

SOLECTRON CORP
Form 10-Q
April 05, 2006

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

Form 10-Q

(Mark One)

- ☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended February 24, 2006
- ☐ **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 ☒

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

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At March 30, 2006, 914,430,596 shares of Common Stock of the Registrant were outstanding (including approximately 20.5 million shares of Soletron Global Services Canada, Inc., which are exchangeable on a one-to-one basis for the Registrant's common stock)

SOLECTRON CORPORATION

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	February 28 2006	August 31 2005
	(Unaudited)	
	(In millions)	
ASSETS		
Current assets:		
Cash, cash equivalents and short-term investments*	\$ 1,526.8	\$ 1,722.3
Accounts receivable, net	1,177.7	1,180.7
Inventories	1,346.1	1,108.5
Prepaid expenses and other current assets	233.2	211.4
Total current assets	4,283.8	4,222.9
Property and equipment, net	681.7	666.3
Goodwill	147.6	148.8
Other assets	221.8	219.8
Total assets	\$ 5,334.9	\$ 5,257.8
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Short-term debt	\$ 228.5	\$ 165.7
Accounts payable	1,430.3	1,371.2
Accrued employee compensation	143.3	167.0
Accrued expenses and other current liabilities	472.1	509.6
Total current liabilities	2,274.2	2,213.5
Long-term debt	628.0	540.9
Other long-term liabilities	79.6	59.2
Total liabilities	\$ 2,981.8	\$ 2,813.6
Commitments and contingencies		
Stockholders' equity:		
Common stock	1.0	1.0
Additional paid-in capital	7,619.6	7,774.1

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Accumulated deficit	(5,152.1)	(5,206.5)
Accumulated other comprehensive loss	(115.4)	(124.4)
Total stockholders' equity	2,353.1	2,444.2
Total liabilities and stockholders' equity	\$ 5,334.9	\$ 5,257.8

* Includes \$31.2 million and \$13.2 million of restricted cash balances as of February 28, 2006 and August 31, 2005, respectively, and \$15.0 million and \$26.3 million of short term investments as of February 28, 2006 and August 31, 2005, respectively.

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended February 28		Six Months Ended February 28	
	2006	2005	2006	2005
	(In millions, except per share data)		(In millions, except per share data)	
	(Unaudited)		(Unaudited)	
Net sales	\$ 2,499.6	\$ 2,756.0	\$ 4,956.0	\$ 5,446.6
Cost of sales	2,370.6	2,598.1	4,701.4	5,133.2
Gross profit	129.0	157.9	254.6	313.4
Operating expenses:				
Selling, general and administrative	104.3	104.7	211.7	200.3
Restructuring and impairment costs	5.6	43.2	6.5	43.9
Operating income	19.1	10.0	36.4	69.2
Interest income	12.3	9.1	24.4	14.9
Interest expense	(6.9)	(16.7)	(13.6)	(33.0)
Other (expense) income net	(1.9)	1.1		5.8
Operating income from continuing operations before income taxes	22.6	3.5	47.2	56.9
Income tax expense	5.5	6.6	9.9	12.5
Income (loss) from continuing operations	\$ 17.1	\$ (3.1)	\$ 37.3	\$ 44.4
Discontinued operations:				
Income from discontinued operations	\$ 13.3	\$ 0.9	\$ 17.1	\$ 13.3
Income tax expense				1.7
Income from discontinued operations	13.3	0.9	17.1	11.6
Net income (loss)	\$ 30.4	\$ (2.2)	\$ 54.4	\$ 56.0
Basic net income (loss) per share				
Continuing operations	\$ 0.02	\$ (0.00)	\$ 0.04	\$ 0.05
Discontinued operations	0.01	0.00	0.02	0.01
Basic net income (loss) per share	\$ 0.03	\$ (0.00)	\$ 0.06	\$ 0.06
Diluted net income (loss) per share				
Continuing operations	\$ 0.02	\$ (0.00)	\$ 0.04	\$ 0.05
Discontinued operations	0.01	0.00	0.02	0.01

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Diluted net income (loss) per share	\$	0.03	\$	(0.00)	\$	0.06	\$	0.06
Shares used to compute basic net income per share		908.8		977.1		917.3		966.7
Shares used to compute diluted net income per share		909.7		977.1		918.1		970.6

