

SOLECTRON CORP
Form 10-Q
July 11, 2007

Table of Contents

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

Form 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 1, 2007**
- 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 1-11098

SOLECTRON CORPORATION

(Exact name of registrant as specified in its charter)

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

94-2447045
*(I.R.S. Employer
Identification Number)*

**847 Gibraltar Drive
Milpitas, California 95035**
(Address of principal executive offices including zip code)

(408) 957-8500
(Registrant's telephone number, including area code)

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

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

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

Edgar Filing: SOLECTRON CORP - Form 10-Q

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

At July 6, 2007, 913,919,916 shares of Common Stock of the Registrant were outstanding (including 13,570,929 shares of Solectron Global Services Canada, Inc., which are exchangeable on a one-to-one basis for the Registrant's common stock).

SOLECTRON CORPORATION

INDEX TO FORM 10-Q

PART I. FINANCIAL INFORMATION

<u>Item 1.</u>	<u>Financial Statements (unaudited)</u>	4
	<u>Condensed Consolidated Balance Sheets at June 1, 2007 and at August 25, 2006</u>	4
	<u>Condensed Consolidated Statements of Operations for the three and nine months ended June 1, 2007 and May 26, 2006</u>	5
	<u>Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended June 1, 2007 and May 26, 2006</u>	6
	<u>Condensed Consolidated Statements of Cash Flows for the nine months ended June 1, 2007 and May 26, 2006</u>	7
	<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	8
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	45
<u>Item 4.</u>	<u>Controls and Procedures</u>	45

PART II. OTHER INFORMATION

<u>Item 1.</u>	<u>Legal Proceedings</u>	45
<u>Item 1a.</u>	<u>Risk Factors</u>	46
<u>Item 6.</u>	<u>Exhibits</u>	55
<u>Signatures</u>		56
<u>EXHIBIT 10.1</u>		
<u>EXHIBIT 10.2</u>		
<u>EXHIBIT 10.4</u>		
<u>EXHIBIT 31.1</u>		
<u>EXHIBIT 31.2</u>		
<u>EXHIBIT 32.1</u>		
<u>EXHIBIT 32.2</u>		

Table of Contents

Cautionary Statement Regarding Forward-Looking Statements

With the exception of historical facts, the statements contained in this quarterly report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and are subject to the safe harbor provisions set forth in the Exchange Act. The forward-looking statements are generally accompanied by words such as may, will, could, should, intend, anticipate, believe, estimate, expect, continue and other similar words and statements. Forward-looking statements relate to matters including, but not limited to:

anticipated sales and future operating results;

our anticipation of the timing and amounts of our future obligations and commitments and our ability to meet those commitments;

the calculations of taxes due and the adequacy of our reserves for potential tax liabilities and credits for open periods;

our ability to successfully defend against proposed IRS adjustments to prior year income tax returns;

the amount of available future cash and our belief that our cash and cash equivalents, short-term investments, lines of credit and cash to be generated from continuing operations will be sufficient for us to meet our obligations for the next twelve months;

the adequacy of our restructuring provisions and adequacy and timing of our restructuring activities and their impact on our business or results of operations;

the anticipated financial impact of recent and future acquisitions and divestitures and the adequacy of our provisions for indemnification obligations pursuant to such transactions;

our ability to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002;

our exposure to foreign currency exchange rate fluctuations;

our belief that our current or future environmental liability exposure related to our facilities will not be material to our business, financial condition or results of operations;

the impact of any litigation;

the impact of customer defaults or bankruptcies;

our ability to implement our enterprise resource planning system and the impact of deficiencies in our IT systems;

our characterization of the markets in which we do business, including our ability to earn increased margins in certain growth markets; and

various other forward-looking statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Our forward-looking statements are based on current expectations, forecasts and assumptions and are subject to risks, uncertainties and changes in condition, significance, value and effect, including those discussed under the heading Risk Factors in this report and in our other reports filed with the Securities and Exchange Commission. Such risks, uncertainties and changes in condition, significance, value and effect could cause our actual results to differ materially from our anticipated outcomes. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate. Therefore, we can give no assurance that the results implied by these forward-looking statements will be realized. The inclusion of forward-looking information should not be regarded as a representation by our company or any other person that the future events, plans or expectations contemplated by Solectron will be achieved. Furthermore, past performance in operations and share price is not necessarily indicative of future performance. We disclaim any intention or obligation to update or revise any forward-looking statements contained herein, whether as a result of new information, future events or otherwise.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. *Financial Statements*****SOLECTRON CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

	June 1, 2007	August 25, 2006
	(In millions) (Unaudited)	
ASSETS		
Current assets:		
Cash, cash equivalents and short-term investments*	\$ 1,195.1	\$ 1,180.5
Accounts receivable, net	1,493.6	1,429.3
Inventories	1,830.8	1,516.1
Prepaid expenses and other current assets	366.3	225.8
Total current assets	4,885.8	4,351.7
Property and equipment, net	737.4	673.4
Goodwill	159.1	155.2
Other assets	120.8	193.3
Total assets	\$ 5,903.1	\$ 5,373.6
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term debt	\$ 64.0	\$ 89.5
Accounts payable	2,070.2	1,616.7
Accrued employee compensation	156.8	170.4
Accrued expenses and other current liabilities	483.0	427.6
Total current liabilities	2,774.0	2,304.2
Long-term debt	609.8	619.4
Other long-term liabilities	36.2	36.3
Total liabilities	3,420.0	2,959.9
Commitments and contingencies		
Stockholders' equity:		
Common stock	0.9	1.0
Additional paid-in capital	7,599.7	7,585.2
Accumulated deficit	(5,039.9)	(5,073.3)

Edgar Filing: SOLECTRON CORP - Form 10-Q

Accumulated other comprehensive loss	(77.6)	(99.2)
Total stockholders' equity	2,483.1	2,413.7
Total liabilities and stockholders' equity	\$ 5,903.1	\$ 5,373.6

* Includes \$16.8 million and \$31.6 million of restricted cash balances as of June 1, 2007 and August 25, 2006, respectively, and \$0 million and \$22.9 million of short-term investments as of June 1, 2007 and August 25, 2006, respectively.

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	June 1,	May 26,	June 1,	May 26,
	2007	2006	2007	2006
	(In millions, except per share data) (Unaudited)		(In millions, except per share data) (Unaudited)	
Net sales	\$ 2,985.3	\$ 2,702.6	\$ 8,886.3	\$ 7,658.6
Cost of sales	2,833.9	2,560.4	8,432.7	7,261.8
Gross profit	151.4	142.2	453.6	396.8
Operating expenses:				
Selling, general and administrative	112.1	112.2	338.6	323.9
Restructuring and impairment costs	29.6	2.6	80.7	9.1
Operating income	9.7	27.4	34.3	63.8
Interest income	7.5	12.3	25.1	36.7
Interest expense	(5.5)	(7.2)	(17.9)	(20.8)
Other income (expense) net	8.7	(0.8)	5.9	(0.8)
Operating income from continuing operations before income taxes	20.4	31.7	47.4	78.9
Income tax expense (benefit)	8.2	(10.7)	13.0	(0.8)
Income from continuing operations	12.2	42.4	34.4	79.7
Discontinued operations:				
(Loss) income from discontinued operations before income taxes of \$0	(0.1)	(0.4)	(1.0)	16.7
(Loss) income from discontinued operations	(0.1)	(0.4)	(1.0)	16.7
Net income	\$ 12.1	\$ 42.0	\$ 33.4	\$ 96.4
Basic net income per share:				
Continuing operations	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.09
Discontinued operations				0.02
Basic net income per share	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.11
Diluted net income per share:				
Continuing operations	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.09
Discontinued operations				0.02

Edgar Filing: SOLECTRON CORP - Form 10-Q

Diluted net income per share	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.11
Shares used to compute basic net income per share	898.6	908.1	895.6	916.2
Shares used to compute diluted net income per share	904.7	909.6	899.4	917.2

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
	(In millions) (Unaudited)			
Net income	\$ 12.1	\$ 42.0	\$ 33.4	\$ 96.4
Other comprehensive income:				
Net gain on derivative instruments	0.3		0.4	
Foreign currency translation adjustments, net	16.2	22.7	21.1	31.7
Comprehensive income	\$ 28.6	\$ 64.7	\$ 54.9	\$ 128.1

Accumulated unrealized foreign currency translation losses were \$68.0 million at June 1, 2007 and \$89.1 million at August 25, 2006. Foreign currency translation adjustments consist of adjustments to consolidate subsidiaries that use the local currency as their functional currency and gains and losses related to intercompany dollar-denominated debt that is not expected to be repaid in the foreseeable future.

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended	
	June 1, 2007	May 26, 2006
	(In millions)	
	(Unaudited)	
Cash flows from operating activities:		
Net income	\$ 33.4	\$ 96.4
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Loss (income) from discontinued operations	1.0	(16.7)
Depreciation and amortization	124.5	130.4
Impairment of property, equipment, goodwill and other long-term assets	3.5	10.3
Stock-based compensation	20.1	16.9
Changes in operating assets and liabilities:		
Accounts receivable, net of allowance	(64.3)	(168.2)
Inventories	(314.7)	(371.7)
Prepaid expenses and other assets	(133.6)	(65.6)
Accounts payable	453.6	246.6
Accrued expenses and other current liabilities	60.8	16.7
Net cash provided by (used) in operating activities of continuing operations	184.3	(104.9)
Net cash used in operating activities of discontinued operations	(2.5)	(8.2)
Net cash provided by (used in) operating activities	181.8	(113.1)
Cash flows from investing activities:		
Change in restricted cash and cash equivalents	14.8	(18.2)
Sale of available for sale securities	22.9	1.6
Purchase of facilities previously held under synthetic lease	(13.2)	
Acquisitions, net of cash received	(18.1)	(5.7)
Capital expenditures	(125.8)	(155.6)
Proceeds from sale of property and equipment	24.7	8.4
Receipts from discontinued operations		8.9
Net cash used in investing activities of continuing operations	(94.7)	(160.6)
Net cash provided by investing activities of discontinued operations		17.1
Net cash used in investing activities	(94.7)	(143.5)
Cash flows from financing activities of continuing operations:		
Proceeds (borrowings) on bank lines of credit and other debt arrangements	29.1	(1.4)
Proceeds from issuance of debt		147.4
Payments made to redeem ACES/Senior Notes	(64.3)	(150.0)

Edgar Filing: SOLECTRON CORP - Form 10-Q

Common stock repurchase	(10.1)	(205.7)
Proceeds from stock issued under option and employee purchase plans	4.5	5.4
Net cash used in financing activities of continuing operations	(40.8)	(204.3)
Net cash provided by (used in) financing activities of discontinued operations	2.5	(8.9)
Net cash used in financing activities	(38.3)	(213.2)
Effect of exchange rate changes on cash and cash equivalents	3.5	
Net increase (decrease) in cash and cash equivalents	52.3	(469.8)
Total cash and cash equivalents at beginning of period	1,126.0	1,682.8
Total cash and cash equivalents at end of period	\$ 1,178.3	\$ 1,213.0

SUPPLEMENTAL SCHEDULE OF

Non-cash investing activities:

Purchase price of facilities previously under synthetic lease	\$ 81.1	\$
Cancellation of receivable as payment for facilities	\$ (74.5)	\$

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

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

NOTE 1 Basis of Presentation and Recent Accounting Pronouncements

Basis of Presentation

The accompanying financial data as of June 1, 2007 and for the three and nine months ended June 1, 2007 and May 26, 2006 has been prepared by the management of Solectron, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The August 25, 2006 condensed consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles. However, the management of Solectron believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in Solectron's Annual Report on Form 10-K for the fiscal year ended August 25, 2006.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair consolidated statement of financial position as of June 1, 2007, the results of operations and comprehensive income for the three and nine months ended June 1, 2007 and May 26, 2006 and cash flows for the nine months ended June 1, 2007 and May 26, 2006 have been made. The consolidated results of operations for the three and nine months ended June 1, 2007 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

In past filings, for clarity of presentation, Solectron's third quarter of fiscal 2006 was presented as having ended on May 31, 2006 rather than the actual close date of May 26, 2006. In these condensed consolidated financial statements, the third quarter of fiscal 2006 is presented as having ended on the actual close date of May 26, 2006. Solectron uses a 52- to 53-week fiscal year ending on the last Friday in August. The Company's second quarters of fiscal 2007 and 2006 ended on March 2, 2007 and February 24, 2006 and contained 14 weeks and 13 weeks, respectively. The additional week is reflected in the nine months results presented for the fiscal period ended June 1, 2007. It is not possible to quantify the impact of this additional week on the fiscal period ended June 1, 2007.

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

Research and Development Expenses

Selling, general and administrative expense includes \$6.6 million and \$19.6 million of research and development expenses for the three and nine months ended June 1, 2007, respectively and \$6.2 million and \$21.9 million for the three and nine months ended May 26, 2006, respectively.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 expands the use of fair value accounting but does not affect existing standards, which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected,

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007, which will be in the first quarter of the Company's fiscal year 2009. The Company is currently evaluating the requirements of SFAS 159 and has not yet determined the impact of adoption, if any, on its financial position, results of operations or cash flows.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, Accounting for Income Tax Uncertainties (FIN 48). FIN 48 defines the threshold for recognizing the benefits of uncertain tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. Any differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is currently in the process of determining the impact, if any, of adopting the provisions of FIN 48 on its financial position, results of operations and cash flows.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, (SAB 108). The interpretations in SAB 108 are being issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. SAB 108 is effective for the first fiscal year ending after November 15, 2006 and must be adopted by the fourth quarter of such fiscal year. Solectron has not yet completed its analysis of the impact of adopting the provisions of SAB 108 on its financial position, results of operations and cash flows; however, the company currently estimates that the expected net reduction to opening retained earnings will be approximately \$13.7 million as a result of adopting SAB 108. The Company is continuing to evaluate the impact of adopting SAB 108 and, as a result, the actual reduction to the opening retained earnings balance could be different than the \$13.7 million estimate.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 replaces the different definitions of fair value in the accounting literature with a single definition. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for fair-value measurements already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is currently in the process of determining the impact, if any, of adopting the provisions of SFAS 157 on its financial position, results of operations and cash flows.

NOTE 2 Stock-Based Compensation

Effective September 1, 2005, Solectron began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123R, Share-Based Payment, (SFAS 123R) as interpreted by SEC Staff Accounting Bulletin No. 107. Solectron adopted the

modified prospective transition method provided under SFAS 123R. Under this transition method, compensation cost associated with stock options now includes 1) quarterly amortization related to the remaining unvested portion of all stock option awards granted prior to September 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) quarterly amortization related to all stock option awards granted subsequent to September 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. In addition, Solectron records expense over the offering period and the vesting

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

term, respectively, in connection with 1) shares issued under its employee stock purchase plan and 2) discounted stock options. The compensation expense for stock based compensation awards includes an estimate for forfeitures and is recognized over the expected term of the options using the straight-line method. Under SFAS 123R, benefits of tax deductions in excess of recognized compensation costs are to be recorded as a financing cash inflow rather than as a reduction of taxes paid. For the three and nine months ended June 1, 2007, no excess tax benefits were generated from option exercises. The Company has recorded no amount for excess tax benefits in additional paid-in capital since the adoption of SFAS 123R. To determine excess tax benefits, the Company used the alternative transition method (short-cut method) as set forth in the FASB Staff Position No. FAS 123R-3 Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.

Total stock compensation expense for the three months ended June 1, 2007 of \$6.3 million was included in cost of sales and selling, general and administrative expense in the amounts of \$0.6 million and \$5.7 million, respectively. Total stock compensation expense for the nine months ended June 1, 2007 of \$20.1 million was included in cost of sales and selling, general and administrative expense in the amounts of \$3.1 million and \$17.0 million, respectively. Total stock compensation expense for the three months ended May 26, 2006, of \$6.7 million was included in cost of sales and selling, general and administrative expense in the amounts of \$1.5 million and \$5.2 million, respectively. Total stock compensation expense for the nine months ended May 26, 2006, of \$16.9 million was included in cost of sales and selling, general and administrative expense in the amounts of \$5.1 million and \$11.8 million, respectively. There is no tax benefit recorded for this expense due to full valuation allowances in the jurisdictions for which these options are deductible for tax purposes.

Stock Options

Solectron's stock option plans provide for grants of options to employees to purchase common stock at the fair market value of such shares on the grant date. The options vest monthly over a four-year period beginning on the grant date. The term of the options is seven years for options granted between January 12, 1994 and September 20, 2001, and ten years for options granted thereafter. Options assumed under past acquisitions generally vest over periods ranging from immediately to five years from the original grant date and have terms ranging from two to ten years. Solectron's 2002 Stock Plan, as amended, also provides for grants of discounted stock options at a price below the market value on the day of the stock option grant and are deemed exercised on the date of grant.

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected life of options is based on observed historical exercise patterns. For the three and nine months ended June 1, 2007 and May 26, 2006 respectively, the expected volatility of stock options is based upon equal weightings of the historical volatility of Solectron stock and, for fiscal periods in which there is sufficient trading volume in options on Solectron's stock, the implied volatility of traded options on Solectron stock having a life of more than six months. The expected volatility of Employee Share Purchase Plan shares is based on the implied volatility of traded options on the Company's stock in periods in which there is sufficient trading volume in those options. Otherwise, historical volatility is utilized. The risk-free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that Solectron has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

Stock Optionstu	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Expected volatility	58%	59%	58%	52% - 59%
Dividend yield	zero	zero	zero	zero
Expected life	5.1	4.4 years	4.4 years to 5.1 years	4.3 years to 4.9 years
Risk-free rate	4.38%	4.90%	4.38% to 4.95%	4.43% to 4.95%

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

Employee Stock Purchase Plan	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Weighted-average volatility	30% - 58%	30%	30% - 58%	30% - 44%
Dividend yield	zero	zero	zero	zero
Expected life	6 - 12 months	6 - 12 months	6 - 12 months	6 - 12 months
Risk-free rate	4.95%	4.43%	4.95% - 5.10%	3.94% - 4.43%

The Company has recorded \$2.1 million and \$8.1 million of compensation expenses relative to stock options (other than discounted stock options) for the three and nine months ended June 1, 2007, respectively, in accordance with SFAS 123R. As of June 1, 2007, there was \$21.6 million of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted-average period of 1.5 years. A summary of stock option activity under the plans for the nine months ended June 1, 2007 is presented as follows:

	Stock Option Awards Outstanding	Weighted Average Exercise Price
Balance, August 25, 2006	45,012,363	\$ 9.09
Granted	718,233	\$ 3.21
Exercised	13,700	\$ 2.09
Forfeited	334,327	\$ 3.80
Cancelled	1,902,567	\$ 28.73
Balance, November 24, 2006	43,480,002	\$ 8.17
Exercisable at November 24, 2006	35,139,930	\$ 9.22
Balance, November 24, 2006	43,480,002	\$ 8.17
Granted	7,389,068	\$ 3.49
Exercised	7,740	\$ 2.35
Forfeited	429,754	\$ 3.97
Cancelled	1,295,618	\$ 10.80
Balance, March 2, 2007	49,135,958	\$ 7.44
Exercisable at March 2, 2007	35,501,315	\$ 8.91
Balance, March 2, 2007	49,135,958	\$ 7.44
Granted	353,900	\$ 3.11
Exercised	51,504	\$ 2.11
Forfeited	796,676	\$ 3.94

Edgar Filing: SOLECTRON CORP - Form 10-Q

Cancelled	8,514,012	\$	6.74
Balance, June 1, 2007	40,127,666	\$	7.62
Exercisable at June 1, 2007	28,110,916	\$	9.36

The weighted-average fair value of stock options granted during the three and nine months ended June 1, 2007 was \$1.70 and \$1.89, respectively. The total intrinsic value of stock options exercised during the three and nine months ended June 1, 2007 was not material.

