ADVANCED MICRO DEVICES INC
Form 10-Q
August 06, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 28, 2008

OR

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

Commission File Number 001-07882

ADVANCED MICRO DEVICES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-1692300**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
One AMD Place Sunnyvale, California	**94088**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (408) 749-4000

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

Indicate the number of shares outstanding of the registrant s common stock, $0.01 par value, as of August 1, 2008: 607,192,663.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Advanced Micro Devices, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

	Quarter Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions, except per share amounts)			
Net revenue	$ 1,349	$ 1,309	$ 2,805	$ 2,439
Cost of sales	653	870	1,505	1,685
Gross margin	696	439	1,300	754
Research and development	442	438	897	830
Marketing, general and administrative	337	356	671	683
Amortization of acquired intangible assets and integration charges	30	41	59	88
Restructuring charges	30		30	
Operating income (loss)	(143)	(396)	(357)	(847)
Interest income	10	19	25	35
Interest expense	(95)	(99)	(190)	(177)
Other income (expense), net	(10)	(9)	(11)	(7)
Income (loss) before minority interest, equity in net loss of Spansion Inc. and other and income taxes	(238)	(485)	(533)	(996)
Minority interest in consolidated subsidiaries	(7)	(9)	(20)	(17)
Equity in net loss of Spansion Inc. and other (see Note 13)	(24)	(13)	(24)	(29)
Income (loss) before income taxes	(269)	(507)	(577)	(1,042)
Provision for income taxes		24		39
Income (loss) from continuing operations	(269)	(531)	(577)	(1,081)
Income (loss) from discontinued operations, net of tax	(920)	(69)	(970)	(130)
Net income (loss)	$ (1,189)	$ (600)	$ (1,547)	$ (1,211)
Per share data:				
Basic and diluted				
Continuing operations	$ (0.44)	$ (0.96)	$ (0.95)	$ (1.96)
Discontinued operations	$ (1.52)	$ (0.13)	$ (1.60)	$ (0.24)
Net income (loss) per common share	$ (1.96)	$ (1.09)	$ (2.55)	$ (2.20)
Shares used in per share calculation:				
Basic and diluted	607	552	606	550

See accompanying notes to condensed consolidated financial statements.

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Advanced Micro Devices, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	June 28, 2008 (unaudited)	December 29, 2007 *
	(In millions, except par value amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,310	$ 1,432
Marketable securities	257	457
Total cash and cash equivalents and marketable securities	1,567	1,889
Accounts receivable	444	598
Allowance for doubtful accounts	(7)	(10)
Total accounts receivable, net	437	588
Inventories:		
Raw materials	36	46
Work-in-process	470	464
Finished goods	285	292
Total inventories	791	802
Deferred income taxes	20	64
Prepaid expenses and other current assets	244	395
Assets of discontinued operations	372	1,323
Total current assets	3,431	5,061
Property, plant and equipment:		
Land and land improvements	50	49
Buildings and leasehold improvements	1,750	1,033
Equipment	4,861	6,109
Construction in progress	477	677
Total property, plant and equipment	7,138	7,868
Accumulated depreciation and amortization	(2,539)	(3,160)
Property, plant and equipment, net	4,599	4,708
Acquisition related intangible assets, net (see Note 3)	253	311
Goodwill (see Note 3)	945	950
Other assets	556	520
Total assets	$ 9,784	$ 11,550

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LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 800	$ 982
Accrued compensation and benefits	160	180
Accrued liabilities	730	814
Income taxes payable	19	72
Deferred income on shipments to distributors	80	98
Current portion of long-term debt and capital lease obligations	246	238
Other short-term obligations	60	
Other current liabilities	350	198
Liabilities of discontinued operations	23	43
Total current liabilities	2,468	2,625
Deferred income taxes	3	6
Long-term debt and capital lease obligations, less current portion	4,955	5,031
Other long-term liabilities (see Note 7)	695	633
Minority interest in consolidated subsidiaries	189	265
Commitments and contingencies (see Note 8)		
Stockholders equity:		
Capital stock:		
Common stock, par value $0.01; 1,500 shares authorized on June 28, 2008 and December 29, 2007; shares issued: 614 on June 28, 2008 and 612 on December 29, 2007; shares outstanding: 607 on June 28, 2008 and 606 on December 29, 2007	6	6
Capital in excess of par value	6,058	6,016
Treasury stock, at cost (7 shares on June 28, 2008 and December 29, 2007)	(96)	(95)
Retained earnings (deficit)	(4,647)	(3,100)
Accumulated other comprehensive income	153	163
Total stockholders equity	1,474	2,990
Total liabilities and stockholders equity	$ 9,784	$ 11,550

* Amounts as of December 29, 2007 were derived from the December 29, 2007 audited financial statements.

See accompanying notes to condensed consolidated financial statements.

