. Net sales in the second half of fiscal 2004 were also adversely affected by a decrease in demand from the mobile phone market and several events that occurred in the first half of fiscal 2004, such as excess inventory accumulation by mobile phone OEMs in China and our inability to meet demand for some of our lower density products for embedded Flash memory customers. This inability to meet demand adversely impacted our relationship with these customers and our competitors were able to take advantage of this situation to increase their market share.

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Also, during fiscal 2005 and the first quarter of fiscal 2006, average selling prices for our products decreased. If our net sales or average selling prices decline in the future, or if these or other similar conditions continue or occur again in the future, we would likely be materially adversely affected.

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

There may be situations in which our manufacturing capacity is inadequate to meet the demand for some of our products. We increasingly depend on foundry, subcontractor and similar arrangements with third parties to meet demand. Our arrangements with third-party suppliers do not necessarily include capacity guarantees. If a third-party manufacturer on which we rely does not have the capacity to deliver an adequate amount of product to meet actual demand, we may not be able to obtain the manufacturing capacity, either in our own facilities or through other third-party arrangements, to meet such demand. During fiscal 2006, demand for certain of our products exceeded the available supply. As a result, we were unable to meet the demand of some of our customers for these products. This could adversely impact our relationships with customers, cause harm to our reputation in the marketplace, cause these customers to move future business to our competitors or cause us to make financial concessions to our customers. Any of these occurrences could have a material adverse effect on us. Also, in the third and fourth quarters of fiscal 2005 and the third quarter of fiscal 2006, we experienced capacity constraints for final test and assembly of some of our products. These constraints continued into the fourth quarter of fiscal 2006. While we have worked internally and with subcontractors to increase capacity to meet anticipated demand, we cannot assure you that we will not experience similar constraints in the future. These capacity constraints limit our ability to respond to rapid and short-term surges or changes in demand for our products. If we are unable to obtain sufficient manufacturing capacity to meet anticipated demand, either in our own facilities or through foundry, subcontractor or similar arrangements with third parties, or if we are unable to obtain foundry services at competitive rates, our business may be materially adversely affected.

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

We currently obtain foundry services from other companies, including Taiwan Semiconductor Manufacturing Company Limited, and following the sale of our JV1 and JV2 manufacturing facilities we will also obtain foundry services from Fujitsu. We also use independent contractors to perform some of the assembly, testing and packaging of our products. Third-party manufacturers are often under no obligation to provide us with any specified minimum quantity of product. We depend on these manufacturers to allocate to us a portion of their manufacturing capacity sufficient to meet our needs, to produce products of acceptable quality and at acceptable manufacturing yields and to deliver those products to us on a timely basis at acceptable prices. We cannot assure you that these manufacturers will be able to meet our near-term or long-term manufacturing requirements. These manufacturers also make products for other companies, including certain of our competitors, and/or for themselves and could choose to prioritize capacity for themselves or other customers beyond any minimum guaranteed amounts, reduce deliveries to us or, in the absence of price guarantees, increase the prices they charge us on short notice, such that we may not be able to pass cost increases on to our customers. Because it could take several quarters or more to establish a relationship with a new manufacturing partner, we may be unable to secure an alternative supply for specific products in a short timeframe or at all at an acceptable cost to satisfy our production requirements. In addition, we may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. Other risks associated with our increased dependence on third-party manufacturers include: their ability to adapt to our proprietary technology, reduced control over delivery schedules, quality assurance, manufacturing yields and cost, lack of capacity in periods of excess demand, misappropriation of our intellectual property, reduced ability to manage inventory and parts and risks associated with operating in foreign countries. If we are unable to secure sufficient or reliable suppliers of wafers or obtain the necessary assembling, testing and packaging services, our ability to meet customer demand for our products may be adversely affected, which could have a material adverse effect on us.

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***Industry overcapacity could require us to lower our prices and have a material adverse effect on us.***

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

***Industry overcapacity could cause us to under-utilize our manufacturing capacity and have a material adverse effect on us.***

It is difficult to predict future growth or decline in the markets we serve, making it very difficult to estimate requirements for production capacity. If our target markets do not grow as we anticipate, we may under-utilize our manufacturing capacity. This may result in write-downs or write-offs of inventories and losses on products whose demand is lower than we anticipate. In addition, during periods of industry overcapacity, such as we have recently experienced, customers do not generally order products as far in advance of the scheduled shipment date as they do during periods when our industry is operating closer to capacity, which can exacerbate the difficulty in forecasting capacity requirements.

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

***Our business has been characterized by average selling prices that decline over relatively short time periods, which can negatively affect our results of operations unless we are able to reduce our costs or introduce new products with higher average selling prices.***

Average selling prices for our products historically have declined over relatively short time periods. For example, in the first quarter of fiscal 2005, our average selling prices decreased by approximately 17 percent compared with the fourth quarter of fiscal 2004. We are unable to predict pricing conditions for any future periods. Even in the absence of downturns or oversupply in the industry, average selling prices of our products have decreased during the products lives, and we expect this trend to continue. When our average selling prices decline, our net sales and net income decline unless we are able to compensate by selling more units, reducing our manufacturing costs or introducing new, higher margin products with higher densities and/or advanced features. We have experienced declining average selling prices in the past, and we expect that we will continue to experience them in the future, although we cannot predict when they may occur or how severe they will be. If our average selling prices decline, our operating results could be materially adversely affected. In addition, average selling prices for our products may also be adversely affected by a significant decline in the price for NAND products. Such a decline may result in downward price pressure in the overall Flash memory market, which would adversely affect us.

***Our historical financial results may not be indicative of our future performance as an independent company.***

Our historical financial information does not necessarily indicate what our results of operations, financial condition or cash flows will be in the future. After our reorganization as Spansion LLC and prior to our initial public offering, we were a majority-owned subsidiary of AMD, and we sold all of our products to our sole distributors, AMD and Fujitsu, who in turn sold our products to customers worldwide. Upon our initial public offering, we became an independent company. Since that time, we have transitioned our sales processes so that we are able to sell our products directly to AMD s former customers and customers not served solely by Fujitsu.

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We have also expanded our administrative functions and reduced our reliance on AMD s provision of administrative services. Because of these significant changes, our historical financial results may not be indicative of our future financial results.

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

Our principal competitors in the Flash memory market are Intel Corporation, Samsung Electronics Co., Ltd., STMicroelectronics, Silicon Storage Technology, Inc., Macronix International Co., Ltd., Toshiba Corporation, Sharp Electronics Corp., Renesas Technology Corp., Micron Technology, Inc. and Hynix Semiconductor Inc. In the future, our principal competitors may also include SanDisk Corporation and IM Flash Technology, LLC, the joint venture between Intel and Micron Technology, Inc. The Flash memory market is characterized by intense competition. The basis of competition is cost, selling price, performance, quality, customer relationships and ability to provide value-added solutions. In particular, in the past, our competitors have aggressively priced their products in order to increase market share, which resulted in decreased average selling prices for our products in the second half of fiscal 2004 and the first quarter of fiscal 2005 and adversely impacted our results of operations. Some of our competitors, including Intel, Samsung, STMicroelectronics, Toshiba, Sharp and Renesas, are more diversified than we are and may be able to sustain lower operating margins in their Flash memory business based on the profitability of their other, non-Flash memory businesses. In addition, recent capital investments by competitors have resulted in substantial industry manufacturing capacity, which may further contribute to a competitive pricing environment. Moreover, some of our competitors are able to manufacture on 300-millimeter wafers or may choose to utilize more advanced manufacturing process technologies than we use today to offer products competitive to ours at a lower cost.

We expect competition in the market for Flash memory devices to intensify as existing manufacturers introduce new products, new manufacturers enter the market, industry-wide production capacity increases and competitors aggressively price their Flash memory products to increase market share. Competition also may increase if NOR memory vendors merge, if NAND memory vendors acquire NOR businesses or other NAND businesses, or if our competitors otherwise consolidate their operations. Furthermore, we face increasing competition from NAND Flash memory vendors in some portions of the integrated Flash memory market.

We also expect to face competition as we address new applications with the introduction of our MirrorBit ORNAND- and MirrorBit Quad-based products. These products are intended to allow us to compete in the data storage portion of the integrated category and select portions of the removable category of the Flash memory market that might otherwise be served by NAND-based Flash memory products or other non-volatile storage technologies such as ROM or optical discs. As a result, we may compete with a number of established NAND-based Flash memory vendors and other incumbent suppliers of alternative technology in marketing and selling these products. Moreover, our MirrorBit ORNAND- and MirrorBit Quad-based products may not have the price, performance, quality and other features necessary to compete successfully for these applications.

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

***If we are unable to diversify our customer base, we could be materially adversely affected.***

We serve our customers worldwide directly through our sales force and indirectly through our distributors, who purchase products from us and sell them to customers, either directly or through their distributors. Our customers consist of OEMs, original design manufacturers, or ODMs, and contract manufacturers. In fiscal 2005 and fiscal 2006, the five largest of these customers accounted for a significant portion of end sales of our products. Our business strategy is to continue to maintain and increase our market share, diversify our customer base in the integrated category of the Flash memory market, and enter new markets enabled by our MirrorBit

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technology. We cannot assure you that we will be successful in implementing this strategy, and if we are unsuccessful, we could be materially adversely affected. For example, in the fourth quarter of fiscal 2006 we were materially adversely affected by the reduced customer demand for some of our custom high density NOR-based Flash memory solutions used in mid-range wireless handsets. We intend to increase our sales to embedded Flash memory customers in part by expanding the number of customers who buy through our distribution channel as well as the number of customers in emerging markets and by developing new markets for our products. If we are unsuccessful in executing this strategy, we could be materially adversely affected.

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

We make substantial investments in research and development for design and process technologies in an effort to design and manufacture advanced Flash memory products. For example, in fiscal 2006, our research and development expenses were approximately $348 million, or approximately 13 percent of our net sales. In fiscal 2005, our research and development expenses were approximately $296 million, or approximately 15 percent of our net sales.

Currently, we are developing new non-volatile memory process technologies, including 65-nanometer and 45-nanometer process technologies. Our SDC facility is developing manufacturing process technologies on 300-millimeter wafers. We cannot assure you that we will have sufficient resources to maintain the level of investment in research and development that is required for us to remain competitive, which could materially adversely affect us. Further, we cannot assure you that our investments in research and development will result in increased sales or competitive advantage, which could adversely affect our operating results.

***Unless we maintain manufacturing efficiency, our future profitability could be materially adversely affected.***

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

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

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concessions to our customers. For example, in the third quarter of fiscal 2006, we had lower than expected yields on 12,000 raw wafers and, as a result, we were unable to meet the demand of some of our customers, including in Japan, and our revenue and gross margins were reduced.

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

- develop advanced process technologies and advanced products that utilize those technologies;
- successfully transition to 65-nanometer and more advanced process technologies;
- continue to reduce test times;
- ramp product and process technology improvements rapidly and effectively to commercial volumes across our facilities;
- achieve acceptable levels of manufacturing wafer output and yields, which may decrease as we implement more advanced technologies; and
- maintain our quality controls and rely upon the quality and process controls of our suppliers.

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

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

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

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

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

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

We recently completed our physical separation from AMD s information systems, and are continuing to design and implement our own enterprise-wide information systems. These systems have been designed to automate more fully our business processes and affect most of our functional areas including sales, finance, procurement, inventory control, collections, order processing and manufacturing. Implementation of information systems is particularly difficult since our systems have historically been integrated into AMD s systems. Implementation has also required significant upgrades and enhancements to our existing computer hardware and software systems. Historically, other companies have experienced substantial delays in the implementation of such information systems. Implementation of these information systems is complex, expensive and time consuming and successful implementation could be delayed or otherwise adversely affected by various factors including: (i) any failure to provide adequate training to employees; (ii) any failure to retain key members of the implementation team or to find suitable replacements for such personnel; (iii) any failure to develop and apply appropriate testing procedures that accurately reflect the demands that will be placed on these information systems following implementation; and (iv) any failure to develop and implement adequate back-up systems and procedures in the event that difficulties or delays arise during or following the implementation of these information systems.

In connection with the implementation of these information systems, we may experience functional and performance problems, including problems relating to the information systems response time and data integrity. In addition, resolution of any such problems could entail significant additional costs. We cannot assure you that we will be able to implement these information systems successfully or on a timely basis and in a cost-effective manner or that these information systems will not fail or prove to be unsuitable for our needs. Our inability to implement or resolve problems with these information systems in a timely and cost-effective manner could materially adversely affect us.

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

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

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We also rely on purchasing commercial memory die from third-party suppliers to incorporate these die into multi-chip package, or MCP, products. The availability of these third-party purchased commercial die is subject to market availability, and the process technology roadmaps and manufacturing capacities of our vendors. For example, our production was constrained in the first half of fiscal 2004 because of difficulties in procuring adequate supply of pseudo static RAM, or pSRAM. In addition, some of our major suppliers, including Samsung, are also our competitors. Interruption of supply from a competitor that is a supplier or otherwise or increased demand in the industry could cause shortages and price increases in various essential materials. If we are unable to procure these materials, or if the materials we receive from our suppliers do not meet our production requirements or product specifications, we may have to reduce our manufacturing operations or our manufacturing yields may be adversely affected. Such a reduction and yield issues has in the past and could in the future have a material adverse effect on us.

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

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

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

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

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

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

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

***We may not be successful in establishing a brand identity.***

We have used the brand name of Spansion since June 2003. Prior to that time, all of our Flash memory products were sold under either AMD s or Fujitsu s brand. AMD s and Fujitsu s brand names are well known by Flash memory customers, suppliers and potential employees. We expend time, effort and resources to continue to establish our brand name in the marketplace. We cannot assure you that this effort will ultimately be successful. If we are unsuccessful in continuing to establish our brand identity, we may be materially adversely affected.

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

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

- some of our manufacturing costs are denominated in Japanese yen, Chinese renminbi, and other foreign currencies such as the Thai baht and Malaysian ringgit;
- sales of our products to Fujitsu are denominated in both US dollars and Japanese yen; and
- some fixed asset purchases are denominated in Japanese yen and European Union euros.

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

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

Worldwide economic conditions may adversely affect demand for our products. For example, China s economy has been growing at a fast pace over the past several years, and the Chinese government introduced various measures to slow down the pace of economic growth. We believe some of these measures negatively impacted demand for our Flash memory products in the second half of fiscal 2004. A decline in economic conditions in China could lead to declining worldwide economic conditions. If economic conditions decline, whether in China, another country or worldwide, we could be materially adversely affected.

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

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

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

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

- expropriation;

changes in political or economic conditions;

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

difficulties in protecting our intellectual property;

difficulties in achieving headcount reductions;

changes in foreign currency exchange rates;

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

changes in freight and interest rates;

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

loss or modification of exemptions for taxes and tariffs.

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

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

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

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

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

Our business is subject to complex and dynamic environmental regulatory schemes. While we have budgeted for reasonably foreseeable environmental expenditures, we cannot assure you that environmental laws will not change or become more stringent in the future. Future environmental regulations could require us to

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procure expensive pollution abatement or remediation equipment; to modify product designs; or to incur other expenses associated with compliance with such regulations. For example, the European Union and China recently began imposing stricter requirements regarding reduced lead content in semiconductor packaging. Therefore, we cannot assure you that our costs of complying with current and future environmental and health and safety laws, or liabilities arising from past or future releases of, or exposure to, hazardous substances, will not have a material adverse effect on our business.

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

Our worldwide operations could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For example, our corporate headquarters are located near major earthquake fault lines in California, and three of our four wafer fabrication facilities are located near major earthquake fault lines in Japan. In addition, our assembly and test facilities located in China, Malaysia and Thailand may be affected by tsunamis. In the event of a major earthquake, tsunami or other natural or manmade disaster, we could experience loss of life of our employees, destruction of facilities or other business interruptions, any of which could materially adversely affect us.

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

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

Our bylaws provide that for so long as AMD or Fujitsu maintains specified ownership levels in our common stock, we will not be able to take the following actions without the prior consent of AMD and/or Fujitsu, as applicable:

engage in or undertake any material activity unrelated to our current Flash memory business, for so long as AMD s aggregate ownership interest in us is at least 20 percent;

amend the charter documents of any of our subsidiaries if such amendment would adversely and disproportionately affect AMD relative to Fujitsu, for so long as AMD s aggregate ownership interest in us is at least 15 percent;

amend our certificate of incorporation or bylaws or effect any resolution to wind up Spansion Inc. or any other subsidiary, for so long as AMD s or Fujitsu s aggregate ownership interest in us is at least 10 percent;

shut down operations at JV3 before April 1, 2007, any facilities of the non-manufacturing organization of our wholly owned subsidiary Spansion Japan before April 1, 2007, operations at JV1 or JV2 before April 1, 2007 without giving AMD and Fujitsu six months advance notice or operations at our assembly and test facility in Kuala Lumpur, Malaysia before April 1, 2007 without giving AMD and Fujitsu three months advance notice, for so long as AMD or Fujitsu owns any shares of any class of our common stock; or

reduce headcount at JV1, JV2 or JV3 by more than ten percent prior to April 1, 2007 or reduce headcount at any facilities of the non-manufacturing organization of Spansion Japan by more than 15 percent prior to April 1, 2007, for so long as AMD or Fujitsu owns any shares of any class of our common stock.

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

***The interests of AMD and Fujitsu, and our directors nominated by them, may differ from or conflict with our interests or those of our other stockholders.***

When exercising their rights as our stockholders, either alone or in concert, AMD and Fujitsu may take into account not only our interests but also their interests and the interests of their other affiliates. Our interests and the interests of AMD and Fujitsu may at times conflict since the growth of our business depends, in part, on successful competition with other semiconductor companies. These conflicts may result in lost corporate opportunities for us, including opportunities to enter into lines of business that may overlap with those pursued by AMD and Fujitsu. We may not be able to resolve any potential conflicts, and, even if we do so, the resolution may be less favorable to us than if we were dealing with unaffiliated parties.

Various other conflicts of interest between our two principal stockholders and us may arise in the future in a number of areas relating to our business and relationships, including potential acquisitions of businesses or properties, intellectual property matters, transfers by AMD or Fujitsu of all or any portion of its ownership interest in us or its other assets, which could be to one of our competitors, indemnity arrangements, service arrangements and business opportunities that may be attractive to AMD, Fujitsu and us.

AMD and Fujitsu are our two largest stockholders. AMD has the right to elect one member to our board of directors. Fujitsu has the right to elect one member to our board of directors. Each stockholder s ability to elect directors is subject to reduction based on the amount of our common stock that they own and this right terminates when their ownership in us falls below ten percent.

In addition, the directors appointed by AMD and Fujitsu continue to hold positions at AMD and Fujitsu. Individuals who are our directors and also officers of either AMD or Fujitsu have a duty of care and loyalty to us when acting in their capacities as our directors and a duty of care and loyalty to AMD or Fujitsu when acting as their officers or directors. However, our certificate of incorporation provides that in the event a director or officer of our company who is also a director or officer of AMD or Fujitsu acquires knowledge of a potential business opportunity that may be deemed a corporate opportunity of our company and AMD or Fujitsu, such opportunity will belong to AMD or Fujitsu, as applicable, unless it has been expressly offered to such director or officer in writing solely in his or her capacity as a director or officer of our company. Ownership of AMD common stock, or stock options to acquire AMD common stock by any of our directors and officers could create, or appear to create, potential conflicts of interest when those directors and officers are faced with decisions that could have different implications for AMD than they do for us.

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

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

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

We currently rely on Fujitsu to act as the sole distributor of our products to customers in Japan, which in fiscal 2006 was one of our most important geographic markets. Under our distribution agreement with Fujitsu, Fujitsu has agreed to use its best efforts to promote the sale of our products in Japan and to other customers served by Fujitsu. In the event that we reasonably determine that Fujitsu s sales performance in Japan and to those customers served by Fujitsu is not satisfactory based on specified criteria, then we have the right to require Fujitsu to propose and implement an agreed-upon corrective action plan. If we reasonably believe that the corrective action plan is inadequate, we can take steps to remedy deficiencies ourselves through means that include appointing another distributor as a supplementary distributor to sell products in Japan and to customers served by Fujitsu. Pursuing these actions would be costly and disruptive to the sales of our products in Japan. If Fujitsu s sales performance in Japan is unsatisfactory or if we are unable to successfully maintain our distribution agreement and relationship with Fujitsu, as a result of its seeking indemnity from us in respect of certain infringement claims made by Texas Instruments or otherwise, and we can not timely find a suitable supplementary distributor, we would be materially adversely affected.

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

In connection with our reorganization as Spansion LLC in June 2003, AMD and Fujitsu transferred approximately 400 patents and patent applications to us. In addition, AMD and Fujitsu contributed additional patents to us at the time of our initial public offering. However, both AMD and Fujitsu have retained the rights to use any patents contributed to us for an unlimited period of time. In addition, under their respective patent cross-license agreements with us, AMD and Fujitsu have also obtained licenses to our present and future patents with effective filing dates prior to the later of June 30, 2013, or such date on which they have transferred all of their shares in us, although the scope of patents under license can be impacted by a change in control of the parties or their semiconductor groups. These licenses continue until the last to expire of the patents under license expires and provide AMD and Fujitsu with licenses to all of our present and future patents in existence through such cross-license termination date. Furthermore, we entered into an Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement with AMD and Fujitsu in connection with our reorganization as Spansion Inc. in December 2005. Pursuant to that agreement, subject to our confidentiality obligations to third parties, and only for so long as AMD s and Fujitsu s ownership interests in us remain above specific minimum levels, we are obligated to identify any of our technology to each of AMD and Fujitsu, and to provide copies of and training with respect to that technology to them. In addition, pursuant to this agreement we have granted a non-exclusive, perpetual, irrevocable fully paid and royalty-free license of our rights, other than patent and trademark rights, in that technology to each of AMD and Fujitsu. AMD may grant licenses under our patents, provided that these licenses are of no broader scope than, and are subject to the same terms and conditions that apply to, any license of AMD s patents granted in connection with such license, and the recipient of such license grants to us a license of similar scope under its patents.

Under our non-competition agreement, both AMD and Fujitsu have agreed that they will not directly or indirectly engage in a business, and have agreed to divest any acquired business, that manufactures or supplies standalone semiconductor devices (including single chip, multiple chip or system devices) containing certain Flash memory, which is the business in which we primarily compete. With respect to each of AMD and Fujitsu, this non-competition restriction will last until the earlier of (i) two years from the date such stockholder s ownership in us falls to or below five percent, or (ii) the dissolution of our company. After that time, should they ever decide to re-enter the Flash memory business, AMD or Fujitsu could use our present and future patents and technologies licensed by us to AMD and Fujitsu under the cross licenses and our Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement to compete against us. If either AMD or Fujitsu were to compete with us, we could be materially adversely affected.

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***Our stock price may decline as a result of sales of common stock by us, AMD or Fujitsu.***

Our reorganization in 2003 was the commencement of AMD s and Fujitsu s respective divestures of their Flash memory businesses. Since that time, our activities as an independent company, including our initial public offering in December 2005 and our secondary stock offering in November 2006, have been vehicles by which AMD and Fujitsu further reduced their holdings in us. Recently, AMD began selling a large number of our shares in the public market under Rule 144, and we expect them to continue their divesture. Sales of substantial amounts of our common stock, or the possibility of such sales, could adversely affect the market price of our common stock and impede our ability to raise capital through the issuance of additional equity securities. Subject to any applicable U.S. federal and state securities laws, AMD and Fujitsu may begin to sell shares of our common stock that they beneficially own. In addition, we could also issue and sell additional shares of our common stock. For example, AMD recently sold a large number of our shares. We cannot predict with any certainty the effects of such sales, however, any further sale by AMD, or a sale by Fujitsu or us of our common stock in the public market, or the perception that sales could occur, could adversely affect prevailing market prices for our common stock.

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

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

- actual or anticipated changes in our operating results;
- changes in financial estimates by securities analysts;
- fluctuations in the valuation of companies perceived to be comparable to us;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, divestitures, joint ventures or other strategic initiatives; and
- stock price and volume fluctuations attributable to inconsistent trading volume levels or other factors.

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

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

The trading market for our securities depends, in part, on the research reports and ratings that securities or industry analysts or ratings agencies publish about us, our business and the Flash memory market in general. We do not have any control over these analysts or agencies. If one or more of the analysts or agencies who cover us downgrades us or our securities, the price of our securities may decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause the price of our securities or trading volume to decline.

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

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

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

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

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

If we conduct an offering of our common stock, we may experience an ownership change as defined in the Internal Revenue Code such that our ability to utilize our federal net operating loss carryforwards of approximately $241 million as of December 31, 2006 may be limited under certain provisions of the Internal Revenue Code. As a result, we may incur greater tax liabilities than we would in the absence of such a limitation and any increased liabilities could materially adversely affect us.

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

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. These provisions include restrictions on the ability of our stockholders to remove directors, a classified board of directors and limitations on action by our stockholders by written consent. In addition, our board of directors has the right to issue preferred stock without stockholder approval, which could be used to make an acquisition of us more difficult. Although we believe these provisions protect our stockholders from coercive or otherwise unfair takeover tactics and thereby provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our board of directors, these provisions apply even if the offer may be considered beneficial by some stockholders.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2. PROPERTIES**

Our principal engineering, manufacturing and administrative facilities comprise approximately 5.5 million square feet and are located in the United States, France, Japan, Korea, Malaysia, Thailand and China. Over 5.1 million square feet of this space is in buildings we own. The remainder of this space is leased. We lease from Fujitsu approximately 2.0 million square feet of land in Aizu-Wakamatsu, Japan for our wafer fabs including the land upon which JV1 and JV2 and JV3 and SP1 are located and we lease office space in Aichi, Japan from a subsidiary of Fujitsu, Fujitsu VLSI. We lease approximately 635,000 square feet of land in Suzhou, China for our assembly and test facility. Our Fab 25 facility in Austin, Texas and our facility in Sunnyvale, California are encumbered by liens securing our senior secured term loan facility and our senior secured revolving credit facility. See Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations.

Our facility leases have terms of generally one to five years. We currently do not anticipate difficulty in either retaining occupancy of any of our facilities through lease renewals prior to expiration or through month-to-month occupancy or replacing them with equivalent facilities. Our land lease in Aizu-Wakamatsu expires in 2033 and the land lease relating to JV1 and JV2 will be terminated at the effective time of the JV1/JV2 Transaction.

**ITEM 3. LEGAL PROCEEDINGS**

On October 7, 2005, Tessera, Inc. filed a complaint, Civil Action No. 05-04063, for patent infringement against Spansion LLC and AMD in the United States District Court for the Northern District of California under the patent laws of the United States of America, 35 U.S.C. section 1, *et seq.*, including 35 U.S.C. section 271. The complaint alleges that Spansion LLC s ball grid array and multichip packages infringe the following Tessera patents: United States Patent No. 5,679,977, United States Patent No. 5,852,326, United States Patent No. 6,433,419 and United States Patent No. 6,465,893. On December 16, 2005, Tessera filed a First Amended Complaint naming Spansion and Spansion Technology Inc., our wholly owned subsidiary, as defendants. On January 31, 2006, Tessera filed a Second Amended Complaint adding Advanced Semiconductor Engineering, Inc., Chipmos Technologies, Inc., Chipmos U.S.A., Inc., Silicon Precision Industries Co., Ltd., Siliconware USA, Inc., ST Microelectronics N.V., ST Microelectronics, Inc., Stats Chippac Ltd., Stats Chippac, Inc., and Stats Chippac (BVI) Limited. The Second Amended Complaint alleges that Spansion LLC s ball grid array and multichip packages infringe on four Tessera patents. The Second Amended Complaint further alleges that each of the newly named defendants is in breach of a Tessera license agreement and is infringing on five Tessera patents. The Second Amended Complaint seeks unspecified damages and injunctive relief. On February 9, 2006, Spansion filed an answer to the Second Amended Complaint and asserted counterclaims against Tessera. On April 18, 2006, U.S. District Court Judge Claudia Wilken issued a Case Management Order that sets a trial date of January 28, 2008.