At June 1, 2007, an aggregate of 52.9 million shares were authorized for future issuance under our stock plans, which cover stock options (including discounted stock options) and shares available for purchase under our, Employee Stock Purchase Plans. A total of 45.2 million shares of common stock were available for grant under

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

Solectron's stock option plans as of June 1, 2007. Awards that expire or are cancelled without delivery of shares generally become available for issuance under the plans.

An initial option is granted to each new outside member of Solectron's Board of Directors to purchase 40,000 shares of common stock at the fair value on the date of the grant. On December 1 of each year, each outside member is granted an additional option to purchase 40,000 shares of common stock at the fair market value on such date. These options vest over one year and have a term of seven years.

Employee Stock Purchase Plan

Under Solectron's Employee Stock Purchase Plan, employees meeting specific employment qualifications are eligible to participate and can purchase shares semi-annually through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement or end of the purchase period. The Employee Stock Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation, with an annual maximum of \$25,000 in retail value. Solectron has treated the Employee Stock Purchase Plan as a compensatory plan. The Company has recorded compensation expense relative to the Employee Stock Purchase Plan in the three and nine months ended June 1, 2007 of zero and \$2.6 million, respectively and \$0.7 million and \$2.4 million for the three and nine months ended May 26, 2006.

Restricted Stock Awards and Discounted Stock Options

During fiscal 2005 and 2004, Solectron issued discounted stock options under its 2002 Stock Plan of 1.5 million and 0.7 million shares, respectively, to certain eligible executives and employees at a price below the market value of the Company's common stock on the day of the stock option grant. During the fiscal year ended August 25, 2006, 7.0 million discounted options were granted to certain eligible employees and during the first quarter of fiscal year 2007, 1.2 million discounted options were granted to certain eligible employees. During the second quarter of fiscal 2007, under Solectron's 2002 Stock Plan, 4.0 million discounted options were granted to certain eligible employees and 1.8 million discounted options were granted to certain executive officers. During the third quarter of fiscal 2007, under Solectron's 2002 Stock Plan, 4.9 million discounted options were granted to certain eligible employees and to certain executive officers. Compensation expense under the fair value method for the three and nine months ended June 1, 2007, is being amortized over the vesting period and was \$4.2 million and \$9.4 million, respectively and for the three and nine months ended May 26, 2006 was \$2.0 million and \$4.4 million, respectively. For compensation expense purposes, the intrinsic value of restricted stock awards and discounted stock options equals the fair market value of these awards on the date of grant.

The weighted-average fair value of the discounted stock options granted in the three and nine months ended June 1, 2007 was \$3.14 per share and \$3.26 per share, respectively and for the three and nine months ended May 26, 2006 was \$4.01 and \$3.84, respectively. At June 1, 2007, unrecognized costs related to restricted stock awards and discounted stock options totaled approximately \$39.4 million and is expected to be recognized over a weighted-average period of 2.7 years. The total fair value of restricted stock and discounted stock options vested was zero during the three and nine months ended June 1, 2007 and \$1.0 million during the three and nine months ended May 26, 2006, respectively.

NOTE 3 Stock Repurchase

On November 1, 2005, Solectron's Board of Directors approved a stock repurchase program whereby the Company was authorized to repurchase up to \$250 million of the Company's common stock pursuant to a 10b5-1 trading plan. Solectron commenced this \$250 million repurchase program at the end of the quarter ended February 24, 2006. In October 2006, the Board of Directors approved a twelve-month extension to the stock repurchase program. As of June 1, 2007, Solectron had repurchased and retired a total of 17.8 million shares under the repurchase program for approximately \$61.6 million. During the third quarter of fiscal 2007, Solectron made no repurchases under the plan.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 4 Inventories**

Inventories related to continuing operations as of June 1, 2007 and August 25, 2006, consisted of the following (in millions):

	June 1, 2007	August 25, 2006
Raw materials	\$ 1,212.9	\$ 1,127.0
Work-in-process	209.1	202.2
Finished goods	408.8	186.9
Total	\$ 1,830.8	\$ 1,516.1

On March 9, 2007, Solectron launched the Cisco Systems Lean Initiative. This initiative required us to purchase PCBA boards that were previously sold to Cisco Systems. As a result, the Company had a net reduction of revenue of \$240.7 million and an increase to inventories of \$260.3 million for the second quarter of fiscal 2007. In addition, during the third quarter of fiscal 2007, the Company purchased \$74.4 million of inventory from third party suppliers in connection with the initiative. Under the Cisco Systems Lean Initiative, Solectron is required to complete the building of systems and boxes. Systems and boxes require PCBA boards and third party built parts. Under the previous arrangement with Cisco Systems, the Company was required only to manufacture PCBA boards and if required by Cisco subsequently, the Company built systems and boxes on a consignment basis.

NOTE 5 Accounts Receivable, Net

Accounts receivable, net related to continuing operations as of June 1, 2007 and August 25, 2006 consisted of the following (in millions):

	June 1, 2007	August 25, 2006
Accounts receivable	\$ 1,500.8	\$ 1,443.8
Less: Allowance for doubtful accounts	7.2	14.5
Accounts receivable, net	\$ 1,493.6	\$ 1,429.3

NOTE 6 Property and Equipment, Net

Edgar Filing: SOLECTRON CORP - Form 10-Q

Property and equipment, net related to continuing operations as of June 1, 2007 and August 25, 2006, consisted of the following (in millions):

	June 1, 2007	August 25, 2006
Land	\$ 61.0	\$ 43.5
Buildings and improvements	429.6	367.1
Leasehold improvements	90.1	100.8
Furniture, fixtures, equipment and other	1,047.9	1,040.0
Computer equipment and software	350.8	338.3
	1,979.4	1,889.7
Less: Accumulated depreciation and amortization	1,242.0	1,216.3
Property and equipment, net	\$ 737.4	\$ 673.4

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 7 Debt*****8.00% Senior Subordinated Notes due 2016***

On February 14, 2006, Solectron's wholly owned subsidiary Solectron Global Finance Ltd (Solectron Global Finance) issued \$150 million of senior subordinated notes due 2016 (the Subordinated Notes). The Subordinated Notes are unconditionally guaranteed by Solectron on a senior subordinated basis, will mature on March 15, 2016, and bear interest at the rate of 8% annually. Cash interest payments on the Subordinated Notes will be made semiannually in arrears on March 15 and September 15 of each year. The Subordinated Notes will be redeemable, in whole or in part, at any time on or after March 15, 2011 at specified redemption prices plus accrued and unpaid interest. Prior to March 15, 2011, Solectron Global Finance or Solectron will have the option to redeem the Subordinated Notes, in whole or in part at a price equal to the greater of (1) 100% of the principal amount of the Subordinated Notes redeemed plus accrued and unpaid interest or (2) the make-whole premium plus accrued and unpaid interest. In addition, subject to certain conditions, prior to March 15, 2009, Solectron Global Finance or Solectron may redeem up to 35% of the aggregate principal amount of the Subordinated Notes with the net proceeds of a qualified public common stock offering by Solectron at a redemption price of 108% of the principal amount of the Subordinated Notes, plus any accrued and unpaid interest to the redemption date. On September 5, 2006, pursuant to a Registration Rights Agreement, Solectron Global Finance and Solectron completed an exchange offer of \$150 million in aggregate principal amount of Solectron Global Finance's 8.00% Senior Subordinated Notes due 2016 (the Exchange Notes) that have been registered under the Securities Act for the same principal amount of its outstanding unregistered Subordinated Notes. 100% of the outstanding unregistered Subordinated Notes were exchanged for the registered Exchange Notes. The Exchange Notes are guaranteed by Solectron on a senior subordinated basis and the guarantee with respect to the Exchange Notes has been registered under the Securities Act. At June 1, 2007, the aggregate carrying amount of the Exchange Notes of \$150 million is classified as long-term debt.

0.5% Convertible Senior Notes due 2034

On February 17, 2004, Solectron issued \$450 million of 0.5% convertible senior notes (the Original Notes). The Original Notes are unsecured and unsubordinated indebtedness of Solectron and will mature on February 15, 2034. Upon conversion of the Original Notes, Solectron will deliver shares of its common stock at the applicable conversion rate. The Original Notes do not provide an adjustment to the conversion rate upon a change in control.

On February 10, 2005, Solectron completed an exchange offer with respect to the Original Notes for an equal amount of its newly issued 0.5% convertible senior notes, Series B due 2034 (the New Notes) and cash. Solectron accepted for exchange \$447.3 million aggregate principal amount of outstanding notes, representing approximately 99.4% of the total outstanding notes. Upon conversion of the New Notes, Solectron will deliver \$1,000 in cash for the principal amount, and at its election, either common stock or cash, for the conversion value above the principal amount. Holders electing to convert upon a change of control, prior to February 15, 2011, unless the consideration consists of at least 90% in the form of listed shares (excluding cash payments for fractional shares and cash payments made pursuant to dissenters' appraisal rights), shall be eligible for an increase in the conversion rate in accordance with the terms of the New Notes.

On or after February 20, 2011, Solectron will have the option to redeem all or a portion of the New Notes that have not been previously purchased, repurchased or converted, at 100% of the principal amount of the New Notes to be

redeemed plus accrued and unpaid interest and liquidated damages owed, if any, up to, but excluding, the date of the purchase. Holders of the New Notes may require Solectron to purchase all or a portion of the convertible notes for cash on each of February 15, 2011, 2014, 2019, 2024, and 2029 at a price equal to 100% of the principal amount of the convertible notes to be repurchased plus accrued and unpaid interest, up to, but excluding, the date of repurchase. Holders will have the option, subject to certain conditions, to require Solectron to repurchase any New Notes held by such holder in the event of a change in control, as defined, at a price of 100% of the principal amount of the convertible notes plus accrued and unpaid interest up to, but excluding, the date of repurchase. The

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

New Notes are convertible into cash and either common stock or cash at any time prior to maturity, subject to the terms of the notes.

After the exchange offer was completed, there were approximately \$2.7 million aggregate principal amount of Original Notes outstanding. Interest on both the Original Notes and the New Notes (together, the convertible notes) will be paid on February 15 and on August 15 of each year. The conversion rate for the convertible notes is 103.4468 per \$1,000 principal amount, subject to certain adjustments in certain circumstances. This is equivalent to a conversion price of \$9.67 per share. At June 1, 2007, the aggregate carrying amount of the convertible notes is \$450 million, and classified as long-term debt.

Adjustable Conversion-Rate Equity Securities (ACES)

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

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

Solectron repaid the remaining \$64.3 million of the 7.97% subordinated debentures at maturity on November 15, 2006.

Liquid Yield Option Notes (LYONstm)

On June 1, 2007, Solectron has \$8.2 million aggregate accreted value of LYONstm outstanding with an interest rate of 2.75%. These notes are unsecured and unsubordinated indebtedness of Solectron. Solectron will pay no interest prior to maturity. Each note has a yield of 2.75% with a maturity value of \$1,000 on May 8, 2020. Each note is convertible at any time by the holder to common shares at a conversion rate of 12.3309 shares per note. Holders will be able to require Solectron to purchase all or a portion of their notes on May 8, 2010, at a price of \$761.00 per note. Solectron, at its option, may redeem all or a portion of the notes at any time. As of June 1, 2007, the accreted value of the 2.75% LYONstm is classified as long-term debt on the consolidated balance sheet.

On June 1, 2007, Solectron had \$0.9 million aggregate accreted value of LYONstm outstanding with an interest rate of 3.25%. These notes are unsecured and unsubordinated indebtedness of Solectron. Solectron will pay no interest prior to maturity. Each note has a yield of 3.25% with a maturity value of \$1,000 on November 20, 2020. Each note is convertible at any time by the holder to common shares at a conversion rate of 11.7862 shares per note. Holders will be able to require Solectron to purchase all or a portion of their notes on November 20, 2010, at a price of \$724.42 per note. Solectron, at its option, may redeem all or a portion of the notes at any time on or after May 20, 2004. As of June 1, 2007, the accreted value of the 3.25% LYONstm is classified as long-term debt.

Credit Facility

On August 28, 2006, Solectron entered into a \$350 million Credit Agreement (the Credit Agreement) that amends and replaces a \$500 million secured revolving facility. The Credit Agreement provides for a revolving, multicurrency, secured-credit facility, which may be used to borrow revolving loans or issue standby letters of credit, subject to a \$100 million letter of credit sub-limit. The Company may request an increase in the credit facility of up to an additional \$150 million, to provide for an aggregate commitment of up to \$500 million. There are currently no revolving loans outstanding and approximately \$0.6 million in letters of credit outstanding under the Credit Agreement. The revolving loans under the Credit Agreement bear interest, at the Company s option, at either (i) the base rate, which is defined as a fluctuating rate per annum equal to the greater of (A) Bank of America N.A. s

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

prime rate, or (B) the average rate on overnight federal funds plus one-half of one percent, or (ii) a rate equal to (A) the London Inter-bank Offered Rate (LIBOR) plus (B) an applicable margin ranging from 1.0% to 2.0% based on Solectron's non-credit-enhanced senior unsecured long-term debt ratings. The Credit Agreement matures on August 28, 2009 and may be prepaid at any time without penalty or premium at the option of the Company.

NOTE 8 Derivative Instruments

Solectron enters into foreign exchange forward contracts intended to reduce the short-term impact of foreign currency fluctuations on foreign currency receivables, investments, payables and indebtedness. The gains and losses on the foreign exchange forward contracts are intended largely to offset the transaction gains and losses on the foreign currency receivables, investments, payables, and indebtedness recognized in operating results. Solectron does not enter into foreign exchange forward contracts for speculative purposes. Solectron's foreign exchange forward contracts related to current assets and liabilities are generally nine months or less in original maturity. The majority of the forward contracts are not designated as hedges under SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133). The changes in the values of these forward contracts are included in other expense, net and were immaterial for the three and nine months ended June 1, 2007.

During the second quarter of fiscal 2007, the Company entered into certain foreign exchange forward contracts, with a total notional amount approximating \$12.2 million. These foreign exchange forward contracts are designated as a cash flow hedge under SFAS No. 133. These contracts have various maturity dates that coincide with the occurrence of the exposure being hedged. The change in the fair value of these contracts representing the effective portion of the hedge is recorded to other comprehensive income. The ineffective portion of these contracts was recorded to earnings. The amount recorded in other comprehensive income will be recognized in net earnings when the underlying hedged exposure occurs. As of June 1, 2007, the deferred foreign exchange gain expected to be reclassified to earnings in the next three months was \$0.4 million.

As of June 1, 2007, Solectron had outstanding foreign exchange forward contracts with a total notional amount of approximately \$423.7 million related to continuing operations, including the \$12.2 million of cash flow hedges discussed previously.

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

Financial instruments that potentially subject Solectron to concentrations of credit risk consist of cash, cash equivalents and trade accounts receivable. Concentrations of credit risk in accounts receivable resulting from sales to major customers are discussed in Note 11, Segment Information and Geographic Information.

NOTE 9 Commitments and Contingencies

Future Minimum Lease Obligations

Future minimum payments for operating lease obligations related to continuing operations are as follows:

	Payments Due by Period							
	Total	Short- Term	Q4 08	FY09	FY10	FY11	FY12	Thereafter
	(In millions)							
Operating leases	\$ 148.7	\$ 37.9	\$ 8.5	\$ 30.4	\$ 23.0	\$ 14.5	\$ 12.0	\$ 22.4

Legal Proceedings

Solectron is from time to time involved in various litigation and legal matters arising in the normal course of its business operations. Management believes that the final resolution of these matters will not have a material adverse

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

effect on the Company's consolidated financial position, cash flows or results of operations. By describing any particular matter, Solectron does not intend to imply that it or its legal advisors have concluded or believe that the outcome of any of those particular matters is or is not likely to have a material adverse impact upon Solectron's consolidated financial position, cash flows or results of operations.

On June 4, 2007, a purported class action complaint has been filed alleging breach of fiduciary duty of the directors of Solectron in the Superior Court of the State of California, County of Santa Clara, seeking to enjoin the proposed merger between Solectron and Flextronics International Ltd. (Flextronics) described in Note 17 below. While this case is in the early stages, Solectron believes that it is without merit. Any judgments, however, in respect of this or similar lawsuits that are adverse to Flextronics and Solectron may adversely affect Flextronics and Solectron's ability to consummate the merger.

Environmental Liability

Solectron has potential environmental liabilities, largely related to (i) our acquisition of sites with potential pre-existing environmental issues and (ii) our indemnification obligations set forth in sale agreements for sites we have divested. Internal and external legal and environmental expertise are utilized to evaluate such past environmental remediation exposures, as well as issues related to continuing operations.

Solectron has an accrued liability balance for environmental remediation of \$35.8 million, as of June 1, 2007 and August 25, 2006.

This environmental remediation liability represents known exposures, which have been disclosed to Solectron's insurance carriers, and identified as self-insured retention. No additional site exposures are known to be probable or reasonably possible, in the context of SFAS 5 Contingencies and SOP 96-1 Environmental Remediation Liabilities for the aforementioned balance sheet dates.