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended February 28		Six Months Ended February 28	
	2006	2005	2006	2005
	(In millions)		(In millions)	
	(Unaudited)		(Unaudited)	
Net income (loss)	\$ 30.4	\$ (2.2)	\$ 54.4	\$ 56.0
Other comprehensive income:				
Foreign currency translation adjustments, net	8.6	17.6	9.0	25.8
Comprehensive income	\$ 39.0	\$ 15.4	\$ 63.4	\$ 81.8

Accumulated unrealized foreign currency translation losses were \$105.2 million at February 28, 2006 and \$114.2 million at August 31, 2005. Foreign currency translation adjustments consist of adjustments to consolidate subsidiaries that use the local currency as their functional currency and transaction gains and losses related to intercompany dollar-denominated debt that is not expected to be repaid in the foreseeable future.

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended February 28	
	2006	2005
	(In millions)	
	(Unaudited)	
	(Revised)	
Cash flows from operating activities:		
Net income	\$ 54.4	\$ 56.0
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Earnings from discontinued operations	(17.1)	(11.6)
Depreciation and amortization	87.5	101.3
Impairment of property, equipment and other long-term assets, net	10.4	40.8
Gain on disposal of property and equipment	(0.1)	(0.1)
Stock based compensation	10.2	1.5
Changes in operating assets and liabilities:		
Accounts receivable, net of allowance	4.5	161.3
Inventories	(237.4)	213.9
Prepaid expenses and other current assets	(27.4)	14.9
Accounts payable	59.0	(55.5)
Accrued expenses and other current liabilities	(14.0)	(45.9)
Net cash (used in) provided by operating activities of continuing operations	(70.0)	476.6
Net cash used in operating activities of discontinued operations	(8.2)	(5.9)
Net cash (used in) provided by operating activities	(78.2)	470.7
Cash flows from investing activities:		
Sale of available for sale securities	11.3	
Change in restricted cash and cash equivalents	(18.0)	(2.9)
Settlement of receivable related to synthetic lease		19.9
Capital expenditures	(109.7)	(66.1)
Proceeds from sale of property and equipment	4.4	9.3
Proceeds from sale of investments		16.0
Dispositions and receipts from discontinued operations	8.9	7.1
Net cash used in investing activities of continuing operations	(103.1)	(16.7)
Net cash provided by investing activities of discontinued operations	17.1	13.0
Net cash used in investing activities	(86.0)	(3.7)
Cash flows from financing activities:		
Net proceeds (repayment) of bank lines of credit and other debt arrangements	0.8	(16.5)

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Proceeds from issuance of debt, net	147.4	
Lyon repurchase	(2.0)	(0.5)
Common stock repurchase	(180.4)	(1.4)
Net proceeds from issuance of common stock		64.3
Net proceeds from stock issued under option and employee purchase plans	5.1	8.1
Net cash (used in) provided by financing activities of continuing operations	(29.1)	54.0
Net cash used in financing activities of discontinued operations	(8.9)	(7.1)
Net cash (used in) provided by financing activities	(38.0)	46.9
Effect of exchange rate changes on cash and cash equivalents		10.7
Net increase (decrease) in cash and cash equivalents	(202.2)	524.6
Cash and cash equivalents of continuing operations at beginning of period	1,682.8	1,412.7
Cash and cash equivalents of discontinued operations at beginning of period		
Total cash and cash equivalents at beginning of period	1,682.8	1,412.7
Cash and cash equivalents continuing operations at end of period	\$ 1,480.6	\$ 1,937.3
Cash and cash equivalents discontinued operations at end of period		
Total cash and cash equivalents at end of period	\$ 1,480.6	\$ 1,937.3

See accompanying notes to condensed consolidated financial statements.

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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 February 28, 2006 and for the three and six months ended February 28, 2006 and 2005 has been prepared by 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 31, 2005 condensed consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles. However, 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 31, 2005.

Solectron's second quarters of fiscal 2006 and 2005 ended on February 24, 2006 and February 25, 2005, respectively. Solectron's fiscal year 2005 ended on August 26, 2005. For clarity of presentation, Solectron has indicated its second quarter as having ended on February 28 and its fiscal year as having ended on August 31.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair consolidated statement of financial position as of February 28, 2006, the results of operations, comprehensive income and cash flows for the six months ended February 28, 2006 and 2005 have been made. The consolidated results of operations for the three and six months ended February 28, 2006 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

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 \$7.8 million and \$15.7 million of research and development expenses for the three and six months ended February 28, 2006, respectively, and \$8.4 million and \$15.2 million for the three and six months ended February 28, 2005, respectively.