Tessera has requested the following findings and remedies:

a finding that Tessera s patents are valid and enforceable and that we are deliberately and willfully infringing Tessera s patents;

injunctive relief prohibiting us from engaging in any further conduct that would infringe Tessera s patents;

an award to Tessera to recover all damages, including interest on damages, from the alleged infringement;

an award of treble damages for deliberate and willful conduct;

a finding that the case is exceptional, in which case attorney fees should be awarded to the prevailing party; and

an unspecified award of attorneys fees and costs.

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

From time to time, we may become a party to litigation and subject to claims incident to the ordinary course of business. As of December 31, 2006, we were not subject to any litigation or claims that we believe will have a material adverse effect on our business. Regardless of the outcome, litigation can have an adverse impact on us because of costs, diversion of management resources and other factors.

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

None.

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## PART II

### ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

**Market Price of Common Stock**

Our Class A Common Stock has been traded on The Nasdaq Global Select Market under the symbol SPSN since December 15, 2005. Our Class A Common Stock had a high trading price of $14.37 and low trading price of $12.00 per share for the period between December 15, 2005 and December 25, 2005, as reported by The Nasdaq Global Select Market. The following table sets forth the high and low per shares sales prices for our Class A Common Stock since the beginning of fiscal year 2006 as reported on the Nasdaq Global Select Market.

| | High | Low |
|---|---|---|
| Fiscal Year Ended December 31, 2006 | | |
| Fourth Quarter | 17.94 | 13.35 |
| Third Quarter | 18.50 | 13.18 |
| Second Quarter | 18.59 | 12.90 |
| First Quarter | 16.19 | 12.31 |

As of February 21, 2007, there were approximately seven holders of record of our Class A Common Stock. Because many of our shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these recordholders.

We currently do not plan to pay dividends on shares of our common stock in the foreseeable future and are currently prohibited from doing so in specific circumstances under agreements governing our borrowing arrangements.

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**ITEM 6. SELECTED FINANCIAL DATA**

The following summary historical financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes included elsewhere in this Form 10-K.

Our fiscal year ended March 31, 2003 began April 1, 2002 and included 52 weeks. In connection with our reorganization effective June 30, 2003, we adopted a fiscal year ending the last Sunday of December. Fiscal 2003 was therefore a transition year beginning April 1, 2003 and ending December 28, 2003, during which we operated as FASL for the initial three months and as Spansion LLC for the final six months. Fiscal 2003 included approximately 39 weeks. Fiscal 2004 and fiscal 2005 included 52 weeks each. Fiscal 2006 included 53 weeks.

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 | Nine Months Ended Dec. 28, 2003 | Year Ended Mar. 31, 2003 |
|---|---|---|---|---|---|
| | (in thousands, except per share amounts) | | | | |
| **Statement of Operations Data[1]:** | | | | | |
| Net sales | $ 1,310,479 | $ | $ | $ | $ |
| Net sales to related parties/members | 1,268,795 | 2,002,805 | 2,262,227 | 1,193,212 | 961,950 |
| Cost of sales | 2,066,642 | 1,809,929 | 1,840,862 | 1,086,030 | 921,924 |
| Gross profit | 512,632 | 192,876 | 421,365 | 107,182 | 40,026 |
| Other expenses: | | | | | |
| Research and development | 347,740 | 295,849 | 280,954 | 146,947 | |
| Marketing, general and administrative | 255,648 | 181,910 | 137,159 | 74,200 | 4,811 |
| Operating income (loss) | (90,756) | (284,883) | 3,252 | (113,965) | 35,215 |
| Interest and other income (expense), net | 11,681 | 3,173 | 3,198 | 1,335 | (202) |
| Interest expense | (70,903) | (45,032) | (40,165) | (20,733) | (1,867) |
| Income (loss) before income taxes | (149,978) | (326,742) | (33,715) | (133,363) | 33,146 |
| Provision (benefit) for income taxes | (2,215) | (22,626) | (14,013) | (4,420) | 12,169 |
| Net income (loss) | $ (147,763) | $ (304,116) | $ (19,702) | $ (128,943) | $ 20,977 |
| Net income (loss) per common share | | | | | |
| Basic and diluted[2] | $ (1.15) | $ (4.15) | $ (0.27) | $ (1.78) | $ 0.29 |
| Shares used in per share calculation: | | | | | |
| Basic and diluted[2] | 128,965 | 73,311 | 72,549 | 72,549 | 72,549 |

| | Dec. 31, 2006 | Dec. 25, 2005 | Dec. 26, 2004 | Dec. 28, 2003 | Mar. 31, 2003 |
|---|---|---|---|---|---|
| **Balance Sheet Data[3]:** | | | | | |
| Cash, cash equivalents and marketable securities | $ 885,769 | $ 725,816 | $ 196,138 | $ 329,544 | $ 25 |
| Working capital (deficit) | 1,085,027 | 881,902 | 359,420 | 640,184 | (110,741) |
| Total assets | 3,549,717 | 3,301,965 | 2,919,515 | 3,125,623 | 1,273,072 |
| Long-term debt and capital lease obligations, including current portion, and notes payable to banks under revolving loans | 1,118,047 | 759,613 | 773,597 | 899,684 | 152,704 |
| Total stockholders equity/members capital | 1,845,760 | 1,921,977 | 1,647,207 | 1,657,595 | 808,600 |

(1)

As discussed more fully in Management s Discussion and Analysis of Financial Condition and Results of Operations, we began producing and selling finished Flash memory devices effective June 30, 2003, which significantly affected our operating results as compared to earlier periods when we solely produced and sold Flash memory wafers.

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(2) Diluted net loss per share is computed using the weighted-average number of common shares and excludes dilutive potential common shares, as their effect is antidilutive. The potential common shares that were antidilutive for fiscal 2006 and fiscal 2005 were approximately 16.8 million and 5.5 million shares, respectively, issuable upon exercise of outstanding stock options, upon vesting of outstanding restricted stock units and upon conversion of Spansion LLC s 2.25% Exchangeable Senior Subordinated Debentures.

(3) As discussed more fully in Management s Discussion and Analysis of Financial Condition and Results of Operations, as of June 30, 2003 AMD and Fujitsu had transferred their Flash memory business assets to us so that we could begin producing and selling finished Flash memory devices, which significantly affected our net assets as compared to earlier periods when we solely produced and sold Flash memory wafers.

## ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and related notes as of December 31, 2006 and December 25, 2005 and for the fiscal years ended December 31, 2006, December 25, 2005 and December 26, 2004, which are included in this annual report.*

### Overview

We are one of the largest Flash memory providers and the largest company in the world exclusively dedicated to designing, developing, manufacturing, marketing and selling Flash memory solutions, a critical semiconductor element of nearly every electronic product and one of the fastest growing segments of the semiconductor industry. Our Flash memory is integrated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment, personal computers and PC peripherals. Our Flash memory solutions are incorporated in products from original equipment manufacturers, or OEMs, in each of these applications, including all of the top ten mobile phone OEMs, all of the top ten consumer electronics OEMs and all of the top ten automotive electronics OEMs. We operate four Flash memory wafer fabrication facilities, or fabs, four assembly and test sites and a development fab, known as our Submicron Development Center, or SDC. We are headquartered in Sunnyvale, California.

For fiscal 2006, our net sales were approximately $2.6 billion and our net loss was approximately $147.8 million. For fiscal 2005, our net sales were approximately $2.0 billion and our net loss was approximately $304.1 million. For fiscal 2004, our net sales were approximately $2.3 billion and our net loss was approximately $19.7 million. Total net sales for fiscal 2006 increased significantly compared to the corresponding period of fiscal 2005. Net loss for fiscal 2006 includes stock-based compensation expense of approximately $17.4 million.

Our results for fiscal 2006 reflected an increase in unit shipments and sales generated from products based on our MirrorBit technology, which represented approximately 50 percent of total net sales and 30 percent of total units shipped for fiscal 2006, compared with approximately 23 percent of total net sales and 17 percent of total units shipped for fiscal 2005. We expect this trend of increased unit shipments and sales generated from such products to continue in fiscal 2007.

During the second quarter of fiscal 2006, we transitioned our information technology systems and our sales processes from AMD, which, along with Fujitsu, had previously served as the sole distributor of our products. With this transition, we now sell our products directly to AMD s former customers and to customers not served solely by Fujitsu. We have also expanded our administrative functions and significantly reduced our reliance on administrative services provided by AMD.

#### *History*

We were originally organized as a Flash memory manufacturing venture of AMD and Fujitsu in 1993 named Fujitsu AMD Semiconductor Limited, or FASL. The primary function of FASL was to manufacture and

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sell Flash memory wafers to AMD and Fujitsu, who in turn converted the Flash memory wafers into finished Flash memory products and sold them to their customers. AMD and Fujitsu were also responsible for all research and development and marketing activities and provided FASL with various support and administrative services.

By 2003, AMD and Fujitsu desired to expand the operations of FASL to: achieve economies of scale; add additional Flash memory wafer fabrication capacity; include assembly, test, mark and pack operations; include research and development capabilities; and include various marketing and administrative functions. To accomplish these goals, in 2003, AMD and Fujitsu reorganized our business as a Flash memory company called FASL LLC, later renamed Spansion LLC, by integrating the manufacturing venture with other Flash memory assets of AMD and Fujitsu. Since this reorganization, until the beginning of the second quarter of 2006, we manufactured and sold finished Flash memory devices to customers worldwide through our two sole distributors, AMD and Fujitsu. Since the beginning of the second quarter of 2006, we have sold our products directly to our customers, including customers not served solely by Fujitsu. Fujitsu acts as our sole distributor in Japan and also as a nonexclusive distributor throughout the rest of the world, other than Europe and the Americas with limited exceptions. We were reorganized from Spansion LLC into Spansion Inc. in connection with our initial public offering in December 2005.

Since AMD s sales force responsible for selling our products was transferred to us, we no longer pay AMD a distribution margin which has resulted in an increase to net sales. This increase in net sales is offset, in part, by increased marketing, general and administrative expenses that we incur as we use our own sales force to sell our products directly to customers.

Fujitsu agreed to reduce the distribution margin earned by Fujitsu on the sale of our Flash memory products from 6.5 percent to 4.3 percent beginning in the second quarter of fiscal 2005. In addition, the royalty rate we pay to each of AMD and Fujitsu under our patent cross-license agreements with them was reduced from one percent of net sales of our products to 0.5 percent on October 1, 2005, and was further reduced to 0.3 percent on December 21, 2005. Following the conversion of our Class D common stock into Class A common stock immediately prior to the completion of our offering in November 2006, the royalty rate was further reduced to 0.15 percent. In November 2008 the obligations to pay the royalty will terminate.

***Flash Memory Market***

Flash memory is one of the largest semiconductor markets. The Flash memory market is characterized by intense competition. The basis of competition is cost, selling price, performance, quality, customer relationships and ability to provide value-added solutions. To compete successfully, a supplier of Flash memory must continuously invest in manufacturing capacity and process technologies while keeping unit manufacturing costs as low as possible. Economies of scale dictate that fabs must be large to achieve competitive manufacturing costs.

Our business operations and financial results are impacted by a number of factors, including the cyclicality of the Flash memory market caused by wide fluctuations in product supply and demand, constant and rapid technological change, continuous new product introduction and price erosion. The expenses associated with our fabs are primarily fixed. Variations in capacity utilization of our fabs therefore significantly impact our gross margins. Rapid technological change and variations in product supply and demand make capacity planning and fab utilization difficult to predict accurately.

**Basis of Presentation**

***Fiscal 2006, 2005 and 2004***

Our fiscal years end on the last Sunday of December. Fiscal 2006 began on December 26, 2005 and ended on December 31, 2006, consisting of 53 weeks. Fiscal 2005 began on December 27, 2004 and ended on December 25, 2005, consisting of 52 weeks. Fiscal 2004 began on December 29, 2003 and ended on December 26, 2004, consisting of 52 weeks.

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**Critical Accounting Policies**

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

We believe the following critical accounting policies are the most significant to the presentation of our financial statements and require the most difficult, subjective and complex judgments.

***Estimates of Sales Returns and Future Price Reductions***

We record a provision for estimated sales returns and allowances on product sales and a provision for estimated future price reductions in the same period that the related revenues are recorded. We base these estimates on actual historical sales returns, allowances, historical price reductions, market activity, and other known or anticipated trends and factors. These estimates are subject to management s judgment, and actual provisions could be different from our estimates and current provisions, resulting in future adjustments to our revenues and operating results.

***Impairment of Long-Lived Assets***

We consider no less frequently than quarterly whether indicators of impairment of long-lived assets are present. These indicators may include, but are not limited to, significant decreases in the market value of an asset and significant changes in the extent or manner in which an asset is used. If these or other indicators are present, we determine whether the estimated future undiscounted cash flows attributable to the assets in question are less than their carrying value. If less, we recognize an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value is determined by discounted future cash flows, appraisals or other methods. We may incur impairment losses in future periods if factors influencing our estimates of the undiscounted cash flows change.

***Income Taxes***

Prior to our reorganization into Spansion Inc. we operated as a Delaware limited liability company that had elected to be treated as a partnership for U.S. federal tax reporting purposes and therefore, we were not a U.S. taxable entity. We now operate as Spansion Inc., which is a taxable entity for U.S. federal tax reporting purposes. Our foreign subsidiaries are wholly owned and are taxable as corporations in their respective foreign countries of formation. In determining taxable income for financial statement reporting purposes, we must make estimates and judgments. These estimates and judgments are applied in the calculation of specific tax liabilities and in the determination of the recoverability of deferred tax assets, which arise from temporary differences between the recognition of assets and liabilities for tax and financial statement reporting purposes.

We must assess the likelihood that we will be able to recover our deferred tax assets. Unless recovery of these deferred tax assets is considered more likely than not, we must increase our provision for taxes by recording a charge to income tax expense, in the form of a valuation allowance against those deferred tax assets for which we believe it is not more likely than not they will be realized. We consider past performance, future expected taxable income and prudent and feasible tax planning strategies in determining the need for a valuation allowance.

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In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax rules and the potential for future adjustment by the relevant tax jurisdiction. If our estimates of these taxes are greater or less than actual results, an additional tax benefit or charge will result.

***Inventory Valuation***

At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. This evaluation includes analysis of sales levels by product and projections of future demand. These projections assist us in determining the carrying value of our inventory and are also used for near-term factory production planning. We do not value inventories on hand in excess of forecasted demand of six months. In addition, we write off inventories that we consider obsolete. We adjust remaining specific inventory balances to approximate the lower of our standard manufacturing cost or market value. Among other factors, management considers forecasted demand in relation to the inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining obsolescence and net realizable value. If we anticipate future demand or market conditions to be less favorable than our projections as forecasted, additional inventory write-downs may be required and would be reflected in cost of sales in the period the revision is made. This would have a negative impact on our gross margins in that period. If in any period we are able to sell inventories that were not valued or that had been written down in a previous period, related revenues would be recorded without any offsetting charge to cost of sales, resulting in a net benefit to our gross margin in that period.

***Pension and Postretirement Benefits***

We provide a pension plan for certain employees of Spansion Japan, and as a result, we have significant pension benefit costs and credits that are computed and recorded in our financial statements based on actuarial valuations. The actuarial valuations require assumptions and methods which must be used to develop the best estimate of the benefit costs. These valuation assumptions include salary growth, long-term return on plan assets, discount rates and other factors. The salary growth assumptions reflect our future and near-term outlook for salary growth within the industry. Long-term return on plan assets is determined based on historical results in the debt and equity markets and management s expectation of the current economic environment and the allocation target and expected future yields of each asset class. The discount rate assumption is based on current investment yields on Japanese government long-term bonds, as no deep corporate market exists for high quality corporate debt instruments. Actual results that differ from these assumptions are accumulated and amortized over the future life of the plan participants. See Note 14 of Notes to Consolidated Financial Statements for an explanation of the pension assumptions. While we believe that the assumptions used are appropriate, significant differences in actual experience or significant changes in assumptions would affect the pension costs and obligations.

***Revenue Recognition***

Prior to the second quarter of fiscal 2006, we generally recognized revenue when AMD and Fujitsu, our sole distributors, sold our products to their OEM customers and title and risk of loss for the products transferred to the OEM.

In the second quarter of fiscal 2006, we began selling our products directly to the customers previously served by AMD. Since such time, we generally recognize revenue when we have sold our products to our OEM customers and title and risk of loss for the products have transferred to the OEM. Estimates of product returns and sales allowances, related to reasons other than product quality, are based on actual historical experience and are recorded as a reduction in revenue at the time revenue is recognized.

Prior to the second quarter of fiscal 2006, AMD sold our products to its distributors under terms allowing these distributors certain rights of return, stock rotation and price protection privileges on unsold merchandise held by them. We extended the same rights on these Flash memory product sales to AMD. Accordingly, we deferred revenue and related product costs from such sales to AMD as deferred income on shipments to related party/member, until the merchandise was resold by AMD s distributors. Since the second quarter of fiscal 2006, we have deferred revenue and related product costs from such sales as deferred income until the merchandise is

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resold by our distributors. We also sell some of our products to some distributors under sales arrangements whose terms do not allow for rights of returns or price protection on unsold products held by them. In these instances, we recognize revenue when we ship the product directly to the distributors.

Fujitsu also sells our products to its distributors. Our distribution agreement with Fujitsu grants limited stock rotation rights to Fujitsu and allows Fujitsu to provide similar limited rights to some of its distributors. However, to date, Fujitsu has not extended these rights to its distributors. Generally, we recognize revenue for sale of products sold to Fujitsu when Fujitsu sells our products to its distributors.

***Stock-Based Compensation Expenses***

Effective December 26, 2005, we adopted Financial Accounting Standards Board (FASB) Statement No. 123(R), Share-Based Payment, which requires a public entity to reflect on its income statement, instead of pro forma disclosures in its financial footnotes, the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. Statement 123(R) supersedes our previous accounting under Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, for periods beginning in fiscal 2006.

We adopted Statement 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of December 26, 2005, the first day of our fiscal year ending December 31, 2006. Our consolidated financial statements as of and for the year ended December 31, 2006 reflect the impact of Statement 123(R). In accordance with the modified prospective transition method, our consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of Statement 123(R).

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 regarding the SEC s interpretation of Statement 123(R) and the valuation of share-based payments for public companies. We applied the provisions of SAB 107 in our adoption of Statement 123(R).

We estimated the fair value of our stock-based awards to employees using the Black-Scholes-Merton option pricing model. Stock-based compensation expense recognized during a period is based on the higher of the grant-date fair value of the portion of share-based payment awards that is ultimately expected to vest, or actually vest, during the period. Stock-based compensation expense recognized in our consolidated statement of operations for the year ended December 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of December 25, 2005 based on the grant-date fair value estimated in accordance with the pro forma provisions of Statement 123 and compensation expense for the share-based payment awards granted subsequent to December 25, 2005 based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Compensation expense for all share-based payment awards was recognized using the straight-line attribution method reduced for estimated forfeitures. We do not have sufficient historical forfeiture experience related to our own stock-based awards. Therefore, we estimated forfeitures based on the average of our fiscal 2006 forfeiture rate and AMD s historical forfeiture rates, as we believe these forfeiture rates to be the most indicative of our own expected forfeiture rate. Statement 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro forma information for the periods prior to fiscal 2006, we accounted for forfeitures as they occurred.

**Financial Operations Overview**

The following describes line items in our consolidated statements of operations.

***Net Sales***

Prior to June 30, 2003, we generated net sales by selling Flash memory wafers to AMD and Fujitsu on a cost plus a pre-determined margin (cost plus) basis. Since June 30, 2003, until the beginning of the second

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quarter of 2006, we generated net sales by manufacturing and selling finished Flash memory devices to customers worldwide through our two sole distributors, AMD and Fujitsu. During this period, our prices to AMD and Fujitsu were based on AMD s and Fujitsu s sales prices to their customers, less an agreed-upon distribution margin. Our results of operations for this period included significantly increased net sales due to our sale of finished Flash memory products as compared to Flash memory wafers.

During the second quarter of fiscal 2006, we transitioned our billing and collection processes from AMD following the transition of the AMD sales force to Spansion in fiscal 2005. With this transition, we now sell our products directly to our customers, including customers not served solely by Fujitsu. Fujitsu acts as our sole distributor in Japan and also as a nonexclusive distributor throughout the rest of the world, other than Europe and the Americas with limited exceptions. Because of these recent changes, our historical net sales may not be indicative of future net sales.

The main factors that affect revenue are unit volumes, fluctuations in average selling prices and the mix of products sold. Higher density products generally command higher prices than lower density products. However, the selling price for products at a given density tends to decline over time.

***Cost of Sales***

Cost of sales primarily consists of the manufacturing cost to produce finished goods. Principal factors impacting cost of sales include the number of units sold and the mix of products sold with respect to density, the manufacturing process technology employed, the cost of third-party commercial die and the costs of third party subcontractors, if any, incorporated in the product, package costs and test costs. Cost of sales is also impacted by the level of capacity utilization at our manufacturing fabs, as capacity costs are largely fixed and cannot be quickly reduced in proportion to reduced demand and reduced revenues.

Prior to our reorganization in June 2003, we manufactured and sold Flash memory wafers to AMD and Fujitsu. Our cost of sales during that time was primarily the cost of wafer production.

After our reorganization, the cost of finished goods has included the cost of manufacturing and sorting integrated circuits, or die, the cost of assembling, testing, marking and packing the die, and the cost of purchasing third-party commercial die, which we incorporate into our multi-chip-products, or MCPs.

We produce die on wafers in our fabs. The cost of manufacturing and sorting die is a function of the cost of producing wafers and the number of die on each wafer. Costs of wafer production are largely fixed and primarily include depreciation, labor and benefits, direct and indirect materials, maintenance and building costs, such as utilities and occupancy costs. The number of die on each wafer is a function of wafer size, Flash memory storage capacity incorporated into the product and manufacturing process technology. For a given manufacturing process technology, the higher the storage capacity of the product the fewer die per wafer. Each new manufacturing process technology permits more die on each wafer at a given storage capacity level. Therefore, the cost of die tends to be higher for products with greater storage capacity but lower for products manufactured on more advanced manufacturing process technologies.

Assembly costs primarily include labor and benefits, depreciation, maintenance and building costs, such as utilities. Test, mark and pack costs primarily include depreciation of testers and handling equipment, labor and benefits and maintenance and building costs such as utilities. Test costs increase as the storage capacity of the product increases, and are higher for products with advanced features.

Cost of sales also includes a royalty for licensed intellectual property paid to AMD, Fujitsu and others, the cost of factory maintenance and repair, the cost of product engineering and product distribution costs, such as freight and duty.

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As an increasing portion of our business migrates to MCPs, cost of finished goods will increasingly include the cost of combining static RAM, or SRAM, pSRAM or other third-party commercial die that we purchase from Fujitsu and other unrelated manufacturers and package together with our Flash memory devices. This may adversely affect gross margin percentage due to higher cost of sales associated with our purchase of third-party commercial die that we incorporate into these MCPs.

***Research and Development***

Prior to our reorganization as Spansion LLC in June 2003, all research and development activities were conducted by AMD and Fujitsu. Since our reorganization, we have conducted the majority of our research and development activities independently. Research and development expense includes the cost of process research and development for new manufacturing and packaging processes and the cost of product research and development of new Flash memory products. Costs of process research and development include depreciation, labor and benefits, direct and indirect materials, maintenance and building costs such as utilities and other costs. Costs of product research and development include labor and benefits expenses of design engineers along with related occupancy costs, the cost of computers, software design tools and mask sets, and the cost of manufacturing, assembling and testing product development wafers in our fabs. In some cases, AMD and Fujitsu have provided, and may continue to provide, research and development services to us on a contract basis, such as in the area of packaging technology, which costs are included in research and development expense. We also participate in alliances or other arrangements with external partners in the area of product technology and systems solutions.

***Marketing, General and Administrative***

Marketing, general and administrative expenses consist primarily of marketing and general administrative functions, such as information technology, human resources, finance, planning and fees previously paid under our service agreements with AMD and Fujitsu. Prior to our reorganization as Spansion LLC in June 2003, we conducted no marketing or sales activities and maintained a limited general and administrative function sufficient to support operation of our fabs. After our reorganization as Spansion LLC, we added our own marketing functions and some administrative functions, although we continued to rely on AMD and Fujitsu to provide some administrative services under our services agreements with them. Subsequent to our initial public offering in December 2005, we expanded our administrative functions and reduced our reliance on administrative services provided by AMD. We significantly reduced our reliance on AMD to provide us with administrative services.

***Operating Income (Loss)***

Operating income (loss) consists of net sales less the sum of (i) costs of sales, (ii) research and development costs and (iii) marketing, general and administrative costs.

***Interest and Other Income (Expense), Net***

Interest and other income (expense), net primarily consists of interest earned on our cash and investments, as well as other non-operating items.

***Interest Expense***

Interest expense is associated with our borrowings under credit agreements with financial institutions, interest on our debt and interest on our borrowings from AMD.

***Provision for Income Taxes***

Following our reorganization as Spansion LLC in June 2003, and prior to the consummation of our initial public offering and reorganization as Spansion Inc. in December 2005, we operated as a Delaware limited

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liability company that elected to be treated as a partnership for U.S. federal tax reporting and, therefore, we were not a taxable entity for U.S. federal income tax purposes. Upon our reorganization as Spansion Inc. in December 2005, we became a U.S. taxable entity for U.S. federal tax reporting. Our foreign subsidiaries are primarily wholly owned and have been taxable as corporations in their respective foreign countries.

**Results of Operations**

The following is a summary of our total net sales for fiscal 2006, fiscal 2005 and fiscal 2004.

| | Year Ended | | |
|---|---|---|---|
| | Dec. 31, 2006 | Dec. 25, 2005[1] | Dec. 26, 2004[1] |
| | | (in thousands) | |
| Total net sales | $ 2,579,274 | $ 2,002,805 | $ 2,262,227 |

(1) Net sales for fiscal 2005 and 2004 consisted of sales of finished Flash memory devices to AMD and Fujitsu at prices based on AMD s and Fujitsu s sales prices to their customers, less an agreed-upon distribution margin.

***Net Sales Comparison for Fiscal 2006 and Fiscal 2005***

Total net sales of $2,579 million in fiscal 2006 increased 29 percent compared to total net sales in fiscal 2005. The increase in total net sales was primarily attributable to a 28 percent increase in unit shipments. The increase was primarily driven by higher demand for MirrorBit products which rose from approximately 23 percent of total net sales in fiscal 2005 to approximately 50 percent of total net sales in fiscal 2006. Average selling prices in fiscal 2006 as compared to fiscal 2005 were relatively flat, primarily as a result of the increase in average selling prices of MirrorBit products which were offset by a decrease in average selling prices of other products.

***Net Sales Comparison for Fiscal 2005 and Fiscal 2004***

Total net sales of $2,003 million in fiscal 2005 decreased 11 percent compared to net sales of $2,262 million in fiscal 2004. The decrease in total net sales was primarily attributable to a 28 percent decrease in average selling prices, partially offset by an increase of 22 percent in unit shipments. Average selling prices decreased from fiscal 2004 as a result of aggressive pricing due in most cases to oversupply of products in the NOR Flash memory market. The decrease in net sales for the period was mitigated by the reduction in the distribution margin earned by AMD under the AMD Distribution Agreement in the first quarter of fiscal 2005 and the elimination of the distribution margin earned by AMD in the second quarter of fiscal 2005, which increased net sales by approximately $52 million as compared to fiscal 2004. The decrease in net sales for the period was also mitigated by the reduction in the distribution margin earned by Fujitsu under the Fujitsu Distribution Agreement in the first quarter of fiscal 2005 and the further reduction in the second quarter of fiscal 2005, which increased net sales by approximately $16 million as compared to fiscal 2004. The distribution margin earned by AMD and Fujitsu in the first quarter of fiscal 2005 was 6.5 percent. AMD did not earn a distribution margin from the second quarter through the fourth quarter of fiscal 2005. The distribution margin earned by Fujitsu from the second quarter through the fourth quarter of fiscal 2005 was 4.3 percent. The distribution margin earned by AMD and Fujitsu in fiscal 2004 was seven percent.