Additionally, routine environmental clean-ups required upon future disposal of Solectron facilities are recorded in accordance with SFAS 143 Accounting for Asset Retirement Obligations and its interpretation under FIN 47 Accounting for Conditional Asset Retirement Obligations.

NOTE 10 Taxes

SFAS No. 109, Accounting for Income Taxes, requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence needs to be considered, including the Company's performance, the market environment in which the Company operates, the utilization of past tax credits, length of carryback and carryforward periods, and existing contracts or sales backlog that will result in future profits, among other factors. It further states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. Therefore, cumulative losses weigh heavily in the overall assessment. As a result of the review undertaken after the end of the third quarter of fiscal 2003, Solectron concluded that it was appropriate to establish a full valuation allowance for most of the net deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. The total valuation allowance is approximately \$1.6 billion as of June 1, 2007. In addition, Solectron expects to continue to provide a full

valuation allowance on future tax benefits until it can demonstrate a sustained level of profitability that establishes its ability to utilize the assets in the jurisdictions to which the assets relate. Solectron incurred tax expense in certain countries that are not subject to the aforementioned valuation allowance during the three and nine months ended June 1, 2007.

Certain of Solectron's non-US operations are reporting taxable profits, mostly arising in the same low-cost locations where the majority of our manufacturing capabilities are found. Solectron will not be able to offset any tax expense associated with these taxable profits with the unrecognized deferred tax assets described above, because, for the most part, those assets did not arise in the same jurisdictions where Solectron is realizing taxable profits.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

The income tax provision for the interim periods is based on the best estimate of the effective tax rate expected to be applicable for the full fiscal year. Changes in the interim period for the tax (or benefit) related to items other than ordinary income are individually computed and recognized when the items occur. Included in the computation of three foreign entities' estimated annual effective tax rate is the income tax benefits associated with a refund of taxes paid on the reinvested earnings of the foreign subsidiaries. During the nine months ended June 1, 2007, the Company recorded income tax benefits of \$4.4 million associated with the refund of taxes paid on the reinvested earnings, of which \$2.5 million of the tax benefit was included in the computation of the foreign entities' estimated annual effective tax rate. The remaining portion of the refund of taxes paid on reinvested earnings in the amount of \$1.9 million was individually computed and recognized in the three months ended November 24, 2006. Beginning January 1, 2007, the Company has decided to no longer apply for reinvestment of earnings, as a result, the amount of the tax benefit included in the foreign entities' estimated annual effective tax rate during the nine months ended June 1, 2007 is lower than the amount reported for the first quarter of fiscal 2007.

The Internal Revenue Service (IRS) and other tax authorities regularly examine the Company's income tax returns. During the fourth quarter of fiscal 2006, the IRS completed its field examination of the Company's federal income tax returns for fiscal years 2001 and 2002 and issued a Revenue Agent's Report (RAR). The RAR is not a final Statutory Notice of Deficiency, and the Company has protested certain of the proposed adjustments with the Appeals Office of the IRS. The most significant of the disputed adjustments relates to transfer pricing arrangements that the Company has with its foreign subsidiaries. The Company believes that the proposed IRS adjustments are inconsistent with applicable tax laws, and that it has meritorious defenses to the proposed adjustments. The Company has accrued an amount determined to be a reasonable estimate of the loss. Although there is a reasonable possibility that additional amounts will be paid or incurred, an estimate of the possible loss or range of loss cannot be made.

During the quarter ended March 2, 2007, the IRS issued a final Statutory Notice of Deficiency for the disallowance of a loss associated with a transaction entered into by a domestic subsidiary in a tax year prior to the subsidiary's acquisition by Solectron. The Company did not record an additional accrual related to this item during the quarter, as it believes that adequate amounts of tax and interest have already been recorded. On April 30, 2007, the Company filed a petition with the U.S. Tax Court for redetermination of the deficiency set forth by the IRS.

A domestic state jurisdiction is currently conducting a sales and use tax audit for the period from January 1, 1999, through December 31, 2001. Solectron filed an application to participate in an amnesty program in order to protect itself from any penalties that may arise as a result of a potential audit assessment. Although there is a reasonable possibility that a loss may be incurred, no estimate of the possible loss can be made at this time.

In addition, Solectron has established contingency reserves for income taxes in various jurisdictions. The estimate of appropriate tax reserves is based upon the amount of prior tax benefit that is at risk upon audit and upon the reasonable estimate of the amount at risk. Solectron periodically reassesses the amount of such reserves and adjusts reserve balances as necessary.

Significant judgment is required in determining Solectron's provision for income taxes. The calculation of Solectron's tax liabilities involves dealing with uncertainties in the application of complex tax rules and regulations. In determining the adequacy of its provision for income taxes, Solectron has assessed the likelihood of adverse outcomes resulting from these examinations, including the IRS RAR for fiscal years 2001 and 2002. Although the ultimate outcome of tax examinations cannot be predicted with certainty, including the total amount payable and the timing of

such payments, the Company believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result. Solectron, however, cannot be certain that such amounts will not be materially different than what is reflected in its historical income tax provisions and accruals. Should the tax authorities assess additional taxes as a result of any current or future examinations, Solectron may be required to record changes to operations in future periods that could have a material adverse effect on its results of operations, financial position or cash flows in the period or periods recorded.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 11 Segment Information and Geographic Information**

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

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

Geographic information for continuing operations as of and for the periods presented is as follows (in millions):

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Geographic net sales:				
United States	\$ 910.6	\$ 787.4	\$ 2,655.8	\$ 2,392.5
Other North and Latin America	458.6	403.9	1,439.8	1,147.6
Europe	376.2	306.6	1,128.2	909.3
Malaysia	515.8	568.7	1,595.8	1,580.8
China	404.7	398.2	1,131.8	936.8
Other Asia Pacific	319.4	237.8	934.9	691.6
	\$ 2,985.3	\$ 2,702.6	\$ 8,886.3	\$ 7,658.6

Geographic net sales are attributable to the country in which the product is manufactured.

	June 1, 2007	August 25, 2006
Long-lived assets:		
United States	\$ 190.6	\$ 110.0
Other North and Latin America	161.6	162.3
Europe	119.3	118.2
Asia Pacific	265.9	282.9

\$ 737.4 \$ 673.4

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

The following table depicts, for the periods indicated, revenue by market expressed as a percentage of net sales. The distribution of revenue across our markets has fluctuated, and will continue to fluctuate, as a result of numerous factors, including but not limited to increased business from new and existing customers; fluctuations in customer demand; seasonality of our customers' markets; and growth in market outsourcing.

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Computing & Storage	32.6%	32.4%	32.8%	33.0%
Networking	25.6%	23.6%	24.2%	25.4%
Communications	19.3%	19.3%	19.9%	18.6%
Consumer	9.9%	11.6%	10.9%	10.0%
Industrial	8.4%	9.1%	8.2%	8.5%
Automotive	2.1%	2.0%	1.9%	2.7%
Other	2.1%	2.0%	2.1%	1.8%
Total	100.0%	100.0%	100.0%	100.0%

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

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Cisco Systems	19.7%	16.3%	17.6%	17.1%
Nortel Networks	*	*	*	10.3%
Hewlett-Packard	10.2%	*	10.1%	*

(*) Less than 10%

Solectron has concentrations of credit risk due to sales to the customers listed above as well as to Solectron's other significant customers. As of June 1, 2007, Hewlett-Packard accounted for approximately 17.2% of total accounts receivable related to continuing operations.

NOTE 12 Restructuring and Impairment

Over the past few years, Solectron has recorded restructuring and impairment costs to optimize its global footprint, reduce its cost structure and to respond to declines in customer demands. The measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, was largely intended to align Solectron's capacity and infrastructure to anticipated customer demand and transition its operations to lower cost regions. The restructuring and impairment costs include employee severance and benefit costs, costs related to leased facilities abandoned and subleased, impairment of owned facilities no longer used by Solectron which will be disposed, costs related to leased equipment that has been abandoned, and impairment of owned equipment that will be disposed. For owned facilities and equipment, the impairment loss recognized was based on the fair value less costs to sell, with fair value estimated based on existing market prices for similar assets. Severance and benefit costs are recorded in accordance with SFAS No. 112, Employer's Accounting for Postemployment Benefits, as Solectron has concluded that it had a substantive severance plan. In accordance with SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, the estimated lease loss accrued for leased facilities abandoned and subleased after December 31, 2002 represents the fair value of the lease liability as measured by the present value of future lease payments subsequent to abandonment, less the present value of any estimated sublease income. For those facilities abandoned and subleased before January 1, 2003, as part of restructuring activities under EITF Issue No. 94-3, the estimated lease loss represents

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

payments subsequent to abandonment less any estimated sublease income. In order to estimate future sublease income, Solectron works with real estate brokers to estimate the length of time until it can sublease a facility and the amount of rent it can expect to receive. Estimates of expected sublease income could change based on factors that affect Solectron's ability to sublease those facilities such as general economic conditions and the real estate market, among others. At each reporting date, the Company evaluates its accruals for exit costs and employee separation costs to ensure the accruals are still appropriate. In certain circumstances, accruals are no longer required because of efficiencies in carrying out the plans or because employees previously identified for separation resigned from the Company and did not receive severance or were redeployed due to circumstances not foreseen when the original plans were initiated. The Company reverses accruals through the income statement line item where the original charges were recorded when it is determined that they are no longer required.

Overview of Restructuring Plans

Fiscal Year 2007 Phase II Restructuring Plan

On March 26, 2007, the Solectron Board of Directors approved the Fiscal Year 2007 Phase II Restructuring Plan, pursuant to Solectron's phased approach to restructuring announced in the first quarter of fiscal 2007, to further optimize its global footprint and reduce its cost structure. Solectron estimates that total charges related to this phase of restructuring will be between \$35 million to \$45 million, of which approximately 90% represents cash expenditures. Total estimated charges primarily consist of (i) \$23 million to \$30 million related to severance costs, (ii) \$9 million to \$12 million related to leased facility liabilities and transfer and other exit costs and (iii) an estimated non-cash charge of \$3 million related to disposition or impairment of facilities and equipment, \$1.3 million of which was impaired at the end of the second quarter of fiscal 2007. The restructuring plan consists of the following measures:

Close or consolidate approximately 400,000 square feet of facilities in Western Europe and North America.

Reduce approximately 1,300 to 1,500 employees at the facilities being closed or consolidated.

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

Cumulative restructuring costs recorded under the Fiscal 2007 Phase II Restructuring Plan as of June 1, 2007 were \$25.4 million. This consists of \$23.7 million in severance, \$1.3 million in impairment charges on facilities and equipment (impaired at the end of the second quarter of fiscal 2007) and \$0.4 million of transfer costs, other expenses and leased facilities expenses.

As of June 1, 2007, Solectron has reduced its workforce by 90 personnel in connection with this plan and expects to reduce headcount by an additional 1,200 to 1,400 personnel prior to the completion of this plan. The remaining accrual balance of \$22.4 million consists primarily of existing severance commitments for 1,200 to 1,400 personnel, the majority of which will be paid by December 31, 2007.

In certain circumstances, severance accruals may not be required. This may result from re-employment outside of Solectron or failure to file for severance benefits. When it is determined that accruals are no longer required in these

situations, the Company reverses the accruals through the income statement line item originally charged. The Fiscal Year 2007 Phase II Restructuring Plan is expected to be completed within twelve months of the Board's approval of the plan.

Fiscal Year 2007 Phase I Restructuring Plan

On October 2, 2006, the Solectron Board of Directors approved the Fiscal Year Phase I 2007 Restructuring Plan to optimize its global footprint and reduce its cost structure. Solectron anticipates that total charges related to this restructuring plan will be between \$50 million to \$60 million. Total estimated charges consist of (i) \$32 million to \$39 million related to severance costs, (ii) \$10 million to \$13 million related to leased facility liabilities and

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

transfer and other exit costs and (iii) an estimated non-cash charge of \$8 million related to disposition or impairment of facilities and equipment. The restructuring plan consists of the following measures:

Close or consolidate approximately 700,000 square feet of facilities in Western Europe and North America.

Reduce approximately 1,200 to 1,400 employees at the facilities being closed or consolidated. Although there may be a potential decrease from the original plan estimate of 1,400 employees, severance costs will still be in the range provided.

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

Cumulative restructuring costs recorded under the Fiscal 2007 Phase I Restructuring Plan as of June 1, 2007 were \$50.0 million. This consists of \$39.1 million in severance, \$5.1 million in impairment charges on facilities and equipment (which includes \$3.1 million recorded in the fourth quarter of fiscal year 2006), and \$5.8 million of transfer costs, other expenses and leased facilities expenses.

As of June 1, 2007, Solectron has reduced its workforce by 1,050 personnel in connection with this plan and expects to reduce headcount by an additional 150 to 350 personnel prior to the completion of this plan. The remaining accrual balance of \$13.1 million is primarily related to existing severance commitments for 150 to 350 personnel, the majority of which will be paid by November 30, 2007.

In certain circumstances, severance accruals may not be required. This may result from re-employment outside of Solectron or failure to file for severance benefits. When it is determined that accruals are no longer required in these situations, the Company reverses the accruals through the income statement line item originally charged. The Fiscal Year 2007 Phase I Restructuring Plan is expected to be completed within twelve months of the Board's approval of the plan.

Fiscal Year 2005 Restructuring Plan

During fiscal year 2005, in response to a decline in revenues from fiscal year 2004 levels, Solectron reviewed its cost structure and geographic footprint and determined that cost savings could be realized by moving certain activities from high-cost facilities in Europe and North America to facilities in low-cost geographies. During fiscal 2006, the Company had lowered its total anticipated restructuring costs for the Fiscal Year 2005 Restructuring Plan from \$80-\$95 million to \$55-\$65 million. The original anticipated costs were based on the occurrence of certain future events. Due to non-occurrence of some events and changes in business conditions, the Company lowered its total anticipated costs. However, for the restructuring items that were executed, the Company expects cost savings to be in line with the original estimates. This restructuring plan as amended will result in restructuring charges of approximately \$55 million to \$65 million, and includes the following measures:

Closing the Company's facilities in Hillsboro, Oregon; Winnipeg, Canada; Lincoln, California; Turnhout, Belgium; and Munich, Germany.

Eliminating approximately 2,500 positions (1) at the facilities being closed; (2) at the Company's facilities in Bordeaux, France; Dunfermline, Scotland; Guadalajara, Mexico; Jaguariuna, Brazil; and other facilities; and (3) within the Company's material procurement and sales organizations in Europe and North America. These actions included the elimination of certain positions, the migration of certain functional activities to facilities in lower cost geographies and the outsourcing of certain activities.

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

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

Cumulative restructuring costs recorded under the Fiscal Year 2005 Restructuring Plan as of June 1, 2007 were \$59.5 million. As of June 1, 2007, Solectron has reduced its workforce by 2,506 personnel in connection with this plan and expects to reduce headcount by an additional 16 personnel prior to the completion of this plan. The remaining accrual balance of \$1.2 million is primarily related to expenses associated with taxes, leased facilities and severance payouts. The Company expects to pay out a substantial portion of these costs during the next two fiscal quarters. This plan was substantially completed as of the end of fiscal 2006.

Fiscal Year 2004 Restructuring Plan

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

The Fiscal Year 2004 Restructuring Plan was expected to result in total restructuring charges of \$20.0 million. Through June 1, 2007, Solectron had recorded restructuring charges of approximately \$26.1 million related to this plan. This amount consisted of \$9.8 million of severance charges, \$10.2 million relating to the impairment of certain long-lived assets, and \$6.1 million of facility lease obligation and other expenses. This restructuring plan is substantially complete. The remaining accrual balance of \$2.4 million as of June 1, 2007 is primarily related to an ongoing facility lease obligation, which expires in 2011. However, Solectron may incur additional restructuring costs as it revises estimates due to changes in assumptions used for the facility lease loss accrual.

Legacy Restructuring Plans

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

Solectron incurred restructuring charges in the third quarter of fiscal 2007 in accordance with previously announced plans. Total net restructuring and impairment costs of \$29.6 million were charged against continuing operations as a result of these planned actions as well as revisions to previous estimates.

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

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

	Three Months Ended		Nine Months Ended		Nature
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006	
Loss on disposal of and impairment of equipment and facilities, net	\$ 0.8	\$ 0.2	\$ 5.5	\$ 8.7	non-cash
Intangible asset impairment charge, net				1.9	non-cash
Total impairment of equipment, facilities and intangibles	0.8	0.2	5.5	10.6	
Severance and benefit costs (reversal)	25.9	(0.2)	63.4	(10.1)	cash
Net adjustment to facility lease loss accrual	0.9	1.8	8.8	6.3	cash
Net adjustment to equipment lease loss accrual				0.1	cash
Other exit costs	2.0	0.8	3.0	2.2	cash
Total cash restructuring	28.8	2.4	75.2	(1.5)	
Total cash and non-cash restructuring	\$ 29.6	\$ 2.6	\$ 80.7	\$ 9.1	

Restructuring Accrual

The following table summarizes the restructuring accrual balance for continuing operations as of June 1, 2007 (in millions). The amounts presented include remaining obligations under both the Fiscal Year 2007 Restructuring Plans and prior plans.

	Severance and Benefits	Lease Facilities and Equipment	Other	Total
Balance of accrual at August 25, 2006	\$ 7.1	\$ 23.1	\$ 0.1	\$ 30.3
Q1 FY07 Provision	29.8	2.9	0.4	33.1
Q1 FY07 Provision adjustments	(0.2)			(0.2)
Q1 FY07 Cash payments	(3.3)	(9.7)	(0.5)	(13.5)

Edgar Filing: SOLECTRON CORP - Form 10-Q

Balance of accrual at November 24, 2006	33.4	16.3		49.7
Q2 FY07 Provision	8.4	4.2	0.6	13.2
Q2 FY07 Provision adjustments	(0.5)	0.4		(0.1)
Q2 FY07 Cash payments	(12.0)	(4.1)	(0.5)	(16.6)
Balance of accrual at March 2, 2007	29.3	16.8	0.1	46.2
Q3 FY07 Provision	26.5	1.0	2.0	29.5
Q3 FY07 Provision adjustments	(0.5)	(0.4)		(0.9)
Q3 FY07 Cash payments	(22.1)	(3.8)	(2.1)	(28.0)
Balance of accrual at June 1, 2007	\$ 33.2	\$ 13.6	\$	\$ 46.8

Accruals related to restructuring activities were recorded in accrued expenses in the accompanying condensed consolidated balance sheets. Solectron expects to pay amounts related to severance and benefits within the next 12 months. The remaining balance, primarily consisting of lease commitment costs on facilities, is expected to be paid out through 2014.