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 \$18 million at February 28, 2006, is classified as

restricted cash and cash equivalents in the condensed consolidated balance sheets. Solectron also has \$13.2 million of restricted cash in connection with its synthetic leases. See also Note 8 Commitments and Contingencies for a discussion of these synthetic leases.

Recent Accounting Pronouncements

In March 2005, the FASB issued FIN 47, Accounting for Conditional Asset Retirement Obligations, as an interpretation of FASB Statement No. 143, Accounting for Asset Retirement Obligations (FASB No. 143). This

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

interpretation clarifies that the term conditional asset retirement obligation as used in FASB No. 143, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. This interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company is currently assessing the impact of the adoption of FIN 47.

Reclassifications

Certain amounts from prior periods have been reclassified to conform to the current period presentation.

NOTE 2 Revision of Statement of Cash Flows

Solectron has revised its statements of cash flows for the six months ended February 28, 2006 and February 28, 2005, respectively, to present cash flows related to discontinued operations consistent with the requirements of Financial Accounting Standards Board (FASB) Statement No. 95, Statement of Cash Flows . This revision includes beginning the indirect method of determining cash flows from operating activities with net income (loss) rather than net income (loss) from continuing operations. In addition, the operating, financing and investing cash flows of discontinued operations have been separately presented within the body of the statements of cash flows which in prior periods were reported on a consolidated basis as a single amount. Solectron intends to utilize this revised presentation in all future annual and quarterly filings. The following table presents revised summary cash flow information for each of the three most recently completed fiscal years.

	Years Ended August 31		
	2005	2004	2003
	(Revised)	(In millions) (Revised)	(Revised)
Cash flows from operating activities:			
Net income (loss)	\$ 3.4	\$ (177.4)	\$ (3,452.6)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:			
(Earnings) loss from discontinued operations	(13.9)	(85.0)	443.7
Depreciation and amortization	193.3	276.3	330.3
Loss (gain) on retirement of debt and interest rate swaps	45.6	72.1	(39.4)
Deferred tax charge	11.9	(12.0)	528.9
Impairment of goodwill and intangible assets		47.5	1,792.0
Loss on disposal and impairment of property and equipment, net	46.6	60.2	157.5
Other			(5.2)

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	Years Ended August 31		
	2005	2004	2003
	(In millions)		
	(Revised)	(Revised)	(Revised)
Changes in operating assets and liabilities:			
Accounts receivable, net of allowance	362.9	(144.3)	123.4
Inventories	348.5	(134.1)	420.4
Prepaid expenses and other assets	11.0	6.8	106.9
Accounts payable	(53.6)	150.3	(132.0)
Accrued expenses and other current liabilities	(8.4)	(69.0)	7.1
Net cash provided by (used in) operating activities of continuing operations	947.3	(8.6)	281.0
Net cash provided by operating activities of discontinued operations	22.4	2.9	109.4
Net cash provided by (used in) operating activities	969.7	(5.7)	390.4
Cash flows from investing activities:			
Change in restricted cash and cash equivalents	4.3	44.5	169.8
Sales and maturities of short-term investments	2.5	27.5	252.5
Purchases of short-term investments	(28.8)		(56.1)
Settlement of loan receivable related to synthetic lease	31.4		
Acquisitions, net of cash acquired	(42.2)		(49.3)
Divestitures			
Capital expenditures	(150.4)	(149.6)	(124.6)
Proceeds from sale of property and equipment	32.1	68.9	60.1
Dispositions and receipts from discontinued operations	38.9	505.6	84.1
Supply agreement and other		0.2	48.3
Net cash (used in) provided by investing activities of continuing operations	(112.2)	497.1	384.8
Net cash provided by (used in) investing activities of discontinued operations	16.5	466.3	(112.2)
Net cash (used in) provided by investing activities	(95.7)	963.4	272.6