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***Gross Margin, Operating Expenses, Interest and Other Income (Expense), Net, Interest Expense and Income Taxes Benefit***

The following is a summary of gross margin; operating expenses; interest and other income, net; interest expense and (benefit) provision for income taxes for fiscal 2006, fiscal 2005 and fiscal 2004.

| | Year Ended | | |
|---|---|---|---|
| | Dec. 31, 2006 | Dec. 25, 2005[1] | Dec. 26, 2004[1] |
| | | (in thousands) | |
| Net sales[1] | $ 2,579,274 | $ 2,002,805 | $ 2,262,227 |
| Cost of sales | 2,066,642 | 1,809,929 | 1,840,862 |
| Gross margin | 20% | 10% | 19% |
| Research and development | 347,740 | 295,849 | 280,954 |
| Marketing, general and administrative | 255,648 | 181,910 | 137,159 |
| Operating income (loss) | (90,756) | (284,883) | 3,252 |
| Interest and other income (expense), net | 11,681 | 3,173 | 3,198 |
| Interest expense | (70,903) | (45,032) | (40,165) |
| Income taxes benefit | (2,215) | (22,626) | (14,013) |

(1) Net sales for fiscal 2005 and 2004 consisted of sales of finished Flash memory devices to AMD and Fujitsu at prices based on AMD s and Fujitsu s sales prices to their customers, less an agreed-upon distribution margin.

The increase in gross margin in fiscal 2006 was primarily due to an increase in the sales of our higher margin MirrorBit products and improved factory utilization. MirrorBit sales represented approximately 50 percent of sales in fiscal 2006 compared to approximately 23 percent of sales in fiscal 2005.

Gross margin decreased to ten percent in fiscal 2005 compared to 19 percent in fiscal 2004. The decrease in gross margin was primarily due to a decrease in net sales of 11 percent relative to a decrease in cost of sales of only two percent. Cost of sales declined at a lower rate than net sales because many of our costs are fixed and cannot be reduced in proportion to the reduced revenues.

Research and development expenses of $348 million in fiscal 2006 increased 18 percent compared to $296 million in fiscal 2005. Approximately 40 percent of the increase was due to an increase in 300-millimeter development costs in SDC in fiscal 2006, offset in part by a gain on the sale of our 200-millimeter equipment of approximately $11.5 million. Also, approximately 30 percent of the increase was due to higher labor costs during fiscal 2006, primarily related to increased headcount during the period and the impact of an extra work week in fiscal 2006. Research and development expense included $4.3 million of stock-based compensation expense in fiscal 2006. We did not have a comparable charge for the corresponding period of fiscal 2005.

Research and development expenses of $296 million in fiscal 2005 increased five percent compared to $281 million in fiscal 2004. The increase was primarily due to an increase in research and development activities in Fab 25 and the SDC, offset in part by reduced payments to AMD and Fujitsu for research and development activities under their respective service agreements in fiscal 2005. We incurred $21.2 million of expenses in fiscal 2005 and $27.6 million of expenses in fiscal 2004 related to research and development activities performed by AMD. We incurred $6.5 million of expenses in fiscal 2005 and $18.4 million of expenses in fiscal 2004 related to research and development activities performed by Fujitsu. We incurred $4.3 million of expenses in fiscal 2005 and $8.2 million of expenses in fiscal 2004 related to research and development activities performed by employees seconded from Fujitsu. Amounts incurred related to activities performed by AMD, Fujitsu and Fujitsu seconded employees represented in the aggregate 11 percent of our total research and development expenses in fiscal 2005 compared to 19 percent in fiscal 2004.

Marketing, general and administrative expenses of $256 million in fiscal 2006 increased 41 percent compared to $182 million in fiscal 2005. The increase was primarily due to expenses incurred as a result of the

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formation of our own sales force and additional information technology, legal and consulting fees incurred as a new public entity. These additional costs accounted for approximately 76 percent of the increase in fiscal 2006. Marketing, general and administrative expense included $4.4 million of stock-based compensation expense in fiscal, 2006. We did not have a comparable charge for the corresponding period of fiscal 2005.

Marketing, general and administrative expenses of $182 million in fiscal 2005 increased 33 percent compared to $137 million in fiscal 2004. The increase from fiscal 2004 was primarily due to the transfer of AMD s sales force in the second quarter of fiscal 2005. Under our services agreements with AMD, we incurred $51.4 million of expenses in fiscal 2005 and $58.2 million of expenses in fiscal 2004 related to marketing, general and administrative services provided by AMD. Under our services agreements with Fujitsu, we incurred $12.5 million of expenses in fiscal 2005 and $15.2 million of expenses in fiscal 2004 related to marketing, general and administrative services provided by Fujitsu. Amounts incurred under our services agreements with AMD and Fujitsu represented in the aggregate 35 percent of our total marketing, general and administrative expenses in fiscal 2005 compared to 53 percent in fiscal 2004.

Interest and other income, net of other expenses, increased by $8.5 million in fiscal 2006 as compared to fiscal 2005, primarily due to an increase of $18.7 million of interest income generated from a portion of the proceeds from our Senior Secured Term Loan Facility and initial public offering in December 2005 that was invested in cash equivalents and marketable securities, and $6.9 million of realized gain from the sale of marketable securities. This increase was partially offset by a $17.3 million loss on early extinguishment of debt as a result of the repurchase and cancellation of the 12.75% Senior Subordinated Notes.

Interest and other income, net in fiscal 2005 was relatively flat as compared to fiscal 2004.

Interest expense increased by $25.9 million in fiscal 2006 as compared to fiscal 2005, primarily due to the additional interest expense on Spansion LLC s 11.25% Senior Notes and 12.75% Senior Subordinated Notes issued at the end of the fourth quarter of fiscal 2005. The Senior Subordinated Notes were repurchased in the second quarter of fiscal 2006 in connection with the issuance of our 2.25% Exchangeable Senior Subordinated Debentures. The increase in interest expenses in fiscal 2006 was also due to the additional interest expense incurred on the borrowing of $500 million under the Senior Secured Term Loan Facility in the fourth quarter of fiscal 2006.

Interest expense of approximately $45 million in fiscal 2005 increased 12 percent from approximately $40 million in fiscal 2004. The increase was primarily due to interest charges on new loans and capital lease obligations entered in fiscal 2005.

We recorded income tax benefits of approximately $2 million in fiscal 2006, approximately $23 million in fiscal 2005, and approximately $14 million in fiscal 2004.

The benefit for income taxes recorded for fiscal 2006 differs from the benefit for income taxes that would be derived by applying a U.S. statutory 35 percent rate to the loss before income taxes primarily due to our inability to benefit U.S. operating losses due to lack of a history of earnings, and income that was incurred and tax effected in foreign jurisdictions with different tax rates.

The benefit for income taxes recorded for fiscal 2005 differs from the benefit for income taxes that would be derived by applying a U.S. statutory 35 percent rate to the loss before income taxes primarily due to our inability to benefit U.S. operating losses due to lack of a history of earnings, and losses that were incurred and tax effected in foreign jurisdictions with different tax rates.

The benefit for income taxes recorded for fiscal 2004 differs from the benefit for income taxes that would be derived by applying a U.S. statutory 35 percent rate to the loss before income taxes primarily due to the fact that AMD and Fujitsu were responsible for U.S. taxes in these years, and losses were incurred and tax effected in foreign jurisdictions with different tax rates.

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As of December 31, 2006, we recorded a valuation allowance of approximately $121 million against our U.S. deferred tax assets, net of deferred tax liabilities. This valuation allowance offsets all of our net U.S. deferred tax assets. As of December 31, 2006 we have also recorded valuation allowances of approximately $37.2 million against various foreign deferred tax assets for which we believe it is not more likely than not that they will be realized.

***Other Items***

In the second quarter of fiscal 2006, we began selling our products directly to AMD s former customers and customers not served solely by Fujitsu (end customers). The following table summarizes net sales by geographic areas for the periods presented:

| | Dec. 31, 2006 | Year ended Dec. 25, 2005 (in thousands) | Dec. 26, 2004 |
|---|---|---|---|
| Geographical sales[1]: | | | |
| Net sales to end customers[2]: | | | |
| North America | $ 174,930 | $ | $ |
| China | 479,040 | | |
| Korea | 282,596 | | |
| Europe | 312,114 | | |
| Others | 61,799 | | |
| Net sales to related parties: | | | |
| United States *(net sales to AMD)*[3] | 336,172 | 1,114,150 | 1,211,033 |
| Japan (*net sales to Fujitsu*) | 932,623 | 888,655 | 1,051,194 |
| Total | $ 2,579,274 | $ 2,002,805 | $ 2,262,227 |

(1) Geographical sales are based on the customer s bill-to/ship-to location.
(2) These represent sales since the end of the first quarter of fiscal 2006 to AMD s former customers and customers not served solely by Fujitsu.
(3) For fiscal year 2006, these represent sales during the first quarter.

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

**Financial Condition**

Our cash and cash equivalents at December 31, 2006 totaled $760 million and consisted of cash, money market funds and commercial paper. We are subject to restrictions on our distribution of cash due to provisions in third-party loan agreements described below.

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

Net cash provided by operating activities was $444 million in fiscal 2006. Non-cash charges included in the net loss consisted primarily of $540 million of depreciation and amortization, loss on debt extinguishment of $17 million and compensation cost recognized under stock plans of $17 million. The net changes in operating assets and liabilities in fiscal 2006 were primarily attributable to an increase in accounts payable and accrued liabilities of $42 million and a decrease in accounts receivable of $20 million.

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Net cash provided by operating activities was $307 million in fiscal 2005. Non-cash charges included in the net loss consisted primarily of $542 million of depreciation and amortization. The net changes in operating assets in fiscal 2005 were primarily attributable to an increase in accounts payable and accrued liabilities of $178 million due to an increase in operating activities in fiscal 2005, partially offset by an increase in receivables of $40 million due to a 22 percent increase in net sales in the last quarter of fiscal 2005 as compared to the net sales in the last quarter of fiscal 2004.

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

Net cash used in investing activities was $604 million in fiscal 2006, primarily as a result of $717 million used to purchase property, plant and equipment, in part related to the construction of our new manufacturing facility, SP1, and a cash outflow of $280 million for the purchase of marketable securities, offset in part by a cash inflow of $373 million from the maturities and sale of marketable securities and $20 million in proceeds from sale of property, plant and equipment.

Net cash used in investing activities was $553 million in fiscal 2005, primarily as a result of $425 million used to purchase property, plant and equipment and a cash outflow of $212 million for the purchase of available-for-sale securities, offset in part by a cash inflow of $78 million from the maturity of available-for-sale securities and $6 million in proceeds from sale of property, plant and equipment.

***Net Cash Provided by (Used in) Financing Activities***

Net cash provided by financing activities was $404 million in fiscal 2006. This amount included $897 million of proceeds received from borrowings, net of issuance costs, of which $500 million was from our Senior Secured Term Loan Facility and approximately $204 million was from the issuance of Spansion LLC s 2.25% Exchangeable Senior Subordinated Debentures. In connection with our secondary stock offering, we sold additional shares of 5,247,000 Class A common stock for which we received net proceeds of approximately 68 million. We also received approximately $48 million of proceeds from equipment sale-leaseback transactions. These amounts were partially offset by $600 million in payments on debt and capital lease obligations, including approximately $198 million in payments to AMD and Fujitsu, of which $175 million was used to repurchase Spansion LLC s 12.75% Senior Subordinated Notes. We also paid AMD approximately $8 million for AMD s grant of options to our employees prior to our IPO in December 2005.

Net cash provided by financing activities was $612 million in fiscal 2005. This amount included $144 million of proceeds received from equipment sale-leaseback transactions, $569 million of proceeds from bank borrowings and debt offerings, and $526 million of proceeds from the issuance of common stock, net of offering costs. These amounts were partially offset by $630 million in payments on debt and capital lease obligations, including approximately $266 million in payments to AMD and Fujitsu.

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**Contractual Obligations**

The following table summarizes our contractual obligations at December 31, 2006. The table is supplemented by the discussion following the table.

| | Total | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 and Beyond |
|---|---|---|---|---|---|---|---|
| | | | | (in thousands) | | | |
| Contractual obligations to related parties: | | | | | | | |
| Promissory Note | $ 500 | $ 500 | $ | $ | $ | $ | $ |
| Contractual obligations to third parties: | | | | | | | |
| Senior Secured Term Loan Facility | 500,000 | 3,000 | 4,000 | 4,000 | 4,000 | 4,000 | 481,000 |
| Senior Notes | 250,000 | | | | | | 250,000 |
| Exchangeable Senior Subordinated Debentures | 207,000 | | | | | | 207,000 |
| Capital lease obligations | 137,240 | 61,706 | 34,614 | 25,616 | 8,774 | 6,530 | |
| Credit Facilities Subsidiaries | 45,076 | 43,168 | 1,635 | 273 | | | |
| Total principal contractual obligations | 1,139,816 | 108,374 | 40,249 | 29,889 | 12,774 | 10,530 | 938,000 |
| Operating leases | 79,064 | 35,807 | 26,881 | 14,729 | 1,234 | 413 | |
| Unconditional purchase commitments | 90,261 | 56,365 | 21,487 | 5,367 | 3,546 | 3,496 | |
| Interest payments | 572,905 | 86,804 | 79,188 | 77,800 | 74,856 | 73,803 | 180,454 |
| Total contractual obligations | $ 1,882,046 | $ 287,350 | $ 167,805 | $ 127,785 | $ 92,410 | $ 88,242 | $ 1,118,454 |

***Promissory Note***

On February 27, 2006, we purchased a software license from AMD and, as payment, we issued a $3.0 million promissory note to AMD. During 2006, we repaid $2.5 million of the principal of the promissory note. The remaining balance of $0.5 million is due in the first quarter of 2007.

***Senior Secured Term Loan Facility***

On November 1, 2006, Spansion LLC entered into a new senior secured term loan facility with a certain domestic financial institution, as administrative agent, and the lenders party thereto, in the aggregate amount of $500 million. We, along with STI, Spansion International, Inc. and Cerium Laboratories LLC, or Cerium, are guarantors of Spansion LLC s obligations under the senior secured term loan facility. Amounts borrowed under the senior secured term loan facility bear interest equal to either (at Spansion LLC s option) (a) LIBOR, plus a 3.0 percent margin or 2.75 percent margin depending upon our credit rating or (b) the base rate, defined as the higher of (i) the administrative agent s prime rate and (ii) the federal funds rate (as defined in the credit agreement for the senior secured term loan facility) plus 0.50 percent, plus a 2.0 percent margin or 1.75 percent margin depending upon our credit rating. The senior secured term loan facility will terminate and all outstanding borrowings must be repaid no later than November 3, 2012.

In connection with the senior secured term loan facility, we and each of Spansion LLC, STI, Spansion International and Cerium, collectively referred to as the loan parties, executed a pledge and security agreement pursuant to which the administrative agent received a first priority security interest in (a) all present and future capital stock of each of our present and future direct and indirect subsidiaries, limited in the case of foreign subsidiaries to a pledge of 65 percent of the capital stock of each first-tier foreign subsidiary, (b) all present and

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future debt of each loan party, but excluding certain intercompany debt to a foreign subsidiary, (c) all present and future other property and assets of each loan party, but excluding intellectual property and any equipment subject to a lien securing a capitalized lease permitted by the credit agreement for the senior secured term loan facility, and (d) all proceeds and products of the property and assets described above. The net book value of the pledged assets as of December 31, 2006 was approximately $663.5 million.

Pursuant to the terms of the senior secured term loan facility, and subject to certain exceptions, Spansion LLC and its subsidiaries are limited in their ability, among other things, to:

- create or permit liens;
- incur indebtedness, subject to certain exceptions, including existing indebtedness under Spansion LLC s 11.25% Senior Notes indenture, Spansion LLC s 2.25% Exchangeable Senior Subordinated Debentures indenture, the senior secured revolving credit facility, capital leases not to exceed 15 percent of Spansion Inc. s total assets, indebtedness of acquired subsidiaries existing at the time of such acquisition and up to $500 million for capital expenditures at SP1;
- make or hold investments above certain thresholds;
- have interest coverage and minimum liquidity of less than specified amounts;
- consolidate, merge or sell assets as an entirety or substantially as an entirety;
- make any disposition of properties, including any sale leaseback transaction;
- make certain distributions, stock redemptions or other payments on account of any equity interests;
- enter into certain types of transactions with affiliates;
- make or become obligated to make any capital expenditures except for those in the ordinary course of business not to exceed specified amounts; and
- voluntarily prepay any indebtedness.

In addition, under the senior secured term loan facility, we are not permitted to engage in any business or activity other than, among other things, holding equity interests in Spansion LLC and STI and activities incidental to being a publicly traded company.

Amounts outstanding under the senior secured term loan facility may become immediately due and payable upon the occurrence of specified events, including, among other things: failure to pay any obligations under the senior secured term loan facility; the breach of any representation or warranty or certain covenants; any default in the payment when due of indebtedness of more than $25 million; filings or proceedings in bankruptcy; judgments or awards entered against us, Spansion LLC, STI, Spansion International, Cerium or any subsidiaries involving aggregate liability of $10 million or more; or a change of control (as defined in the credit agreement for the senior secured term loan facility).

***Senior Notes***

On December 21, 2005, Spansion LLC completed an offering of $250 million aggregate principal amount of 11.25% Senior Notes due 2016. The Senior Notes were issued at 90.302 percent of face value, resulting in net proceeds of approximately $218.1 million after deducting the initial purchasers discount and estimated offering expenses. The Senior Notes are general unsecured senior obligations of Spansion LLC and will rank equal in right of payment with any of our existing and future senior debt. Interest is payable on January 15 and July 15 of each year beginning July 15, 2006 until the maturity date of January 15, 2016.

Certain events may result in the accelerated maturity of the Senior Notes, including a default in any interest, principal or premium amount payment; a merger, consolidation or sale of all or substantially all of the Spansion LLC s property; a breach of covenants in the Senior Notes or the respective indenture; a default in certain debts;

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or if a court enters certain orders or decrees under any bankruptcy law. Upon occurrence of one of these events, the principal of and accrued interest on all of the Senior Notes, as the case may be, may become immediately due and payable. If we, our wholly owned subsidiary, Spansion Technology Inc., or STI, or Spansion LLC incurs any judgment for the payment of money in an aggregate amount in excess of $50 million or takes certain voluntary actions in connection to insolvency, all amounts on the Senior Notes shall become due and payable immediately.

***Exchangeable Senior Subordinated Debentures***

In June 2006, Spansion LLC, our wholly owned operating subsidiary, issued $207.0 million of aggregate principal amount of 2.25% Exchangeable Senior Subordinated Debentures due 2016. The Debentures are general unsecured senior subordinated obligations and rank subordinate in right of payment to all of our senior indebtedness, including the Senior Notes, and senior in right of payment to all of our subordinated indebtedness. The Debentures bear interest at 2.25 percent per annum. Interest is payable on June 15 and December 15 of each year beginning December 15, 2006 until the maturity date of June 15, 2016.

The Debentures were not exchangeable prior to January 6, 2007. On or after January 6, 2007, the Debentures became exchangeable for shares of our Class A common stock, cash or a combination of cash and shares of such Class A common stock, at our option. Full conversion of the Debentures into shares would result in an initial exchange rate of 56.7621 shares of Class A common stock per debenture representing an initial exchange price of approximately $17.6174 per share of Class A common stock. We have reserved 11.7 million shares issuable upon conversion of the debentures. No debentures have been exchanged for our Class A common stock as of February 21, 2007.

At any time prior to maturity, we may make an irrevocable election to satisfy the exchange obligation in cash up to 100 percent of the principal amount of the debentures exchanged, with any remaining amount to be satisfied in shares of Class A common stock or a combination of cash and shares of Class A common stock at the above exchange ratio. In the event that we make this irrevocable election, debenture holders may exchange their debentures only under the following circumstances:

during any fiscal quarter after our fiscal quarter ending April 1, 2007 (and only during such fiscal quarter) if the sale price of our Class A common stock, for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous fiscal quarter, is greater than or equal to 120 percent of the conversion price per share of our Class A common stock;

subject to certain exceptions, during the five business day period following any five consecutive trading day period in which the trading price of the debentures for each day of such period was less than 98 percent of the product of the sale price of our Class A common stock and the number of shares issuable upon exchange of $1,000 principal amount of the debentures; or

Upon the occurrence of specified corporate events that constitute a fundamental change under certain circumstances. The holders of the Debentures will have the ability to require us to repurchase the Debentures in whole or in part for cash in the event of a fundamental change. In such case, the repurchase price would be 100 percent of the principal amount of the Debentures plus any accrued and unpaid interest.

***Capital Lease Obligations***

As of December 31, 2006 we had aggregate outstanding capital lease obligations of approximately $137 million. Obligations under these lease agreements are collateralized by the assets leased and are payable through 2011. Leased assets consist principally of machinery and equipment. AMD has guaranteed approximately $3 million of our aggregate outstanding capital lease obligations as of December 31, 2006.

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On September 29, 2006, we entered into a sale-leaseback transaction with a third-party financial institution for certain equipment in the amount of $29.1 million of cash proceeds. Upon execution of the agreements, the equipment had a net book value of approximately $30.7 million. As the term on the leaseback transaction is more than 75 percent of the remaining estimated economic life of the equipment, we accounted for the leaseback transaction as a capital lease. The equipment lease terminates on September 29, 2010, unless terminated earlier in the event of default, or by either party upon written notice in accordance with the terms of the equipment lease. As of December 31, 2006, the outstanding lease obligation under this agreement was approximately $26.2 million.

On December 19, 2006, we entered into a sale-leaseback transaction with a third-party financial institution for certain equipment in the amount of $18.5 million of cash proceeds. Upon execution of the agreement, the equipment had a net book value of approximately $18.1 million. This transaction did not result in a significant gain or loss. As the present value of the minimum lease payments was more than 90 percent of the fair values of the equipment at the inception of the lease, we accounted for the leaseback transaction as a capital lease. The equipment lease terminates on December 19, 2011, unless terminated earlier in the event of default, or by either party upon written notice in accordance with the terms of the equipment lease. As of December 31, 2006, the outstanding lease obligation under this agreement was approximately $17.5 million.

***Credit Facilities Subsidiaries***

Certain of our subsidiaries maintain local in-country credit facilities to cover short-term liquidity requirements. As of December 31, 2006, we had credit facilities for Spansion Japan, Spansion China, Spansion Penang, and Spansion Thailand. As of December 31, 2006, we borrowed approximately $45.1 million and had approximately $116.2 million available under these credit facilities. Interest rates range from approximately 1 percent to 6.41 percent. Borrowing may be made in local currency and US dollar as applicable. All of these facilities are without parent guarantee, and callable by the lending financial institution. We have the ability to draw on our Senior Secured Revolving Credit Facility and to provide intercompany funding to meet the worldwide financial obligations of our subsidiaries. We intend to continue to maintain these facilities based on cost of funds, availability and subsidiary funding requirements.

***Senior Secured Revolving Credit Facility***

On November 1, 2006, Spansion LLC, the agent and the other lenders party to the senior secured revolving credit facility amended the credit agreement and the security agreement in connection therewith, and we, STI and Spansion International entered into certain new pledge agreements. Pursuant to the amendment to the revolving facility credit agreement, lenders consented to the incurrence of the senior secured term loan facility and the grant of related liens, and the amount available under the revolving credit facility was amended to be based on the sum of 85 percent of accounts receivable meeting eligibility requirements, plus the lesser of (i) $10 million and (ii) 25 percent of eligible foreign accounts receivable, minus reserves established by the agent in its reasonable credit judgment. In addition, pursuant to the amendment, subject to certain limitations, the equity interests in Spansion LLC owned by us and by STI, the equity interests in foreign subsidiaries owned by Spansion International and Spansion LLC s equipment, inventory and equity interests in its foreign subsidiaries were added as the collateral securing the revolving credit facility. This resulted in the revolving credit facility lenders and the senior secured term loan lenders holding substantially similar security. The relative priorities of the classes of lenders in various types of collateral is set forth in an intercreditor agreement between the agent for the revolving credit facility lenders and the agent for the senior secured term loan lenders.

As of December 31, 2006 and December 25, 2005, no amounts were outstanding under this revolving credit facility.

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**Other Financial Matters**

***JV1/JV2 Transaction***

On September 28, 2006, Spansion Japan entered into an asset purchase agreement with Fujitsu, pursuant to which Spansion Japan will sell two wafer fabrication facilities located in Aizu-Wakamatsu, Japan, which we refer to as the JV1/JV2 Facilities, and certain assets located in the JV1/JV2 Facilities, to Fujitsu for a purchase price of approximately $150 million plus the value of the inventory at the time of closing. Concurrently with the execution of the asset purchase agreement, Spansion Japan and Fujitsu also executed (i) a master lease agreement, pursuant to which Spansion Japan will lease certain equipment to Fujitsu to use in the JV1/JV2 Facilities, (ii) a foundry agreement, pursuant to which Fujitsu has agreed to manufacture, and we have agreed to purchase, wafers to be manufactured by Fujitsu for us in the JV1/JV2 Facilities (the foundry agreement also includes minimum supply and purchase commitments between both the parties resulting in financial penalties if such supply and purchase commitments are not achieved) and (iii) a secondment and transfer agreement, pursuant to which Spansion Japan has agreed to second a specified number of employees to Fujitsu to work in the JV1/JV2 Facilities and ultimately to transfer certain of the employees to Fujitsu. In addition to the agreements previously executed, Spansion Japan and Fujitsu continue to negotiate other ancillary agreements associated with the sale of the JV1/JV2 Facilities. We refer to these agreements collectively as the JV1/JV2 Transaction. Under the terms of the asset purchase agreement, the JV1/JV2 Transaction is scheduled to close in the second quarter of fiscal 2007.

***Liquidity and Capital Resources***

Our primary future cash needs on a recurring basis will be working capital, capital expenditures and debt service and other contractual obligations. In fiscal 2006, our capital expenditures were $717 million, and we expect to spend approximately $1.0 billion on capital expenditures in fiscal 2007. The total amount that is due in fiscal 2007 on our debt service and other contractual obligations is approximately $287 million.

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

We believe that anticipated cash flows from operations and current cash balances, the net proceeds from the JV1/JV2 Transaction, available external financing and our existing credit facilities will be sufficient to fund working capital requirements, capital investments, debt service and operations and meet our needs over at least the next twelve months. The total availability under our credit facilities, which is subject to certain borrowing base limitations and other covenants, was approximately $236 million as of December 31, 2006.

***Off-Balance-Sheet Arrangements***

During the normal course of business, we may provide certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These indemnities include non-infringement of patents and intellectual property indemnities to our customers in connection with the delivery, design, manufacture and sale of our products, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to other parties to certain acquisition agreements, such as under the JV1/JV2 Transaction. The duration of these indemnities, commitments and guarantees varies, and in certain cases, is indefinite. We believe that substantially all of our indemnities, commitments and guarantees provide for limitations on the maximum potential future payments we could be obligated to make. However, we are unable to estimate the maximum amount of liability related to our indemnities, commitments and guarantees because such liabilities are contingent upon the occurrence of events

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which are not reasonably determinable. Management believes that any liability for these indemnities, commitments and guarantees would not be material to our accompanying consolidated financial statements.

**Recently Issued Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (FASB) ratified the Emerging Issue Task Force (EITF) Issue No. 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43. Issue 06-2 provides guidelines under which sabbatical leave or other similar benefits provided to an employee are considered to accumulate. If such benefits are deemed to accumulate, they should be accrued as compensation expense over the employee s requisite service period. The provisions of this Issue are effective for fiscal years beginning after December 15, 2006 and allow for either retrospective application or a cumulative effect adjustment approach upon adoption. We adopted this Issue beginning January 1, 2007 using the cumulative effect adjustment approach. The effect of this adoption resulted in an additional increase to our sabbatical liability and accumulated deficit of approximately $10 million as of the beginning of fiscal 2007.