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

The restructuring and impairment charges incurred by restructuring plan during the nine months ended June 1, 2007 (in millions) were as follows:

	Fiscal 2007 Phase II Plan	Fiscal 2007 Phase I Plan	Fiscal 2005 Plan	Fiscal 2004 Plan	Legacy Plans	Total
Balance of accrual at August 25, 2006	\$	\$	\$ 7.1	\$ 2.1	\$ 21.1	\$ 30.3
Q1 FY 2007 Provision		29.6	0.7	0.7	2.1	33.1
Q1 FY 2007 Provision adjustments			(0.1)		(0.1)	(0.2)
Q1 FY 2007 Cash payments		(3.1)	(0.8)	(0.2)	(9.4)	(13.5)
Balance of accrual at November 24, 2006	\$	\$ 26.5	\$ 6.9	\$ 2.6	\$ 13.7	\$ 49.7
Q1 2007 Non-cash items						\$ 1.4
Q2 FY 2007 Provision		11.8	0.9	0.3	0.2	13.2
Q2 FY 2007 Provision adjustments		0.4	(0.1)	(0.1)	(0.3)	(0.1)
Q2 FY 2007 Cash payments		(6.8)	(6.3)	(0.5)	(3.0)	(16.6)
Balance of accrual at March 2, 2007	\$	\$ 31.9	\$ 1.4	\$ 2.3	\$ 10.6	\$ 46.2
Q2 2007 Non-cash items						\$ 3.3
Q3 FY 2007 Provision	\$ 24.1	\$ 4.3	\$ 0.3	\$ 0.3	\$ 0.5	29.5
Q3 FY 2007 Provision adjustments		(0.8)			(0.1)	(0.9)
Q3 FY 2007 Cash payments	(1.7)	(22.3)	(0.5)	(0.2)	(3.3)	(28.0)
Balance of accrual at June 1, 2007	\$ 22.4	\$ 13.1	\$ 1.2	\$ 2.4	\$ 7.7	\$ 46.8
Q3 2007 Non-cash items						\$ 0.8

NOTE 13 Goodwill and Intangible Assets

Goodwill information is as follows (in millions):

	Goodwill
Balance at August 25, 2006	\$ 155.2
Acquisitions	3.4
Goodwill adjustments	0.5
Balance at June 1, 2007	\$ 159.1

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

Solectron's intangible assets are classified as other assets on the condensed consolidated balance sheets and categorized into three main classes: supply agreements, intellectual property and contractual and non-contractual customer relationships obtained in asset purchases or business combinations. The following table summarizes the intangible asset balance at June 1, 2007 and August 25, 2006 (in millions):

	Supply Agreements	Intellectual Property Agreements	Customer Relationships and Other	Total
June 1, 2007				
Gross amount	\$ 95.9	\$ 81.9	\$ 75.3	\$ 253.1
Accumulated amortization	(85.6)	(75.3)	(65.5)	(226.4)
Carrying value	\$ 10.3	\$ 6.6	\$ 9.8	\$ 26.7
August 25, 2006				
Gross amount	\$ 85.5	\$ 80.3	\$ 72.6	\$ 238.4
Accumulated amortization	(85.4)	(73.3)	(63.4)	(222.1)
Carrying value	\$ 0.1	\$ 7.0	\$ 9.2	\$ 16.3

In January 2007, Solectron acquired NCR's North American manufacturing business responsible for producing ATMs and payment solutions in the Americas and self-checkout systems globally. The acquisition resulted in acquiring identifiable intangible assets of approximately \$12.9 million. The identifiable intangible assets acquired included a supply agreement valued at \$11.0 million and intellectual property valued at \$1.5 million. Both categories of identifiable intangible assets will be amortized over five years. The remaining balance of \$0.4 million was allocated to goodwill.

During the three months ended June 1, 2007, Solectron acquired Software Remodeling, Inc., a business that provides software, electronic, mechanical, industrial design, and user interface design and engineering services to its customers for the production of electromechanical and software driven products. The purchase price of the acquisition was approximately \$6.0 million, of which \$0.8 million will be paid on the termination date, net of claims. The identifiable intangible assets acquired were comprised of customer relationships valued at \$1.4 million and a noncompete agreement valued at \$1.4 million. The amount allocated to goodwill was \$3.0 million and the amount allocated to fixed assets was \$0.2 million. The Company may be required to pay an additional amount of \$1.9 million after the 12 month anniversary of the closing date as a retention award to certain key employees.

Amortization expense for the three and nine months ended June 1, 2007 was approximately \$2.2 million and \$4.7 million, respectively. Amortization expense for the three and nine months ended May 26, 2006 was approximately \$1.0 million and \$5.0 million, respectively. The Company anticipates that annual amortization expense for these intangibles over the next five years to be approximately \$7.8 million, \$6.6 million, \$5.2 million, \$3.8 million and \$2.8 million, respectively.

NOTE 14 Discontinued Operations

During fiscal 2004, as a result of a full review of our portfolio of businesses, we committed to a plan to divest a number of business operations that were no longer part of our strategic plan for the future. In accordance with SFAS No. 144, we have reported the results of operations and financial position of these businesses in discontinued operations within the consolidated statements of operations and balance sheets for all periods presented. The companies that we have divested and that are currently included in discontinued operations are Solectron's MicroTechnology division, Stream International Inc. and Force Computers, Inc.

These businesses each qualify as a discontinued operation component of Solectron under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Solectron has reported the results of operations

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

and consolidated financial position of these businesses in discontinued operations within the consolidated statements of operations and the balance sheets for all periods presented.

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

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Net sales	\$	\$	\$	\$
Cost of sales				
Gross profit				
Operating expense (income) net	0.1	0.4	1.0	(7.8)
Operating (loss) income	(0.1)	(0.4)	(1.0)	7.8
Other income net				8.9
(Loss) income before income taxes, income taxes of \$0	(0.1)	(0.4)	(1.0)	16.7
(Loss) income from discontinued operations, net of tax	\$ (0.1)	\$ (0.4)	\$ (1.0)	\$ 16.7

During the first quarter of fiscal 2007, Solectron recorded \$0.6 million of costs related to a sales tax assessment and ongoing facility carrying costs. During the second quarter of fiscal 2007, Solectron recorded \$0.3 million of costs related to a foreign tax assessment formerly associated with a discontinued operation. During the third quarter of fiscal 2007, Solectron recorded \$0.1 million of costs related to a foreign tax assessment formerly associated with a discontinued operation.

During the second quarter of fiscal 2007, Solectron paid \$1.9 million related to a foreign tax assessment formerly associated with a discontinued operation.

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

The sale agreements for all the divestitures contain certain indemnification provisions pursuant to which Solectron may be required to indemnify the buyer of the divested business for a limited period subsequent to the completion of the sale for liabilities, losses, or expenses arising out of breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. As of June 1, 2007, most of

these indemnification provisions have expired, and there were no significant liabilities recorded under these indemnification obligations. Additionally, Solectron may be required to indemnify a buyer for certain environmental remediation costs until 2014, such indemnification not to exceed \$13 million. Solectron maintains an insurance policy to cover environmental remediation liabilities in excess of reserves previously established upon the acquisition of these properties. Solectron did not record any environmental charges upon disposition of these properties.

NOTE 15 Net Income Per Share Calculation

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

The computation of diluted net income per share includes the effect of dilutive securities on weighted average shares. Dilutive securities include options to purchase common stock and shares issuable upon conversion of

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

Solectron's LYONs and Series A Convertible Senior Notes and are excluded in all periods as their effect was anti-dilutive.

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

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Basic earnings per share:				
Income from continuing operations	\$ 12.2	\$ 42.4	\$ 34.4	\$ 79.7
Shares used in computation:				
Weighted average ordinary shares outstanding	898.6	908.1	895.6	916.2
Basic earnings per share	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.09
Diluted earnings per share:				
Income from continuing operations	\$ 12.2	\$ 42.4	\$ 34.4	\$ 79.7
Shares used in computation:				
Weighted average ordinary shares outstanding	898.6	908.1	895.6	916.2
Employee stock options	0.1	0.2	0.1	0.2
Restricted stock	6.0	0.8	3.7	0.7
Shares issuable upon conversion of convertible securities		0.5		0.1
Weighted average number of shares	904.7	909.6	899.4	917.2
Diluted earnings per share	\$ 0.01	\$ 0.05	\$ 0.04	\$ 0.09

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

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Anti-dilutive securities:				
Employee stock options	44.3	48.7	45.9	36.6
Shares issuable upon conversion of LYONS	0.2		0.2	
Shares issuable upon conversion of 0.5% notes	0.3		0.3	

Total anti-dilutive shares	44.8	48.7	46.4	36.6
----------------------------	------	------	------	------

NOTE 16 Related Party Transactions

In January 2006, Paul Tufano became Executive Vice President and Chief Financial Officer of Solectron and is currently serving as interim President and Chief Executive Officer and principal executive officer. Mr. Tufano is also a member of the Board of Directors of Teradyne, a customer of Solectron. Solectron has for the past 10 years, in the ordinary course of business, sold printed circuit board assemblies and sub-system assemblies to Teradyne and purchased in-circuit testers from Teradyne. During the quarter ended June 1, 2007, Solectron had sales of \$55.3 million to Teradyne, all of which were made on an arms-length basis.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

NOTE 17 Subsequent and Other Events

On June 4, 2007, it was announced that Solectron and Flextronics International Ltd. (Flextronics) entered into a definitive agreement for Flextronics to acquire Solectron. Under the terms of the definitive agreement, unanimously approved by the Boards of Directors of both companies, stockholders of Solectron will receive total consideration currently valued at approximately \$3.7 billion, based on the closing price of Flextronics ordinary shares on June 1, 2007.

Upon consummation of the merger, each share of common stock of Solectron will be converted into the right to receive, at the election of each of the individual holders of Solectron shares, either, but not a combination of (i) 0.3450 shares of Flextronics or (ii) a cash payment of \$3.89 per share, subject to the limitation that not more than 70% in the aggregate and no less than 50% in the aggregate of Solectron shares will be converted into shares of Flextronics. Completion of the merger is subject to customary conditions, including the approval of the stockholders of Solectron and Flextronics and the receipt of applicable regulatory approvals and clearances. Upon consummation, each outstanding option to purchase shares with an exercise price equal to or less than \$5.00, whether or not exercisable, would be assumed by Flextronics. All other outstanding options to purchase shares will accelerate and become immediately exercisable for a period of at least 30 days prior to the effective time.

On February 27, 2007, in connection with the departure of the then Chief Executive Officer (CEO), the Executive Compensation and Management Resources Committee of the Board of Directors (the Committee) of Solectron approved retention arrangements for certain senior executives. On March 14, 2007, in connection with his appointment as Interim President and Chief Executive Officer to replace the former CEO, Board of Directors (the Board) of the Company entered into an Amended and Restated Executive Employment Agreement with Paul Tufano (the Restated Agreement). On April 16, 2007, in connection with the appointment of Roop Lakkaraju as Senior Vice President and Interim Chief Financial Officer to replace Mr. Tufano, who had been the Company s Chief Financial Officer prior to being named the Company s Interim President and Chief Executive Officer, the Committee approved the terms of the executive employment agreement to be entered into with Mr. Lakkaraju, which included a retention arrangement.

On June 3, 2007, the Committee approved the contribution and crediting of the Company contributions to be made to the Deferred Compensation Plan pursuant to the Retention Arrangements for Mr. Tufano, Mr. Lakkaraju and the senior executives to each individual s deferred compensation account as of June 3, 2007, subject to the terms and conditions of the Deferred Compensation Plan. The Committee also approved accelerated vesting of all Company contributions to the Deferred Compensation Plan, including Company contributions credited to each executive s account under the Deferred Compensation Plan pursuant to the Retention Arrangements, if the Deferred Compensation Plan is terminated. The Committee approved these changes to the Retention Arrangements to reflect the importance to the Company and its stockholders of retaining these executives, in light of the fact that the contribution trigger for the executives (other than Mr. Lakkaraju), namely the appointment of a new Chief Executive Officer, might not occur in light of the pending merger with Flextronics, and that the Deferred Compensation Plan could be terminated in connection with the merger prior to the vesting of the contributed amounts. Also, on June 3, 2007, the Board approved the contribution and crediting of the Company contributions to be made to the Deferred Compensation Plan pursuant to the Retention Arrangement for Mr. Tufano to Mr. Tufano s deferred compensation account as of June 3, 2007, subject to the terms and conditions of the Deferred Compensation Plan. The Board also

approved accelerated vesting of all Company contributions to the Deferred Compensation Plan, including Company contributions credited to Mr. Tufano's account under the Deferred Compensation Plan pursuant to the Retention Arrangement, if the Deferred Compensation Plan is terminated. The Board approved these changes to Mr. Tufano's Retention Arrangement to reflect the importance to the Company and its stockholders of retaining Mr. Tufano, in light of the fact that the contribution trigger, namely the appointment of a new Chief Executive Officer, might not occur in light of the pending merger with Flextronics and that the Deferred Compensation Plan could be terminated in connection with the merger prior to the vesting of the contributed amounts. In addition, the Committee adopted resolutions to clarify its original intent when it adopted the Retention Arrangements for Mr. Tufano and the senior executives, namely that such contribution amounts and the equity awards made or to be made to each individual pursuant to the Retention Arrangements would vest in full upon a termination of such individual's employment under circumstances that would otherwise entitle the individual to severance payments pursuant to his employment agreement.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

We provide a range of worldwide manufacturing and integrated supply-chain services to companies who design and market electronic products. Our revenue is generated from sales of our services primarily to customers in the Computing & Storage, Networking, Communications, Consumer, Industrial, Automotive, Medical and other markets. As a result of the services we perform for our customers, we are impacted by our customers' ability to appropriately predict market demand for their products. While we work with our customers to understand their demand needs, we are removed from the actual end-market served by our customers. Consequently, determining future trends and estimates of activity can be difficult.

On March 9, 2007, Solectron launched the Cisco Systems Lean Initiative. This initiative required us to purchase PCBA boards that were previously sold to Cisco Systems. As a result, the Company had a net reduction of revenue of \$240.7 million and an increase to inventories of \$260.3 million for the second quarter of fiscal 2007. In addition, during the third quarter of fiscal 2007, the Company purchased \$74.4 million of inventory from third party suppliers in connection with the initiative. Under the Cisco Systems Lean Initiative, Solectron is required to complete the building of systems and boxes. Systems and boxes require PCBA boards and third party built parts. Under the previous arrangement with Cisco Systems, the Company was required only to manufacture PCBA boards and if required by Cisco subsequently, the Company built systems and boxes on a consignment basis.

On June 4, 2007, it was announced that Solectron and Flextronics International Ltd. (Flextronics) entered into a definitive agreement for Flextronics to acquire Solectron. Under the terms of the definitive agreement, unanimously approved by the Boards of Directors of both companies, stockholders of Solectron will receive total consideration currently valued at approximately \$3.7 billion, based on the closing price of Flextronics ordinary shares on June 1, 2007. Upon consummation of the merger each share of common stock of Solectron will be converted into the right to receive, at the election of each of the individual holders of Solectron shares, either, but not a combination of (i) 0.3450 shares of Flextronics or (ii) a cash payment of \$3.89 per share, subject to the limitation that not more than 70% in the aggregate and no less than 50% in the aggregate of Solectron shares will be converted into shares of Flextronics. Completion of the merger is subject to customary conditions, including the approval of the stockholders of Solectron and Flextronics and the receipt of applicable regulatory approvals and clearances.

Summary of Results and Key Performance Indicators

The following table sets forth, for the three and nine month periods indicated, certain key operating results and other financial information (in millions):

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Net sales	\$ 2,985.3	\$ 2,702.6	\$ 8,886.3	\$ 7,658.6
Gross profit	151.4	142.2	453.6	396.8
Selling, general and administrative expense	112.1	112.2	338.6	323.9
Income from continuing operations	12.2	42.4	34.4	79.7

Management regularly reviews financial and non-financial performance indicators to assess the Company's operating results. The following table sets forth, for the quarterly periods indicated, certain of management's key financial performance indicators.

	Three Months Ended				
	June 1, 2007	March 2, 2007	November 24, 2006	August 25, 2006	May 26, 2006
Inventory turns	6.2 turns	6.5 turns	7.3 turns	7.3 turns	7.2 turns
Days sales outstanding (DSO)	44 days	45 days	44 days	43 days	42 days
Days payable outstanding (DPO)	63 days	59 days	52 days	53 days	54 days
Cash-to-cash cycle (C2C)	38 days	42 days	41 days	39 days	38 days
Capital expenditures (in millions)	\$ 42.4	\$ 50.0	\$ 33.4	\$ 40.9	\$ 46.0

Table of Contents

Inventory turns are calculated as the ratio of cost of sales compared to the average inventory for the quarter. DSO is calculated as the ratio of average accounts receivable, net, for the quarter compared to average daily net sales for the quarter. DPO is calculated as the ratio of average accounts payable during the quarter compared to average daily cost of sales for the quarter. The decrease in inventory turns and the increase in DPO for the three months ended June 1, 2007 and March 2, 2007 compared to the three months ended November 24, 2006 were a result of the Cisco Systems Lean Initiative launched in the second quarter of fiscal 2007, in which the Company repurchased \$260.3 million of inventory in the second quarter of fiscal 2007 and purchased \$74.4 million of inventory from third-party suppliers in the third quarter of fiscal 2007. The C2C cycle is determined by taking the ratio of 360 days compared to inventory turns plus DSO minus DPO. The calculation of the C2C cycle for the three months ended June 1, 2007 used 90 days rather than the number of days in the 14-week period that ended on March 2, 2007. Capital expenditures are primarily related to building and improvements, equipment purchases supporting replacement of aged equipment, increased demand in certain products, new programs and information technology projects.

Critical Accounting Policies and Estimates

Management is required to make judgments, assumptions and estimates that affect the amounts reported when we prepare consolidated financial statements and related disclosures in conformity with generally accepted accounting principles in the United States. Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended August 25, 2006, describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. Estimates are used for, but not limited to, our accounting for revenue recognition, inventory valuation, allowance for doubtful accounts, goodwill, intangible assets, restructuring and related impairment costs, income taxes, loss contingencies and stock-based compensation. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

Solectron principally generates revenues from the manufacture of products for customers, the repair of both in-warranty and out-of-warranty products, and the provision of supply chain services. The Company also derives revenues from sales of certain inventory, including raw materials, to customers who reschedule, amend or cancel purchase orders after we have procured inventory to fulfill their purchase orders. The Company recognizes manufacturing revenue, net of estimated product return costs, when it ships goods or the goods are received by its customer, title and risk of ownership have passed, the price to the buyer is fixed or determinable and recoverability is reasonably assured. Generally, there are no formal customer acceptance requirements related to manufacturing services. If such requirements or obligations exist, then the Company recognizes revenues at the time when such requirements are completed and the obligations are fulfilled. The Company recognizes service revenue when the services have been performed, and the related costs are expensed as incurred.