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	Years Ended August 31		
	2005	2004	2003
	(Revised)	(In millions) (Revised)	(Revised)
Cash flows from financing activities:			
Proceeds used for ACES early settlement		(63.3)	
Net repayment of bank lines of credit and other debt arrangements	(23.8)	(50.5)	(85.0)
Proceeds from issuance of ACES and Senior Notes		436.5	
Payments made to redeem ACES and Senior Notes	(544.7)		
Net (costs) proceeds to settle interest rate swap	(8.2)	6.0	
Repurchase of LYONS		(950.2)	(967.5)
Common stock repurchase	(71.0)		
Net proceeds from issuance of common stock	77.7	111.1	7.8
Other			28.4
Net cash used in financing activities of continuing operations	(570.0)	(510.4)	(1,016.3)
Net cash used in financing activities of discontinued operations	(38.9)	(507.4)	(6.3)
Net cash used in financing activities	(608.9)	(1,017.8)	(1,022.6)
Effect of exchange rate changes on cash and cash equivalents	5.0	14.7	35.8
Net increase (decrease) in cash and cash equivalents	270.1	(45.4)	(323.8)
Cash and cash equivalents of continuing operations at beginning of period	1,412.7	1,425.3	1,742.9
Cash and cash equivalents of discontinued operations at beginning of period		32.8	39.0
Total cash and cash equivalents at beginning of period	1,412.7	1,458.1	1,781.9
Cash and cash equivalents of continuing operations at end of period	1,682.8	1,412.7	1,425.3
Cash and cash equivalents of discontinued operations at end of period			32.8
Total cash and cash equivalents at end of period	\$ 1,682.8	\$ 1,412.7	\$ 1,458.1
SUPPLEMENTAL DISCLOSURES			
Cash paid (received) during the period:			
Income taxes	\$ 14.7	\$ 6.6	\$ (199.6)
Interest	\$ 59.0	\$ 100.8	\$ 133.4
Non-cash investing and financing activities:			
Early settlement of ACES for stock	\$	\$ 1,006.6	\$
Accrued stock repurchase	\$ 11.2	\$	\$

NOTE 3 Stock-Based Compensation

Effective September 1, 2005, Solelectron began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123-R, *Share-Based Payment*, (SFAS 123R) as interpreted by SEC Staff Accounting Bulletin No. 107. Prior to September 1, 2005, the Company accounted for stock options according to the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations, and therefore no related compensation expense was recorded for awards granted with no intrinsic value. Solelectron adopted the modified prospective transition method provided for under SFAS 123R, and consequently has not

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retroactively adjusted results from prior periods. 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 term, respectively, in connection with 1) shares issued under its employee stock purchase plan and 2) restricted stock and 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. As a result of the adoption of SFAS 123R, Solectron's earnings from continuing operations before income taxes, earnings from continuing operations, and net earnings for the three-month and six-month period ended February 28, 2006, were \$3.8 million and \$7.6 million lower respectively, than under Solectron's previous accounting method for share-based compensation. Basic and diluted net earnings per common share for the quarter ended February 28, 2006, were not impacted by the change in accounting method. Prior to our adoption of SFAS 123R, benefits of tax deductions in excess of recognized compensation costs were reported as operating cash flows. SFAS 123R requires that they be recorded as a financing cash inflow rather than as a reduction of taxes paid. For the quarter ended February 28, 2006, no excess tax benefits were generated from option exercises. The Company evaluated the need to record a cumulative effect adjustment for estimated forfeitures upon the adoption of SFAS 123R and determined the amount to be immaterial. The company is in the process of computing the excess tax benefits in additional paid-in capital as of the date of adoption of SFAS 123R. This analysis is not expected to result in a material change to Solectron's financial statements.

Total stock compensation expense for the three months ended February 28, 2006, of \$5.4 million was included in cost of sales and selling, general and administrative expense in the amounts of \$1.8 million and \$3.6 million, respectively. Total stock compensation expense for the six months ended February 28, 2006, of \$10.2 million was included in cost of sales and selling, general and administrative expense in the amounts of \$3.6 million and \$6.6 million, respectively. Total stock compensation expense for the three months and six months ended February 28, 2005, of \$0.6 million and \$1.5 million, respectively, was included in selling, general, and administrative expense.