Our Sabbatical Program provides for eight weeks of paid leave for salaried (exempt) employees in the United States upon the completion of seven years of service. In addition, our Recognition Trip Program provides for one week of paid leave and a fixed cash compensation for hourly (non-exempt) employees in the United States who have completed seven years of service. Prior to the adoption of the Issue, we accounted for the above programs only after the completion of the seven years by the eligible employees because none of the benefits vested or accreted to the employee until completion of the full seven years of service. With the adoption of Issue 06-2, we account for the programs by recording the estimated total program payouts upon attaining the requisite service conditions as compensation expense ratably over each employee s requisite service period.

In July 2006, the FASB issued Financial Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, which applies to all tax positions related to income taxes subject to Statement 109, Accounting for Income Taxes. FIN 48 requires a new evaluation process for all tax positions taken. If the probability for sustaining a tax position is greater than 50 percent, then the tax position is warranted and recognition should be at the largest amount that is more-likely-than-not to be realized upon ultimate settlement. FIN 48 requires expanded disclosure at each annual reporting period unless a significant change occurs in an interim period. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption are to be accounted for as an adjustment to the beginning balance of retained earnings. We are currently evaluating the impact of adoption of FIN 48, and we expect to adopt FIN 48 as required for the fiscal year beginning January 1, 2007.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). This Statement requires balance sheet recognition of the overfunded or underfunded status of pension and postretirement benefit plans. Under Statement 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized under previous accounting standards must be recognized in accumulated other comprehensive income in equity, net of tax effects, until they are amortized as a component of net periodic benefit cost. In addition, the measurement date, the date at which plan assets and the benefit obligation are measured, is required to be our fiscal year end. Statement 158's provisions regarding the change in the measurement date of postretirement benefit plans are not applicable to us because we already use a year end measurement date for our pension plan. On December 31, 2006, we adopted the recognition and disclosure provisions of SFAS 158, the effect of which is disclosed in Note 14 to the accompanying consolidated financial statements.

**ITEM 7A. QUALITATIVE AND QUANTITATIVE DISCLOSURE ABOUT MARKET RISK**

***Interest Rate Risk***

Our exposure to market risk for changes in interest rates relates to our variable rate debt and our investment portfolio. As of December 31, 2006, substantially all of the investments in our portfolio were in highly liquid

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securities and consisted of money market instruments (institutional money funds and commercial paper) and auction rate securities. Our auction rate securities are classified as current as they are intended to be used in current operations, and have rate and liquidity resets of 35 days or less.

As of December 31, 2006, approximately 52 percent of the principal amounts outstanding under our unrelated third party debt obligations were fixed rate. Approximately 48 percent of our total debt obligations were variable rate. Changes in interest rates associated with the variable rate portion of our debt could result in a change to our interest expense For example, a 1 percent aggregate change in interest rates would increase/decrease our interest expense by $5.4 million annually. We continually monitor market conditions and may enter into hedges if deemed appropriate. We do not currently have any hedges of interest rate risk in place. We do not use derivative financial instruments for speculative or trading purposes.

***Default Risk***

We mitigate default risk by investing in only high credit quality securities. Our investment portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

The following table presents the cost basis, fair value and related weighted-average interest rates by year of maturity for our investment portfolio and debt obligations as of December 31, 2006 and comparable fair values as of December 25, 2005:

| | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter | Total | 2006 Fair value | 2005 Fair value |
|---|---|---|---|---|---|---|---|---|---|
| | (in thousands, except for percentages) | | | | | | | | |
| **Investment Portfolio** | | | | | | | | | |
| **Cash equivalents:** | | | | | | | | | |
| Fixed rate amounts | $ 565,660 | $ | $ | $ | $ | $ | $ 565,660 | $ 565,660 | $ 336,141 |
| Weighted-average rate | 5.39% | | | | | | 5.39% | 5.39% | 4.43% |
| Variable rate amounts | $ 67,000 | $ | $ | $ | $ | $ | $ 67,000 | $ 67,000 | $ 59,000 |
| Weighted-average rate | 5.24% | | | | | | 5.24% | 5.24% | 4.11% |
| **Marketable Securities:** | | | | | | | | | |
| Fixed rate amounts | $ | $ | $ | $ | $ | $ | $ | $ | $ 177,086 |
| Weighted-average rate | 0.00% | | | | | | 0.00% | 0.00% | 4.58% |
| Variable rate amounts | $ 125,975 | $ | $ | $ | $ | $ | $ 125,975 | $ 125,975 | $ 15,000 |
| Weighted-average rate | 5.33% | | | | | | 5.33% | 5.33% | 4.44% |
| Equity investments | $ | $ | $ | $ | $ | $ | $ | $ | $ 27,291 |
| **Total Investment Portfolio** | $ 758,635 | $ | $ | $ | $ | $ | $ 758,635 | $ 758,635 | $ 614,518 |
| **Debt Obligations** | | | | | | | | | |
| Debt fixed rate amounts | $ 1,635 | $ 1,635 | $ 273 | $ | $ | $ 435,231 | $ 438,774 | $ 483,393 | $ 225,787 |
| Weighted-average rate | 5.90% | 5.90% | 5.90% | | | 6.97% | 6.96% | 7.16% | 13.00% |
| Debt to related parties/members fixed rate amounts | $ 500 | $ | $ | $ | $ | $ | $ 500 | $ 500 | $ 183,915 |
| Weighted-average rate | 0.00% | | | | | | 0.00% | 0.00% | 13.02% |
| Debt variable rate amounts | $ 44,533 | $ 4,000 | 4,000 | $ 4,000 | $ 4,000 | $ 481,000 | $ 541,533 | $ 541,533 | $ 134,016 |
| Weighted-average rate | 2.46% | 8.38% | 8.38% | 8.38% | 8.38% | 8.38% | 7.89% | 7.89% | 1.73% |
| **Total Debt Obligations** | $ 46,668 | $ 5,635 | $ 4,273 | $ 4,000 | $ 4,000 | $ 916,231 | $ 980,807 | $ 1,025,426 | $ 543,718 |

***Foreign Exchange Risk***

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

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

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

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

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

We had an aggregate of $10.9 million (notional amount) of short-term foreign currency forward contracts denominated in Japanese yen outstanding as of December 31, 2006. Unrealized gains related to the foreign currency forward contracts for fiscal 2006 decreased by $1.0 million. We do not anticipate any material adverse effect on our consolidated financial position, results of operations or cash flows resulting from the use of these instruments in the future. However, we cannot assure you that these strategies will be effective or that transaction losses can be minimized or forecasted accurately. In particular, we generally cover only a portion of our foreign currency exchange exposure. Moreover, we determine our total foreign currency exchange exposure using projections of long-term expenditures for items such as equipment and materials used in manufacturing. We cannot assure you that these activities will eliminate foreign exchange rate exposure. Failure to eliminate this exposure could have an adverse effect on our business, financial condition and results of operations.

The following table provides information about our foreign currency forward contracts as of December 31, 2006 and December 25, 2005. All of our foreign currency forward contracts mature within the next 12 months.

| | As of Dec. 31, 2006 | | | As of Dec. 25, 2005 | | |
|---|---|---|---|---|---|---|
| | Notional Amount | Average Contract Rate | Estimated Fair Value | Notional Amount | Average Contract Rate | Estimated Fair Value |
| | (in thousands, except contract rates) | | | | | |
| Foreign currency forward contracts: | | | | | | |
| Japanese yen | $ 10,900 | ¥ 118.76 | $ 24 | $ 49,600 | ¥ 118.95 | $ 1,040 |

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**Spansion Inc.**

**Consolidated Statements of Operations**

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | (in thousands, except per share amounts) | | |
| Net sales | $ 1,310,479 | $ | $ |
| Net sales to related parties/members | 1,268,795 | 2,002,805 | 2,262,227 |
| Total net sales | 2,579,274 | 2,002,805 | 2,262,227 |
| Expenses: | | | |
| Cost of sales (*including $202,122, $251,626 and $345,512 of expenses charged by related parties/members*) | 2,066,642 | 1,809,929 | 1,840,862 |
| Research and development (*including $14,105, $31,994 and $54,304 of expenses charged by related parties/members*) | 347,740 | 295,849 | 280,954 |
| Marketing, general and administrative (*including $24,296, $63,902 and $73,377 of expenses charged by related parties/members*) | 255,648 | 181,910 | 137,159 |
| Operating income (loss) | (90,756) | (284,883) | 3,252 |
| Other income (expense): | | | |
| Gain on sale of marketable securities | 6,884 | | |
| Loss on early extinguishment of debt (*Note 9*) | (17,310) | | |
| Interest income and other, net | 22,107 | 3,173 | 3,198 |
| Interest expense (*including $11,998, $25,975 and $24,134 of expenses to related parties/members*) | (70,903) | (45,032) | (40,165) |
| Loss before income taxes | (149,978) | (326,742) | (33,715) |
| Benefit for income taxes | (2,215) | (22,626) | (14,013) |
| Net loss | $ (147,763) | $ (304,116) | $ (19,702) |
| Net loss per common share: | | | |
| Basic and diluted | $ (1.15) | $ (4.15) | $ (0.27) |
| Shares used in per share calculation: | | | |
| Basic and diluted | 128,965 | 73,311 | 72,549 |

**See accompanying notes**

Net loss for the year ended December 31, 2006 included stock-based compensation expense of $17.4 million, which consisted of $17.3 million related to the Company s stock options and restricted stock units, and $0.1 million related to AMD stock options granted to the Company s employees. Net loss for the year ended December 25, 2005 included stock-based compensation expense of approximately $0.2 million. As a result of adopting FASB Statement No. 123(R) on December 26, 2005, the Company s losses before income taxes and net losses for the year ended December 31, 2006 was $3.4 million higher than if it had continued to account for its stock options under APB Opinion No. 25. Basic and diluted loss per share for the year ended December 31, 2006 were $0.03 higher than if the Company had continued to account for its stock options under Opinion 25. See Notes 3 and 4 to the consolidated financial statements for additional information. The Company did not provide stock-based compensation to its employees or third parties and there was no stock-based compensation expense for the year ended December 26, 2004.

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**Spansion Inc.**

**Consolidated Balance Sheets**

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands, except par value and share amounts) | |
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 759,794 | $ 506,439 |
| Marketable securities | 125,975 | 219,377 |
| Trade accounts receivable | 202,359 | |
| Trade accounts receivable from related parties (*Note 5*) | 195,816 | 406,789 |
| Allowance for doubtful accounts (including $2,088 and $2,214 for related parties) | (4,597) | (2,214) |
| Trade accounts receivable, net | 393,578 | 404,575 |
| Other receivables from related parties | 2,325 | 14,067 |
| Inventories: | | |
| Raw materials | 44,840 | 31,299 |
| Work-in-process | 344,603 | 354,748 |
| Finished goods | 66,397 | 74,096 |
| Total inventories | 455,840 | 460,143 |
| Deferred income taxes | 1,395 | 34,452 |
| Prepaid expenses and other current assets | 36,163 | 33,789 |
| Total current assets | 1,775,070 | 1,672,842 |
| Property, plant and equipment: | | |
| Land | 38,828 | 39,081 |
| Buildings and leasehold improvements | 1,445,037 | 1,430,086 |
| Equipment | 4,601,702 | 4,390,435 |
| Construction in progress | 258,084 | 153,017 |
| Total property, plant and equipment | 6,343,651 | 6,012,619 |
| Accumulated depreciation and amortization | (4,607,957) | (4,424,856) |
| Property, plant and equipment, net | 1,735,694 | 1,587,763 |
| Deferred income taxes | 13,556 | 7,128 |
| Other assets | 25,397 | 34,232 |
| Total assets | $ 3,549,717 | $ 3,301,965 |
| **Liabilities and Stockholders Equity** | | |
| Current liabilities: | | |
| Notes payable to banks under revolving loans | $ 33,608 | $ 43,020 |
| Accounts payable | 408,365 | 280,057 |
| Accounts payable to related parties (*Note 5*) | 14,559 | 123,801 |

| | | |
|---|---|---|
| Accrued compensation and benefits | 51,598 | 51,534 |
| Accrued liabilities to related parties (*Note 5*) | 11,273 | 21,470 |
| Other accrued liabilities | 59,045 | 35,564 |
| Income taxes payable | 4,333 | 13,058 |
| Deferred income on shipments to a related party | 229 | 31,901 |
| Deferred income on shipments | 32,267 | |
| Current portion of long-term obligations to related parties (*Note 9*) | 500 | 21,638 |
| Current portion of long-term debt | 12,560 | 60,021 |
| Current portion of long-term obligations under capital leases | 61,706 | 108,876 |
| Total current liabilities | 690,043 | 790,940 |

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**Spansion Inc.**

**Consolidated Balance Sheets (Continued)**

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands, except par value and share amounts) | |
| Deferred income taxes | 188 | 29,498 |
| Long-term accrued liabilities to a related party *(Note 4)* | | 8,732 |
| Long-term obligations to related parties, less current portion (*Note 9*) | | 162,277 |
| Long-term debt, less current portion | 934,138 | 256,762 |
| Long-term obligations under capital leases, less current portion | 75,535 | 107,019 |
| Other long-term liabilities | 4,053 | 24,760 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Capital stock: | | |
| Preferred stock, $0.001 par value per share, 50,000,000 shares authorized, no shares issued and outstanding | | |
| Class A common stock, $0.001 par value per share, 714,999,998 shares authorized; 134,219,224 and 95,793,402 shares issued and oustanding as of December 31, 2006 and December 25, 2005 *(Note 16)* | 134 | 96 |
| Class B convertible common stock, $0.001 par value per share, 1 share authorized, 1 share issued and outstanding *(Note 16)* | | |
| Class C convertible common stock, $0.001 par value per share, 1 share authorized, 1 share issued and outstanding *(Note 16)* | | |
| Class D convertible common stock, $0.001 par value per share, 35,000,000 shares authorized; 0 and 32,352,934 shares issued and outstanding as of Decmeber 31, 2006 and Decmeber 25, 2005 (*Note 16*) | | 32 |
| Additional paid-in capital | 2,204,513 | 2,110,540 |
| Accumulated deficit | (279,181) | (131,418) |
| Accumulated other comprehensive loss | (79,706) | (57,273) |
| Total stockholders equity | $ 1,845,760 | $ 1,921,977 |
| Total liabilities and stockholders equity | $ 3,549,717 | $ 3,301,965 |

**See accompanying notes**

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**Spansion Inc.**

**Consolidated Statements of Cash Flows**

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | | (in thousands) | |
| **Cash Flows from Operating Activities:** | | | |
| Net loss | $ (147,763) | $ (304,116) | $ (19,702) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | |
| Depreciation and amortization | 540,151 | 542,286 | 534,275 |
| Loss on early extinguishment of debt | 17,310 | | |
| Provision for doubtful accounts | 2,383 | 2,214 | |
| Benefit for deferred income taxes | (2,528) | (27,710) | (35,220) |
| Gain on equipment sale-leaseback transactions | | | (785) |
| Gain on sale and disposal of property, plant, and equipment | (14,582) | (2,282) | (6,003) |
| Gain on sale of marketable securities | (6,884) | | |
| Compensation recognized under employee stock plans | 17,424 | 231 | |
| Changes in operating assets and liabilities: | | | |
| Decrease (increase) in trade accounts receivable from related parties/members | 210,973 | (34,097) | 34,794 |
| Decrease (increase) in other receivables from related parties/members | 11,742 | (6,312) | 5,681 |
| Increase in trade account receivables | (202,359) | | |
| Decrease (increase) in inventories | 4,304 | 404 | (18,366) |
| (Increase) decrease in prepaid expenses and other current assets | (2,374) | (16,873) | 18,833 |
| (Increase) decrease in other assets | (3,757) | (19,772) | 2,908 |
| (Decrease) increase in accounts payable and accrued liabilities to related parties/members | (111,776) | 77,092 | (54,566) |
| Increase (decrease) in accounts payable and accrued liabilities | 153,429 | 101,367 | (51,257) |
| (Decrease) increase in accrued compensation and benefits | (13,403) | 8,385 | 15,624 |
| (Decrease) increase in income taxes payable | (8,725) | (14,324) | 21,650 |
| (Decrease) increase in deferred income on shipments to a related party/member | (31,672) | 861 | 15,432 |
| Increase in deferred income on shipments | 32,267 | | |
| Net cash provided by operating activities | 444,160 | 307,354 | 463,298 |
| **Cash Flows from Investing Activities:** | | | |
| Proceeds from sale of property, plant and equipment | 20,075 | 6,409 | 36,432 |
| Purchases of property, plant and equipment | (716,618) | (425,339) | (530,095) |
| Proceeds from maturity and sale of marketable securities | 372,583 | 77,950 | 50,139 |
| Purchases of marketable securities | (279,587) | (212,086) | (108,089) |
| Net cash used in investing activities | (603,547) | (553,066) | (551,613) |

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**Spansion Inc.**

**Consolidated Statements of Cash Flows (Continued)**

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | | (in thousands) | |
| **Cash Flows from Financing Activities:** | | | |
| Cash contribution from related parties/members | | 3,750 | |
| Cash distributions to related parties/members for stock-based compensation | (8,485) | (869) | (1,438) |
| Proceeds from sale-leaseback transactions | 48,236 | 144,096 | 44,160 |
| Proceeds from borrowings from related parties/members, net of issuance costs | | 158,970 | |
| Proceeds from borrowings, net of issuance costs | 897,192 | 409,965 | 50,209 |
| Payments on loans from related parties/members | (197,619) | (265,607) | (36,907) |
| Payments on debt and capital lease obligations | (402,711) | (364,257) | (181,600) |
| Proceeds from issuance of common stock, net of offering costs | 67,813 | 525,612 | |
| Net cash provided by (used in) financing activities | 404,426 | 611,660 | (125,576) |
| Effect of exchange rate changes on cash and cash equivalents | 8,316 | 2,303 | 22,535 |
| Net increase (decrease) in cash and cash equivalents | 253,355 | 368,251 | (191,356) |
| Cash and cash equivalents at the beginning of period | 506,439 | 138,188 | 329,544 |
| Cash and cash equivalents at end of period | $ 759,794 | $ 506,439 | $ 138,188 |
| **Supplemental Cash Flows Disclosures:** | | | |
| Interest paid (including $11,306, $30,944, $23,608 of interest related to obligations to related parties/members) | $ 48,457 | $ 45,111 | $ 41,360 |
| Income taxes paid | 6,229 | 17,540 | 2,137 |
| **Non-cash investing and financing activities:** | | | |
| Equipment sale-leaseback transactions | 45,956 | 167,991 | 34,515 |
| Contributed assets from AMD Investments, Inc., net | | 7,500 | |
| Contributed assets from Fujitsu Microelectronics Holding, Inc., net | | 7,500 | |
| Accrued capital distributions to (contribution from) realted parties/members for stock-based compensation *(Note* 4) | (9,157) | 9,166 | 8,777 |
| Conversion of debt to common stock | | 100,000 | |
| Acquisition of assets from AMD | | 11,121 | |

**See accompanying notes**

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**Spansion Inc.**

**Consolidated Statement of Stockholders Equity/Members Capital**

**(in thousands)**

| | Common Stock | | Capital in | | | | Total Stockholders Equity/ |
|---|---|---|---|---|---|---|---|
| | Number of Shares | Amount | Excess of Stated Value | Contributed Capital | Retained Earnings (Deficit) | Accumulated Other Comprehensive Income (Loss) | Members Capital |
| **Balance at December 28, 2003** | | | | 1,485,456 | 192,400 | (20,261) | 1,657,595 |
| Distribution to members for stock-based compensation (*Note 4*): | | | | | | | |
| AMD Investments, Inc. | | | | (6,129) | | | (6,129) |
| Fujitsu Microelectronics Holding, Inc. | | | | (4,086) | | | (4,086) |
| Comprehensive loss: | | | | | | | |
| Net loss | | | | | (19,702) | | (19,702) |
| Other comprehensive income: | | | | | | | |
| Net change in cumulative translation adjustment | | | | | | 19,529 | 19,529 |
| Total other comprehensive income | | | | | | | 19,529 |
| Total comprehensive loss | | | | | | | (173) |
| **Balance at December 26, 2004** | | | | 1,475,241 | 172,698 | (732) | 1,647,207 |
| Contributed capital: | | | | | | | |
| AMD Investments, Inc. | | | | 11,250 | | | 11,250 |
| Fujitsu Microelectronics Holdings, Inc. | | | | 7,500 | | | 7,500 |
| Distribution to members for stock-based compensation (*Note 4*): | | | | | | | |
| AMD Investments, Inc. | | | | (5,500) | | | (5,500) |
| Fujitsu Microelectronics Holding, Inc. | | | | (3,666) | | | (3,666) |
| Comprehensive loss: | | | | | | | |
| Net loss | | | | | (304,116) | | (304,116) |
| Other comprehensive income: | | | | | | | |
| Net unrealized gains on investment, net of taxes of $0 | | | | | | 7,291 | 7,291 |
| Net change in minimum pension liability, net of taxes of $0 | | | | | | 10,792 | 10,792 |
| Net change in cumulative translation adjustment | | | | | | (74,624) | (74,624) |
| Total other comprehensive loss | | | | | | | (56,541) |
| Total comprehensive loss | | | | | | | (360,657) |
| Issuance of shares: | | | | | | | |
| Issuance of common stock in initial public offering, net of issuance costs of $7,526 | 47,264 | 47 | 525,565 | | | | 525,612 |
| Conversion of debt to common stock | 8,333 | 8 | 99,992 | | | | 100,000 |
| Conversion of contributed capital to common stock | 72,549 | 73 | 1,484,752 | (1,484,825) | | | |
| Compensation recognized under employee stock plans | | | 231 | | | | 231 |
| **Balance at December 25, 2005** | 128,146 | 128 | 2,110,540 | | (131,418) | (57,273) | 1,921,977 |
| Comprehensive loss: | | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net loss | | | | (147,763) | | (147,763) |
| Other comprehensive income: | | | | | | |
| Net unrealized gains on investment, net of taxes of $0 | | | | | (407) | (407) |
| Net change in minimum pension liability, net of taxes of $0 | | | | | 7,412 | 7,412 |
| Net change in cumulative translation adjustment | | | | | (11,801) | (11,801) |
| Reclassification adjustment for realized gain on sale of marketable securities included in net loss | | | | | (6,884) | (6,884) |
| Total other comprehensive loss | | | | | | (11,680) |
| Total comprehensive loss | | | | | | (159,443) |
| Adjustment to initially apply FASB Statement No. 158, net of tax | | | | | (10,753) | (10,753) |
| Stock-based compensation activity with related party, net | | | (415) | | | (415) |
| Discharge of stock-based compensation payable to AMD *(Note 4)* | | | 9,157 | | | 9,157 |
| Issuance of shares: | | | | | | |
| Vesting of RSUs | 826 | 1 | (1) | | | |
| Issuance of common stock in secondary offering, net of issuance costs of $2,133 | 5,247 | 5 | 67,808 | | | 67,813 |
| Compensation recognized under employee stock plans | | | 17,424 | | | 17,424 |
| **Balance at December 31, 2006** | 134,219 | 134 | 2,204,513 | (279,181) | (79,706) | 1,845,760 |

**See accompanying notes**

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**Spansion Inc.**

**Notes to Consolidated Financial Statements**

**1. Nature of Operations**

**The Company**

Spansion Inc. is a semiconductor manufacturer headquartered in Sunnyvale, California, with manufacturing, research and assembly operations in the United States and Asia. The Company designs, manufactures and markets Flash memory devices that encompass a broad spectrum of densities and features to address the integrated Flash memory market. The Company s products are marketed under the Spansion® global product brand name.

The Company s Flash memory devices are incorporated into a broad range of electronic products, including mobile phones, consumer electronics, automotive electronics, networking and telecommunications equipment and PC peripheral applications.

Spansion LLC, the former manufacturing venture owned 60 percent by Advanced Micro Devices, Inc. (AMD) and 40 percent by Fujitsu Limited (Fujitsu), was reorganized into Spansion Inc. and completed its underwritten initial public offering (IPO) of its Class A common stock on December 21, 2005. The Company s shares of Class A common stock trade on The Nasdaq Global Select Market under the symbol SPSN.

**History of the Company**

In 1993, AMD and Fujitsu formed a corporate manufacturing venture, Fujitsu AMD Semiconductor Limited (FASL).

FASL produced wafers containing Flash memory circuits. These wafers were then sold to AMD and Fujitsu, who separated the circuits on each wafer into individual die, processed the die into finished goods and sold the finished Flash memory devices to their customers. AMD and Fujitsu performed all research and development activities for the design and development of Flash memory devices and developed the manufacturing processes that were to be used in the operation of the fabs to manufacture Flash memory devices. Through June 30, 2003, FASL contracted with AMD and Fujitsu for the receipt of certain support and administrative services (See Note 5).

As of June 30, 2003, in order to expand their existing manufacturing venture, AMD and Fujitsu formed a limited liability company called FASL LLC and later renamed Spansion LLC. In addition to its 49.992 percent ownership in FASL, AMD contributed to Spansion LLC its Flash memory inventory, its wafer manufacturing facility located in Austin Texas, its Flash memory research and development facility (the Submicron Development Center (SDC)) located in Sunnyvale, California, and its Flash memory assembly and test facilities located in Thailand, Malaysia and China. Fujitsu contributed to Spansion LLC its 50.008 percent ownership interest in FASL, its Flash memory inventory and its Flash memory assembly and test facilities located in Malaysia. Both AMD and Fujitsu transferred employees to Spansion LLC to perform various research and development, marketing and administration functions. AMD and Fujitsu also provided working capital to Spansion LLC in the form of cash contributions and loans (See Note 9). As a result, Spansion LLC began manufacturing finished Flash memory devices which through the first fiscal quarter of fiscal 2006 were exclusively sold to AMD and Fujitsu. In the second quarter of fiscal 2006, the Company began selling its products directly to customers previously served by AMD (See Note 5).

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**Spansion Inc.**

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

**2. Change in Fiscal Year and Basis of Presentation**

**Fiscal Year**

The Company operates on a 52- to 53-week fiscal year ending on the last Sunday in December. The year ended December 31, 2006 consisted of 53 weeks and the years ended December 25, 2005 and December 26, 2004 each consisted of 52 weeks.

**3. Summary of Significant Accounting Policies**

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries after elimination of intercompany accounts and transactions.

**Use of Estimates**

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

**Cash Equivalents**

Cash equivalents consist of financial instruments that are readily convertible into cash and have original maturities of three months or less at the time of purchase.

**Investments**

The Company s investments in marketable securities consist of money market funds, commercial paper, auction rate securities and publicly traded equity securities. These securities are designated as available-for-sale and are reported at fair market value with the related unrealized gains and losses included in accumulated other comprehensive income (loss), net of tax, a component of stockholders equity/members capital. The Company recognizes an impairment charge when the declines in the fair values of its investments below the cost basis are judged to be other-than-temporary. The Company considers various factors in determining whether to recognize a decline in value, including the length of time and extent to which the fair value has been less than the Company s cost basis, the financial condition and near-term prospects of the issuer or investee, and the Company s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. The Company has not recorded any such impairment in any of the periods presented. The cost of securities sold is based on the specific identification method. The Company classifies investments in marketable securities as current when their remaining time to maturity is less than or equal to 12 months or, if time to maturity is greater than 12 months, when they represent investments of cash that are intended to be used in current operations.

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**Spansion Inc.**

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

**Allowance for Doubtful Accounts**

The following describes activity in the accounts receivable allowance for doubtful accounts for the years ended December 31, 2006, December 25, 2005 and December 26, 2004.

| Year | Balance at Beginning of Period | Addition Charged to Costs and Expenses | Deductions[1] | Balance at End of Period |
|---|---|---|---|---|
| | | (in thousands) | | |
| 2006 | $ 2,214 | $ 2,383 | $ | $ 4,597 |
| 2005 | $ | $ 2,472 | $ 258 | $ 2,214 |
| 2004 | $ | $ | $ | $ |

(1) Uncollectible amounts written off, net of recoveries

**Inventories**

Inventories are stated at standard cost adjusted to approximate the lower of actual cost (first-in, first-out method) or market. Inventories in stock in excess of forecasted customer demand over the next six months are not valued. Obsolete inventories are written off.