We record reductions to revenue for customer incentive programs in accordance with the provisions of Emerging Issues Task Force (EITF) Issue No. 01-09, Accounting for Consideration Given from a Vendor to a Customer (Including a Reseller of the Vendor's Products). Such incentive programs include premium payments and rebates. Premium payments are up-front payments to customers at program inception, made as a part of a competitive bidding arrangement, and sometimes in lieu of acquiring manufacturing assets and workforce from the customer. Premium payments are recognized either up-front or over time based on the terms of the customer agreement. In order to recognize a premium over time, the customer agreement must clearly state that we are entitled to a refund of the premium payment from the customer, either pro rata or otherwise, if certain production levels are not achieved. Where such contractual recovery provisions exist, we believe that a probable future economic benefit exists and, thus, establish an asset, which is amortized against revenue as product or service delivery occurs under the contract. When

the contractual recovery provisions do not exist, we record the premium payment as an immediate up-front reduction of revenues. For those incentives that require the estimation of future sales, such as for rebates, we use historical experience and internal and customer data to estimate the sales incentive

Table of Contents

at the time revenue is recognized. In the event that the actual results of these items differ from the estimates, adjustments to the sales incentive accruals are recorded. To date, these adjustments have not been material.

From time to time, Solectron includes an extended warranty at the time of product shipment. The revenue associated with the extended warranty is deferred and recognized over the extended warranty period.

Certain customer arrangements require evaluation of the criteria outlined in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal Versus Net as an Agent*, in determining whether it is appropriate to record the gross amount of sales and related costs or the net amount earned as commissions. Generally, when Solectron is primarily obligated in a transaction, is subject to general and physical inventory risk, has latitude in establishing prices, has discretion in selecting suppliers, changes the product or performs the service, is involved in the determination of product or service specifications, and has credit risk, or has several but not all of these indicators, revenue is recorded gross. If several of these indicators are not present, Solectron generally records the net amounts as commissions earned. For example, in a situation where a customer retains ownership of the materials utilized in their products, Solectron would generally only recognize revenue on a net basis.

In June 2006, the EITF reached a consensus on EITF Issue No. 06-03, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF 06-03). EITF 06-03 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The provisions of EITF 06-03 were adopted by Solectron in the third quarter of fiscal 2007. Taxes assessed by a governmental authority on revenue transactions between Solectron and its customers are presented on a net basis.

Inventory Valuation

Our inventories are stated at the lower of weighted average cost or market. Our industry is characterized by rapid technological change, short-term customer commitments and rapid changes in demand, as well as other factors that may influence the recoverability of inventories. We make provisions for estimated excess and obsolete inventory based on our regular reviews of inventory quantities on hand and the latest forecasts of product demand and production requirements from our customers. Our provisions for excess and obsolete inventory are also impacted by our contractual arrangements with our customers including our ability or inability to re-sell such inventory to them. If actual market conditions or our customers' product demands are less favorable than those projected or if our customers are unwilling or unable to comply with any contractual arrangements related to excess and obsolete inventory, additional provisions may be required. If an additional 0.2% to 0.5% of our inventory were determined to be excess and obsolete at June 1, 2007, our gross profit and operating income from continuing operations before income taxes for the three months ended June 1, 2007 would have each decreased by \$3.7 million to \$9.2 million.

Allowance for Doubtful Accounts

Another area of judgment affecting reported revenue and net income is management's estimate of receivables that will ultimately be collected. We evaluate the collectibility of our accounts receivable based on a combination of factors. This risk is mitigated by (i) sales to well-established companies, (ii) ongoing credit evaluation of our customers, and (iii) frequent contact with our customers, especially our most significant customers, which enables us to monitor current changes in business operations and to respond accordingly. When we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations to us, we record a specific allowance against amounts due to us and thereby reduce the net receivable to the amount we reasonably believe is likely to be collected. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are

outstanding, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, additional allowances may be required. Using this information, management reserves an amount that is believed to be uncollectible. Based on management's analysis of uncollectible accounts, reserves totaling

Table of Contents

\$7.2 million or 0.5% of the gross accounts receivable balance were established at June 1, 2007, compared with \$14.5 million or 1.0% of the gross accounts receivable balance at August 25, 2006.

Goodwill

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), we review the carrying amount of goodwill for impairment on an annual basis during the fourth quarter (as of June 1). Additionally, we perform an impairment assessment of goodwill whenever events or changes in circumstances indicate that the carrying value of goodwill may not be recoverable. Significant changes in circumstances can be both internal to our strategic and financial direction, as well as changes to the competitive and economic landscape. We have determined that there is a single reporting unit for the purpose of goodwill impairment tests under SFAS No. 142. For purposes of assessing the impairment of our goodwill, we estimate the value of the reporting unit using our market capitalization as the best evidence of fair value. This fair value is then compared to the carrying value of the reporting unit. If the fair value of the reporting unit is less than its carrying value, we then allocate the fair value of the unit to all the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit's fair value was the purchase price to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of the goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The process of evaluating the potential impairment of goodwill is subjective and requires judgment at many points during the test including future revenue forecasts, discount rates and various reporting unit allocations.

Impairment of Long-Lived and Intangible Assets

Solectron evaluates long-lived assets, such as property, plant and equipment and intangible assets obtained in acquisitions such as supply agreements, intellectual property, and contractual and non-contractual customer relationships for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). When conducting our impairment analysis, assets are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets or liabilities. Intangible assets subject to impairment testing whenever events or changes in circumstances indicate total \$26.7 million as of June 1, 2007. We assess the fair value of the assets based on the undiscounted future cash flow the assets are expected to generate and recognize an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When we identify an impairment, we reduce the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach, or, when available and appropriate, to comparable market values. There is significant judgment involved in determining these cash flows.

Restructuring and Related Impairment Costs

Over the past few years, we have recorded restructuring and impairment costs as we rationalized our operations in light of customer demand declines and the economic downturn. These measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, were largely intended to align our capacity and infrastructure to anticipated customer demand and transition our operations to lower cost regions. These restructuring measures were undertaken in accordance with restructuring plans that were reasonable, probable and unlikely of significant change at the time of plan establishment. These restructuring and impairment costs include employee severance and benefit costs, costs related to leased facilities abandoned and subleased, impairment of owned facilities no longer used by us which will be disposed, costs related to leased equipment that has been abandoned, and impairment of owned equipment that will be disposed. For owned facilities and equipment, the impairment loss

recognized was based on the fair value less costs to sell, with fair value estimated based on existing market prices for similar assets.

Severance and benefit costs have been recorded in accordance with SFAS No. 112, Employer's Accounting for Postemployment Benefits, as we concluded that we had a substantive severance plan based on past

Table of Contents

restructuring actions in many of the geographies in which we operate. These costs are recognized when Solectron management has committed to a formal restructuring plan and the severance costs are probable and estimable. We apply the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* relating to one-time termination benefits to both (1) severance activities in geographies where we do not have a substantive severance plan and (2) situations in which the severance benefits offered to employees within a given geography are in excess of those offered under prior restructuring plans. Severance costs accounted for under SFAS No. 146 are recognized when Solectron management having the appropriate authorization has committed to a restructuring plan and communicated those actions to employees. Our estimate of severance and benefit costs assumptions are subjective as they are based on estimates of employee attrition and assumptions about future business opportunities.

In accordance with SFAS No. 146, the estimated lease loss accrued for leased facilities abandoned and subleased after December 31, 2002 represents the fair value of the lease liability as measured by the present value of future lease payments subsequent to abandonment less the present value of any estimated sublease income. For those facilities abandoned and subleased before January 1, 2003, as part of restructuring activities under EITF Issue No. 94-3,

Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity, the estimated lease loss represents payments subsequent to abandonment less any estimated sublease income. In order to estimate future sublease income, we work with real estate brokers to estimate the length of time until we can sublease a facility and the amount of rent we can expect to receive. Estimates of expected sublease income could change based on factors that affect our ability to sublease those facilities such as general economic conditions and the real estate market, among others.

Other exit costs include costs to consolidate facilities or close facilities and relocate employees. A liability for such costs is recorded at its fair value in the period in which the liability is incurred.

At each reporting date, we evaluate our accruals for exit costs and employee separation costs to ensure the accruals are still appropriate. In certain circumstances, accruals are no longer required because of efficiencies in carrying out the plans or because employees previously identified for separation resigned and did not receive severance or were redeployed due to circumstances not foreseen when the original plans were initiated. If necessary, we reverse accruals through the income statement line item entitled *restructuring and impairment costs*, where the original charges were recorded, when it is determined that they are no longer required.

Income Taxes

We currently have significant deferred tax assets in certain jurisdictions resulting from tax credit carry forwards, net operating losses and other deductible temporary differences, which will reduce taxable income in such jurisdictions in future periods. We have provided valuation allowances for future tax benefits resulting from U.S. and certain foreign net operating loss carry-forwards and for certain other U.S. and foreign deductible temporary differences where we believe future realizability is in doubt. SFAS No. 109 requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized, and further provides that it is difficult to conclude that a valuation allowance is not needed when there is negative evidence in the form of cumulative losses in recent years. Therefore, cumulative losses weigh heavily in the overall assessment. In the third quarter of fiscal year 2003, we established a valuation allowance for most of our deferred tax assets. This was primarily due to cumulative losses from prior years and uncertainty regarding our ability to generate certain minimum levels of taxable income within the next three years. We have not yet established a sustained level of profitability since that time in those countries in which the deferred tax assets arose and thus expect to record a full valuation allowance on future tax benefits. Our ability to realize sustained profitability in those jurisdictions in the near term is uncertain as Solectron derives the majority of its revenue from low-cost locations. It is these low-cost locations where Solectron anticipates reporting taxable profits. Solectron will not be able to offset any tax expense associated with these taxable profits with the unrecognized deferred tax assets described above. As a result of our assessment, our total valuation allowance on

deferred tax assets arising from continuing operations is approximately \$1.6 billion as of June 1, 2007.

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide income tax provision and evaluating tax positions. There are many transactions and calculations where the ultimate tax determination is uncertain and we are regularly under audit by tax authorities.

Table of Contents

Accordingly, we have established contingency reserves for income taxes in various jurisdictions in accordance with SFAS No. 5 Accounting for Contingencies.

We believe that our accruals for tax liabilities are adequate for all open years, based on our assessment of many factors, including past experience and interpretations of tax law applied to the facts of each matter. Although we believe that our accruals for tax liabilities are reasonable, tax regulations are subject to interpretation and the tax controversy process is inherently uncertain; therefore, our assessments can involve both a series of complex judgments about future events and rely heavily on estimates and assumptions. To the extent that the probable tax outcome of these matters changes, such changes in estimates will impact the income tax provision in the period in which such determination is made.

In the quarter ended May 26, 2006, the IRS completed its field examination of the Company's federal income tax returns for fiscal years 2001 and 2002 and issued a Revenue Agent's Report (RAR). The RAR is not a final Statutory Notice of Deficiency, and we filed a protest during the quarter ended August 25, 2006 to protest certain of the proposed adjustments with the Appeals Office of the IRS. The most significant of the disputed adjustments relates to transfer pricing arrangements that the Company has with its foreign subsidiaries. We believe that the proposed IRS adjustments are inconsistent with applicable tax laws, and that we have meritorious defenses to the proposed adjustments.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business (for example, environmental and legal matters). We consider the likelihood of the loss occurring and our ability to reasonably estimate the amount of loss in determining the necessity for, and amount of, any loss contingencies. Estimated loss contingencies are accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate information available to us to determine whether any such accruals should be adjusted. Such revisions in the estimates of the potential loss contingencies could have a material impact on our consolidated results of operations and financial position.

Stock-Based Compensation

We account for stock-based compensation in accordance with SFAS No. 123R (revised 2004), Share-Based Payment (SFAS 123R). Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards at the grant date requires judgment, including estimating our stock price volatility and employee stock option exercise behaviors.

Our expected volatility is based upon equal weightings of the historical volatility of Solectron's stock and, for fiscal periods in which there is sufficient trading volume in options on Solectron's stock, the implied volatility of traded options on Solectron stock having a life of more than 6 months.

The expected life of options is based on observed historical exercise patterns, which can vary over time.

As stock-based compensation expense recognized in the Consolidated Statement of Operations is based on awards ultimately expected to vest, the amount of expense has been reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

If factors change and we employ different assumptions in the application of SFAS No. 123R, the compensation expense that we record in future periods may differ significantly from what we have recorded in the current period.

Results of Operations

In past filings, for clarity of presentation, Solectron's third quarter of fiscal 2006 was presented as having ended on May 31, 2006 rather than the actual close date of May 26, 2006. In these condensed consolidated financial statements, the third quarter of fiscal 2006 is presented as having ended on the actual close date of May 26, 2006. Solectron uses a 52- to 53-week fiscal year ending on the last Friday in August. The Company's second quarters of

Table of Contents

fiscal 2007 and 2006 ended on March 2, 2007 and February 24, 2006 and contained 14 weeks and 13 weeks, respectively. The additional week is reflected in the nine months results presented for the fiscal period ended June 1, 2007. It is not possible to quantify the impact of this additional week on the fiscal period ended June 1, 2007.

The following table summarizes certain items in the condensed consolidated statements of operations as a percentage of net sales. The financial information and the discussion below should be read in conjunction with the accompanying condensed consolidated financial statements and notes thereto. The discussion following the table is provided separately for continuing and discontinued operations. For all periods presented, our condensed consolidated statements of operations exclude the results from certain operations we plan to divest which have been classified as discontinued operations. Information related to the discontinued operations results is provided separately following the continuing operations discussion below.

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	94.9	94.7	94.9	94.8
Gross profit	5.1	5.3	5.1	5.2
Operating expenses:				
Selling, general and administrative	3.8	4.2	3.8	4.2
Restructuring and impairment costs	1.0	0.1	0.9	0.1
Operating income	0.3	1.0	0.4	0.9
Interest income	0.3	0.5	0.2	0.5
Interest expense	(0.2)	(0.3)	(0.2)	(0.3)
Other income (expense) net	0.3		0.1	
Operating income from continuing operations before income taxes	0.7	1.2	0.5	1.1
Income tax expense	0.3	(0.4)	0.1	
Income from continuing operations	0.4%	1.6%	0.4%	1.1%
Discontinued operations:				
Income from discontinued operations, income taxes of \$0				0.2
Income from discontinued operations	%	%	%	0.2%
Net income	0.4%	1.6%	0.4%	1.3%

Net Sales Continuing Operations

Net sales increased \$282.7 million, or 10.5%, and \$1,227.7 million, or 16.0%, for the three and nine months ended June 1, 2007, respectively, as compared to the three and nine months ended May 26, 2006. The consumer market decreased by \$19.6 million, or 6.2% for the three months ended June 1, 2007 and increased \$201.2 million, or 26.4%, for the nine months ended June 1, 2007, as compared to the corresponding periods in fiscal 2006. The decrease in

consumer end market revenue experienced in the three months ended June 1, 2007 primarily resulted from a decrease in seasonal demand and transitions to newer models. Consumer end market revenue grew in the nine months ended June 1, 2007 primarily due to new program wins and increases with existing customers in set-top boxes. Computing and storage end market revenues increased by \$96.1 million, or 11.0%, and \$387.9 million, or 15.4%, respectively, in the three and nine months June 1, 2007 as compared to the corresponding periods in fiscal 2006. The increase in computing and storage revenues was largely related to the new product-program wins with existing customers for both periods under comparison. Communication market revenues increased by \$54.1 million, or 10.4%, and \$338.7 million, or 23.7%, respectively, in the three and nine months ended June 1, 2007 as compared to the corresponding periods in fiscal 2006. Revenue increases in the communications market were primarily due to new program wins experienced during both periods. Industrial and other revenues increased by \$27.3 million, or

Table of Contents

7.7%, and \$90.4 million, or 9.1%, respectively, in the three and nine months ended June 1, 2007, as compared to the corresponding periods of fiscal 2006. The increase in industrial and other revenues was primarily due to new customer wins and organic demand growth with existing customers. Networking revenues increased \$124.7 million or 19.5%, and \$209.3 million or 10.8%, respectively, for the three and nine months ended June 1, 2007, as compared to the corresponding periods in 2006. The increase in networking revenues for the three- and nine-month periods under comparison was attributable to growth in Cisco's existing programs with us.

The following table depicts, for the periods indicated, revenue by market expressed as a percentage of net sales. The distribution of revenue across our markets has fluctuated, and will continue to fluctuate, as a result of customer demand.

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Computing & Storage	32.6%	32.4%	32.8%	33.0%
Networking	25.6%	23.6%	24.2%	25.4%
Communications	19.3%	19.3%	19.9%	18.6%
Consumer	9.9%	11.6%	10.9%	10.0%
Industrial	8.4%	9.1%	8.2%	8.5%
Automotive	2.1%	2.0%	1.9%	2.7%
Other	2.1%	2.0%	2.1%	1.8%
Total	100.0%	100.0%	100.0%	100.0%

International Sales – Continuing Operations

In the three and nine months ended June 1, 2007, our international locations contributed approximately 69.5% and 70.1% of net sales compared to approximately 70.9% and 68.8% for the corresponding periods of fiscal 2006.

Major Customers – Continuing Operations

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

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Cisco Systems	19.7%	16.3%	17.6%	17.1%
Nortel Networks	*	*	*	10.3%
Hewlett-Packard	10.2%	*	10.1%	*

(*) Less than 10%

Our top ten customers accounted for approximately 64.1% and 63.1% of net sales for the three and nine months ended June 1, 2007, compared to approximately 61.4% and 61.1% of net sales in the corresponding periods of fiscal 2006. We cannot guarantee that these or any other customers will not increase or decrease as a percentage of our consolidated net sales either individually or as a group. Consequently, any material decrease in sales to these or other customers could materially harm our consolidated results of operations.