For stock options granted prior to the adoption of SFAS 123R, if compensation expense for the Company's various stock option plans had been determined based upon estimated fair values at the grant dates in accordance with SFAS 123, the Company's pro forma net income (loss), and basic and diluted income (loss) per share would have been as follows:

	Three Months Ended February 28, 2005		Six Months Ended February 28, 2005	
Net income (loss):				
As reported	\$	(2.2)	\$	56.0
Fair value-based expense, net of tax	\$	(43.1)	\$	(52.3)
Pro forma	\$	(45.3)	\$	3.7

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Net income (loss) per common share:

Basic

As reported	\$	(0.00)	\$	0.06
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Pro Forma	\$	(0.05)	\$	0.00
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Diluted

As reported	\$	(0.00)	\$	0.06
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Pro Forma	\$	(0.05)	\$	0.00
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Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)*****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.

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. Groups of employees that have similar historical exercise patterns have been considered separately for valuation purposes. 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.

	Three Months Ended February		Six Months Ended	
	28		February 28	
Stock Options	2006	2005	2006	2005
Expected volatility	59%	69%	52%-59%	70%
Dividends Yield	zero	zero	zero	zero
Expected life	4.32 years	3.9 years	4.32 years to 4.91 years	3.9 years
Risk-free rate	4.35%	3.54%	4.26% to 4.35%	3.43%

	Three Months Ended		Six Months Ended	
	February 28		February 28	
Employee Stock Purchase Plan	2006	2005	2006	2005
Weighted-average volatility	30%	39%	30%-44%	40%
Dividends Yield	zero	zero	zero	zero
Expected life	6 months	6 months	6 months	6 months
Risk-free rate	4.43%	2.68%	3.94%-4.43%	2.50%

The Company has recorded \$2.8 million and \$5.9 million of compensation expenses relative to stock options (other than discounted stock options) for the three-month and six-month periods ended February 28, 2006 in accordance with SFAS 123R. As of February 28, 2006, there was \$21.2 million of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average period of 1.4 years.

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

A summary of stock option activity under the plans for the three-months and six-months ended February 28, 2006 is presented as follows:

	Shares (In millions)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In millions)
Balance, September 1, 2005	50.9	\$ 9.75		
Granted	1.1	\$ 3.77		
Cancelled	(2.8)	\$ 10.60		
Balance, November 30, 2005	49.2	\$ 9.57	6.86	
Exercisable, November 30, 2005	37.5	\$ 11.34	6.21	
Balance, November 30, 2005	49.2	\$ 9.57	6.86	
Granted	1.1	\$ 3.74		
Cancelled	(2.3)	\$ 10.18		
Balance, February 28, 2006	48.0	\$ 9.41	6.67	\$ 0.70
Exercisable, February 28, 2006	36.8	\$ 11.09	6.02	\$ 0.60

The weighted-average fair value of stock options granted during the three months and six months ended February 28, 2006, was \$1.90 and \$1.88, respectively. The total intrinsic value of stock options exercised during the three months and six months ended February 28, 2006, was \$.03 million and \$.03 million, respectively.

At February 28, 2006, an aggregate of 60.9 million shares were authorized for future issuance under our stock plans, which cover stock options, Employee Stock Purchase Plans, Restricted Stock Awards and Discounted Stock Options. A total of 49.9 million shares of common stock were available for grant under Solelectron's stock option plans as of February 28, 2006. 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 Solelectron's Board of Directors to purchase 20,000 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 20,000 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 offering period. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation. We have treated the Employee Stock Purchase Plan as a compensatory plan. The Company has recorded compensation expense relative to the Purchase Plan in the three-month and six-month periods ended February 28, 2006 of \$1 million and \$1.7 million, respectively.

Restricted Stock Awards and Discounted Stock Options

During fiscal 2003, Solectron issued restricted stock awards of 1.4 million shares of common stock to certain eligible executives at a purchase price of \$0.001 per share. These restricted shares are not transferable until fully vested and are subject to the Company Repurchase Option for all unvested shares upon certain early termination events and also subject to accelerated vesting in certain circumstances. Compensation expense computed under the

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

fair value method for the three and six months ended February 28, 2006, is being amortized over the vesting period and was \$0.1 million and \$0.2 million, respectively. Compensation expense computed under the intrinsic value method for the three and six months ended February 28, 2005, is being amortized over the vesting period and was \$0.3 million and \$0.9 million, respectively.