**Revenue Recognition**

Prior to the second quarter of fiscal 2006, the Company generally recognized revenue when AMD and Fujitsu, the Company s sole distributors, sold its products to their OEM customers and title and risk of loss for the products transferred to the OEM. In the second quarter of fiscal 2006, the Company began selling its products directly to the customers previously served by AMD. Since such time, the Company generally recognizes revenue when it has sold its products to its OEM customers and title and risk of loss for the products have transferred to the OEM. Estimates of product returns and sales allowances, related to reasons other than product quality, are based on actual historical experience and are recorded as a reduction in revenue at the time revenue is recognized.

Prior to the second quarter of fiscal 2006, AMD sold the Company s products to its distributors under terms allowing these distributors certain rights of return, stock rotation and price protection privileges on unsold merchandise held by them. The Company extended the same rights on these Flash memory product sales to AMD. Accordingly, the Company deferred revenue and related product costs from such sales to AMD as deferred income on shipments to related party/member, until the merchandise was resold by AMD s distributors. In the second quarter of fiscal 2006, the Company began to sell directly to such distributors and to provide similar rights of return, stock rotation and price protection previously offered by AMD. The Company defers the recognition of revenue and related product costs on these sales as deferred income until the merchandise is resold by its distributors. The Company also sells some of its products to certain distributors under sales arrangements with terms that do not allow for rights of returns or price protection on unsold products held by them. In these instances, the Company recognizes revenue when it ships the product directly to the distributors.

Fujitsu also sells the Company s products to its distributors. The Company s distribution agreement with Fujitsu grants limited stock rotation rights to Fujitsu and allows Fujitsu to provide similar limited rights to some of its distributors. However, to date, Fujitsu has not extended these rights to its distributors. Accordingly, the Company recognizes revenue for sale of products sold to Fujitsu when Fujitsu sells the Company s products to its distributors.

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**Spansion Inc.**

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

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation and amortization are provided on a straight-line basis over the estimated useful lives of the assets.

The estimated useful lives of property, plant and equipment for financial reporting purposes are as follows: machinery and equipment, two to five years; buildings and building improvements, from five to 26 years; and leasehold improvements, the shorter of the remaining terms of the leases or the estimated economic useful lives of the improvements.

**Impairment of Long-Lived Assets**

For long-lived assets used in operations, the Company evaluates the potential for impairment losses when events and circumstances indicate that those assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than their carrying value. If assets are judged to be impaired, impairment losses are determined based on the excess, if any, of the carrying value of these assets over their respective fair value. If impairment losses are recorded, the fair value of the assets would become the new cost basis. Fair value is determined by discounted future cash flows, appraisals or other methods. For assets held for sale, impairment losses are measured at the lower of the carrying amount of the assets or their fair value less costs to sell. For assets to be disposed of other than by sale, impairment losses are measured as their carrying amount less salvage value, if any, at the time the assets cease to be used. Impairment losses were not material in any of the periods presented.

**Product Warranties**

The Company offers a one-year limited warranty for Spansion Flash memory devices (See Note 8). At the time revenue is recognized, the Company provides for estimated costs that may be incurred under product warranty, with the corresponding expense recognized in cost of sales. Estimates of warranty expense are based on the Company s historical experience. Warranty accruals are evaluated periodically and are adjusted for changes in experience.

**Foreign Currency Translation/Transactions**

The functional currency of the Company and its foreign subsidiaries, except for its wholly owned subsidiary in Japan (Spansion Japan), is the U.S. dollar. Adjustments resulting from remeasuring the foreign currency financial statements of these subsidiaries, other than Spansion Japan, into U.S. dollar financial statements are included in operations. Adjustments resulting from translating the foreign currency financial statements of Spansion Japan, for which the functional currency is the Japanese yen, into U.S. dollar financial statements are included as a separate component of accumulated other comprehensive income (loss). Gains or losses resulting from transactions denominated in currencies other than the functional currencies of the Company and its subsidiaries are recorded in cost of sales. The aggregate exchange loss included in determining net loss was $0.9 million, $4.7 million, and $5.3 million for the year ended December 31, 2006, December 25, 2005 and December 26, 2004, respectively.

**Derivative Financial Instruments**

The Company has sales, expenses, assets and liabilities denominated in Japanese yen and other foreign currencies. Therefore, movements in exchange rates could cause net sales and expenses to fluctuate, affecting the Company s profitability and cash flows. The Company s general practice is to use foreign currency forward

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**Spansion Inc.**

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

contracts to reduce its exposure to foreign currency exchange rate fluctuations. Realized and unrealized gains and losses associated with these foreign currency contracts are reflected in the Company s balance sheet and recorded in other current asset or accrued liabilities. Changes in fair value and premiums paid for foreign currency contracts are recorded directly in cost of sales. The objective of these contracts is to reduce the impact of foreign currency exchange rate movements on the Company s operating results. All of the Company s foreign currency forward contracts mature within the next twelve months. The Company does not use derivatives for speculative or trading purposes, nor does the Company designate its derivative instruments as hedging instruments, as defined by the Financial Accounting Standard Board, or FASB, under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities.

**Research and Development Expenses**

The Company expenses such research and development costs in the period in which such costs are incurred.

**Advertising Expenses**

Advertising costs are expensed as incurred. Advertising expenses for the year ended December 31, 2006, December 25, 2005 and December 26, 2004 were approximately $8.1 million, $4.8 million and $3.4 million, respectively.

**Net Loss per Share**

Basic net loss per share is computed based on the weighted-average number of common shares outstanding during the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the net income of the Company.

In connection with the IPO, certain employees have been awarded initial stock option and restricted stock unit grants to purchase Class A common stock of the Company. For the years ended December 31, 2006 and December 25, 2005, respectively, the Company excluded approximately 16.8 million and 5.5 million shares issuable upon exercise of outstanding stock options, upon vesting of outstanding restricted stock units and upon conversion of Spansion LLC s 2.25% Exchangeable Senior Subordinated Debentures because they had an antidilutive effect due to net losses recorded.

The Company has presented basic and diluted net loss per share amounts for periods prior to the IPO as if the exchange of AMD s and Fujitsu s contributed capital for the Company s common stock had occurred at the beginning of the periods presented. Prior to the completion of the IPO, the Company had approximately 43.5 million shares of Class A common stock, 1 share of Class B common stock, 1 share of Class C common stock and approximately 29.0 million shares of Class D common stock outstanding as a result of the contribution from AMD and Fujitsu. On November 21, 2006, the Company closed a secondary stock offering of its Class A common stock held by AMD and Fujitsu, and subsequently issued and sold 5,247,000 shares of its Class A common stock in such offering in December 5, 2006. As a result of this offering, the Company has approximately 134.2 million shares of Class A common stock, 1 share of Class B common stock, and 1 share of Class C common stock as of December 31, 2006. In connection with this offering, all the Class D common stock converted to Class A common stock.

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**Spansion Inc.**

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

**Accumulated Other Comprehensive Loss**

The following are the components of accumulated other comprehensive loss:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Minimum pension liability, net of tax benefits of ($5,429) in 2006 and 2005 | $ (298) | $ 3,043 |
| Cumulative translation adjustment | (79,408) | (67,607) |
| Net unrealized gains on marketable securities, net of taxes of $0 | | 7,291 |
| Total accumulated other comprehensive loss | $ (79,706) | $ (57,273) |

Total other comprehensive loss for fiscal 2006 includes reclassification adjustment of $6.9 million realized gain, net of tax of $0, from sale of marketable securities. There was no reclassification adjustment for fiscal 2005 and fiscal 2004.

**Stock-Based Compensation**

*Accounting Treatment for AMD Options Held by Spansion Employees*

Prior to the IPO, the Company did not provide stock-based compensation to its employees or third parties. However, certain of the Company s employees received stock options to purchase shares of AMD common stock from the Company s then majority and controlling member, AMD who consolidated Spansion s financial statements for financial reporting purposes. The Company accounted for AMD s stock option grants and restricted stock unit, or RSU, awards to its employees under the intrinsic value recognition and measurement principles of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees and related interpretations, consistent with the accounting method followed by AMD for stock options and RSU awards issued to employees of the consolidated AMD group. The exercise price of these stock options was equal to the market price of AMD s common stock on the date of grant. The Company reimbursed AMD for these stock options based on an agreed amount equal to the grant-date fair value of the stock options calculated using the Black-Scholes-Merton valuation model, less a 15 percent discount (the grant-date fair value ). The Company recorded a liability for amounts due to AMD under this arrangement with a corresponding reduction to additional paid-in capital. Reimbursements to AMD, which commenced on the last day of the quarter following the quarter in which the stock options were granted, were payable in sixteen equal quarterly installments through fiscal 2009 (See Note 4).

Subsequent to the Company s IPO and the cessation of AMD s consolidation of Spansion s financial statements, these awards were being accounted for under variable fair value accounting following the guidance in Emerging Issues Task Force (EITF) Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Good or Services, and EITF Issue No. 00-12, Accounting by an Investor for Stock-Based Compensation Granted to Employee of an Equity Method Investee, and continued to be remeasured to their fair value in future periods until they were fully vested (See Note 4).

*Spansion Stock-Based Incentive Compensation Plans*

Effective December 26, 2005, the Company adopted FASB Statement No. 123(R), Share-Based Payment, which requires a public entity to reflect on its income statement, instead of pro forma disclosures in its financial footnotes, the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. Statement 123(R) supersedes the Company s previous accounting under Opinion 25 for periods beginning in fiscal 2006.

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**Spansion Inc.**

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

The Company adopted Statement 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of December 26, 2005, the first day of the Company s fiscal year ending December 31, 2006. The Company s consolidated financial statements as of and for the year ended December 31, 2006, reflect the impact of Statement 123(R). In accordance with the modified prospective transition method, the Company s consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of Statement 123(R).

In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107 regarding the SEC s interpretation of Statement 123(R) and the valuation of share-based payments for public companies. The Company applied the provisions of SAB 107 in its adoption of Statement 123(R).

The Company estimated the fair value of its stock-based awards to employees using Black-Scholes-Merton option pricing model. Stock-based compensation expense recognized during a period is based on the higher of the grant-date fair value of the portion of share-based payment awards that is ultimately expected to vest, or actually vest, during the period. Stock-based compensation expense recognized in the Company s consolidated statement of operations for the year ended December 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of December 25, 2005 based on the grant-date fair value estimated in accordance with the pro forma provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, and compensation expense for the share-based payment awards granted subsequent to December 25, 2005 based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Compensation expense for all share-based payment awards was recognized using the straight-line attribution method reduced for estimated forfeitures. The Company does not have sufficient historical forfeiture experience related to its own stock-based awards. Therefore, the Company estimated forfeitures based on the average of its own fiscal 2006 forfeiture rate and AMD s historical forfeiture rates, as the Company believes these forfeiture rates to be the most indicative of its own expected forfeiture rate. Statement 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company s pro forma information for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

**Pension and Post-retirement Benefits**

The Company provides a pension plan for certain employees of Spansion Japan, and as a result, the Company has significant pension benefit costs and credits that are computed and recorded in the Company s financial statements based on actuarial valuations. The actuarial valuations require assumptions and methods which must be used to develop the best estimate of the benefit costs. These valuation assumptions include salary growth, long-term return on plan assets, discount rates and other factors. The salary growth assumptions reflect the Company s future and near-term outlook for salary growth within the industry. Long-term return on plan assets is determined based on historical results in the debt and equity markets and management s expectation of the current economic environment and the allocation target and expected future yields of each asset class. The discount rate assumption is based on current investment yields on Japanese government long-term bonds, as no deep corporate market exists for high quality corporate debt instruments. Actual results that differ from these assumptions are accumulated and amortized over the future life of the plan participants. While the Company believes that the assumptions used are appropriate, significant differences in actual experience or significant changes in assumptions would affect the pension costs and obligations.

**New Accounting Pronouncements**

In June 2006, the Financial Accounting Standards Board (FASB) ratified the Emerging Issue Task Force (EITF) Issue No. 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB

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Statement No. 43. Issue 06-2 provides guidelines under which sabbatical leave or other similar benefits provided to an employee are considered to accumulate. If such benefits are deemed to accumulate, they should be accrued for, as compensation expense over the employee s requisite service period. The provisions of this Issue are effective for fiscal years beginning after December 15, 2006 and allow for either retrospective application or a cumulative effect adjustment approach upon adoption. The Company adopted this Issue beginning January 1, 2007 using the cumulative effect adjustment approach. The effect of this adoption resulted in an additional increase to the Company s sabbatical liability and accumulated deficit of approximately $10 million as of the beginning of fiscal 2007.

The Company s Sabbatical Program provides for eight weeks of paid leave for salaried (exempt) employees in the United States upon the completion of seven years of service. In addition, the Company s Recognition Trip Program provides for one week of paid leave and a fixed cash compensation for hourly (non-exempt) employees in the United States who have completed seven years of service. Prior to the adoption of the Issue, the Company accounted for the above programs only after the completion of the seven years by the eligible employees because none of the benefits vested or accreted to the employee until completion of the full seven years of service. With the adoption of Issue 06-2, the Company account for the programs by recording the estimated total program payouts upon attaining the requisite service conditions as compensation expense ratably over each employee s requisite service period.

In July 2006, the FASB issued Financial Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, which applies to all tax positions related to income taxes subject to Statement 109, Accounting for Income Taxes. FIN 48 requires a new evaluation process for all tax positions taken. If the probability for sustaining a tax position is greater than 50 percent, then the tax position is warranted and recognition should be at the largest amount that is more-likely-than-not to be realized upon ultimate settlement. FIN 48 requires expanded disclosure at each annual reporting period unless a significant change occurs in an interim period. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption are to be accounted for as an adjustment to the beginning balance of retained earnings. The Company is currently evaluating the impact of adoption of FIN 48, and the Company expect to adopt FIN 48 as required for the fiscal year beginning January 1, 2007.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R). This Statement requires balance sheet recognition of the overfunded or underfunded status of pension and postretirement benefit plans. Under Statement 158, actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations that have not been recognized under previous accounting standards must be recognized in accumulated other comprehensive income in equity, net of tax effects, until they are amortized as a component of net periodic benefit cost. In addition, the measurement date, the date at which plan assets and the benefit obligation are measured, is required to be the company s fiscal year end. Statement 158 s provisions regarding the change in the measurement date of postretirement benefit plans are not applicable to the Company because the Company already uses a year end measurement date for its pension plan. On December 31, 2006, the Company adopted the recognition and disclosure provisions of SFAS 158, the effect of which is disclosed in Note 14.

**4. Stock-Based Compensation**

**AMD Stock Options**

Through December 25, 2005, AMD granted stock options to the Company s employees with an aggregate grant-date value of approximately $19.4 million. The Company paid AMD approximately $8.5 million and $0.9

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**Spansion Inc.**

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

million for stock options during the years ended December 31, 2006 and December 25, 2005, respectively. The Company s outstanding liability to AMD for stock option reimbursements as of December 25, 2005 was approximately $17.1 million. On November 21, 2006, the Company closed a public offering of its Class A common stock held by AMD and Fujitsu. As a result of the offering, AMD s ownership interest in the Company dropped below 30 percent and, by their terms all unvested AMD stock options and AMD RSU awards held by the Company s employees were forfeited and cancelled. The Company wrote off its remaining liability to AMD of approximately $9.2 million against additional paid-in capital, a component of stockholders equity, because the original agreed upon value of these awards to be paid to AMD was recorded as a reduction of contributed capital, a component of stockholders equity. In addition, upon cancellation of the options in the fourth quarter of fiscal 2006, the Company reversed approximately $6 million of previously recorded compensation expense associated with these cancelled awards, which had been recorded using variable fair value accounting pursuant to ETIF Issues 98-16 and 00-12.

**Spansion Stock-Based Incentive Compensation Plans**

***Plan Description***

As of December 31, 2006, the Company had one stock-based incentive plan, the 2005 Equity Incentive Plan, under which 9,500,000 shares of Class A common stock have been reserved and made available for issuance in the form of equity awards, including incentive and nonqualified stock options and RSU awards. The 2005 Equity Incentive Plan is administered by the Compensation Committee of the Company s Board of Directors, and that committee has the authority to, among other things, grant awards, delegate certain of its powers, accelerate or extend the vesting or exercisability of awards and determine the date of grant of an award. Shares that are subject to or underlie awards that expire or for any reason are cancelled, terminated or forfeited, or fail to vest will again be available for grant under the 2005 Equity Incentive Plan. The maximum term of any stock option granted under the 2005 Equity Incentive Plan is 10 years from the date of grant and the exercise price of each option is determined under the applicable terms and conditions as approved by the Compensation Committee.

The 2005 Equity Incentive Plan provides awards that may be granted to an officer or employee, a consultant or advisor, or a non-employee director of the Company or its subsidiaries; provided that, the incentive stock options granted under the 2005 Equity Incentive Plan may only be granted to employees of the Company or its subsidiaries. The exercise price of each incentive stock option is required to be not less than 100 percent of the fair market value of the Company s Class A common stock on the date of grant (not less than 110 percent if such stock option is granted to a person who has more than 10 percent of the total voting power of all classes of the Company s stock).

The 2005 Equity Incentive Plan provides for payment of the exercise price of options in the form of, among other things, cash, services rendered, notice and third party payments as authorized by the Compensation Committee, delivery of shares of common stock and cashless exercise with a third party who provides financing for the purposes of the purchase or exercise of the award.

The Compensation Committee may, in its discretion, accelerate vesting of awards under the plan under certain circumstances, including:

- the acquisition by a person other than AMD or its affiliates of more than 33 percent of either the then outstanding shares of the Company s common stock or the combined voting power entitled to vote in the election of directors, except for any such acquisition by Fujitsu or its affiliates so long as such level of ownership is (1) less than AMD s level of ownership in such securities and (2) not more than 40 percent of the Company s outstanding shares of the Company s common stock or the combined power entitled to vote in the election of directors;

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a change in the Board such that individuals who comprised the Board at the effective date of the 2005 Equity Incentive Plan cease to constitute at least a majority of the Board; and

the consummation of a reorganization, share exchange, merger, consolidation, or a sale or other dispositions of all or substantially all of the Company s assets.

**Shares Available to Grant**

Number of awards available for grant under the 2005 Equity Incentive Plan:

| | |
|---|---|
| Amounts reserved for grant | 9,500,000 |
| Stock options granted through December 31, 2006, net of cancelled stock options | (2,134,906) |
| Restricted stock awards granted through December 31, 2006, net of cancelled restricted stock awards | (3,749,503) |
| Shares available for grant | 3,615,591 |

The Company grants stock options that generally vest ratably over a period of four years and expire if not exercised by the seventh anniversary of the grant date. RSU awards have no exercise price or expiration date. The Company grants RSU awards that generally vest ratably over a four-year period, except for awards of 2.3 million shares granted on the date of the Company s IPO (December 15, 2005), which vested 25 percent on April 28, 2006 and the remainder in equal installments quarterly over the remaining 36 months.

***Valuation and Expense Information***

The following table sets forth the total recorded stock-based compensation expense, by financial statement caption, resulting from the Company s stock options and RSU awards under Statement 123(R) for the year ended December 31, 2006:

| | Year Ended Dec. 31, 2006 (in thousands) |
|---|---|
| Cost of sales | $ 8,653 |
| Research and development | 4,326 |
| Marketing, general and administrative | 4,326 |
| Stock-based compensation expense under Statement 123(R) before income taxes[1] | 17,305 |
| Income tax benefit[2] | |
| Stock-based compensation expense under Statement 123(R) after income taxes[1] | $ 17,305 |

(1) Stock-based compensation expense under Statement 123(R) does not include the compensation expense of AMD stock options and AMD RSU awards granted to the Company s employees, which were accounted for under EITF Issue Nos. 96-18 and 00-12.

(2) There is no income tax benefit relating to stock option expenses because all of the Company s U.S. deferred tax assets, net of U.S. deferred tax liabilities continue to be subject to a full valuation allowance.

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

The weighted average fair value of the Company s stock options granted in the year ended December 31, 2006 and December 25, 2005 was $7.82 and $6.87 per share, respectively. The Company did not provide stock-based compensation to its employees or third parties prior to the IPO on December 15, 2005. The fair value of each stock option was estimated at the date of grant using a Black-Scholes-Merton option pricing model, with the following assumptions for grants:

| | Weighted Average for the Year Ended Dec. 31, 2006 | Weighted Average for the Year Ended Dec. 25, 2005 |
|---|---|---|
| Expected volatility | 58% | 66% |
| Risk-free interest rate | 4.82% | 4.54% |
| Expected term (in years) | 4.60 | 4.61 |
| Dividend yield | 0% | 0% |

The Company s dividend yield is zero because the Company has never paid dividends and does not have plans to do so over the expected life of the stock options. The expected volatility is based on the Company s recent historical volatility and the volatilities of the Company s competitors who are in the same industry sector with similar characteristics ( guideline companies) given the lack of historical realized volatility data of the Company. The risk-free interest rate is based on the yield from U.S. Treasury zero-coupon bond with a remaining term equal to the expected stock option life. The expected term is based on the shortcut approach provided in SAB 107 for developing the estimate of the expected life of a plain vanilla stock option. Under this approach, the expected term is presumed to be the mid-point between the average vesting date and the end of the contractual term.

As of December 31, 2006, the total unrecognized compensation cost related to unvested stock options and RSU awards was approximately $42.1 million after reduction for estimated forfeitures, and such stock options and RSU awards will generally vest ratably through 2010.

*Pro Forma Stock-Based Compensation*

The following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provision of Statement 123 to options granted under the Company s stock option plan for fiscal 2005 and 2004. The pro forma stock-based compensation includes the impact for AMD stock options awarded to Spansion employees.

| | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|
| | (in thousands, except per share amounts) | |
| Net loss as reported | $ (304,116) | $ (19,702) |
| Stock-based compensation expense related to stock-based awards, net of tax | (3,421) | (1,040) |
| Net loss, including the effect of stock-based compensation expense | $ (307,537) | $ (20,742) |
| Basic and diluted net loss per common share as reported | $ (4.15) | $ (0.27) |
| Basic and diluted net loss per common share pro forma | $ (4.19) | $ (0.29) |

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

***Stock Option and Restricted Unit Activity***

The following table summarizes stock option activity and related information for the period presented:

| | Number of Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Options: | | | | |
| Outstanding as of December 26, 2005[1] | 1,949,750 | $ 12.00 | | |
| Granted | 462,500 | $ 14.93 | | |
| Cancelled | (277,344) | $ 12.00 | | |
| Outstanding as of December 31, 2006 | 2,134,906 | $ 12.63 | 6.08 | $ 4,761 |
| Exercisable as of December 31, 2006[2] | 35,156 | $ 12.00 | 5.96 | $ 101 |

(1) Outstanding shares at the beginning of fiscal 2006 were the shares granted upon Company s IPO on December 15, 2005

(2) There were 35,156 shares vested during the year ended December 31, 2006, with a total grant date fair value of approximately $241,000. The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company s closing stock price of $14.86 as of December 31, 2006, which would have been received by the stock option holders had all stock option holders exercised their stock options as of that date.

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

| | Number of Shares | Weighted-Average Grant-date Fair Value |
|---|---|---|
| Restricted Stock Units: | | |
| Unvested as of December 26, 2005[1] | 3,604,090 | $ 12.00 |
| Granted | 362,434 | $ 15.23 |
| Cancelled | (217,021) | $ 13.02 |
| Vested | (825,888) | $ 12.00 |
| Unvested as of December 31, 2006 | 2,923,615 | $ 12.33 |

(1) Unvested shares at the beginning of fiscal 2006 were the shares granted upon Company s IPO on December 15, 2005

**Employee Stock Purchase Plan**

The 2005 Employee Stock Purchase Plan is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code with the purpose of providing eligible employees (including officers) and eligible employees of participating subsidiaries with an opportunity to purchase Class A common stock through payroll deductions. The 2005 Employee Stock Purchase Plan would allow eligible and

participating employees to purchase, through payroll deductions, shares of Class A common stock at a discount, not to exceed 15 percent, applied to either (1) the fair market value per share of Class A common stock on the first business date of an offering period, or (2) the fair market value per share of Class A common stock on the last business date of that offering period. The Company has reserved 2,250,000 shares of Class A common stock available for

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

issuance under this plan. As of December 31, 2006, no shares have been issued under this plan and the Company has not determined whether it will issue shares under this plan in the future. The 2005 Employee Stock Purchase Plan, if implemented, will be administered by the Compensation Committee.

**5. Related Party Transactions**

Prior to the second quarter of fiscal 2006, the Company relied on AMD and Fujitsu as sole distributors of its products. In the second quarter of fiscal 2006, the Company began selling its products directly to the customers previously served by AMD. The Company receives services from AMD and Fujitsu, including among others, certain information technology, facilities, logistics, legal, tax, finance, human resources and environmental health and safety services. Since its IPO, the Company has taken on some of these functions and the Company decreased the use of these services. The charges for these services are negotiated annually between the Company and AMD and Fujitsu based on the Company s expected requirements and the estimated future costs of the services to be provided. AMD has the right to review the proposed services to be provided by Fujitsu, and Fujitsu has the right to review the proposed services to be provided by AMD. The service charges are billed monthly on net 45 days terms.

The following tables present significant related party transactions and account balances between the Company and AMD (See Note 9 for separate disclosure of debt obligations to related parties):

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | | (in thousands) | |
| Net sales to AMD[1] | $ 336,172 | $ 1,114,150 | $ 1,211,033 |
| Cost of sales: | | | |
| Royalties to AMD | $ 6,228 | $ 13,760 | $ 18,080 |
| Service fees to AMD: | | | |
| Cost of sales | $ 3,276 | $ 21,397 | $ 21,915 |
| Research and development | 11,591 | 21,213 | 27,614 |
| Marketing, general and administrative | 19,981 | 50,229 | 56,697 |
| Service fees to AMD[2] | $ 34,848 | $ 92,839 | $ 106,226 |
| Cost of employees seconded from AMD: | | | |
| Marketing, general and administrative | $ | $ 1,199 | $ 1,524 |

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | | (in thousands) |
| Trade accounts receivable from AMD, net of allowance for doubtful accounts | $ 3,400 | $ 205,351 |
| Other receivables from AMD | $ 2,325 | $ 13,850 |
| Accounts payable to AMD | $ 1,513 | $ 97,844 |
| Royalties payable to AMD | $ 3,130 | $ 6,384 |
| Accrued liabilities to AMD | $ 43 | $ 17,434 |

(1) In the second quarter of fiscal 2006, the Company began selling its products directly to the customers previously served by AMD.
(2) Service fees to AMD are net of reimbursements from AMD for services provided to AMD by the Company.

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

The following tables present the significant related party transactions and account balances between the Company and Fujitsu (See Note 9 for separate disclosure of debt obligations to related parties):

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | | (in thousands) | |
| Net sales to Fujitsu | $ 932,623 | $ 888,655 | $ 1,051,194 |
| Cost of sales | | | |
| Royalties to Fujitsu | $ 6,228 | $ 13,760 | $ 18,080 |
| Other purchases of goods and services from Fujitsu and rental expense to Fujitsu | 117,999 | 69,219 | 66,525 |
| Subcontract manufacturing purchases from Fujitsu | 15,041 | 35,150 | 74,800 |
| Commercial die purchases from Fujitsu | 51,054 | 94,327 | 141,117 |
| Service fees to Fujitsu: | | | |
| Cost of sales | $ 2,269 | $ 3,271 | $ 3,662 |
| Research and development | 2,453 | 6,501 | 18,449 |
| Marketing, general and administrative | 4,220 | 10,339 | 11,382 |
| Service fees to Fujitsu | $ 8,942 | $ 20,111 | $ 33,493 |
| Cost of employees seconded from Fujitsu: | | | |
| Cost of sales | $ 27 | $ 742 | $ 1,333 |
| Research and development | 61 | 4,280 | 8,241 |
| Marketing, general and administrative | 95 | 2,135 | 3,774 |
| Cost of employees seconded from Fujitsu | $ 183 | $ 7,157 | $ 13,348 |

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Trade accounts receivable from Fujitsu | $ 190,328 | $ 199,224 |
| Other receivables from Fujitsu | $ | $ 217 |
| Accounts payable to Fujitsu | $ 13,046 | $ 25,957 |
| Royalties payable to Fujitsu | $ 3,130 | $ 6,384 |
| Accrued liabilities to Fujitsu | $ 4,970 | $ |

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

Fujitsu provides test and assembly services to the Company on a contract basis. Also, the Company purchases commercial die from Fujitsu, which are packaged together with the Company s Flash memory devices.