We believe our ability to grow depends on increasing sales to existing customers and on successfully attracting new customers. Customer contracts can be canceled and volume levels can be changed or delayed by our customers. The timely replacement of delayed, canceled or reduced orders with new business cannot be assured. In addition, we have no assurance that any of our current customers will continue to utilize our services. Consequently, in the event one or more of our current customers terminate or reduce their use of our services, our consolidated results of operations may be materially adversely affected.

Table of Contents

Gross Profit Continuing Operations

Gross profit varies from period to period and is affected by a number of factors, including product mix, production efficiencies, component costs and delivery linearity, product life cycles, unit volumes, expansion and consolidation of manufacturing facilities, utilization of manufacturing capacity, pricing, competition, and anticipated restructuring or inventory charges.

Our gross profit percentage decreased to 5.1% for the three months ended June 1, 2007 as compared to 5.3% for the corresponding period in fiscal 2006. The decrease in the three months ended June 1, 2007 in gross profit percentage is primarily attributable to execution and supply chain issues at certain services sites. Our gross profit percentage of 5.1% for the nine months ended June 1, 2007, is comparable to the corresponding period in fiscal 2006.

Sales of inventory previously written down or written off have not been significant and have not had any material impact on our gross profit for the three or nine months ended June 1, 2007.

Selling, General and Administrative (SG&A) Expenses Continuing Operations

SG&A expenses amounted to \$112.1 million and \$112.2 million for the three months ended June 1, 2007 and 2006, respectively. SG&A expenses increased \$14.7 million, or 4.5%, for the nine months ended June 1, 2007, compared to the corresponding period in fiscal 2006. As a percentage of net sales, SG&A expenses decreased to 3.8% and 3.8% for the three and nine months ended June 1, 2007 as compared to 4.2% for the three months ended May 26, 2006 and 4.3% for the nine months ended May 26, 2006. The decrease as a percentage of net sales was primarily attributable to an increase in net sales for the three and nine months ended June 1, 2007.

Restructuring and Impairment Continuing Operations

Total restructuring and impairment charges were \$29.6 million and \$80.7 million during the three and nine months ended June 1, 2007, respectively.

During the third quarter of fiscal 2007, the Company incurred restructuring costs of approximately \$29.6 million primarily related to \$25.9 million of severance expenses resulting from the adoption of the Fiscal Year 2007 Phase I and Phase II Restructuring Plans. In addition, restructuring costs included the following: \$0.9 million of charges arising from the disposition of a leased facility and changes in estimates for lease termination costs on restructured facilities; \$2.0 million of transfer and other exit costs; and \$0.8 million of equipment and facilities impairment charges.

The restructuring and impairment charges of \$2.6 million incurred during the third quarter of fiscal 2006 primarily related to Fiscal Year 2005 Restructuring Plan consisted of \$1.8 million of charges arising from the abandonment of a leased facility and changes in lease estimates relative to restructured facilities; \$0.8 million of transfer and other exit costs; \$0.2 million of equipment and facilities impairment charges; and a net reduction to the severance provision of \$0.2 million due to changes in planned severance actions. Included in these amounts is a \$0.7 million reversal related to a release of an accrual established under acquisition accounting that is no longer required.

Fiscal Year 2007 Phase II Restructuring Plan

On March 26, 2007, the Solectron Board of Directors approved the Fiscal Year 2007 Phase II Restructuring Plan, pursuant to Solectron's phased approach to restructuring announced in the first quarter of fiscal 2007, to further optimize its global footprint and reduce its cost structure. Solectron estimates that total charges related to this phase of restructuring will be between \$35 million to \$45 million, of which approximately 90% represents cash expenditures.

The restructuring plan consists of the following measures:

Close or consolidate approximately 400,000 square feet of facilities in Western Europe and North America.

Reduce approximately 1,300 to 1,500 employees at the facilities being closed or consolidated.

Table of Contents

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

Total estimated charges consist of (i) \$23 million to \$30 million related to severance costs, (ii) \$9 million to \$12 million related to leased facility liabilities and transfer and other exit costs and (iii) an estimated non-cash charge of \$3 million related to disposition or impairment of facilities and equipment, \$1.3 million of which was impaired at the end of the second quarter of fiscal 2007.

Cumulative restructuring costs recorded under the Fiscal 2007 Phase II Restructuring Plan as of June 1, 2007 were \$25.4 million. This consisted of \$23.7 million in severance, \$1.3 million in impairment charges on facilities and equipment (impaired at the end of the second quarter of fiscal 2007) and \$0.4 million of transfer costs, other expenses and leased facilities expenses.

As of June 1, 2007, Solectron has reduced its workforce by 90 personnel in connection with this plan and expects to reduce headcount by an additional 1,200 to 1,400 personnel prior to the completion of this plan. The remaining accrual balance of \$22.4 million consists primarily of existing severance commitments for 1,200 to 1,400 personnel, the majority of which will be paid by December 31, 2007.

Currently, Solectron estimates that the Fiscal Year 2007 Phase II Restructuring Plan will realize a savings of approximately \$0.005 per share quarterly once fully implemented due to reductions in workforce, facility, lease and depreciation expenses. Cash payments associated with the Fiscal Year 2007 Phase II Restructuring Plan scheduled in the next 12 months, which have already been accrued for, are expected to be \$22 million

Fiscal Year 2007 Phase I Restructuring Plan

On October 2, 2006, the Solectron Board of Directors approved the Fiscal Year 2007 Phase I Restructuring Plan to optimize its global footprint and reduce its cost structure. Solectron anticipates that total charges related to this restructuring plan will be between \$50 million to \$60 million. Total estimated charges consist of (i) \$32 million to \$39 million related to severance costs, (ii) \$10 million to \$13 million related to leased facility liabilities and transfer and other exit costs and (iii) an estimated non-cash charge of \$8 million related to disposition of facilities and equipment. The restructuring plan consists of the following measures:

Closing or consolidating approximately 700,000 square feet of facilities in Western Europe and North America.

Reducing approximately 1,200 to 1,400 employees at the facilities being closed or consolidated. Although there may be a potential decrease from the original plan estimate of 1,400 employees, severance costs will still be in the range provided.

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

Cumulative restructuring costs recorded under the Fiscal 2007 Phase I Restructuring Plan as of June 1, 2007 were \$50.0 million. This consists of \$39.1 million in severance, \$5.1 million in impairment charges on facilities and equipment (which includes \$3.1 million recorded in the last quarter of fiscal year 2006), and \$5.8 million of transfer costs, other expenses and leased facilities expenses.

As of June 1, 2007, Solectron has reduced its workforce by 1,050 personnel in connection with this plan and expects to reduce headcount by an additional 150 to 350 personnel prior to the completion of this plan. The remaining accrual balance of \$13.1 million is primarily related to existing severance commitments for 150 to 350 personnel, the majority of which will be paid by November 30, 2007.

In certain circumstances, severance accruals may not be required. This may result from re-employment outside of Solectron or failure to file for severance benefits. When it is determined that accruals are no longer required in these situations, the Company reverses the accruals through the income statement line item originally charged. The restructuring plan is expected to be complete within 12 months of the October 2006 Board approval of the plan.

Table of Contents

Currently, Solectron estimates that the Fiscal Year 2007 Phase I Restructuring Plan will realize a savings of approximately \$0.01 per share quarterly once fully implemented due to reductions in workforce, facility, lease and depreciation expenses. Cash payments associated with the Fiscal Year 2007 Phase I Restructuring Plan scheduled in the next 6 months, which have already been accrued for, are expected to be \$11 million.

We continue to evaluate our operations and we may propose future restructuring actions as a result of changes in market conditions and footprint alignment with our customers' production needs.

Interest Income – Continuing Operations

Interest income decreased \$4.8 million to \$7.5 million for the three months ended June 1, 2007 from \$12.3 million in the corresponding period in fiscal 2006 as a result of the Company liquidating its short-term investments during the second quarter of fiscal 2007. Interest income decreased \$11.6 million to \$25.1 million for the nine months ended June 1, 2007 from \$36.7 million in the corresponding period in fiscal year 2006. For the nine months ended June 1, 2007, the decrease in interest income was primarily due to lower cash balances and lower effective yield in the first, second and third quarter of fiscal 2007, when compared to the corresponding periods in fiscal 2006.

Interest Expense – Continuing Operations

Interest expense decreased \$1.7 million to \$5.5 million for the three months ended June 1, 2007 from \$7.2 million in the corresponding period in fiscal 2006. For the nine months ended June 1, 2007, interest expense decreased \$2.9 million to \$17.9 million from \$20.8 million in the corresponding period in fiscal 2006. The decreases were primarily due to the Company's redemption of its ACES debentures in the first quarter of fiscal 2007.

Other Income (Expense) – net – Continuing Operations

Other income (expense) – net amounted to income of \$8.7 million and \$5.9 million for the three and nine months ended June 1, 2007, respectively. Other income (expense) – net amounted to expense of \$0.8 million for the three and nine months ended June 1, 2006. Other income (expense) – net, for the three months ended June 1, 2007 consisted primarily of foreign currency gains of \$10.9 million due to the favorable fluctuations in the foreign currencies of certain regions where the Company does not hedge; offset by \$2.2 million of miscellaneous items.

Income Taxes – Continuing Operations

Our income tax expense was \$8.2 million and \$13.0 million for the three and nine months ended June 1, 2007, respectively, as compared to \$10.7 million income tax benefit and \$0.8 million income tax benefit for the three and nine months ended May 26, 2006, respectively. We incurred net tax expense in certain countries in which we had profitable operations during the periods ended June 1, 2007 and May 26, 2006. Income tax expense for the nine months ended June 1, 2007 includes the recognition of benefits of \$4.4 million associated with a refund of taxes paid on the earnings by reinvesting the earnings of a foreign subsidiary.

The effective income tax rate is largely a function of the balance between income and losses from international and domestic operations. Our international operations, taken as a whole, have been subject to tax at a lower rate than operations in the United States, primarily due to tax holidays granted to certain of our overseas sites in Malaysia and Singapore and from benefits resulting from reinvesting the earnings of three of our international operations. The Malaysian tax holiday is effective through January 2012, and the Singapore tax holiday is effective through March 2011. Both tax holidays are subject to certain conditions, including maintaining levels of research and development expenditures, incremental fixed asset expenditures, or qualifying headcount. During the nine months ended June 1, 2007, the Company included in its computation of its estimated annual effective income tax rate for fiscal 2007,

\$1.9 million of discrete benefit resulting from taxes refunded on previously taxed earnings by reinvesting such earnings of one of the international operations. Beginning January 1, 2007, the Company has decided to no longer apply for reinvestment of earnings, as a change in tax law eliminates the reinvestment tax refund provision for tax years beyond calendar year 2006.

Table of Contents

Certain of our offshore operations are reporting taxable profits, mostly arising in low-cost locations. Accordingly, we are recognizing some tax expense related to those operations. We will not be able to offset this tax expense with unrecognized deferred tax assets, because, for the most part, those assets did not arise in the jurisdictions where we are realizing taxable profits.

In addition, Solectron has established contingency reserves for income taxes in various jurisdictions. The estimate of appropriate tax reserves is based upon the probable amount of prior tax benefit that is at risk upon audit and upon the reasonable estimate of the amount at risk. Solectron periodically reassesses the amount of such reserves and adjusts reserve balances as necessary.

In the three months ended May 26, 2006, the IRS completed its field examination of the Company's federal income tax returns for fiscal years 2001 and 2002 and issued a Revenue Agent's Report (RAR). The RAR is not a final Statutory Notice of Deficiency, and the Company filed a protest during the quarter ended August 25, 2006 to protest certain of the proposed adjustments with the Appeals Office of the IRS. Although the outcome of the Appeals process is always uncertain, the Company believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result for these years.

During the second quarter of fiscal 2007, the IRS issued a final Statutory Notice of Deficiency for the disallowance of a loss associated with a transaction entered into by a domestic subsidiary in a tax year prior to the subsidiary's acquisition by Solectron. The Company did not record an additional accrual related to this item during the quarter, as it believes that adequate amounts of tax and interest have already been provided for. During the three months ended June 1, 2007, the Company filed a petition with the US Tax Court for redetermination of the deficiency set forth by the IRS.

In the three months ended March 2, 2007, the Company recorded an additional accrual for a potential penalty assessment by a foreign tax authority related to the late payment of withholding taxes. The recorded amount represents management's best estimate of the cost it will incur in relation to the exposure, but there is a reasonable possibility that the amounts that may be assessed will differ from the estimate.

Liquidity and Capital Resources***Cash***

Cash, cash equivalents and short-term investments remained unchanged at approximately \$1.2 billion at June 1, 2007 as compared to the balance at August 25, 2006. The table below, for the periods indicated, provides selected condensed consolidated cash flow information (in millions):

	Nine Months Ended	
	June 1, 2007	May 26, 2006
Net cash provided by (used) in operating activities of continuing operations	\$ 184.3	\$ (104.9)
Net cash used in operating activities of discontinued operations	(2.5)	(8.2)
Net cash provided by (used) in operating activities	\$ 181.8	\$ (113.1)
Net cash used in investing activities of continuing operations	\$ (94.7)	\$ (160.6)
Net cash provided by investing activities of discontinued operations		17.1

Edgar Filing: SOLECTRON CORP - Form 10-Q

Net cash used in investing activities	\$ (94.7)	\$ (143.5)
Net cash used in financing activities of continuing operations	\$ (40.8)	\$ (204.3)
Net cash provided by (used in) financing activities of discontinued operations	2.5	(8.9)
Net cash used in financing activities	\$ (38.3)	\$ (213.2)

Net cash provided by operating activities of continuing operations was \$184.3 million during the nine months ended June 1, 2007. The change in net cash from operating activities was primarily due to a \$453.6 million increase in accounts payable; non-cash depreciation and amortization charges of \$124.5 million; and a \$60.8 million increase in accrued expenses and other current liabilities. This was partially offset by a \$314.7 million increase in inventories, a \$133.6 million increase in prepaid expenses and other assets and a \$64.3 million increase in accounts

Table of Contents

receivable. The inventory and accounts payable increase was primarily attributable to the inventory purchase resulting from the launch of the Cisco Systems Lean Initiative.

Net cash used in operating activities of continuing operations was \$104.9 million during the nine months ended May 26, 2006, which was generated by a \$371.7 million increase in inventories and a \$168.2 million increase in accounts receivable. This was partially offset by non-cash depreciation and amortization charges of \$130.4 million and a \$246.6 million increase in accounts payable. The inventory and accounts payable increases were attributable to new program ramps, certain program launch delays and the creation of buffer stock to accommodate both program transfers between sites and the go-live date of a new ERP system at one of our facilities.

Net cash used in investing activities of continuing operations of \$94.7 million during the nine months ended June 1, 2007 primarily consisted of \$125.8 million in capital expenditures; \$18.1 million of acquisitions, net of cash received; and a \$13.2 million purchase of facilities previously under synthetic lease. This was offset by proceeds from the sale of property and equipment of \$24.7 million and cash provided of \$22.9 million from the sale of available for sale securities.

Net cash used in investing activities of continuing operations was \$160.6 million during the nine months ended May 26, 2006 which primarily consisted of \$155.6 million in capital expenditures.

Net cash used in financing activities of continuing operations of \$40.8 million during the nine months ended June 1, 2007 primarily consisted of \$64.3 million of payments made to redeem the 7.97% Adjustable Conversion-Rate Equity Securities (ACES) and \$10.0 million of share repurchases.

Net cash used in financing activities of continuing operations was \$204.3 million during the nine months ended May 26, 2006 and primarily consisted of \$205.7 million of share repurchases and \$150 million of payments to redeem the 7.375% Senior Notes, partially offset by \$147.4 million in net proceeds from the issuance of our 8% senior subordinated notes due 2016.

Net cash used in operating activities of discontinued operations during the nine months ended June 1, 2007 primarily relate to \$1.9 million of ongoing facility carrying costs and a payment of \$0.6 million for a sales tax assessment made on behalf of a discontinued operation.

Debt

On August 28, 2006, Solectron entered into a \$350 million Credit Agreement (the Credit Agreement) that amends and replaces a \$500 million secured revolving facility. The Credit Agreement provides for a revolving, multicurrency, secured-credit facility, which may be used to borrow revolving loans or issue standby letters of credit, subject to a \$100 million letter of credit sub-limit. The Company may request an increase in the credit facility of up to an additional \$150 million, to provide for an aggregate commitment of up to \$500 million. There are currently no revolving loans outstanding and approximately \$0.6 million in letters of credit outstanding under the Credit Agreement. The revolving loans under the Credit Agreement bear interest, at the Company's option, at either (i) the base rate, which is defined as a fluctuating rate per annum equal to the greater of (A) Bank of America N.A.'s prime rate, or (B) the average rate on overnight federal funds plus one-half of one percent, or (ii) a rate equal to (A) the London Inter-bank Offered Rate (LIBOR) plus (B) an applicable margin ranging from 1.0% to 2.0% based on Solectron's non-credit-enhanced senior unsecured long-term debt ratings. The Credit Agreement matures on August 28, 2009 and may be prepaid at any time without penalty or premium at the option of the Company.

The obligations under the Credit Agreement are guaranteed by the Company's existing and future material domestic subsidiaries, and such obligations, including the guarantees, are secured by: (i) the Company's and its domestic

subsidiaries accounts receivable, equipment and inventory, (ii) a pledge of the capital stock of the Company's material domestic subsidiaries, (iii) a pledge of 65% of the capital stock of the Company's material first-tier foreign subsidiaries, and (iv) a pledge of certain inter-company indebtedness among the Company and certain of its subsidiaries. In the event that the Company's issuer credit rating of BB/Ba3 (stable/stable) or BB-/Ba2 (stable/stable) or higher from Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, the liens on the collateral described in clause (i) above will be released. Solectron is subject to compliance with certain financial covenants set forth in this facility including, but not limited to, capital expenditures, cash interest coverage ratio and leverage ratio. Solectron was in compliance with all applicable covenants as of June 1, 2007.

Table of Contents

In addition, we had no committed foreign lines of credit and \$150.0 million in uncommitted foreign lines of credit and other bank facilities as of June 1, 2007. These lines of credit are guaranteed by Solectron. A committed line of credit obligates a lender to loan us amounts under the credit facility as long as we adhere to the terms of the credit agreement. An uncommitted line of credit is extended to us at the sole discretion of a lender. The interest rates range from the bank's prime lending rate to the bank's prime rate plus 1.0%. As of June 1, 2007, we had \$63.3 million of borrowings under uncommitted foreign lines of credit and \$2.1 million of guaranteed amounts under uncommitted foreign lines of credit.