During fiscal 2005 and 2004, Solectron also issued discounted stock options of 1.5 million and 0.7 million shares, respectively, to certain eligible executives and employees at a price below the market value on the day of the stock option grant. During the six month period ended February 28, 2006, an additional 4.2 million discounted options were granted to certain eligible employees. Compensation expense under the fair value method for the three months and six months ended February 28, 2006, is being amortized over the vesting period and was \$1.5 million and \$2.3 million, respectively. Compensation expense under the intrinsic value method for the three months and six months ended February 28, 2005, was \$0.3 million and \$0.5 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.

The weighted-average fair value of the discounted stock options granted in the three-month and six-month period ended February 28, 2006 was \$3.73 and \$3.79, respectively. At February 28, 2006, unrecognized costs related to restricted stock awards and discounted stock options totaled approximately \$19.4 million and is expected to be recognized over a weighted average period of 2.8 years. The total fair value of restricted stock and discounted stock options vested was zero during the three months and six months ended February 28, 2006.

Pro Forma Net Loss and Assumptions for Fiscal Years 2005 and 2004

The table below sets out the pro forma amounts of net loss and net loss per share that would have resulted for fiscal years 2005 and 2004, if Solectron accounted for its employee stock plans under the fair value recognition provisions of SFAS No. 123.

	Fiscal 2005 (In millions, except per-share data)	Fiscal 2004
Net income (loss) as reported	\$ 3.4	\$ (177.4)
Stock-based employee compensation expense determined under fair value method, net of related tax effects	(58.7)	(60.5)
Pro forma net loss	\$ (55.3)	\$ (237.9)
Net loss per share		
Basic and diluted as reported	\$ 0.00	\$ (0.20)
Basic and diluted pro forma	\$ (0.06)	\$ (0.27)

Stock based employee compensation expense determined under the fair value method, net of related tax effects, included zero and \$6.5 million of expense relating to discontinued operations during fiscal years 2005 and 2004,

respectively.

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

For purposes of computing pro forma net loss, the fair value of each option grant and employee stock purchase plan purchase right was estimated on the date of grant using the Black-Scholes option pricing model. The assumptions used to value the option grants and purchase rights are stated below.

	Fiscal 2005	Fiscal 2004
Stock Options		
Expected life of options	4.5 years	3.9 years
Volatility	57%	75%
Risk-free interest rate	3.79%	2.30% to 3.06%
Dividend yield	zero	zero
Employee Stock Purchase Plan		
Expected life of purchase right	6 months	6 months
Volatility	37%	77%
Risk-free interest rate	2.90%	1.00% to 1.70%
Dividend yield	zero	zero

NOTE 4 Stock Repurchase

On July 22, 2005, Solelectron's board of directors authorized a \$250 million stock repurchase program. During the first fiscal quarter of 2006, Solelectron repurchased and retired 46.6 million shares of its common stock at an average price of \$3.87 for approximately \$180.4 million. In October 2005, Solelectron completed the stock repurchase program. Solelectron repurchased and retired a total of 63.6 million shares for approximately \$250.0 million under this program. On November 1, 2005, Solelectron announced that the Company's Board of Directors had approved a new stock repurchase program whereby the Company is authorized to repurchase up to an additional \$250 million of the Company's common stock. Solelectron commenced this second \$250 million repurchase program at the end of the quarter ended February 28, 2006. However, no repurchase transactions were settled during the quarter.

NOTE 5 Inventories

Inventories related to continuing operations as of February 28, 2006 and August 31, 2005, consisted of the following (in millions):

	February 28 2006	August 31 2005
Raw materials	\$ 985.2	\$ 771.0
Work-in-process	168.7	152.8
Finished goods	192.2	184.7

Total	\$	1,346.1	\$	1,108.5
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NOTE 6 Accounts Receivable, Net

Accounts receivable, net related to continuing operations as of February 28, 2006 and August 31, 2005 consisted of the following (in millions):

	February 28 2006	August 31 2005
Accounts Receivable	\$ 1,194.1	\$ 1,203.0
Less: Allowance for doubtful accounts	16.4	22.3
Accounts Receivable, net	\$ 1,177.7	\$ 1,180.7

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 7 Property and Equipment, Net**

Property and equipment, net related to continuing operations as of February 28, 2006 and August 31, 2005 consisted of the following (in millions):