Fujitsu seconded certain employees to the Company until the second quarter of fiscal 2006. The Company paid these employees directly. AMD also seconded certain employees to the Company until the fourth quarter of fiscal 2005. The Company reimbursed AMD for the costs of these employees.

On September 28, 2006, Spansion Japan Limited, or Spansion Japan, the Company s wholly-owned subsidiary, entered into an asset purchase agreement with Fujitsu, pursuant to which Spansion Japan will sell two wafer fabrication facilities located in Aizu-Wakamatsu, Japan, which the Company refers to as the JV1/JV2

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**Spansion Inc.**

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

Facilities, and certain assets located in the JV1/JV2 Facilities, to Fujitsu for a purchase price of approximately $150 million plus the value of the inventory at the time of closing. Concurrently with the execution of the asset purchase agreement, Spansion Japan and Fujitsu also executed (i) a master lease agreement, pursuant to which Spansion Japan will lease certain equipment to Fujitsu to use in the JV1/JV2 Facilities, (ii) a foundry agreement, pursuant to which Fujitsu has agreed to manufacture, and the Company has agreed to purchase, wafers to be manufactured by Fujitsu for Spansion in the JV1/JV2 Facilities (the foundry agreement also includes minimum supply and purchase commitments between both the parties resulting in financial penalties if such supply and purchase commitments are not achieved) and (iii) a secondment and transfer agreement, pursuant to which Spansion Japan has agreed to second a specified number of employees to Fujitsu to work in the JV1/JV2 Facilities and ultimately to transfer certain of the employees to Fujitsu. The Company refers to these agreements collectively as the JV1/JV2 Transaction. Under the terms of the asset purchase agreement, the JV1/JV2 Transaction is scheduled to close in the second quarter of fiscal 2007.

**6. Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash equivalents, marketable securities, trade receivables and foreign currency forward contracts. The Company places its cash equivalents and marketable securities with high quality credit financial institutions and, by policy, limits the amount of credit exposure with any one financial institution.

Concentration of credit risk with respect to trade receivables exists because the Company sells a significant portion of its products directly to Fujitsu. Trade accounts receivable from Fujitsu comprised approximately 48 percent and 49 percent of the total consolidated trade accounts receivable balance as of December 31, 2006 and December 25, 2005, respectively. However, the Company does not believe the receivable balances from the related party subject the Company to significant credit risk as historical losses have not been significant and Fujitsu s own customer base represent a large number of geographically diverse companies. Fujitsu is required to pay its trade receivables regardless of whether it can collect from its customers. The Company does not require collateral or other security from Fujitsu.

The counterparties relating to the Company s financial activities, including investing, borrowing and foreign exchange hedging, consist of large international financial institutions. The Company does not believe that there is significant risk of nonperformance by these counterparties because the Company monitors their credit ratings and limits the financial exposure and the notional amount of agreements entered into with any one financial institution. While the notional amounts of derivative financial instruments are often used to express the volume of these transactions, the potential accounting loss on these transactions if all counterparties failed to perform is limited to the amounts, if any, by which the counterparties obligations under the contracts exceed the Company s obligations to the counterparties. As of December 31, 2006 and December 25, 2005, the Company had a total notional amount of approximately $10.9 million and $49.6 million, respectively, in outstanding foreign currency forward exchange contracts. Foreign currency gains and losses were not significant for the periods presented.

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

**7. Financial Instruments**

Marketable securities held by the Company as of December 31, 2006 and December 25, 2005 are as follows:

| | Amortized Cost | Gross Unrealized Gains (in thousands) | Fair Value |
|---|---|---|---|
| **2006** | | | |
| Cash equivalents: | | | |
| Money market funds | $ 67,000 | $ | $ 67,000 |
| Commercial paper | 565,660 | | 565,660 |
| Total cash equivalents | 632,660 | | 632,660 |
| Marketable securities: | | | |
| Auction rate securities | 125,975 | | 125,975 |
| Total marketable securities | 125,975 | | 125,975 |
| Total cash equivalents and marketable securities | $ 758,635 | $ | $ 758,635 |
| **2005** | | | |
| Cash equivalents: | | | |
| Money market funds | $ 59,000 | $ | $ 59,000 |
| Commercial paper | 336,141 | | 336,141 |
| Total cash equivalents | 395,141 | | 395,141 |
| Marketable securities: | | | |
| Auction rate preferred stocks | 15,000 | | 15,000 |
| Commercial paper | 177,086 | | 177,086 |
| Investment in equity securities | 20,000 | 7,291 | 27,291 |
| Total marketable securities | 212,086 | 7,291 | 219,377 |
| Total cash equivalents and marketable securities | $ 607,227 | $ 7,291 | $ 614,518 |

As of December 31, 2006, all investments in the Company s portfolio were either cash equivalents or marketable securities, which, with the exception of auction rate securities, scheduled to mature within next twelve months. The auction rate securities are classified as short-term as they are intended to be used in current operations, and have rate and liquidity resets of 35 days or less.

As of December 31, 2006, the Company s marketable securities approximated the fair market values of the securities and the unrealized gains and losses on these securities were not significant. As of December 25, 2005, the Company had recorded an unrealized gain of approximately $7.3 million in other comprehensive loss on its investment in certain publicly-traded equity securities. In fiscal 2006 the Company sold this investment in its entirety and realized a gain on the sale of $6.9 million.

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

**Fair Value of Other Financial Instruments**

The fair value of the Company s fixed rate long-term debt is estimated by considering the Company s credit rating, the interest rates and the terms of the debt. The fair value of the Company s variable rate long-term debt is estimated based on the current rates offered to the Company for debt of the same remaining maturities. The carrying amounts and estimated fair values of the Company s debt instruments are as follows:

| | Dec. 31, 2006 | | Dec. 25, 2005 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (in thousands) | | | |
| Debt obligations | 980,307 | 1,024,926 | 359,803 | 359,803 |
| Debt obligations to related parties | 500 | 500 | 183,915 | 183,915 |
| Total debt obligations | $ 980,807 | $ 1,025,426 | $ 543,718 | $ 543,718 |

The fair value of the Company s accounts receivable and accounts payable approximate their carrying value based on existing payment terms. As of December 31, 2006 and December 25, 2005, the fair values of the Company s foreign currency forward contracts were not significant.

**8. Warranties and Indemnities**

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

Changes in the Company s liability for product warranty during the years ended December 31, 2006 and December 25, 2005 are as follows:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Balance, beginning of fiscal year | $ 1,000 | $ 600 |
| Provision for warranties issued | 4,529 | 2,418 |
| Settlements | (5,562) | (5,246) |
| Changes in liability for pre-existing warranties during the period, including expirations | 1,383 | 3,228 |
| Balance, end of fiscal year | $ 1,350 | $ 1,000 |

In addition to product warranties, the Company, from time to time in its normal course of business, indemnifies other parties with whom it enters into contractual relationships, including customers, directors, lessors and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against specified losses, such as those arising from a breach of representations or covenants, third-party infringement claims or other claims made against certain parties. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim and indemnification provision. Historically, there have been no indemnification claims.

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

**9. Debt and Capital Lease Obligations**

The Company s debt and capital lease obligations consist of:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Debt obligations to related parties: | | |
| Spansion China Line of Credit | $ | $ 15,000 |
| Spansion Penang Loan | | 4,833 |
| Spansion Penang Building Loan | | 5,112 |
| Senior Subordinated Notes | | 158,970 |
| Promissory Note | 500 | |
| Total debt obligations to related parties | 500 | 183,915 |
| Debt obligations to third parties: | | |
| Spansion Japan Term Loan | | 72,274 |
| Spansion China Bank Enterprise Cooperation Revolver | 7,925 | 18,722 |
| Spansion Japan Revolving Credit Facility | | 43,020 |
| Senior Notes | 228,231 | 225,787 |
| Spansion Japan 2006 Revolving Credit Facility | 8,402 | |
| Spansion Penang Loan | 3,543 | |
| Spansion Japan 2006 Merged Revolving Credit Facility | 16,804 | |
| Exchangeable Senior Subordinated Debentures | 207,000 | |
| Spansion Japan 2006 Uncommitted Revolving Credit Facility | 8,402 | |
| Senior Secured Term Loan Facility | 500,000 | |
| Obligations under capital leases | 137,240 | 215,895 |
| Total debt obligations to third parties | 1,117,547 | 575,698 |
| Total debt obligations | 1,118,047 | 759,613 |
| Less: current portion | 108,374 | 233,555 |
| Long-term debt and capital lease obligations, less current portion | $ 1,009,673 | $ 526,058 |

**Debt Obligations to Related Parties**

***Spansion China Line of Credit***

As part of the reorganization in 2005, the Company assumed $60 million of unsecured debt, payable by the Company s subsidiary in the People s Republic of China, Spansion China Limited, to AMD and its subsidiary in Singapore, Advanced Micro Devices (Singapore) Pte., or AMD Singapore.

On February 15, 2006, the Company repaid the remaining outstanding principal of $15.0 million and accrued interest of approximately $121,000 to AMD under the Spansion China Line of Credit.

***Spansion Penang Loan***

On January 29, 2004, Spansion Penang entered into a financial arrangement with AMD. Under the terms of the arrangement, Spansion Penang borrowed approximately 29.0 million Malaysian Ringgit (approximately $8.0 million based on the exchange rate as of January 29, 2004) from AMD to fund the purchase of manufacturing equipment.

In January 2006, AMD s loan to Spansion Penang, more fully described under Debt Obligations to Third Parties Spansion Penang Loan below, was transferred from AMD to a third-party financial institution.

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**Spansion Inc.**

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

***Spansion Penang Building Loan***

On December 20, 2005, Spansion Penang assumed approximately 19.3 million Malaysian Ringgit (approximately $5 million based on the exchange rate as of December 20, 2005) of an unsecured promissory note, payable to AMD Export, in connection with the sale of certain assets by AMD Export to Spansion Penang.

On June 28, 2006, the Company repaid AMD the remaining outstanding principal of approximately 19.3 million Malaysian Ringgit (approximately $5.4 million based on the exchange rate as of June 28, 2006) under the Spansion Penang Building Loan.

***Senior Subordinated Notes***

On December 21, 2005, the Company issued to AMD $175 million aggregate principal amount of its 12.75% Senior Subordinated Notes Due 2016. The senior subordinated notes were issued at 90.828 percent of face value, resulting in net proceeds of approximately $158.9 million.

On June 12, 2006, the Company repurchased and cancelled the 12.75% Senior Subordinated Notes. The Company recognized a loss on early extinguishment of debt of approximately $17.3 million as a result of the repurchase of these notes. The loss included the write-off of debt issuance costs of approximately $2.0 million and the write-off of unamortized debt discount of approximately $15.3 million.

***Promissory Note***

On February 27, 2006, the Company purchased a software license from AMD and, as payment, the Company issued a $3.0 million promissory note to AMD. As of December 31, 2006, the Company has repaid $2.5 million of the principal of the promissory note. The remaining balance of $0.5 million is due in the first quarter of 2007.

**Debt Obligations to Third Parties**

***Spansion Japan Term Loan***

Spansion Japan entered into a term loan with a Japanese financial institution in September 2003.

On December 30, 2005, Spansion Japan voluntarily prepaid and terminated the Spansion Japan Term Loan agreement. There were no penalties associated with the prepayment and termination of this loan agreement.

***Spansion China Bank Enterprise Cooperation Revolver***

On December 1, 2005, Spansion China entered into a bank enterprise cooperation agreement with a local financial institution, effective as of October 24, 2005. Under the terms of the agreement, Spansion China may draw under two credit facilities, equal to U.S. $26 million and RMB 176 million (approximately $22 million as of October 24, 2005), respectively. Borrowings must be used for working capital purposes. The two credit facilities terminate on June 22, 2008. The interest rate for each loan denominated in RMB is a floating rate per annum and is set at the time each revolving loan agreement is entered into. The interest rate may thereafter be adjusted every 12 months at a rate equal to the benchmark rate published by the People s Bank of China for RMB loans of the same term less a ten percent discount. The interest rate for each loan denominated in U.S. dollars is a floating rate per annum and is initially set at the time each revolving loan agreement is entered into, ranging from 5.39 percent to 6.61 percent for the outstanding balance as of December 31, 2006. The interest rate is thereafter adjusted every six months at a rate equal to the six-month LIBOR plus one percent. The U.S. dollar denominated revolving loan agreements are unsecured. Under the terms of the agreements, Spansion China is prohibited from encumbering any of its assets.

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**Spansion Inc.**

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

As of December 31, 2006 and December 25, 2005, the amount outstanding under the U.S. dollar denominated loan agreement was approximately $7.9 million and $8.3 million, respectively. There was no amount outstanding under RMB credit facility as of December 31, 2006. The total amount outstanding under the RMB denominated loan agreement was approximately RMB 84 million (approximately $10.4 million) as of December 25, 2005. The dollar amounts for these RMB loans were calculated using an exchange rate as of December 25, 2005.

***Spansion Japan Revolving Credit Facility***

On September 20, 2005, Spansion Japan entered into an uncommitted revolving credit facility agreement with a certain Japanese financial institution in the aggregate principal amount of up to 5.0 billion yen (approximately $45 million as of September 20, 2005).

On March 31, 2006, Spansion Japan entered into an Amended and Restated Uncommitted Revolving Credit Facility Agreement with a certain Japanese financial institution (the Spansion Japan 2006 Merged Revolving Credit Facility), which provides for a revolving credit facility in the aggregate principal amount of up to 8.0 billion yen (or up to approximately $68 million based as of March 31, 2006). The Spansion Japan 2006 Merged Revolving Credit Facility replaces the Spansion Japan Revolving Credit Facility and Spansion Japan Uncommitted Revolving Credit Facility as a result of the merger of the two respective financial institutions that had previously provided those separate facilities.

***Senior Notes***

On December 21, 2005, the Company completed an offering of $250 million aggregate principal amount of 11.25% Senior Notes due 2016. The Senior Notes were issued at 90.302 percent of face value, resulting in net proceeds to the Company of approximately $218.1 million after deducting the initial purchasers discount and estimated offering expenses. The Senior Notes are general unsecured senior obligations of Spansion LLC and will rank equal in right of payment with any of the Company s existing and future senior debt. Interest is payable on January 15 and July 15 of each year beginning July 15, 2006 until the maturity date of January 15, 2016.

Certain events may result in the accelerated maturity of the Senior Notes, including a default in any interest, principal or premium amount payment; a merger, consolidation or sale of all or substantially all of the Company s property; a breach of covenants in the senior notes or the respective indenture; a default in certain debts; or if a court enters certain orders or decrees under any bankruptcy law. Upon occurrence of one of these events, the principal of and accrued interest on all of the senior notes, as the case may be, may become immediately due and payable. If the Company incurs any judgment for the payment of money in an aggregate amount in excess of $50 million or takes certain voluntary actions in connection to insolvency, all amounts on the Senior Notes shall become due and payable immediately.

***Spansion Japan 2006 Revolving Credit Facility***

On December 26, 2005, Spansion Japan entered into an uncommitted revolving credit facility agreement with a certain Japanese financial institution in the aggregate principal amount of up to 3.0 billion yen (or up to approximately $25.2 million as of December 31, 2006). Because the amount subject to the credit facility is denominated in yen, the dollar amount stated above is subject to change based on applicable exchange rates.

Spansion Japan may, pursuant to the terms of the credit facility, borrow amounts in increments of 50 million yen (approximately $420,000 as of December 31, 2006), which may remain outstanding for up to three months. Amounts borrowed under the credit facility bear interest at a rate equal to the Tokyo Interbank Offered Rate, or TIBOR, at the time of the drawdown, plus a margin of 0.5 percent per annum.

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**Spansion Inc.**

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

Pursuant to the terms of the credit facility, Spansion Japan is required, among other things, to submit any annual securities reports, semiannual reports, quarterly reports, extraordinary reports, revision reports, and group reports and accounts prepared by Spansion Japan to the Japanese financial institution.

In addition, Spansion Japan is not permitted, among other things, to:

- create any security interests or liens on any of its assets, subject to certain exceptions;
- subordinate the payment of its debt under the credit facility to the payment of any unsecured debts; and
- enter into any merger, company partition, exchange or transfer of shares, assign all or a part of its business or assets to a third party, or otherwise transfer all or a material part of its assets to a third party, subject to certain exceptions.

The credit facility terminates on December 26, 2007 unless terminated earlier in the event of default, or by either party upon written notice in accordance with the terms of the credit facility.

On December 15, 2006, Spansion Japan borrowed 1.0 billion yen (approximately $8.4 million as of December 31, 2006) under this facility. This amount bears interest at a rate of 1.05 percent and must be repaid no later than March 15, 2007.

***Spansion Penang Loan***

On January 29, 2004, Spansion Penang entered into a financial arrangement with AMD. Under the terms of the arrangement, Spansion Penang borrowed approximately 29.0 million Malaysian Ringgit (approximately $8.0 million based on the exchange rate as of January 29, 2004) from AMD to fund the purchase of manufacturing equipment. In January 2006, this loan was transferred from AMD to a third-party financial institution. The loan bears a fixed annual interest rate of 5.9 percent and is payable in equal, consecutive, monthly principal and interest installments through February 2009.

***Spansion Japan 2006 Merged Revolving Credit Facility***

On March 31, 2006, Spansion Japan entered into an Amended and Restated Uncommitted Revolving Credit Facility Agreement with a Japanese financial institution (the Spansion Japan 2006 Merged Revolving Credit Facility), which provides for a revolving credit facility in the aggregate principal amount of up to 8.0 billion yen (or up to approximately $67.2 million as of December 31, 2006). The Spansion Japan 2006 Merged Revolving Credit Facility replaced the Spansion Japan Revolving Credit Facility and Spansion Japan Uncommitted Revolving Credit Facility as a result of the merger of the two respective financial institutions that had previously provided those separate facilities.

Pursuant to the terms of the Spansion Japan 2006 Merged Revolving Credit Facility, Spansion Japan may borrow amounts in increments of 50 million yen (approximately $420,000 as of December 31, 2006), which may remain outstanding in monthly increments of up to three months. Amounts borrowed bear interest at a rate equal to TIBOR, at the time of the drawdown, plus a margin of 0.5 percent per annum.

Spansion Japan is not permitted, among other things, to create any security interests or liens on any of its assets, subject to certain exceptions; subordinate the payment of its debt under this credit facility to the payment of any unsecured debts; or enter into any merger, company partition, exchange or transfer of shares, assign all or a part of its business or assets to a third party, or otherwise transfer all or a material part of its assets to a third party, subject to certain exceptions.

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**Spansion Inc.**

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All of Spansion Japan s debts under the Spansion Japan 2006 Merged Revolving Credit Facility will automatically become due and payable without any notice or demand if proceedings of bankruptcy, insolvency, dissolution or similar matters are initiated by or against Spansion Japan. All of the debts under this credit facility will become due and payable upon notice to Spansion Japan by the lenders in an event of default, which includes, among other things, the following: a default in performance of payment; any of Spansion Japan s debts or guarantee obligations (other than those under Spansion Japan 2006 Merged Revolving Credit Facility) in an aggregate amount exceeding 10 million yen (approximately $84,000 as of December 31, 2006) become due and payable; or the suspension of the business of Spansion Japan by Spansion Japan or by a government authority, in each case if not cured within applicable time periods set forth in the Spansion Japan 2006 Merged Revolving Credit Facility.

The Spansion Japan 2006 Merged Revolving Credit Facility may be terminated in the event of default or by either party upon written notice in accordance with its terms.

On December 15, 2006, Spansion Japan borrowed 2.0 billion yen (approximately $16.8 million as of December 31, 2006) under this facility. This amount bears interest at a rate of 1.05 percent and must be repaid no later than March 15, 2007.

***Exchangeable Senior Subordinated Debentures***

In June 2006, Spansion LLC, the wholly owned operating subsidiary of the Company, issued $207.0 million of aggregate principal amount of 2.25% Exchangeable Senior Subordinated Debentures due 2016. The Debentures are general unsecured senior subordinated obligations and rank subordinate in right of payment to all of the Company s senior indebtedness, including the Senior Notes, and senior in right of payment to all of the Company s subordinated indebtedness. The Debentures bear interest at 2.25 percent per annum. Interest is payable on June 15 and December 15 of each year beginning December 15, 2006 until the maturity date of June 15, 2016.

The Debentures were not exchangeable prior to January 6, 2007. On January 6, 2007, the Debentures became exchangeable for shares of the Company s Class A common stock, cash or a combination of cash and shares of such Class A common stock, at the Company s option. Full conversion of the Debentures into shares would result in an initial exchange rate of 56.7621 shares of Class A common stock per debenture representing an initial exchange price of approximately $17.6174 per share of Spansion Inc. Class A common stock. The Company has reserved 11.7 million shares issuable upon conversion of the debentures. The debentures have not been exchanged for Class A common stock as of February 21, 2007.

The Company, at any time prior to maturity may make an irrevocable election to satisfy the exchange obligation in cash up to 100 percent of the principal amount of the debentures exchanged, with any remaining amount to be satisfied in shares of Class A common stock or a combination of cash and shares of Class A common stock at the above exchange ratio. In the event that the Company makes this irrevocable election, debenture holders may exchange their debentures only under the following circumstances:

- during any fiscal quarter after the Company s fiscal quarter ending April 1, 2007 (and only during such fiscal quarter) if the sale price of Spansion Inc. Class A common stock, for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous fiscal quarter, is greater than or equal to 120 percent of the conversion price per share of the Spansion Inc. Class A common stock;

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**Spansion Inc.**

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

subject to certain exceptions, during the five business day period following any five consecutive trading day period in which the trading price of the debentures for each day of such period was less than 98 percent of the product of the sale price of the Spansion Inc. Class A common stock and the number of shares issuable upon exchange of $1,000 principal amount of the debentures; or

Upon the occurrence of specified corporate events that constitute a fundamental change of the Company under certain circumstances. The holders of the Debentures will have the ability to require the Company to repurchase the Debentures in whole or in part for cash in the event of a fundamental change of the Company. In such case, the repurchase price would be 100 percent of the principal amount of the Debentures plus any accrued and unpaid interest.

***Spansion Japan 2006 Uncommitted Revolving Credit Facility***

On September 29, 2006, Spansion Japan entered into an Uncommitted Revolving Credit Facility Agreement with a Japanese financial institution (the Spansion Japan 2006 Uncommitted Revolving Credit Facility), which provides for a revolving credit facility in the aggregate principal amount of up to 2.0 billion yen (or up to approximately $16.8 million as of December 31, 2006).

Pursuant to the terms of the Spansion Japan 2006 Uncommitted Revolving Credit Facility, Spansion Japan may borrow amounts in increments of 50 million yen (approximately $420,000 as of December 31, 2006), which may remain outstanding in monthly increments of up to three months. Amounts borrowed bear interest at a rate equal to TIBOR, at the time of the drawdown, plus a margin of 0.5 percent per annum.

Spansion Japan is not permitted, among other things, to create any security interests or liens on any of its assets, subject to certain exceptions; subordinate the payment of its debt under this credit facility to the payment of any unsecured debts; or enter into any merger, company partition, exchange or transfer of shares, assign all or a part of its business or assets to a third party, or otherwise transfer all or a material part of its assets to a third party, subject to certain exceptions.

All of Spansion Japan s debts under the Spansion Japan 2006 Uncommitted Revolving Credit Facility will automatically become due and payable without any notice or demand if proceedings of bankruptcy, insolvency, dissolution or similar matters are initiated by or against Spansion Japan. All of the debts under this credit facility will become due and payable upon notice to Spansion Japan by the lenders in an event of default, which includes, among other things, the following: a default in performance of payment; any of Spansion Japan s debts or guarantee obligations (other than those under Spansion Japan 2006 Uncommitted Revolving Credit Facility) in an aggregate amount exceeding 10 million yen (approximately $84,000 as of December 31, 2006) become due and payable; or the suspension of the business of Spansion Japan by Spansion Japan or by a government authority, in each case if not cured within applicable time periods set forth in the Spansion Japan 2006 Uncommitted Revolving Credit Facility.

The Spansion Japan 2006 Uncommitted Revolving Credit Facility may be terminated in the event of default or by either party upon written notice in accordance with its terms.

On December 15, 2006, Spansion Japan borrowed 1.0 billion yen (approximately $8.4 million as of December 31, 2006) under this facility. This amount bears interest at a rate of 1.05 percent and must be repaid no later than March 15, 2007.

***Senior Secured Term Loan Facility***

On November 1, 2006, Spansion LLC entered into a new senior secured term loan facility with a certain domestic financial institution, as administrative agent, and the lenders party thereto, in the aggregate amount of

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

$500 million. The Company, along with STI, Spansion International, Inc. and Cerium Laboratories LLC, or Cerium, are guarantors of Spansion LLC s obligations under the senior secured term loan facility. Amounts borrowed under the senior secured term loan facility bear interest equal to either (at Spansion LLC s option) (a) LIBOR, plus a 3.0 percent margin or 2.75 percent margin depending upon the Company s credit rating or (b) the base rate, defined as the higher of (i) the administrative agent s prime rate and (ii) the federal funds rate (as defined in the credit agreement for the senior secured term loan facility) plus 0.50 percent, plus a 2.0 percent margin or 1.75 percent margin depending upon the Company s credit rating. The senior secured term loan facility will terminate and all outstanding borrowings must be repaid no later than November 3, 2012.

In connection with the senior secured term loan facility, the Company and each of Spansion LLC, STI, Spansion International and Cerium, collectively referred to as the loan parties, executed a pledge and security agreement pursuant to which the administrative agent received a first priority security interest in (a) all present and future capital stock of each of the Company s present and future direct and indirect subsidiaries, limited in the case of foreign subsidiaries to a pledge of 65 percent of the capital stock of each first-tier foreign subsidiary, (b) all present and future debt of each loan party, but excluding certain intercompany debt to a foreign subsidiary, (c) all present and future other property and assets of each loan party, but excluding intellectual property and any equipment subject to a lien securing a capitalized lease permitted by the credit agreement for the senior secured term loan facility, and (d) all proceeds and products of the property and assets described above. The net book value of the pledged assets as of December 31, 2006 was approximately $663.5 million.

Pursuant to the terms of the senior secured term loan facility, and subject to certain exceptions, Spansion LLC and its subsidiaries are limited in their ability, among other things, to:

- create or permit liens;
- incur indebtedness, subject to certain exceptions, including existing indebtedness under Spansion LLC s 11.25% Senior Notes indenture, Spansion LLC s 2.25% Exchangeable Senior Subordinated Debentures indenture, the senior secured revolving credit facility, capital leases not to exceed 15 percent of Spansion Inc. s total assets, indebtedness of acquired subsidiaries existing at the time of such acquisition and up to $500 million for capital expenditures at SP1;
- make or hold investments above certain thresholds;
- have interest coverage and minimum liquidity of less than specified amounts;
- consolidate, merge or sell assets as an entirety or substantially as an entirety;
- make any disposition of properties, including any sale leaseback transaction;
- make certain distributions, stock redemptions or other payments on account of any equity interests;
- enter into certain types of transactions with affiliates;

make or become obligated to make any capital expenditures except for those in the ordinary course of business not to exceed specified amounts; and

voluntarily prepay any indebtedness.

In addition, under the senior secured term loan facility, the Company is not permitted to engage in any business or activity other than, among other things, holding equity interests in Spansion LLC and STI and activities incidental to being a publicly traded company.