\$64.3 million aggregate principal amount of our 7.97% ACES debentures was due November 15, 2006 and repaid per the terms of the indenture.

Restricted Cash

During the first quarter of fiscal 2006, Solectron elected to put in place a line of credit for the issuance of standby letters of credit. The letters of credit are principally related to self-insurance for workers compensation liability coverage. These standby letters of credit were previously issued under Solectron's revolving credit facility. Solectron opted to post cash collateral totaling 105% of the standby letter of credit balances in order to reduce annual issuance commissions of the standby letters of credit. Total cash collateral of \$16.8 million at June 1, 2007, is classified as restricted cash and cash equivalents in the condensed consolidated balance sheets.

Off-Balance Sheet Arrangements and Contractual Obligations

Our off-balance sheet arrangements consist of operating leases, our foreign exchange contracts (described in the "We are exposed to fluctuations in foreign currency exchange rates and interest rate fluctuations" Risk Factor), and certain indemnification provisions related to our divestitures (described in the "Discontinued Operations" section below).

A tabular presentation of our contractual obligations is provided below under "Contractual Obligations and Commitments."

Contractual Obligations and Commitments

We believe that our current cash, cash equivalents, short-term investments, lines of credit and cash anticipated to be generated from continuing operations will satisfy our expected working capital, capital expenditures, debt service and investment requirements through at least the next 12 months.

The following is a summary of certain contractual obligations and commitments as of June 1, 2007 for continuing operations:

	Total	Short-Term	Payment Due by Period					
			Q4 08	FY09	FY10	FY11	FY12	Thereafter
			(In millions)					
Debt(1)	\$ 673.8	\$ 64.0	\$ 0.1	\$ 0.5	\$ 8.2	\$ 451.0	\$	\$ 150.0
Interest expense on long-term debt	118.1	14.7	1.3	14.5	14.5	13.1	12.0	48.0
Operating lease	148.7	37.9	8.5	30.4	23.0	14.5	12.0	22.4
	18.5	8.4	1.2	3.6	3.1	1.4	0.4	0.4

Operating leases for
restructured facilities and
equipment

Purchase obligations(2)

362.8	362.3			0.5				
\$ 1,321.9	\$ 487.3	\$ 11.1	\$ 49.0	\$ 49.3	\$ 480.0	\$ 24.4	\$ 220.8	

(1) Total debt includes capital lease commitments of \$1.6 million.

(2) We have various purchase commitments for materials, supplies and services incurred during the normal course of business.

Table of Contents

Other long-term liabilities of \$36.2 million disclosed in the condensed consolidated balance sheet include deferred tax liabilities related to timing differences and non-US pension liabilities, which due to their nature are not projected.

Discontinued Operations

During fiscal 2004, as a result of a full review of our portfolio of businesses, we committed to a plan to divest a number of business operations that were no longer part of our strategic plan for the future. In accordance with SFAS No. 144, we have reported the results of operations and financial position of these businesses in discontinued operations within the consolidated statements of operations and balance sheets for all periods presented. The companies that we have divested and that are currently included in discontinued operations are Solectron's MicroTechnology division, Stream International Inc. and Force Computers, Inc.

The collective results from all discontinued operations for all periods presented were as follows (in millions):

	Three Months Ended		Nine Months Ended	
	June 1, 2007	May 26, 2006	June 1, 2007	May 26, 2006
Net sales	\$	\$	\$	\$
Cost of sales				
Gross profit				
Operating expense (income) net	0.1	0.4	1.0	(7.8)
Operating (loss) income	(0.1)	(0.4)	(1.0)	7.8
Other income net				8.9
(Loss) income before income taxes, income taxes of \$0	(0.1)	(0.4)	(1.0)	16.7
(Loss) income from discontinued operations, net of tax	\$ (0.1)	\$ (0.4)	\$ (1.0)	\$ 16.7

During the first quarter of fiscal 2007, Solectron recorded \$0.6 million of costs related to a sales tax assessment and ongoing facility carrying costs. During the second quarter of fiscal 2007, Solectron recorded \$0.3 million of costs related to a foreign tax assessment formerly associated with a discontinued operation. During the third quarter of fiscal 2007, Solectron recorded \$0.1 million of costs related to a foreign tax assessment formerly associated with a discontinued operation.

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

The sale agreements for all the divestitures contain certain indemnification provisions pursuant to which Solectron may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of

breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. In aggregate, Solectron is contingently liable for up to \$94.8 million for claims submitted within a period of 12 to 24 months subsequent to the completion of the sale. As of June 1, 2007, most of these indemnification provisions have expired, and there were no significant claims received or significant liabilities recorded under these indemnification obligations. Additionally, Solectron may be required to indemnify a buyer for certain environmental remediation costs until 2014, such indemnification not to exceed \$13 million. Solectron maintains an insurance policy to cover environmental remediation liabilities in excess of reserves previously established upon the acquisition of these properties. Solectron did not record any environmental charges upon disposition of these properties.

Table of Contents

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

We have currency exposure arising from both sales and purchases denominated in currencies other than the functional currency of our sites. Fluctuations in the rate of exchange between the currency of the exposure and the functional currency of our sites could seriously harm our business, operating results and consolidated financial condition.

As of June 1, 2007, we had outstanding foreign exchange forward contracts with a total notional amount of approximately \$423.7 million related to continuing operations. The change in value of the foreign exchange forward contracts resulting from a hypothetical 10% change in foreign exchange rates would be offset by the remeasurement of the related balance sheet items, the result of which would not be significant.

The primary objective of our investment activities is to preserve principal, while at the same time maximize yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents in a variety of securities, including government and corporate obligations, certificates of deposit and money market funds. As of June 1, 2007, substantially our entire portfolio was scheduled to mature in less than three months. A hypothetical 10% change in interest rates would not have a material effect on the fair value of our investment portfolios.

Item 4. *Controls and Procedures*

Evaluation of Disclosure Controls and Procedures. Based on their evaluation as of the end of the period covered by this Report, Solectron's principal executive officer and principal financial officer have concluded that Solectron's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) are effective to ensure that information required to be disclosed by Solectron in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in internal control over financial reporting. There were no changes in Solectron's internal control over financial reporting during the third quarter of fiscal 2007 or in other factors that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

Solectron is from time to time involved in various litigation and legal matters arising in the normal course of its business operations. Management believes that the final resolution of these matters will not have a material adverse effect on the Company's consolidated financial position, cash flows, or results of operations. By describing any particular matter, Solectron does not intend to imply that it or its legal advisors have concluded or believe that the outcome of any of those particular matters is or is not likely to have a material adverse impact upon Solectron's consolidated financial position, cash flows or results of operations.

On June 4, 2007, a purported class action complaint has been filed alleging breach of fiduciary duty of the directors of Solectron in the Superior Court of the State of California, County of Santa Clara, seeking to enjoin the proposed merger between Solectron and Flextronics. While this case is in the early stages, Solectron believes that it is without merit. Any judgments, however, in respect of this or similar lawsuits that are adverse to Flextronics and Solectron may adversely affect Flextronics and Solectron's ability to consummate the merger.

Table of Contents

Item 1a. Risk factors

The following risk factors should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that our management currently deems immaterial also may impair our business operations. If any of the risks described below were to occur, our business, operating results and consolidated financial condition could be materially adversely affected.

Risks Relating to our Business

Most of our sales come from a small number of customers; if we lose any of these customers, our net sales could decline significantly.

Most of our annual net sales come from a small number of our customers. Our ten largest customers accounted for approximately 64.1% and 61.4% of net sales from continuing operations in the third quarter of fiscal 2007 and 2006, respectively. During the third quarter of fiscal 2007, two of these customers individually accounted for more than ten percent of our net sales. Any material delay, cancellation or reduction of orders from these or other major customers could cause our sales to decline significantly, and we may not be able to reduce the accompanying expenses at the same time. We cannot guarantee that we will be able to retain any of our largest customers or any other accounts, or that we will be able to realize the expected revenues under existing or anticipated supply agreements with these customers. Our earnings per share, cash flow and results of operations will continue to depend significantly on our ability to obtain orders from new customers, retain existing customers, realize expected revenues under existing and anticipated agreements, as well as on the financial condition and success of our customers and their customers.

Our customers may cancel their orders, change production quantities or locations, or delay production.

To remain competitive, EMS companies must provide their customers increasingly rapid product turnaround, at increasingly competitive prices. We generally do not have long-term contractual commitments from our top customers. As a result, we cannot guarantee that we will continue to receive any orders or revenues from our customers. Customers may cancel orders at their sole discretion, change production quantities or delay production for a number of reasons outside of our control. Many of our customers have experienced from time to time significant decreases in demand for their products and services, as well as continual material price competition and sales price erosion. This volatility has resulted, and will continue from time to time to result, in our customers delaying purchases on the products we manufacture for them, and placing purchase orders for lower volumes of products than previously anticipated. Cancellations, reductions or delays by a significant customer or by a group of customers would seriously harm our results of operations by lowering, eliminating or deferring revenue without substantial offsetting reductions in our costs thereby reducing our profitability. In addition, customers may require that manufacturing of their products be transitioned from one of our facilities to another of our facilities to achieve cost reductions and other objectives. Such transfers, if unanticipated or not properly executed, could result in various inefficiencies and increased costs, including excess capacity and overhead at one facility and capacity constraints and related strains on our resources at the other, disruption and delays in product deliveries and sales, deterioration in product quality and customer satisfaction, and increased manufacturing and scrap costs all of which would have the effect of reducing our profits.

Our business has low operating margins and any increase in cost of sales or operating expenses could have a material adverse effect on our profitability.

Our business generates low operating margins. Increases in cost of sales or operating expenses without corresponding increases in net sales would have a material adverse effect on the profitability of the Company on a consolidated basis.

We may not be able to sell excess or obsolete inventory to customers or third parties, which could have a material adverse impact on our consolidated financial condition.

The majority of our inventory purchases and commitments are based upon demand forecasts that our customers provide to us. The customers' forecasts, and any changes to the forecasts, including cancellations,

Table of Contents

may lead to on-hand inventory quantities and on-order purchase commitments that are in excess of the customers revised needs, or on-hand inventory that becomes obsolete. If our contracts with customers do not require our customers to purchase, or our customers do not comply with contractual obligations to purchase, excess or obsolete inventory, our results of operations could be materially harmed. In recent years some of our OEM customers have experienced declining revenue, large losses, negative cash flows, and bankruptcies or defaults on borrowing arrangements. There is a risk that, in the future, these or other customers may not purchase inventory back from us despite contractual obligations, which could harm our results of operations. In addition, enforcement of these supply agreements may result in material expenses, delays in payment for inventory or disruptions in our customer relationships.

In addition, we are generally responsible for excess and obsolete inventory resulting from inventory purchases in excess of inventory needed to meet customer demand forecasts at the time the purchase commitments were made, as well as any inventory purchases outside those provided for in our agreements. For inventory which is not the customer's responsibility, provisions are made when required to reduce any such excess or obsolete inventory to its estimated net realizable value, based on the quantity of such inventory on hand, our customer's latest forecasts of production requirements, and our assessment of available disposition alternatives such as use of components on other programs, the ability and cost to return components to the vendor, and our estimates of resale values and opportunities. These assessments are based upon various assumptions and market conditions which are subject to rapid change, or which may ultimately prove to be inaccurate. Any material changes in our assumptions or market conditions could have a significant effect on our estimates of net realizable value, could necessitate material changes in our provisions for excess and obsolete inventory, and could have a material adverse impact on our consolidated financial condition. In addition, in the normal course of business, bona fide disagreements may arise over the amount or timing of such claims, and in order to avoid litigation expenses, collection risks, or disruption of customer relationships, we may elect to settle such disputes for lesser amounts than we believe we should be entitled to recover. In these instances, we must bear the economic loss of any such excess or obsolete inventory, which could have a material adverse impact on our consolidated financial condition.

We are exposed to risks associated with operating internationally.

Approximately 69.5% and 70.9% of our net sales from continuing operations are the result of services and products manufactured in countries outside the United States during the third quarter of fiscal 2007 and 2006, respectively. As a result of our foreign sales and facilities, our operations are subject to a variety of risks and costs that are unique to international operations, including the following:

adverse movement of foreign currencies against the U.S. dollar in which our results are reported;

import and export duties, and value added taxes;

import and export regulation changes that could erode our profit margins or restrict exports or imports;

potential restrictions on the transfer of funds;

government and license requirements governing the transfer of technology and products abroad;

disruption of local labor supply or transportation services;

inflexible employee contracts in the event of business downturns;

potential disruption related to organized labor stoppages;

the burden and cost of compliance with import and export regulations and foreign laws;
economic and political risks in emerging or developing economies;
risks of conflict and terrorism that could disrupt our or our customers' and suppliers' businesses; and
increased risk of improper payments or inappropriate business activities.

We have been granted tax holidays, which are effective through 2012 and 2011, subject to some conditions, for our Malaysian and Singapore sites, respectively. It is possible that the current tax holidays will be terminated or

Table of Contents

modified or that future tax holidays that we may seek will not be granted. If the current tax holidays are terminated or modified, or if additional tax holidays are not granted in the future or when our current tax holidays expire, our future effective income tax rate could increase.

Possible fluctuation of operating results from quarter to quarter and factors out of our control could affect the market price of our securities.

Our quarterly earnings or stock price may fluctuate in the future due to a number of factors including the following:

differences in the profitability of the types of manufacturing services we provide. For example, high velocity and low complexity printed circuit boards and systems assembly services have typically lower gross profit than low volume/complex printed circuit boards and systems assembly services;

our ability to maximize the hours of use of our equipment and facilities is dependent on the duration of the production run time for each job and customer;

the amount of automation that we can use in the manufacturing process for cost reduction varies, depending upon the complexity of the product being made;

our customers' demand for our products and their ability to take delivery of our products and to make timely payments for delivered products;

our ability to optimize the ordering of inventory as to timing and amount to avoid holding inventory in excess of immediate production needs;

our ability to offer technologically advanced, cost-effective, quick response manufacturing services;

our ability to drive down manufacturing costs in accordance with customer and market requirements, which is dependent upon our ability to apply Lean Six Sigma operating principles;

fluctuations in the availability and pricing of components;

timing of expenditures in anticipation of increased sales;

cyclicality in our target markets;

fluctuations in our market share;

fluctuations in currency exchange rates;

expenses and disruptions associated with acquisitions and divestitures;

announcements of operating results and business conditions by our customers;

announcements by our competitors relating to new customers, technological innovation or new services;

economic developments in the electronics industry as a whole;

credit rating and stock analyst downgrades;

our ability to successfully implement changes to our enterprise resource planning systems;
political and economic developments in countries in which we have operations; and
general market conditions.

If our operating results in the future are below the expectations of securities analysts and investors, the market price of our outstanding securities could be harmed.

Table of Contents

If we incur more restructuring-related charges than currently anticipated, our consolidated financial condition and results of operations may suffer.

We incurred approximately \$29.6 million of restructuring and impairment costs relating to continuing operations in the third quarter of fiscal 2007 and approximately \$2.6 million during the third quarter of fiscal 2006, and we anticipate incurring approximately \$16.0 million to \$24.0 million of restructuring and impairment costs in total under the Fiscal 2007 Phase I and Fiscal 2007 Phase II Restructuring Plans during the next twelve months. If our estimates about previous and currently contemplated restructuring charges prove to be incorrect, our consolidated financial condition and results of operations may suffer. While we believe our capacity is appropriate for current revenue levels, we continue to evaluate our cost structure relative to future financial results and customer demand. If our estimates about future financial results and customer demand prove to be incorrect, our consolidated financial condition and consolidated results of operations may suffer.

Failure to attract and retain key personnel and skilled associates could hurt our operations.

Our continued success depends to a large extent upon the efforts and abilities of key managerial and technical associates. Losing the services of key personnel could harm us. Our business also depends upon our ability to continue to attract and retain key executives, senior managers and skilled associates. Our failure to attract and retain key personnel, a high rate of turnover and the loss of key employees in recent quarters could harm our business. The difficult business environment associated with the EMS industry in general and the results generated by the Company in particular have made it increasingly difficult to attract and retain key personnel at compensation levels proportionate to the return provided to the Company's shareholders. This risk is particularly high as we compete for talent from a broad range of industries. While the Company established an executive retention program in the second quarter of fiscal 2007, there can be no assurance that this program will be successful in retaining the targeted executive officers. In addition, there is no guarantee that the Company will be able to attract and retain the necessary personnel in the future in a manner that does not impact the Company's profitability.

We depend on limited or sole source suppliers for critical components. The inability to obtain sufficient components as required, and under favorable purchase terms, would harm our business.

We are dependent on certain suppliers, including limited and sole source suppliers, to provide key components used in our products. We have experienced, and may continue to experience, delays in component deliveries, which in turn could cause delays in product shipments and require the redesign of certain products. In addition, if we are unable to procure necessary components under favorable purchase terms, including at favorable prices and with the order lead-times needed for the efficient and profitable operation of our factories, our results of operations could suffer. The electronics industry has experienced in the past, and may experience in the future, shortages in semiconductor devices, including application-specific integrated circuits, DRAM, SRAM, flash memory, certain passive devices such as tantalum capacitors, and other commodities that may be caused by such conditions as overall market demand surges or supplier production capacity constraints. The inability to continue to obtain sufficient components as and when required, or to develop alternative sources as and when required, could cause delays, disruptions or reductions in product shipments or require product redesigns which could damage relationships with current or prospective customers, and increase inventory levels and costs, thereby causing harm to our business.

We potentially bear the risk of price increases associated with shortages in electronics components.

At various times, there have been shortages of components in the electronics industry leading to increased component prices. One of the services that we perform for many customers is purchasing electronics components used in the manufacturing of the customers' products. As a result of this service, we potentially bear the risk of price increases for these components if we are unable to purchase components at the pricing level anticipated to support the margins

assumed in our agreements with our customers.

Table of Contents

Our net sales could decline if our competitors provide comparable manufacturing services and improved products at a lower cost.