	February 28 2006	August 31 2005
Original Cost	\$ 1,843.0	\$ 1,818.3
Less: Accumulated depreciation	1,161.3	1,152.0
Total	\$ 681.7	\$ 666.3

NOTE 8 Commitments and Contingencies***Synthetic Leases***

Solectron has synthetic lease agreements relating to three manufacturing sites. The synthetic leases have expiration dates in August 2007. At the end of the lease terms, Solectron has an option, subject to certain conditions, to purchase or to cause a third party to purchase the facilities subject to the synthetic leases for the Termination Value, which approximates the lessor's original cost for each facility, or may market the property to a third party at a different price. Solectron is entitled to any proceeds from a sale of the properties to third parties in excess of the Termination Value and is liable to the lessor for any shortfall not to exceed 85% of the Termination Value. Solectron has provided loans to the lessor equaling approximately 85% of the Termination Value for each synthetic lease. These loans are repayable solely from the sale of the properties to third parties in the future, are subordinated to the amounts payable to the lessor at the end of the synthetic leases, and may be credited against the Termination Values payable if Solectron purchases the properties. The approximate aggregate Termination Values and loan amounts were \$87.7 million and \$74.5 million, respectively, as of February 28, 2006.

In addition, cash collateral of \$13.2 million, an amount equal to the difference between the aggregate Termination Values and the loan amounts, is pledged as collateral. Each synthetic lease agreement contains various affirmative covenants. A default under a lease, including violation of these covenants, may accelerate the termination date of the arrangement. Solectron was in compliance with all applicable covenants as of February 28, 2006. Monthly lease payments are generally based on the Termination Value and 30-day LIBOR index (4.57% as of February 28, 2006) plus an interest-rate margin, which may vary depending upon Solectron's Moody's Investors Services and Standard and Poor's ratings, and are allocated between the lessor and Solectron based on the proportion of the loan amount to the Termination Value for each synthetic lease.

During fiscal 2004, Solectron determined that it is probable that the expected fair value of the properties under the synthetic lease agreements will be less than the Termination Value at the end of the lease terms by approximately \$13.5 million. The \$13.5 million is being accreted over the remaining lease terms. As of February 28, 2006, Solectron

had accreted \$7.3 million.

Solelectron accounts for these synthetic lease arrangements as operating leases in accordance with SFAS No. 13, Accounting for Leases, as amended. Solelectron's loans to the lessor and cash collateral are included in other assets and restricted cash and cash equivalents, respectively, in the consolidated balance sheets.

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

Future minimum payments for operating lease obligations related to facilities in use, including the synthetic leases discussed above, are as follows (in millions):

	Total	Short-Term	Payments Due by Period					
			Q3 07-Q4 07	FY08	FY09	FY10	FY11	Thereafter
			(In millions)					
Operating lease	\$ 142.1	\$ 34.2	\$ 20.2	\$ 21.3	\$ 16.4	\$ 14.5	\$ 13.5	\$ 22.0

Legal Proceedings

Solectron is from time to time involved in various litigation and legal matters, including the one described below.

Solectron has settled the previously reported shareholder class action lawsuit entitled *Abrams v. Solectron Corporation et al.*, Case No. C-03-0986 CRB, filed in the United States District Court for the Northern District of California, on terms not considered to be material to Solectron. Court approval of the settlement terms was obtained on March 3, 2006.

NOTE 9 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 Chief Executive Officer. The 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 net sales are attributable to the country in which the product is manufactured. Geographic information for continuing operations as of and for the periods presented is as follows (in millions):

Three Months Ended		Six Months Ended	
February 28		February 28	
2006	2005	2006	2005

Geographic net sales:

United States	\$ 808.5	\$ 828.8	\$ 1,605.2	\$ 1,615.2
Other North and Latin America	385.6	448.0	743.6	921.7
Europe	288.8	381.2	602.7	815.3
Malaysia	515.3	514.7	1,012.1	951.2
China	279.1	349.5	538.6	689.6
Other Asia Pacific	222.3	233.8	453.8	453.6
	\$ 2,499.6	\$ 2,756.0	\$ 4,956.0	\$ 5,446.6

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

	February 28 2006	August 31 2005
Long-lived assets:		
United States	\$ 299.7	\$ 314.3
Other North and Latin America	165.7	165.7
Europe	130.7	138.0
Asia Pacific	299.7	275.8
	\$ 895.8	\$ 893.8

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:

	Three Months Ended February 28 2006	2005	Six Months Ended February 28 2006	2005
Cisco Systems	18.1%	17.0%	17.4%	15.6%
Nortel Networks	11.7%	10.7%	11.0%	10.5%

Solectron has concentrations of credit risk due to sales to the customers listed above as well as to Solectron's other significant customers. No customer accounted for 10% or more of total accounts receivable at February 28, 2006.