Amounts outstanding under the senior secured term loan facility may become immediately due and payable upon the occurrence of specified events, including, among other things: failure to pay any obligations under the senior secured term loan facility; the breach of any representation or warranty or certain covenants; any default in

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**Spansion Inc.**

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

the payment when due of indebtedness of more than $25 million; filings or proceedings in bankruptcy; judgments or awards entered against the Company, Spansion LLC, STI, Spansion International, Cerium or any subsidiaries involving aggregate liability of $10 million or more; or a change of control (as defined in the credit agreement for the senior secured term loan facility).

***Senior Secured Revolving Credit Facility***

On November 1, 2006, Spansion LLC, the agent and the other lenders party to the senior secured revolving credit facility amended the credit agreement and the security agreement in connection therewith, and the Company, STI and Spansion International entered into certain new pledge agreements. Pursuant to the amendment to the revolving facility credit agreement, lenders consented to the incurrence of the senior secured term loan facility and the grant of related liens, and the amount available under the revolving credit facility was amended to be based on the sum of 85 percent of accounts receivable meeting eligibility requirements, plus the lesser of (i) $10 million and (ii) 25 percent of eligible foreign accounts receivable, minus reserves established by the agent in its reasonable credit judgment. In addition, pursuant to the amendment, subject to certain limitations, the equity interests in Spansion LLC owned by the Company and by STI, the equity interests in foreign subsidiaries owned by Spansion International and Spansion LLC s equipment, inventory and equity interests in its foreign subsidiaries were added as the collateral securing the revolving credit facility. This resulted in the revolving credit facility lenders and the senior secured term loan lenders holding substantially similar security. The relative priorities of the classes of lenders in various types of collateral is set forth in an intercreditor agreement between the agent for the revolving credit facility lenders and the agent for the senior secured term loan lenders.

As of December 31, 2006 and December 25, 2005, no amounts were outstanding under this revolving credit facility.

***Obligations under Capital Leases***

On September 29, 2006, the Company entered into a sale-leaseback transaction with a third-party financial institution for certain equipment in the amount of $29.1 million of cash proceeds. Upon execution of the agreements, the equipment had a net book value of approximately $30.7 million. As the term on the leaseback transaction is more than 75 percent of the remaining estimated economic life of the equipment, the Company accounted for the leaseback transaction as a capital lease. The equipment leases shall terminate on September 29, 2010, unless terminated earlier in the event of default, or by either party upon written notice in accordance with the terms of the equipment lease. As of December 31, 2006, the outstanding lease obligation under this agreement was approximately $26.2 million.

On December 19, 2006, the Company entered into a sale-leaseback transaction with a third-party financial institution for certain equipment in the amount of $18.5 million of cash proceeds. Upon execution of the agreements, the equipment had a net book value of approximately $18.1 million. This transaction did not result in a significant gain or loss. As the present value of the minimum lease payments was more than 90 percent of the fair values of the equipment at the inception of the lease, the Company accounted for the leaseback transaction as a capital lease. The equipment leases shall terminate on December 19, 2011, unless terminated earlier in the event of default, or by either party upon written notice in accordance with the terms of the equipment lease. As of December 31, 2006, the outstanding lease obligation under this agreement was approximately $17.5 million.

As of December 31, 2006 and December 25, 2005, the Company had aggregate outstanding capital lease obligations of approximately $137 million and $216 million, respectively. Obligations under these lease agreements are collateralized by the assets leased and are payable through 2011. Leased assets consist principally of machinery and equipment.

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**Spansion Inc.**

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

The gross amount of assets recorded under capital leases totaled approximately $320 million and $396 million as of December 31, 2006 and December 25, 2005, respectively and accumulated amortization of these leased assets was approximately $177 million and $229 million as of December 31, 2006 and December 25, 2005, respectively. These leased assets are included in the related property, plant and equipment category. Amortization of assets recorded under capital leases is included in depreciation expense. AMD has guaranteed approximately $3 million and $36 million of the Company s aggregate outstanding capital lease obligations as of December 31, 2006 and December 25, 2005, respectively. Fujitsu did not guarantee any of the Company s outstanding capital lease obligations as of December 31, 2006. Fujitsu has guaranteed approximately $18 million of the Company s aggregate outstanding capital lease obligations as of December 25, 2005.

***Scheduled Maturities of Debt and Future Minimum Capital Lease Payments***

For each of the next five years and beyond, the Company s scheduled maturities of debt and future minimum capital lease payments outstanding as of December 31, 2006 are as follows:

| | Debt Obligations to Related Parties | Other Debt | Capital Leases |
|---|---|---|---|
| Fiscal 2007 | $ 500 | $ 46,168 | $ 73,418 |
| Fiscal 2008 | | 5,635 | 39,163 |
| Fiscal 2009 | | 4,273 | 29,178 |
| Fiscal 2010 | | 4,000 | 9,728 |
| Fiscal 2011 | | 4,000 | 6,765 |
| 2012 and beyond | | 938,000 | |
| | 500 | 1,002,076 | 158,252 |
| Less amount representing interest | | | (21,012) |
| Less amount representing discount | | (21,769) | |
| Total | $ 500 | $ 980,307 | $ 137,240 |

**10. Guarantees of Company Debt by Related Parties**

The following tables summarize the amounts guaranteed by AMD and Fujitsu related to the underlying liabilities of the Company:

***Liabilities Guaranteed by AMD***

| | As of Dec. 31, 2006 | As of Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Spansion capital lease guarantees | $ 2,708 | $ 35,851 |
| Spansion operating lease guarantees | 3,977 | 7,071 |
| Total debt guaranteed by AMD | $ 6,685 | $ 42,922 |

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**Spansion Inc.**

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

***Liabilities Guaranteed by Fujitsu***

| | As of Dec. 31, 2006 | As of Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Spansion Japan term loan guarantee[1] | $ | $ 72,274 |
| Spansion capital lease guarantees | | 18,184 |
| Spansion operating lease guarantees | 223 | 722 |
| Total debt guaranteed by Fujitsu | $ 223 | $ 91,180 |

(1) AMD agreed to reimburse Fujitsu 60 percent of any amount paid by Fujitsu under its guarantee of this loan.

The amounts above represent the principal amounts of the underlying obligations guaranteed by AMD and Fujitsu and are exclusive of obligations for interest, fees and expenses.

**11. Commitments**

Certain equipment and facilities are leased under various operating leases expiring at various dates through the year 2011. Certain of these leases contain renewal options. Rental expense was $28.9 million, $35.7 million and $30.6 million for the years ended December 31, 2006, December 25, 2005 and December 26, 2004, respectively.

Future minimum lease payments under operating leases and unconditional commitments to purchase manufacturing supplies and services as of December 31, 2006 are as follows:

| | Operating Leases | Unconditional Purchase Commitments |
|---|---|---|
| | (in thousands) | |
| Fiscal 2007 | $ 35,807 | $ 56,365 |
| Fiscal 2008 | 26,881 | 21,487 |
| Fiscal 2009 | 14,729 | 5,367 |
| Fiscal 2010 | 1,234 | 3,546 |
| Fiscal 2011 | 413 | 3,496 |
| | $ 79,064 | $ 90,261 |

AMD and Fujitsu have guaranteed approximately $4 million and $200,000, respectively, of the Company s operating lease obligations as of December 31, 2006.

In June 2002, AMD and Fujitsu entered into a non-exclusive, perpetual license to manufacture and distribute a third-party company s patented technology. AMD and Fujitsu agreed to pay this third-party company a running royalty based on AMD s and Fujitsu s annual cumulative net sales on the sale of products containing this technology. The royalty is triggered only if annual cumulative sales targets are met. The license to manufacture and distribute these products was assigned to the Company as of September 1, 2003. Royalty related to the sale of products containing this license was not significant in fiscal 2006 and fiscal 2005. The Company did not meet the minimum requirements to trigger royalty payments in fiscal 2004.

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**Spansion Inc.**

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

**12. Interest Income and Other Income, Net**

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 26, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | | (in thousands) | |
| Interest income | $ 21,738 | $ 3,017 | $ 2,708 |
| Other income, net | 369 | 156 | 490 |
| | $ 22,107 | $ 3,173 | $ 3,198 |

**13. Income Taxes**

The provision (benefit) for income taxes consists of:

| | Year Ended Dec. 31, 2006 | Year Ended Dec. 25, 2005 | Year Ended Dec. 26, 2004 |
|---|---|---|---|
| | | (In thousands) | |
| Current: | | | |
| U.S. Federal | $ (2,065) | $ 3,826 | $ |
| U.S. State and Local | 24 | 150 | |
| Foreign National and Local | 2,373 | 1,105 | 21,207 |
| | 332 | 5,081 | 21,207 |
| Deferred: | | | |
| U.S. Federal | 2,253 | (2,637) | |
| U.S. State and Local | | (959) | |
| Foreign National and Local | (4,800) | (24,111) | (35,220) |
| | (2,547) | (27,707) | (35,220) |
| Benefit for income taxes | $ (2,215) | $ (22,626) | $ (14,013) |

Pre-tax profit from foreign operations was $10 million for the year ended December 31, 2006. Pre-tax losses from foreign operations were $41 million for the year ended December 25, 2005 and $0.7 million for the year ended December 26, 2004.

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**Spansion Inc.**

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

Deferred income taxes reflect the net tax effects of tax carryovers and temporary differences between the carrying amounts of assets and liabilities for financial reporting and the balances for income tax purposes. Significant components of the Company s deferred tax assets and liabilities as of December 31, 2006 and December 25, 2005 are as follows:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (In thousands) | |
| Deferred tax assets: | | |
| Net operating loss carryovers | $ 88,633 | $ 73,579 |
| Deferred distributor income | 16,489 | 14,432 |
| Inventory valuation | 6,604 | 13,639 |
| Accrued expenses not currently deductible | 11,322 | 12,676 |
| Pension benefits | 6,342 | 957 |
| Property, plant and equipment | 31,929 | 24,254 |
| Federal and state tax credit carryovers | 13,346 | 1,990 |
| Stock-based compensation | 2,850 | |
| Other | 9,855 | 949 |
| Total deferred tax assets | 187,370 | 142,476 |
| Less: valuation allowance | (158,168) | (63,920) |
| | 29,202 | 78,556 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | (8,703) | (50,770) |
| Capitalized interest | (4,452) | (4,924) |
| Unrealized gain on investments | | (2,552) |
| Unrealized gain on balance sheet translation | (1,096) | (3,482) |
| Other | (188) | (4,746) |
| Total deferred tax liabilities | (14,439) | (66,474) |
| Net deferred tax assets | $ 14,763 | $ 12,082 |

In 2006, the net valuation allowance increased by $94 million primarily due to losses and tax credits generated in the U.S. and the net reversal of certain deferred tax liabilities from the prior year. In 2005, the net valuation allowance increased by $50 million primarily due to losses incurred in the U.S. and an increase in reinvestment allowances in Malaysia. In 2004, the net valuation allowance decreased by $6.1 million due to the realization of pension benefits and the utilization of tax loss carryforwards in China. In all periods discussed above, management concluded that valuation allowances were necessary in certain jurisdictions due to the Company s historic net operating losses in those jurisdictions.

As of December 31, 2006, the Company had U.S. federal and state net operating loss carryforwards of approximately $241 million and $17, million respectively. These net operating losses, if not utilized, expire from 2016 to 2026. The Company had foreign net operating loss carryforwards of approximately $8 million that will expire in 2010. The Company also had U.S. federal and state tax credit carryovers of $17.2 million which expire from 2023 to 2026. Included in this amount are California state tax credits of $10.5 million which can be carried forward indefinitely.

If the Company conducts an offering of its common stock, it may experience an ownership change as defined in the Internal Revenue Code such that its ability to utilize its federal net operating loss carryforwards of approximately $241 million as of December 31, 2006 may be limited

under certain provisions of the Internal

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**Spansion Inc.**

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

Revenue Code. As a result, the Company may incur greater tax liabilities than it would in the absence of such a limitation and any incurred liabilities could materially adversely affect it.

The table below displays the reconciliation between statutory federal income taxes and the total provision (benefit) for income taxes. For purposes of the reconciliation between the provision (benefit) for income taxes and the effective rate for the period prior to the IPO in the year ended December 25, 2005 and earlier periods, a notional U.S. rate of 35 percent is applied.

| | Tax | Rate |
|---|---|---|
| | (In thousands, except for percentages) | |
| **Year Ended December 31, 2006** | | |
| Statutory federal income tax expense | $ (52,493) | 35.0% |
| State taxes | 24 | % |
| Foreign income at other than U.S. rates | (7,677) | 5.1% |
| Reserve release | (6,399) | 4.3% |
| Valuation allowance | 64,330 | (42.9)% |
| Benefit for income taxes | $ (2,215) | 1.5% |
| **Year Ended December 25, 2005** | | |
| Statutory federal income tax expense | $ (114,360) | 35.0% |
| State taxes, net of federal benefit | 150 | (0.1)% |
| Foreign income at other than U.S. rates | (8,500) | 2.6% |
| Valuation allowance | 100,084 | (30.6)% |
| Benefit for income taxes | $ (22,626) | 6.9% |
| **Year Ended December 26, 2004** | | |
| Provision at U.S. notional statutory rate | $ (11,801) | 35.0% |
| Losses not subject to U.S. notional income tax | 11,571 | (34.3)% |
| Foreign income at other than U.S. rates | (7,680) | 22.8% |
| Valuation allowance | (6,103) | 18.1% |
| Benefit for income taxes | $ (14,013) | 41.6% |

The Company s operations in China and Penang currently operate under tax holidays, which will expire in whole or in part at various dates through 2013. Certain of the tax holidays may be extended if specific conditions are met. The net impact of these tax holidays was to decrease the Company s net loss by approximately $2.3 million in fiscal year 2006 (less than $0.02 per share, diluted), $2.3 million in fiscal year 2005 (less than $.035 per share, diluted), $0.7 million in fiscal year 2004 (less than $0.01 per share, diluted).

The Company has made no provision for U.S. income taxes on approximately $374 million of cumulative undistributed earnings of certain foreign subsidiaries at December 31, 2006 because it is the Company s intention to reinvest such earnings permanently. If such earnings were distributed, the Company would incur additional income taxes of approximately $107 million (subject to an adjustment for foreign tax credits). These additional income taxes may not result in income tax expense or a cash payment to the Internal Revenue Service, but may result in the utilization of deferred tax assets that are currently subject to a valuation allowance.

During fiscal year 2006, the Company resolved audits in Japan and Thailand that resulted in the reversal of the tax reserves of approximately $6.4 million.

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**Spansion Inc.**

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

**14. Employee Benefit Plans**

***Employee Pension Benefits***

Through August 2005, certain employees of Spansion Japan were enrolled in a defined benefit pension plan and/or a lump-sum retirement benefit plan sponsored by Fujitsu. The Company, by agreement with Fujitsu, is required to fund those proportional benefit obligations attributable to the Company s employees enrolled in these plans. Until September 1, 2005, the Company accounted for its participation in these plans as multiemployer plans wherein the expense recorded for the plans was equal to its annual cash contributions. The Company recorded estimated pension expense of approximately $5.7 million and $7.5 million for the years ended December 25, 2005 and December 26, 2004, respectively. There were no unpaid contributions for the year ended December 25, 2005.

***Establishment of Spansion Japan Pension Plan***

On September 1, 2005, the Company adopted the new Spansion Japan pension plan and changed the formula to a cash balance formula. The new pension plan has two components. The first component provides a lump-sum payment, or twenty-year certain annuity or twenty-year guaranteed life annuity. The second component consists of a lump-sum payment or an optional period certain annuity. Participants have the option to choose a cash payment in lieu of participation in the second component. The effective date of the plan is September 1, 2005. Assets and obligations have been transferred from the Fujitsu Group Employee Pension Fund ( EPF ) to the newly adopted Spansion Japan pension plan.

As part of the transfer of benefits from the EPF, the new Spansion Japan pension plan also received approximately $48.7 million in pension assets directly from the EPF trust.

As a result of the adoption of the plan and amendment to a cash balance formula, a prior service cost base was established for approximately $12.5 million an unrecognized net loss base was established for approximately $7.7 million and an additional minimum liability was recognized for $20.3 million.

***Adoption of Statement 158***

As disclosed in Note 3, on December 31, 2006, the Company adopted the pension accounting and disclosure provisions of Statement 158. The incremental effects of adopting the provisions of Statement 158 on the Company s consolidated balance sheet at December 31, 2006 are presented in the following table. The adoption of Statement 158 had no effect on the Company s consolidated statement of operations for the year ended December 31, 2006, or for any prior period presented, and it will not effect the Company s operating results in future periods. Had the Company not been required to adopt Statement 158 at December 31, 2006, it would have recognized an additional minimum liability pursuant to the provisions of Statement 87. The effect of recognizing the additional minimum liability is included in table below in the column labeled Prior to Application of Statement 158.

| | Prior to Adopting Statement 158 | Effect of Adopting Statement 158 | As Reported at Dec. 31, 2006 |
|---|---|---|---|
| | | (in thousands) | |
| Other assets | 35,628 | (10,231) | 25,397 |
| Total assets | 3,559,948 | (10,231) | 3,549,717 |
| Other long-term liabilities | (3,531) | (522) | (4,053) |
| Accumulated other comprehensive income | 68,953 | 10,753 | 79,706 |
| Total stockholders equity | (1,856,513) | 10,753 | (1,845,760) |

| | | | |
|---|---|---|---|
| Total liabilities and stockholders equity | (3,559,948) | 10,231 | (3,549,717) |

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**Spansion Inc.**

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

The below tables summarizes the funded status of the plan components of the minimum pension liability and the related amounts recognized in the statement of financial position as of December 31, 2006:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| **Change in Projected Benefit Obligation** | | |
| Benefit obligation, beginning of year | $ (76,024) | $ (81,818) |
| Service cost | (5,123) | (1,612) |
| Interest cost | (1,517) | (376) |
| Actuarial (loss)/gain | 87 | 2,931 |
| Benefits paid | 628 | 526 |
| Foreign currency exchange rate changes | 1,893 | 4,325 |
| Benefit obligation, end of year | $ (80,056) | $ (76,024) |

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| **Change in Projected Benefit Obligation** | | |
| **Change in Fair Value of Plan Assets** | | |
| Fair value of plan assets, beginning of year | $ 63,705 | $ 48,736 |
| Actual return on plan assets | 4,566 | 3,247 |
| Employer contribution | 11,448 | 14,468 |
| Benefits paid | (628) | (526) |
| Foreign currency exchange rate changes | (1,827) | (2,220) |
| Fair value of plan assets at December 31, 2006 | $ 77,264 | $ 63,705 |

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| **Funded status** | $ (2,792) | $ (12,319) |
| Unrecognized net actuarial loss | | 1,965 |
| Unrecognized prior service cost | | 11,619 |
| Amount recognized, end of year | $ (2,792) | $ 1,265 |
| **Amount recognized in the statement of financial position consist of:** | | |
| Current liability | $ | $ |
| Noncurrent liability | (2,792) | |
| Prepaid benefit cost | | 1,265 |
| Intangible asset | | (11,619) |
| Accumulated other comprehensive income | | (1,965) |
| | $ (2,792) | $ (12,319) |

| | | |
|---|---|---|
| **Amount recognized in accumulated other comprehensive income consist of:** | | |
| Net actuarial loss/(gain) | $ 127 | $ |
| Prior service cost | 10,626 | |
| | $ 10,753 | $ |

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**Spansion Inc.**

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

The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with a projected benefit obligation in excess of plan assets as of December 31, 2006 and December 25, 2005 were as follows:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| **Projected benefit obligation in excess of plan assets** | | |
| Projected benefit obligation, end of year | 80,056 | 76,024 |
| Accumulated benefit obligation, end of year | 79,534 | 76,004 |
| Fair value of plan assets, end of year | 77,264 | 63,705 |

The below table summarizes the weighted average assumptions used for purposes of calculating the benefit obligations as of December 31, 2006 and December 25, 2005:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| Discount rate | 2.00% | 2.00% |
| Average rate of compensation increase | 2.70% | 2.70% |
| Cash balance interest crediting rate | 2.00% | 2.00% |

The Company uses Japanese government bonds for setting the discount rate. Japanese government 20-year bonds currently yield in the 2.0 percent range. Due to the current yield on the Japanese government 20-year bonds, the Company believes that a discount rate of 2.0 percent is appropriate as of December 31, 2006.

The below table summarizes the components of the net periodic pension expense:

| | Dec 31, 2006 | Period from Sept 1, 2005 to Dec 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Service cost | $ 5,123 | $ 1,612 |
| Interest cost | 1,517 | 376 |
| Expected return on plan assets | (2,818) | (488) |
| Amortization of prior service cost | 741 | 243 |
| Total net periodic pension expense | $ 4,563 | $ 1,743 |

Prior to September 1, 2005, the plan was not accounted for under single employer plan accounting; therefore, no prior calculation of net period pension expense was completed. However, in prior years, pension expense was recognized equal to cash contributions for the year of approximately $5.7 million and $7.5 million for the years ended December 25, 2005 and December 26, 2004, respectively.

The estimated amount of prior service cost that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2007 is $724,000.

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**Spansion Inc.**

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

The below table summarizes the weighted average assumptions used for purposes of calculating the net periodic pension expense for the period ended December 31, 2006:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| Discount rate | 2.00% | 1.50% |
| Expected long-term return on plan assets | 4.40% | 2.50% |
| Average rate of compensation increase | 2.70% | 2.70% |
| Cash balance interest crediting rate | 2.00% | 1.50% |

The pension plan s investment policy is to invest in assets to best match liabilities and minimize underfunding and risks to the employer related to additional pension contributions. The Company is not currently anticipating investing in non-traditional investments. The long-term rate of return assumption was determined using the building block approach based upon the best estimate range of equity securities (both foreign and domestic) earning 5.0 to 8.0 percent and debt securities (both foreign and domestic) earning 0.5 to 6.0 percent as summarized below:

| Asset Category | Target Allocation of Plan Assets | Expected Return by Asset Class |
|---|---|---|
| Equity Securities | 40% | 6.30% |
| Debt Securities | 57% | 3.40% |
| Cash | 3% | |
| **Total** | 100% | |

The weighted-average asset allocations by asset category at December 31, 2006 and December 25, 2005 are as follows:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| **Asset Category** | | |
| Equity Securities | 42% | 46% |
| Debt Securities | 55% | 51% |
| Cash | 3% | 3% |
| Total | 100% | 100% |

No plan assets are invested in employer securities and no future benefits are currently covered by insurance contracts issued by the insurer or related parties.

The Company expects to contribute $8.2 million to the Spansion Japan pension plan during the fiscal year ending December 30, 2007.

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**Spansion Inc.**

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

The below table summarizes the benefits expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter:

| Fiscal Year | Expected Benefit Payments |
|---|---|
| 2007 | $ 488,000 |
| 2008 | 570,000 |
| 2009 | 701,000 |
| 2010 | 783,000 |
| 2011 | 984,000 |
| 2012-2016 | 7,570,000 |

**Profit Sharing Program**

Effective June 30, 2003 and through January 11, 2007, the Company elected to participate in AMD s profit sharing program. Under that plan, the Company could allocate profit sharing contributions quarterly in any quarter in which it had an operating profit. Employees who had worked with the Company for three months or more were eligible to participate in the plan. Profit sharing expense under this plan was approximately $0, $0 and $3.3 million for the years ended December 31, 2006, December 25, 2005 and December 26, 2004, respectively.

**Retirement Savings Plan**

Effective June 30, 2003 and through January 11, 2007, the Company elected to participate in AMD s retirement savings plan, commonly known as a 401(k) plan. Under that plan, the Company s U.S. employees were able to contribute up to 100 percent of their pre-tax salary subject to Internal Revenue Service limits. The Company matched employee contributions at a rate of 50 cents on each dollar of the first six percent of participants contributions, to a maximum of three percent of eligible compensation. The Company s matching contributions to this 401(k) plan were approximately $5.3 million, $4.3 million and $3.7 million for the years ended December 31, 2006, December 25, 2005 and December 26, 2004, respectively.

**15. Segment Reporting**

The Company operates and tracks its results in one reportable segment. The Company primarily designs, develops, manufactures, markets and sells Flash memory products for the wireless and embedded applications in the integrated category of the Flash memory market.

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**Spansion Inc.**

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

The following table presents a summary of net sales by geographic areas for the periods presented:

| | Year ended | | |
|---|---|---|---|
| | Dec. 31, 2006 | Dec. 25, 2005 | Dec. 26, 2004 |
| | | (in thousands) | |
| Geographical sales[1]: | | | |
| Net sales to end customers[2]: | | | |
| North America | $ 174,930 | $ | $ |
| China | 479,040 | | |
| Korea | 282,596 | | |
| Europe | 312,114 | | |
| Others | 61,799 | | |
| Net sales to related parties: | | | |
| United States *(net sales to AMD)*[3] | 336,172 | 1,114,150 | 1,211,033 |
| Japan (*net sales to Fujitsu*) | 932,623 | 888,655 | 1,051,194 |
| Total | $ 2,579,274 | $ 2,002,805 | $ 2,262,227 |

(1) Geographical sales are based on the customer s bill-to/ship-to location.
(2) These represent sales since the end of the first quarter of fiscal 2006 to AMD s former customers and customers not served solely by Fujitsu.
(3) For fiscal year 2006, these represent sales during the first quarter.

In the second quarter of fiscal 2006, the Company began to sell directly to AMD s former customers and customers not served solely by Fujitsu (end customers). Among those customers, Nokia Corporation accounted for approximately 12 percent of the Company s net sales in fiscal 2006.

Long-lived assets information is based on the physical location of the assets at the end of each fiscal year. The following table presents a summary of long-lived assets by geography:

| | Dec. 31, 2006 | Dec. 25, 2005 |
|---|---|---|
| | (in thousands) | |
| Geographical long lived-assets: | | |
| Net property, plant and equipment | | |
| United States | $ 967,568 | $ 744,026 |
| Japan | 420,870 | 578,676 |
| Other countries | 347,256 | 265,061 |
| Total | **$ 1,735,694** | **$ 1,587,763** |

**16. Capital Structure**

The Company s authorized capital stock consists of 714,999,998 shares of Class A common stock, par value $0.001 per share, one share of Class B common stock, par value $0.001 per share, one share of Class C common stock, par value $0.001 per share, 35,000,000 shares of Class D common stock, par value $0.001 per share, and 50,000,000 shares of preferred stock, par value $0.001 per share.

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***Common Stock***

In November 2006, the Company completed a secondary offering of Class A common stock held by AMD and Fujitsu. In connection with this offering, the Company also sold an additional 5,247,000 shares of Class A common stock for which it received net proceeds of approximately $68 million. All of the outstanding shares of Class D common stock held by Fujitsu were converted into shares of Class A common stock on a one-for-one basis immediately prior to the initial closing of this offering by resolution of the Board of Directors into shares of Class A common stock on a one-for-one basis.

As of December 31, 2006, the common stock outstanding consists of three classes of stock: Class A common stock, Class B common stock and Class C common stock.

- 134,219,224 shares of Class A common stock issued and outstanding,
- one share of Class B common stock issued and outstanding and beneficially held by AMD;
- one share of Class C common stock issued and outstanding and beneficially held by Fujitsu.

The purpose of the Class B common stock and the Class C common stock is solely to entitle AMD and Fujitsu to elect such number of members to the Company s board of directors as set forth in the certificate of incorporation, which depends on the holder s aggregate ownership interest in the Company.

Except as described below or as required by law, the holders of the Company s common stock are entitled to one vote per share on all matters to be voted on by stockholders and shall vote together as a single class. Stockholders are not entitled to cumulative voting rights, and, accordingly, the holders of a majority of the shares voting for the election of directors can elect the entire board if they choose to do so and, in that event, the holders of the remaining shares will not be able to elect any person to the board of directors. Amendments to the Company s certificate of incorporation that would alter or change the powers, preferences or special rights of any class of the Company s common stock, so as to affect the holders of such class adversely, must be proposed in a resolution adopted by the Company s board of directors, declaring its advisability, and must be approved by a majority of the votes entitled to be cast by the holders of the shares affected by the amendment, voting as a separate class.