We compete with a number of different contract manufacturers, depending on the type of service we provide or the geographic locale of our operations. Our industry is intensely competitive and many of our competitors may have greater manufacturing, financial, R&D or marketing resources than we have. In order to compete, we may have to provide our manufacturing and other services at lower margins, or we may lose customers. In addition, we may not be able to offer prices as low as some of our competitors because those competitors may have lower cost structures as a result of their geographic location or the services they provide, or because such competitors are willing to accept business at lower margins in order to utilize more of their excess capacity. In that event, our net sales would decline. We also expect our competitors to continue to improve the performance of their current products or services, to reduce their current products or service sales prices and to introduce new products or services that may offer greater value-added performance and improved pricing. If we are unable to improve our capabilities substantially, any of these could cause a decline in sales, loss of market acceptance of our products or services and corresponding loss of market share, or profit margin compression. We have experienced instances in which customers have transferred all or certain portions of their business to competitors in response to more attractive pricing quotations than we have been willing to offer to retain such customers, and there can be no assurance that we will not lose business in the future in response to such competitive pricing or other inducements which may be offered by our competitors.

We depend on the continuing trend of OEMs to outsource.

A substantial factor in our past revenue growth was attributable to the transfer of manufacturing and supply-based management activities from our OEM customers. Future growth is partially dependent on new outsourcing opportunities. To the extent that these opportunities are not available, our future growth would be unfavorably impacted.

Our strategic relationships with major customers create risks.

In the past several years, we completed several strategic transactions with OEM customers. Under these arrangements, we generally acquired inventory, equipment and other assets from the OEM, and leased (or in some cases acquired) their manufacturing facilities, while simultaneously entering into multi-year supply agreements for the production of their products. There has been strong competition among EMS companies for these transactions, and this competition may continue to be a factor in customers' selection of their EMS providers. These transactions contributed to a significant portion of our past revenue growth, as well as to a significant portion of our more recent restructuring charges and goodwill and intangible asset impairments. While we do not anticipate our acquisitions of OEM plants and equipment in the near future to return to the levels at which they occurred in the recent past, there may be occasions on which we determine it to be advantageous to complete acquisitions in selected geographic or industry markets. As part of such arrangements, we would typically enter into supply agreements with the divesting OEMs, but such agreements generally do not require any minimum volumes of purchases by the OEM and the actual volume of purchases may be less than anticipated. Arrangements, which may be entered into with divesting OEMs typically would involve many risks, including the following:

we may pay a purchase price to the divesting OEMs that exceeds the value we are ultimately able to realize from the future business of the OEM;

the integration into our business of the acquired assets and facilities may be time-consuming and costly;

we, rather than the divesting OEM, would bear the risk of excess capacity;

we may not achieve anticipated cost reductions and efficiencies;

we may be unable to meet the expectations of the OEM as to volume, product quality, timeliness and cost reductions; and

if demand for the OEM's products declines, the OEM may reduce its volume of purchases, and we may not be able to sufficiently reduce the expenses of operating the facility or use the facility to provide services to

Table of Contents

other OEMs, and we might find it appropriate to close, rather than continue to operate, the facility, and any such actions would require us to incur significant restructuring and/or impairment charges.

As a result of these and other risks, we may be unable to achieve anticipated levels of profitability under such arrangements and they may not result in material revenues or contribute positively to our earnings. Additionally, other OEMs may not wish to obtain logistics or operations management services from us.

Business disruptions could seriously 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 seriously harm our revenue and financial condition and increase our costs and expenses. We are predominantly self-insured for losses and interruptions caused by earthquakes, power shortages, telecommunications failures, water shortages, tsunamis, floods, typhoons, hurricanes, fires, extreme weather conditions and other natural or manmade disasters.

If we are unable to manage future acquisitions, and cost-effectively run our operations, our profitability could be adversely affected.

Our ability to manage and integrate future acquisitions will require successful integration of such acquisitions into our manufacturing and logistics infrastructure, and may require enhancements or upgrades of accounting and other internal management systems and the implementation of a variety of procedures and controls. We cannot guarantee that significant problems in these areas will not occur. Any failure to enhance or expand these systems and implement such procedures and controls in an efficient manner and at a pace consistent with our business activities could harm our consolidated financial condition and results of operations. In addition, we may experience inefficiencies from the management of geographically dispersed facilities and incur substantial infrastructure and working capital costs. We incurred approximately \$29.6 million of restructuring and impairment costs relating to continuing operations in the third quarter of fiscal 2007 and approximately \$2.6 million in the corresponding period of fiscal 2006. See also the Risk Factor entitled "If we incur more restructuring-related charges than currently anticipated, our consolidated financial condition and results of operations may suffer."

If we have a material weakness in our internal controls over financial reporting, investors could lose confidence in the reliability of our financial statements, which could result in a decrease in the value of our securities.

One or more material weaknesses in our internal controls over financial reporting could occur or be identified in the future. In addition, because of inherent limitations, our internal controls over financial reporting may not prevent or detect misstatements, and any projections of any evaluation of effectiveness of internal controls 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 our policies or procedures may deteriorate. If we fail to maintain the adequacy of our internal controls, including any failure or difficulty in implementing required new or improved controls, our business and results of operations could be harmed, we may not be able to provide reasonable assurance as to our financial results or meet our reporting obligations and there could be a material adverse effect on the price of our securities.

If our products are subject to warranty or liability claims, we may incur significant costs.

Our customers may experience defects in our designs or deficiencies with respect to our manufacturing services. We may be exposed to warranty or manufacturers' liability claims as a result of these defects or deficiencies, and some claims may relate to customer product recalls. A claim for damages arising as a result of such defects or deficiencies could have a material adverse effect on our business, results of operations and financial condition. A claim for such damages, or a product recall conducted by one of our customers, also could have an adverse effect on our business.

reputation.

In addition, as we increase our engagements with customers in the medical device and automotive industries, we may have greater exposure to product and personal injury liability claims, as well as to liabilities relating to

Table of Contents

product recalls. Any claim, regardless of merit, may be time-consuming and expensive to resolve, and a successful claim could have a material adverse effect on our results of operations and financial condition.

We may not have sufficient insurance coverage for certain of the risks and liabilities we assume in connection with the products and services we provide to our customers.

We carry various forms of business and liability insurance that we believe are typical for companies in our industry. However, we may not have sufficient insurance coverage for certain risks and liabilities we assume in connection with the products and services we provide to our customers, such as potential warranty, product liability and product recall claims. Such liability claims may only be partially covered under our insurance policies. We continue to monitor the insurance marketplace to evaluate the need to obtain additional insurance coverage in the future. Costs associated with potential claims and liabilities for which we do not have sufficient insurance coverage could have a material adverse effect on our results of operations, financial condition and liquidity.

Our design and engineering services may result in additional exposure to product liability, intellectual property infringement and other claims.

We are offering more design services, primarily those relating to products that we manufacture for our customers, and we offer design services related to collaborative design manufacturing and turnkey solutions. Providing such services can expose us to different or greater potential liabilities than those we face when providing our regular manufacturing services. With the growth of our design services business, we have increased exposure to potential product liability claims resulting from injuries caused by defects in products we design, as well as potential claims that products we design infringe third-party intellectual property rights. Such claims could subject us to significant liability for damages and, regardless of their merits, could be time-consuming and expensive to resolve. We also may have greater potential exposure from warranty claims, and from product recalls due to problems caused by product design. Costs associated with possible product liability claims, intellectual property infringement claims, and product recalls could have a material adverse effect on our results of operations.

Notwithstanding our divestiture of certain businesses in recent years, we remain subject to certain indemnification obligations for a period of time after completion of the divestitures.

The sale agreements for the businesses we divested in recent years contain indemnification provisions pursuant to which we may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. While we believe, based upon the facts presently known to us, that we have made adequate provision for any such potential indemnification obligations, it is possible that other facts may become known in the future which may subject us to claims for additional liabilities or expenses beyond those presently anticipated and provided for. Should any such unexpected liabilities or expenses be of a material amount, our finances could be adversely affected.

We are exposed to fluctuations in foreign currency exchange rates and interest rate fluctuations.

We have currency exposure arising from both sales and purchases denominated in currencies other than the functional currency of our sites. Fluctuations in the rate of exchange between the currency of the exposure and the functional currency of our sites could seriously harm our business, operating results and consolidated financial condition.

Failure to comply with environmental regulations could harm our business.

As a company in the electronics manufacturing services industry, we are subject to a variety of environmental regulations, including those relating to the use, storage, discharge and disposal of hazardous chemicals used during our manufacturing process as well as air quality and water quality regulations, restrictions on water use, and storm water regulations. We are also required to comply with laws and regulations relating to occupational safety and health, product disposal and product content and labeling. Although we have never sustained any significant loss as a result of non-compliance with such regulations, any failure by us to comply with environmental laws and

Table of Contents

regulations could result in liabilities or the suspension of production. In addition, these laws and regulations could restrict our ability to expand our facilities or require us to acquire costly equipment or incur other significant costs to comply with regulations.

We own and lease some contaminated sites (for some of which we have been indemnified by third parties for required remediation), sites for which there is a risk of the presence of contamination, and sites with some levels of contamination for which we may be liable and which may or may not ultimately require any remediation. We have obtained environmental insurance to reduce potential environmental liability exposures posed by some of our operations and facilities. We believe, based on our current knowledge, that the cost of any groundwater or soil clean up that may be required at our facilities would not materially harm our business, consolidated financial condition and results of operations. Nevertheless, the process of remediating contamination in soil and groundwater at facilities is costly and cannot be estimated with high levels of confidence, and there can be no assurance that the costs of such activities would not harm our business, consolidated financial condition and results of operations in the future.

In general, we are not directly responsible for compliance with laws like Waste Electrical and Electronic Equipment (WEEE) and Restrictions of Hazardous Substances (RoHS). However, some customers may require that we take responsibility for the non-compliance risk of some or all of the components we procure for the customer product. Solectron requires all of its suppliers to comply with all hazardous substance laws and regulations and employs inventory management processes to mitigate non-compliance risk. Failure to have the capability of delivering the products which comply with these present and future environmental laws and regulations could restrict our ability to expand facilities, or could require us to acquire costly equipment or to incur other significant expenses to comply with environmental regulations, and could impair our relations with our customers. Moreover, to the extent we are found non-compliant with any environmental laws and regulations applicable to our activities, we may incur substantial fines and penalties.

Our ongoing implementation of new enterprise resource planning (ERP) software and systems may cause disruptions in our business operations.

The ongoing implementation of new ERP software and systems at various Solectron sites domestically and internationally is a technically intensive process, requiring extensive testing, modifications, customization and project coordination. We may experience disruptions in our business operations from time to time relating to these implementation efforts or as a result of complications with the software or systems, and such disruptions may have a material adverse effect on our business, consolidated financial condition and results of operations.

We may not be able to adequately protect or enforce our intellectual property rights and could become involved in intellectual property disputes.

In the past we have been and may from time to time continue to be notified of claims that we may be infringing patents, copyrights or other intellectual property rights owned by other parties. In the event of an infringement claim, we may be required to spend a significant amount of money to develop a non-infringing alternative, to obtain licenses, or to defend against the claim. We may not be successful in developing such an alternative or obtaining a license on reasonable terms, if at all. Any litigation, even where an infringement claim is without merit, could result in substantial costs and diversion of resources. Accordingly, the resolution or adjudication of intellectual property disputes could have a material adverse effect on our business, consolidated financial condition and results of operations.

Our ability to effectively compete may be affected by our ability to protect our proprietary information. We hold a number of patents, patent applications, and various trade secrets and license rights. These patents, trade secrets, and license rights may not provide meaningful protection for our proprietary manufacturing processes, equipment

innovations and products, or we might find it necessary to initiate litigation proceedings to protect our intellectual property rights. Any such litigation could be lengthy and costly and could harm our consolidated financial condition.

Table of Contents

Rating downgrades may make it more expensive for us to borrow money.

Our senior unsecured debt was recently rated as BB- with a stable outlook by Standard and Poor's and as B1 with a positive outlook by Moody's. These credit ratings are subject to change at the discretion of the rating agencies. If our credit ratings were downgraded, it would increase our cost of capital should we borrow under our revolving lines of credit, and it may make it more expensive for us to raise additional capital in the future. Such capital raising may be on terms that may not be acceptable to us or otherwise not available. Any future adverse rating agency actions with respect to our ratings could have an adverse effect on the market price of our securities, our ability to compete for new business, our cost of capital, and our ability to access capital markets.

Unanticipated changes in our tax rates or in our exposure to additional tax liabilities could affect our operating results and financial condition.

We are subject to income taxes both in the United States and various foreign jurisdictions. Our effective tax rates could be adversely affected by changes in tax laws and increases in the percentages of our earnings from countries with higher tax rates, as well as other factors. If any of these changes were to occur, our income tax provision, operating results and financial condition could be adversely affected.

We have received an examination report from the Internal Revenue Service proposing a tax deficiency in certain of our tax returns, and the outcome may have a material adverse effect on our results of operations and cash flows.

The Internal Revenue Service (IRS) and other tax authorities regularly examine our income tax returns. In the three months ended May 31, 2006, the IRS completed its field examination of the Company's federal income tax returns for fiscal years 2001 and 2002 and issued a Revenue Agent's Report (RAR). The RAR is not a final Statutory Notice of Deficiency, and we filed a protest during the quarter ended August 25, 2006 to protest certain of the proposed adjustments with the Appeals Office of the IRS. The most significant of the disputed adjustments relates to transfer pricing arrangements that the Company has with its foreign subsidiaries. We believe that the proposed IRS adjustments are inconsistent with applicable tax laws, and that it has meritorious defenses to the proposed adjustments.

In determining the adequacy of our provision for income taxes, we regularly assess the likelihood of adverse outcomes resulting from tax examinations, including the IRS RAR for the fiscal years 2001 and 2002. Based upon that assessment, Solectron may establish contingency reserves for income taxes in various jurisdictions. The estimate of appropriate tax reserves is based upon the amount of prior tax benefit that might be at risk upon audit and the reasonable estimate of the amount at risk. However, the ultimate outcome of the tax examination process is always uncertain, including the total amount payable or the timing of any such payments upon resolution of these issues. In addition, we cannot assure you that such amount will not be materially different than that which is reflected in our historical income tax provisions and accruals. Should the IRS or other tax authorities assess additional taxes as a result of current or future examinations, we may be required to record charges to operations in future periods that could have a material impact on the results of operations, financial position or cash flows in the applicable period or periods recorded.

Risks Relating to the Proposed Merger with Flextronics

Failure to complete the merger could materially and adversely affect our results of operations and stock price.

Completion of the merger is subject to customary conditions, including the approval of the stockholders of Solectron and Flextronics and the receipt of applicable regulatory approvals and clearances. There can be no assurance that these conditions will be met or waived, that the necessary approvals will be obtained, or that we will be able to successfully

consummate the merger as currently contemplated under the merger agreement or at all.

If the merger is not consummated:

we will remain liable for significant transaction costs, including legal, accounting, financial advisory and other costs relating to the merger;

Table of Contents

under specified circumstances, we may have to pay a termination fee in the amount of \$100 million to Flextronics;

any operational investments that we may delay due to the pending transaction would need to be made, potentially on an accelerated timeframe, which could then prove costly and more difficult to implement; and

the market price of our common stock may decline to the extent that the current market price reflects a belief by investors that the merger will be completed.

Additionally, the announcement of the pending merger may lead to uncertainty for our employees and some of our customers and suppliers. This uncertainty may mean:

the attention of our management and employees may be diverted from day-to-day operations as the integration activities become more intense;

our customers and suppliers may seek to modify or terminate existing agreements, or prospective customers may delay entering into new agreements or purchasing our products as a result of the announcement of the merger; and

our ability to attract new employees and retain existing employees may be harmed by uncertainties associated with the prospective merger.

The occurrence of any of these events individually or in combination could materially and adversely affect our results of operations and the price of our common stock.

Item 6. Exhibits

INDEX TO EXHIBITS

Exhibit No	Exhibit Description
3.1*	Certificate of Incorporation of the Registrant, as amended
3.2**	Amended and Restated Bylaws of the Registrant
10.1	Employment Agreement dated April 17, 2007 by and between Registrant and Roop Kaylan Lakkaraju
10.2****	Manufacturing and Product Purchase Agreement dated as of March 9, 2007 by and among Cisco Systems International B.V., Solectron Corporation and certain signing affiliates
10.3***	Executive Retention Arrangement
10.4****	Inventory Purchase and Transfer Agreement dated as of March 11, 2007 by and between Cisco Systems International B.V. and Solectron Corporation
31.1	Certification of Chief Executive Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Edgar Filing: SOLECTRON CORP - Form 10-Q

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Incorporated by reference from Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 28, 2001, Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 25, 2000, and Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 26, 1999.

** Incorporated by reference from Exhibit 3.2 filed with Registrant's Form 10-Q for the quarter ended November 28, 2003.

*** Incorporated by reference from Registrant's Report on Form 8-K filed on March 2, 2007.

**** Pursuant to a request for confidential treatment, portions of this Exhibit have been redacted from the publicly filed document and have been furnished separately to the Securities and Exchange Commission as required by Rule 24b-2 under the Securities Exchange Act of 1934.

Table of Contents

SOLECTRON CORPORATION

SIGNATURES

Pursuant to the requirements 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.

SOLECTRON CORPORATION
(Registrant)

By: /s/ ROOP LAKKARAJU
Roop Lakkaraju
Senior Vice President and
Interim Chief Financial Officer
(Principal Financial Officer)

By: /s/ WARREN J. LIGAN
Warren J. Ligan
Senior Vice President
and Corporate Controller
(Principal Accounting Officer)

Date: July 11, 2007

Table of Contents

INDEX TO EXHIBITS

Exhibit No	Exhibit Description
3.1*	Certificate of Incorporation of the Registrant, as amended
3.2**	Amended and Restated Bylaws of the Registrant
10.1	Employment Agreement dated April 17, 2007 by and between Registrant and Roop Kaylan Lakkaraju
10.2****	Manufacturing and Product Purchase Agreement dated as of March 9, 2007 by and among Cisco Systems International B.V., Solectron Corporation and certain signing affiliates
10.3***	Executive Retention Arrangement
10.4****	Inventory Purchase and Transfer Agreement dated as of March 11, 2007 by and between Cisco Systems International B.V. and Solectron Corporation
31.1	Certification of Chief Executive Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002
32.1	Certification of 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 Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Incorporated by reference from Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 28, 2001, Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 25, 2000, and Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 26, 1999.

** Incorporated by reference from Exhibit 3.2 filed with Registrant's Form 10-Q for the quarter ended November 28, 2003.

*** Incorporated by reference from Registrant's Report on Form 8-K filed on March 2, 2007.

**** Pursuant to a request for confidential treatment, portions of this Exhibit have been redacted from the publicly filed document and have been furnished separately to the Securities and Exchange Commission as required by Rule 24b-2 under the Securities Exchange Act of 1934.