NOTE 10 Long-Term 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 to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The notes are unconditionally guaranteed by Solectron on a senior subordinated basis, and will mature on March 15, 2016, and bear interest at the rate of 8% annually. Cash interest payments on the notes will be made semiannually in arrears on March 15 and September 15 of each year, beginning on September 15, 2006. The 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, subject to certain outstanding principal amount and redemption timing conditions, Solectron Global Finance will have the option to redeem the notes, in whole or in part at a price equal to the greater of 100% or 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 notes with the net proceeds of a public common stock offering by Solectron at a redemption price of 108% of the principal amount of the notes, plus any accrued and unpaid interest to the redemption date. Solectron used the net proceeds from the offering, together with cash on hand, to repay its 7.375% Senior Notes

on March 1, 2006.

0.5% Convertible Senior Notes due 2034

On February 17, 2004, Solectron issued \$450 million of convertible senior notes (the "Original Notes"), to qualified institutional buyers in reliance on Rule 144A under the Securities Act. The Original Notes are unsecured and unsubordinated indebtedness of Solectron and will mature on February 15, 2034.

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

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SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

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 to 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 convertible notes that have not been previously purchased, repurchased or converted, at 100% of the principal amount of the convertible 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 convertible 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 convertible 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 convertible notes are convertible into shares of common stock of Solectron at any time prior to maturity, subject to the terms of the notes.

After the exchange offer was complete, 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. As of February 28, 2006, the aggregate carrying amount of the convertible notes of \$450.0 million was classified as long-term debt.

7.375% Senior Notes

In February 1996, Solectron issued \$150 million aggregate principal amount of unsubordinated notes. These notes are in denominations and have a maturity value of \$1,000 each and are due on March 1, 2006. Interest is payable semiannually at a rate of 7.375% per annum. The notes may not be redeemed prior to maturity. As of February 28, 2006, the carrying amount of the notes of \$150.0 million was classified as short-term debt. These notes were redeemed at maturity on March 1, 2006.

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 November 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 has been settled. Accordingly, the remaining obligation of the original ACES is the 7.97% subordinated debentures.

As of February 28, 2006, the 7.97% subordinated debentures due November 2006 had a carrying value of \$64.3 million and were classified as short-term debt.

Liquid Yield Option Notes (LYONstm)

On February 28, 2006, Solectron had \$8.6 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.

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

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 on or after May 20, 2004. As of February 28, 2006, the accreted value of the 2.75% LYONs™ is classified as long-term debt.

On February 28, 2006, Solectron had \$1.1 million aggregate accreted value of LYONs™ 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 February 28, 2006, the accreted value of the 3.25% LYONs™ is classified as long-term debt.

NOTE 11 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 to largely 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 three months or less in original maturity.

As of February 28, 2006, Solectron had outstanding foreign exchange forward contracts with a total notional amount of approximately \$391.0 million.

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 9, Segment Information and Geographic Information.

NOTE 12 Goodwill and Intangible Assets

Goodwill information is as follows (in millions):

	Goodwill
Balance at August 31, 2005	\$ 148.80
Adjustments	(1.20)
Balance at February 28, 2006	\$ 147.60

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

Sollectron'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 February 28, 2006 and August 31, 2005 (in millions):

	Supply Agreements	Intellectual Property Agreements	Customer Relationships and Other	Total
February 28, 2006				
Gross amount	\$ 89.5	\$ 61.0	\$ 98.9	\$ 249.4
Accumulated amortization	(85.9)	(57.1)	(88.9)	(231.9)
Carrying value	\$ 3.6	\$ 3.9	\$ 10.0	\$ 17.5
August 31, 2005				
Gross amount	\$ 91.9	\$ 61.0&nb		