The Company does not anticipate paying dividends on the common stock in the foreseeable future. In addition, the terms of the Company s current credit arrangements and the indenture governing the Company s senior notes restrict the Company s ability to declare or pay dividends on the Company s common stock. Holders of the common stock are entitled to receive such dividends, if any, as may be declared from time to time by the board of directors, in its discretion, from funds legally available therefrom and subject to prior dividend rights of holders of any shares of preferred stock which may be outstanding. Upon liquidation or dissolution of the company, subject to prior liquidation rights of the holders of any shares of preferred stock which may be outstanding, the holders of common stock are entitled to receive on a pro rata basis the Company s remaining assets available for distribution. Holders of the common stock have no preemptive or other subscription rights, and there are no redemption or sinking fund provisions with respect to such shares.

There are no conversion rights with respect to the Company s Class A common stock. Class B common stock and Class C common stock are convertible automatically into Class A common stock upon the occurrence of specific events.

The Class B common stock will convert automatically on a one-for-one basis into Class A common stock in the event that:

- AMD s aggregate ownership interest in the Company falls below ten percent of the outstanding shares of the Company s capital stock, as calculated on an as-converted to common stock basis; or
- AMD transfers its share of Class B common stock to any person other than an AMD affiliate.

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**Spansion Inc.**

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

The Class C common stock will convert automatically on a one-for-one basis into Class A common stock in the event that:

- Fujitsu s aggregate ownership interest in the Company falls below ten percent of the outstanding shares of the Company s capital stock, as calculated on an as-converted to common stock basis; or
- Fujitsu transfers its share of Class C common stock to any person other than a Fujitsu affiliate.

In the event of any such conversion, any rights specifically granted to the holders of Class B common stock or Class C common stock, as the case may be, shall cease to exist, and the Company shall not be authorized to reissue such shares of Class B common stock or Class C common stock, as the case may be.

In the event of the Company s merger or consolidation with or into another company in connection with which shares of common stock are converted into or exchangeable for shares of stock, other securities or property (including cash), all holders of common stock, regardless of class, will be entitled to receive the same kind and amount of shares of stock, other securities or property (including cash).

***Preferred Stock***

The Company s directors has the authority, without action by the stockholders, to designate and issue preferred stock in one or more series and to designate the rights, preferences and privileges of each series, such as dividend rates, dividend rights, liquidation preferences, voting rights and the number of shares constituting any series and designation of such series, which may be greater than the rights of the common stock. It is not possible to state the actual effect of the issuance of any shares of preferred stock upon the rights of holders of the common stock until the board of directors determines the specific rights of the holders of such preferred stock. However, the effects might include, among other things:

- restricting dividends on the common stock;
- diluting the voting power of the common stock;
- impairing the liquidation rights of the common stock; or
- delaying or preventing a change of control of Spansion Inc. without further action by the stockholders.

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders of

Spansion Inc.

We have audited the accompanying consolidated balance sheets of Spansion Inc. as of December 31, 2006 and December 25, 2005, and the related consolidated statements of operations, stockholders equity / members capital and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spansion Inc. as of December 31, 2006 and December 25, 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Spansion Inc. s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2007 expressed an unqualified opinion thereon.

As discussed in Note 4 to the consolidated financial statements, in the year ended December 31, 2006, Spansion, Inc. changed its method of accounting for stock-based compensation in accordance with guidance provided in Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*.

As discussed in Note 14 to the consolidated financial statements, in the year ended December 31, 2006, the Company adopted Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans-an amendment of FASB Statements No. 87, 88, 106, and 132(R)*.

/s/ Ernst & Young LLP

San Jose, California

February 26, 2007

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**Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting**

The Board of Directors and Stockholders of

Spansion Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Spansion Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Spansion Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Spansion Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Spansion Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Spansion Inc. as of December 31, 2006 and December 25, 2005, and the related consolidated statements of operations, stockholders equity/members capital and cash flows for each of the three years in the period ended December 31, 2006 of Spansion Inc. and our report dated February 26, 2007 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California

February 26, 2007

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**Supplementary Financial Data**

**(Unaudited)**

**(in thousands, except per share amounts)**

| | Dec. 31, 2006 | Oct. 1, 2006 | Jul. 2, 2006 | Mar. 26, 2006 | Dec. 25, 2005 | Sept. 25, 2005 | Jun. 26, 2005 | Mar. 27, 2005 |
|---|---|---|---|---|---|---|---|---|
| Net sales | $ 455,004 | $ 458,740 | $ 396,735 | $ | $ | $ | $ | $ |
| Net sales to related parties/members | 232,270 | 215,978 | 258,617 | 561,929 | 591,596 | 515,653 | 462,367 | 433,189 |
| Total net sales | 687,274 | 674,718 | 655,352 | 561,929 | 591,596 | 515,653 | 462,367 | 433,189 |
| Cost of sales | 557,793 | 532,563 | 523,295 | 452,973 | 497,459 | 445,307 | 430,477 | 436,686 |
| Gross profit | 129,481 | 142,155 | 132,057 | 108,956 | 94,137 | 70,346 | 31,890 | (3,497) |
| Other expenses: | | | | | | | | |
| Research and development | 81,123 | 90,259 | 91,800 | 84,573 | 75,749 | 74,124 | 74,597 | 71,379 |
| Marketing, general and administrative | 64,058 | 61,866 | 67,305 | 62,421 | 55,127 | 45,259 | 45,426 | 36,099 |
| Operating loss | (15,700) | (9,970) | (27,048) | (38,038) | (36,739) | (49,037) | (88,133) | (110,975) |
| Gain on sale of marketable securities | | | 6,884 | | | | | |
| Loss on early extinguishment of debt (Note 9) | | | (17,310) | | | | | |
| Interest and other income, net | 7,940 | 3,888 | 4,300 | 5,979 | 677 | 432 | 779 | 1,285 |
| Interest expense | (20,698) | (13,020) | (18,391) | (18,794) | (11,458) | (11,363) | (11,076) | (11,135) |
| Loss before income taxes | (28,458) | (19,102) | (51,565) | (50,853) | (47,520) | (59,968) | (98,430) | (120,825) |
| (Benefit) Provision for income taxes | (3,445) | 3,013 | (2,806) | 1,024 | 8 | 1,755 | (12,406) | (11,983) |
| Net loss | $ (25,013) | $ (22,115) | $ (48,759) | $ (51,877) | $ (47,528) | $ (61,723) | $ (86,024) | $ (108,842) |
| Net loss per share | | | | | | | | |
| Basic and diluted | $ (0.19) | $ (0.17) | $ (0.38) | $ (0.40) | $ (0.63) | $ (0.85) | $ (1.19) | $ (1.50) |
| Shares used in per share calculation | | | | | | | | |
| Basic and diluted | 130,489 | 128,800 | 128,464 | 128,146 | 75,604 | 72,549 | 72,549 | 72,549 |
| Common Stock market price range | | | | | | | | |
| High | $ 17.94 | $ 18.50 | $ 18.59 | $ 16.19 | $ 14.37 | N/A | N/A | N/A |
| Low | $ 13.35 | $ 13.18 | $ 12.90 | $ 12.31 | $ 12.00 | N/A | N/A | N/A |

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**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed with the objective of providing reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As of December 31, 2006, the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

**Management s Report on Internal Control over Financial Reporting**

Internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles, and includes those policies and procedures that:

(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company s assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company.

Management has used the framework set forth in the report entitled Internal Control Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission to evaluate

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the effectiveness of the Company s internal control over financial reporting. Management has concluded that the Company s internal control over financial reporting was effective as of December 31, 2006. Ernst & Young has issued an attestation report on management s assessment of the Company s internal control over financial reporting, which is included in Item 8, Financial Statements and Supplementary Data, immediately following the financial statement audit report of Ernst & Young LLP.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal controls over financial reporting during our fourth quarter of fiscal 2006 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

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## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information under the captions, Item 1 Election of Directors, Corporate Governance, Committees and Meetings of the Board of Directors, Executive Officers and Section 16(a) Beneficial Ownership Reporting Compliance in our 2007 Proxy Statement is incorporated herein by reference.

### ITEM 11. EXECUTIVE COMPENSATION

The information under the captions, Committees and Meetings of the Board of Directors Compensation Committee Interlocks and Insider Participation, Compensation Committee Report, Compensation Discussion and Analysis, Directors Compensation, Executive Compensation, Summary Compensation Table, Grants of Plan-Based Awards, Outstanding Equity Awards at Fiscal Year End, Option Exercise and Stock Vested, Pension Benefits, Nonqualified Deferred Compensation, and Potential Payments Upon a Termination or Change of Control in our 2007 Proxy Statement is incorporated herein by reference.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information under the captions, Security Ownership and Item 3 Approval of the 2007 Spansion Inc. Equity Incentive Plan Equity Compensation Plan Information in our 2007 Proxy Statement is incorporated herein by reference.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information under the caption, Certain Relationships and Related Party Transactions in our 2007 Proxy Statement is incorporated herein by reference.

### ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information under the captions, Item 2 Ratification of Independent Registered Public Accounting Firm in our 2007 Proxy Statement is incorporated herein by reference.

With the exception of the information specifically incorporated by reference in Part III of this Form 10-K from our 2007 Proxy Statement, our 2007 Proxy Statement shall not be deemed to be filed as part of this report. Without limiting the foregoing, the information under the captions, Board Audit Committee Report and Performance Graph in our 2007 Proxy Statement is not incorporated by reference into this Form 10-K.

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**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**1. Financial Statements**

The financial statements are set forth in Item 8 of this report on Form 10-K.

**2. Exhibits**

The exhibits listed in the accompanying Index to Exhibits are filed as part of, or incorporated by reference into, this Annual Report on Form 10-K (except for such exhibits that are marked on such exhibit list as furnished and not filed). The following is a list of such Exhibits:

| Exhibit Number | Description of Exhibits |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation, filed as Exhibit 3.1 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 3.2 | Amended and Restated Bylaws of Spansion Inc., filed as Exhibit 3.2 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 4.1 | Specimen of Class A Common Stock Certificate, filed as Exhibit 4.1 to Spansion s Amendment No. 6 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 4.2 | Indenture, dated as of December 21, 2005, between Spansion LLC, Spansion Inc., Spansion Technology Inc. and Wells Fargo Bank, N.A., governing the 11.25% Senior Notes due 2016, filed as Exhibit 4.1 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 4.3 | Specimen of 11.25% Senior Notes due 2016, filed as Exhibit 4.2 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 4.4 | Indenture, dated June 12, 2006, between Spansion LLC, Spansion Inc., Spansion Technology Inc. and Wells Fargo Bank, N.A., including the form of 2.25% Exchangeable Senior Subordinated Debenture due 2016, filed as exhibit 4.1 to Spansion s Current Report on Form 8-K dated June 15, 2006, is hereby incorporated by reference. |
| 10.1 | Spansion Inc. 2005 Employee Stock Purchase Plan, filed as Exhibit 10.18 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.2 | Spansion Inc. 2005 Equity Incentive Plan, filed as Exhibit 10.17 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.3 | Form of Indemnification Agreement with Directors and Executive Officers, filed as Exhibit 10.3 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.4 | Stockholders Agreement, dated as of December 21, 2005, by and among AMD Investments, Inc., Spansion Inc., Advanced Micro Devices, Inc., and Fujitsu Limited, filed as Exhibit 10.3 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.5* | Amended and Restated Distribution Agreement between Spansion Inc. and Fujitsu Limited, filed as Exhibit 10.4 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |

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| Exhibit Number | Description of Exhibits |
|---|---|
| 10.6 | Amended and Restated Fujitsu-Spansion Patent Cross-License Agreement between Fujitsu Limited and Spansion Inc., filed as Exhibit 10.5 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.7 | Amended and Restated AMD-Spansion Patent Cross-License Agreement between Advanced Micro Devices, Inc. and Spansion Inc., filed as Exhibit 10.6 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.8 | Amended and Restated Intellectual Property Contribution and Ancillary Matters Agreement among Fujitsu Limited, Advanced Micro Devices, Inc., AMD Investments, Inc. and Spansion Inc., filed as Exhibit 10.7 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.9 | Amended and Restated Information Technology Services Agreement between Spansion Inc. and Fujitsu Limited, filed as Exhibit 10.8 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.10 | Amended and Restated Information Technology Services Agreement between Spansion Inc. and Advanced Micro Devices, Inc., filed as Exhibit 10.9 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.11 | Amended and Restated General Administrative Services Agreement between Spansion Inc. and Fujitsu Limited, filed as Exhibit 10.10 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.12 | Amended and Restated General Administrative Services Agreement between Spansion Inc. and Advanced Micro Devices, Inc., filed as Exhibit 10.11 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.13 | Amended and Restated Reverse General Administrative Services Agreement between Spansion Inc. and Advanced Micro Devices, Inc., filed as Exhibit 10.12 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.14* | Amended and Restated Non-Competition Agreement among Spansion Inc., Advanced Micro Devices, Inc. and Fujitsu Limited, filed as Exhibit 10.13 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference |
| 10.15 | Remediation Agreement among Advanced Micro Devices, Inc., Fujitsu Limited and FASL LLC, dated as of June 30, 2003, filed as Exhibit 10.15 to Spansion s Amendment No. 1 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.16 | Master Rental Agreement, dated July 16, 2003, among GE Capital Leasing Corporation, as Lessor, FASL Japan Ltd., as Lessee, and Advanced Micro Devices, Inc. as Guarantor, filed as Exhibit 10.19 to Spansion s Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.17(a) | Master Lease Agreement, dated January 5, 2005, between SumiCrest Leasing Ltd. and Spansion Japan Limited., filed as Exhibit 10.24 to Spansion s Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.17(b) | Amendment Agreement, dated as of December 30, 2005, to Master Lease Agreement, dated January 5, 2005, between SumiCrest Leasing Ltd. and Spansion Japan Limited., filed as Exhibit 10.1 to Spansion s Current Report on Form 8-K dated January 5, 2006, is hereby incorporated by reference. |
| 10.18 | Master Purchase Agreement, dated January 5, 2005, between Spansion Japan Limited and SumiCrest Leasing Ltd., filed as Exhibit 10.25 to Spansion s Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |

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| Exhibit Number | Description of Exhibits |
|---|---|
| 10.19 | Manufacturing Services Agreement, dated June 30, 2003, between FASL LLC and Fujitsu Limited, filed as Exhibit 10.30 to Spansion s Amendment No. 2 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.20 | Amended and Restated Agency Agreement, dated December 7, 2005, between Spansion LLC and Advanced Micro Devices, Inc., filed as Exhibit 10.32 to Spansion s Amendment No. 2 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.21* | Foundry Agreement, dated August 11, 2005, between Spansion LLC and Taiwan Semiconductor Manufacturing Company, filed as Exhibit 10.33 to Spansion s Amendment No. 2 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.22* | Foundry Agreement, dated March 31, 2005, between Spansion Japan and Fujitsu Limited, filed as Exhibit 10.34 to Spansion s Amendment No. 3 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.23 | Amendment to Manufacturing Services Agreement between FASL LLC and Fujitsu Limited, filed as Exhibit 10.35 to Spansion s Amendment No. 3 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.24 | Executive Investment Account Plan, filed as Exhibit 10.36 to Spansion s Amendment No. 6 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.25 | Supplemental Secondment and Transfer Agreement, dated July 1, 2005, between Spansion Japan Limited and Fujitsu Limited, filed as Exhibit 10.37 to Spansion s Amendment No. 3 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.26 | Credit Agreement, dated September 19, 2005, among Spansion LLC, Bank of America, N.A., and the lenders party thereto, filed as Exhibit 3.3 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.27 | Security Agreement, dated September 19, 2005, between Spansion LLC, as Grantor, and Bank of America, N.A., as Agent, filed as Exhibit 10.42 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.28 | Stock Pledge, dated September 19, 2005, between Spansion LLC, as Pledgor, and Bank of America, N.A., as Agent, filed as Exhibit 10.43 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.29 | Deed of Trust, Security Agreement, Assignment of Rents and Financing Statement, dated as of September 13, 2005, effective as of September 19, 2005, by Spansion LLC in favor of Bank of America, N.A., filed as Exhibit 10.44 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.30 | Form of Spansion LLC Change of Control Severance Agreement, filed as Exhibit 10.46 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.31 | Form of Loan Agreement between Spansion (China) Co., Ltd. and Gusu Sub-branch, Agricultural Bank of China, filed as Exhibit 10.50 to Spansion s Amendment No. 5 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.32 | Spansion LLC Employment Offer Letter to Bertrand F. Cambou, dated as of April 6, 2005, filed as Exhibit 10.52 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.33 | Spansion LLC Employment Offer Letter to Thomas T. Eby, dated as of September 15, 2005, filed as Exhibit 10.53 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |

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| Exhibit Number | Description of Exhibits |
|---|---|
| 10.34 | Spansion LLC Employment Offer Letter to Robert C. Melendres, dated as of December 17, 2004, filed as Exhibit 10.54 to Spansion s Amendment No. 4 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.35 | Advanced Micro Devices, Inc. 2005 Annual Incentive Plan, filed as Exhibit 10.55 to Spansion s Amendment No. 5 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.36 | Bank Enterprise Cooperation Agreement, dated as of December 1, 2005, between Spansion (China) Co., Ltd. And Gusu Sub-branch, Agricultural Bank of China, filed as Exhibit 10.56 to Spansion s Amendment No. 10 to Form S-1 Registration Statement (No. 333-124041), is hereby incorporated by reference. |
| 10.37 | Contribution Agreement, dated as of December 13, 2005, by and among Spansion Inc., Spansion LLC, Advanced Micro Devices, Inc., AMD Investments, Fujitsu Limited, and Fujitsu Microelectronics Holding, Inc., filed as Exhibit 10.1 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.38 | Exchange Agreement, dated as of December 15, 2005, by and among Spansion Inc., Spansion LLC, Advanced Micro Devices, Inc., AMD Investments, Fujitsu Limited, and Spansion Technology, Inc. (formerly Fujitsu Microelectronics Holding, Inc.), filed as Exhibit 10.2 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.39 | Cerium Purchase Agreement, dated as of October 25, 2005, between Advanced Micro Devices, Inc. and Spansion LLC, filed as Exhibit 10.14 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.40 | Purchase and Sale Agreement, dated as of December 21, 2005, between Advanced Micro Devices, Inc. and Spansion LLC, filed as Exhibit 10.15 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.41 | Sale and Purchase Agreement, dated as of December 20, 2005, between Advanced Micro Devices Export Sdn. Bhd. and Spansion (Penang) Sdn. Bhd., filed as Exhibit 10.16 to Spansion s Current Report on Form 8-K dated December 21, 2005, is hereby incorporated by reference. |
| 10.42(a) | Lease Agreement, dated as of September 30, 2005, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.1(a) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(b) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between General Electric Capital Corporation and Spansion LLC, filed as Exhibit 10.1(b) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(c) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.1(c) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(d) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.1(d) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(e) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between General Electric Capital Corporation and Spansion LLC, filed as Exhibit 10.1(e) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(f) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between ORIX Financial Services, Inc. and Spansion LLC, filed as Exhibit 10.1(f) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |

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| Exhibit Number | Description of Exhibits |
|---|---|
| 10.42(g) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between Merrill Lynch Capital and Spansion LLC, filed as Exhibit 10.1(g) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(h) | Amended Schedule to Lease Agreement, dated as of December 23, 2005, between Macquarie Electronics USA Inc. and Spansion LLC, filed as Exhibit 10.1(h) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(i) | Amended Schedule to Lease Agreement, dated as of December 21, 2005, between Macquarie Electronics USA Inc. and Spansion LLC, filed as Exhibit 10.1(i) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.42(j) | Amended Schedule to Lease Agreement, dated as of December 21, 2005, between Merrill Lynch Capital and Spansion LLC, filed as Exhibit 10.1(j) to Spansion s Current Report on Form 8-K dated December 27, 2005, is hereby incorporated by reference. |
| 10.43 | Uncommitted Revolving Credit Facility Agreement, dated as of December 26, 2005, between Spansion Japan Limited and Shinkin Central Bank, filed as Exhibit 10.1 to Spansion s Current Report on Form 8-K dated December 28, 2005, is hereby incorporated by reference. |
| 10.44 | Summary Compensation Arrangements for Named Executive Officers, the Chief Financial Officer and Directors, filed as Exhibit 10.64 to Spansion s Annual Report on Form 10-K for the year ended December 25, 2005, is hereby incorporated by reference. |
| 10.45 | Employment Offer Letter, dated as of February 9, 2006, between Spansion LLC and Dario Sacomani, filed as Exhibit 10.65 to Spansion s Annual Report on Form 10-K for the year ended December 25, 2005, is hereby incorporated by reference. |
| 10.46 | Registration Rights Agreement, dated June 12, 2006, between Spansion Inc., Spansion LLC, Citigroup Global Markets Inc. and Credit Suisse Securities (USA) LLC, filed as Exhibit 10.1 to Spansion s Current Report on Form 8-K dated June 15, 2006, is hereby incorporated by reference. |
| 10.47 | Amendment Agreement dated December 30, 2005 to Master Lease Agreement dated January 5, 2005, between Spansion Japan Limited and Sumicrest Leasing Limited, filed as Exhibit 10.1 to Spansion s Current Report on Form 8-K dated January 5, 2006, is hereby incorporated by reference. |
| 10.48 | Amendment No. 1 to Credit Agreement, dated April 7, 2006, among Spansion LLC, Bank of America, N.A., and the lenders party thereto, filed as Exhibit 10.41(a) to Spansion s Form 10-Q for the quarter ended March 26, 2006, is hereby incorporated by reference. |
| 10.49 | Joinder Agreement to the Credit Agreement, dated April 21, 2006, among Spansion Inc., Bank of America, N.A., and the lenders party to the Credit Agreement, filed as Exhibit 10.41(b) to Spansion s Form 10-Q for the quarter ended March 26, 2006, is hereby incorporated by reference. |
| 10.50 | Continuing Guaranty to the Credit Agreement, dated April 21, 2006, between Spansion Inc. and Bank of America, N.A., filed as Exhibit 10.41(c) to Spansion s Form 10-Q for the quarter ended March 26, 2006, is hereby incorporated by reference. |
| 10.51 | Amended and Restated Uncommitted Revolving Credit Facility Agreement, dated as of March 31, 2006, between Spansion Japan Limited and The Bank of Tokyo-Mitsubishi UFJ, Ltd., filed as Exhibit 10.66 to Spansion s Form 10-Q for the quarter ended March 26, 2006, is hereby incorporated by reference. |
| 10.52 | Employment Offer Letter, dated as of June 14, 2006, between Spansion LLC and José Mejia, filed as Exhibit 10.68 to Spansion s Form 10-Q for the quarter ended July 2, 2006, is hereby incorporated by reference. |

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| Exhibit Number | Description of Exhibits |
|---|---|
| 10.53 | Master Rental Agreement, dated as of September 15, 2006, between Spansion Japan Limited and GE Capital Asset Finance KK, filed as Exhibit 10.1 to Spansion s Current Report on Form 8-K dated September 25, 2006, is hereby incorporated by reference. |
| 10.54 | Specific Rental Agreement, dated as of September 15, 2006, between Spansion Japan Limited and GE Capital Asset Finance KK, filed as Exhibit 10.2 to Spansion s Current Report on Form 8-K dated September 25, 2006, is hereby incorporated by reference. |
| 10.55 | Position Assignment and Termination with Agreement, dated as of September 15, 2006, between Spansion Japan Limited, GE Capital Leasing KK and GE Capital Asset Finance KK, filed as Exhibit 10.3 to Spansion s Current Report on Form 8-K dated September 25, 2006, is hereby incorporated by reference. |
| 10.56 | Asset Purchase Agreement, dated as of September 28, 2006, by and among Spansion Japan Limited, Spansion Inc., Spansion Technology Inc. and Spansion LLC, in their capacities as guarantors of Spansion Japan Limited, and Fujitsu Limited, filed as Exhibit 10.72 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.57 | Master Lease Agreement, dated as of September 28, 2006, by and among Spansion Japan Limited, Spansion Inc., Spansion Technology Inc. and Spansion LLC, in their capacities as guarantors of Spansion Japan Limited, and Fujitsu Limited, filed as Exhibit 10.73 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.58 | Foundry Agreement, effective as of September 28, 2006, by and among Spansion Japan Limited, Spansion Inc., Spansion Technology Inc. and Spansion LLC, in their capacities as guarantors of Spansion Japan Limited, and Fujitsu Limited, filed as Exhibit 10.74 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.59 | Secondment and Transfer Agreement, dated as of September 28, 2006, between Spansion Japan Limited and Fujitsu Limited, filed as Exhibit 10.75 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.60(a) | Schedule to Lease Agreement, dated as of September 28, 2006, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.62(k) to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.60(b) | Schedule to Lease Agreement, dated as of September 28, 2006, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.62(l) to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.60(c) | Schedule to Lease Agreement, dated as of September 28, 2006, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.62(m) to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.60(d) | Schedule to Lease Agreement, dated as of September 28, 2006, between Banc of America Leasing & Capital, LLC and Spansion LLC, filed as Exhibit 10.62(n) to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.61 | Credit Agreement, dated as of November 1, 2006, among Spansion LLC, Spansion Inc., Bank of America, N.A., as administrative agent, and the other lenders party thereto, filed as Exhibit 10.76 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.62 | Pledge and Security Agreement, dated as of November 1, 2006, by and among Spansion LLC, Spansion Inc., Spansion Technology Inc., Spansion International, Inc., Cerium Laboratories LLC and Bank of America, N.A., as administrative agent, filed as Exhibit 10.77 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |

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| Exhibit Number | Description of Exhibits |
|---|---|
| 10.63 | Guaranty Agreement, dated as of November 1, 2006, by Spansion Technology Inc., Spansion International, Inc. and Cerium Laboratories LLC in favor of Bank of America, N.A., as administrative agent, filed as Exhibit 10.78 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 10.64 | Amendment No. 2 to Credit Agreement and Amendment to Security Agreement, dated as of November 1, 2006, by and among Spansion LLC, Spansion Inc., Spansion International, Inc., Bank of America, N.A., as administrative agent, and the other lenders party thereto, filed as Exhibit 10.79 to Spansion s Quarterly Report on Form 10-Q for the quarter ended October 1, 2006, is hereby incorporated by reference. |
| 21 | Subsidiaries of Spansion Inc. |
| 23.1 | Consent of Independent Registered Public Accounting Firm. |
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1** | Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2** | Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Registrant has been granted confidential treatment pursuant to Rule 406 for portions of the referenced exhibit.

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

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SPANSION INC.

By: /s/ DARIO SACOMANI
**Dario Sacomani**

**Executive Vice President and Chief Financial Officer**

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Dario Sacomani and Robert C. Melendres, and each of them, their true and lawful attorneys-in-fact, each with full power of substitution, for them in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1933, this report has been signed below by the following persons, on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ BERTRAND F. CAMBOU<br>**Bertrand F. Cambou** | President, Chief Executive Officer and Director (Principal Executive Officer) | February 26, 2007 |
| /s/ DARIO SACOMANI<br>**Dario Sacomani** | Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer) | February 26, 2007 |
| /s/ HECTOR DE J. RUIZ<br>**Hector de J. Ruiz** | Chairman of the Board of Directors | February 26, 2007 |
| /s/ DAVID K. CHAO<br>**David K. Chao** | Director | February 26, 2007 |
| /s/ ROBERT L. EDWARDS<br>**Robert L. Edwards** | Director | February 24, 2007 |
| /s/ PATTI S. HART<br>**Patti S. Hart** | Director | February 26, 2007 |
| /s/ TOSHIHIKO ONO<br>**Toshihiko Ono** | Director | February 23, 2007 |

| | | |
|---|---|---|
| /s/ David E. Roberson<br>**David E. Roberson** | Director | February 26, 2007 |
| /s/ John M. Stich<br>**John M. Stich** | Director | February 21, 2007 |