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Advanced Micro Devices Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 28, 2008	June 30, 2007
	(In millions)	
Cash flows from operating activities:		
Net income (loss)	$ (1,547)	$ (1,211)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Minority interest in consolidated subsidiaries	17	17
Depreciation and amortization	627	640
Provision for doubtful accounts	(3)	(7)
Equity in net loss of Spansion Inc.		29
(Benefit) provision for deferred income taxes	(70)	35
Amortization of foreign grant and subsidy income	(46)	(80)
Net loss (gain) on sale/ disposal of property, plant and equipment	(169)	8
Compensation recognized under employee stock plans	41	59
Non-cash foreign exchange loss	1	21
Other than temporary impairment on marketable securities	35	
Impairment of goodwill and acquired intangible assets	876	
Other	(5)	(1)
Changes in operating assets and liabilities:		
Accounts receivable	185	495
Inventories	13	(78)
Prepaid expenses and other current assets	34	(115)
Other assets	(11)	(65)
Accounts payables and accrued liabilities	(254)	(262)
Income taxes payable	50	(79)
Net cash used in operating activities	(226)	(594)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(429)	(1,000)
Proceeds from sale of property, plant and equipment	343	1
Proceeds from sale of Spansion Inc. stock		13
Purchases of available-for-sale securities	(125)	(362)
Proceeds from sale and maturity of available-for-sale securities	289	233
Purchase of limited partnership interest	(95)	
Other	(14)	(3)
Net cash used in investing activities	(31)	(1,118)
Cash flows from financing activities:		
Repayments of debt and capital lease obligations	(51)	(531)
Proceeds from borrowings, net of issuance costs	65	2,169
Purchase of capped call instrument in connection with borrowings		(182)
Payment of silent partnership obligation	(38)	
Payments on return of limited partnership contributions	(3)	(22)
Net proceeds from foreign grants and subsidies	146	156
Proceeds from issuance of common stock under stock-based compensation plans		46
Other financing activities	16	

Net cash provided by financing activities	135	1,636
Net decrease in cash and cash equivalents	(122)	(76)
Cash and cash equivalents at beginning of period	1,432	1,380
Cash and cash equivalents at end of period	$ 1,310	$ 1,304
Non-cash investing and financing activities:		
Capital leases	$	$ 57

See accompanying notes to condensed consolidated financial statements.

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Advanced Micro Devices, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements of Advanced Micro Devices, Inc. and subsidiaries (the Company or AMD) have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. The results of operations for the interim period ended June 28, 2008 shown in this report are not necessarily indicative of results to be expected for the full fiscal year ending December 27, 2008. In the opinion of the Company s management, the information contained herein reflects all adjustments necessary for a fair presentation of the Company s results of operations, financial position and cash flows. We have reclassified certain amounts previously reported in our financial statements to conform to the current presentation. The unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

The Company uses a 52-to-53 week fiscal year ending on the last Saturday in December. The quarters and six months ended June 28, 2008 and June 30, 2007 each consisted of 13 and 26 weeks.

As a result of the Company s evaluation of the viability of its non-core businesses, the Company determined that it s Handheld and Digital Television business units are not directly aligned with computing and graphics market opportunities. Therefore, the Company decided to divest these business units, which were previously part of the Consumer Electronics segment, and to classify them as discontinued operations in the financial statements in accordance with the provisions of Financial Accounting Standards Board (FASB) Statement No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (SFAS 144). Cash flows from discontinued operations are not material and are combined with cash flows from continuing operations within condensed consolidated statement of cash flows categories. (See Note 12)

The assets and liabilities of these businesses are reflected as assets and liabilities of discontinued operations in the consolidated balance sheets as of June 28, 2008 and December 29, 2007. The historical results of operations of these businesses have been segregated from the Company s consolidated financial statements and are included in income (loss) from discontinued operations, net of tax, in the consolidated statements of operations. Prior period amounts have been reclassified to conform to current period presentation including discontinued operations.

Principles of Consolidation. The consolidated financial statements include the Company s accounts and those of its majority-owned subsidiaries. Upon consolidation, all significant intercompany accounts and transactions are eliminated, and amounts pertaining to the non-controlling ownership interests held by third parties in the operating results and financial position of the Company s majority-owned subsidiaries, are reported as minority interest.

Fair Value Measurements. In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* (SFAS 157). This statement does not require any new fair value measurements but clarifies the fair value definition, establishes a fair value hierarchy that prioritizes the information used to develop assumptions for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 clarifies that fair value is the exchange price in an orderly transaction between market participants to sell the asset or transfer the liability in the market. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1 input), then to quoted prices (in non-active markets or in active markets for similar assets or liabilities), inputs other than quoted prices that are observable for the asset or liability, and inputs that are not directly observable, but that are corroborated by observable market data for the asset or liability (Level 2 input), then the lowest priority to unobservable inputs, for example, the Company s own data about the assumptions that market participants would use in pricing an asset or liability (Level 3 input). It emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and a fair value measurement should therefore be based on the assumptions that market participants would use in pricing the asset or liability. The Company adopted SFAS 157 on December 30, 2007, the first day of its fiscal year 2008. In February 2008, the FASB issued Staff Position (FSP) No. 157-1 to exclude SFAS 13, *Accounting for Leases*, and its related interpretive accounting pronouncements that address leasing transactions from the scope of FAS 157. Also in February 2008, the FASB issued FSP No. 157-2 to defer the effective date of SFAS 157 for one year for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis at least annually, which are deferred until fiscal years beginning after November 15, 2008 and interim periods within those fiscal years.

In order to determine the implications of adopting SFAS 157, the Company reviewed all the assets and liabilities recorded on its balance sheet. Based on the results of its review, the Company determined that a majority of its assets and liabilities are either not required to be measured at fair value in its financial statements, are outside the scope of SFAS 157, or are subject to the deferred implementation provisions of FSP No. 157-2. Therefore, the only assets and liabilities in the Company s financial statements subject to SFAS 157 (i.e. measured at fair value on a recurring basis) at June 28, 2008 and December 30, 2007 are the Company s investment portfolio and derivative contracts.

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Recently Issued Accounting Pronouncements. In March 2008, the FASB issued Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). This statement requires enhanced disclosures about an entity s derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with earlier application encouraged. The Company will adopt SFAS 161 in the first fiscal quarter of 2009. Since SFAS 161 requires only additional disclosures concerning derivatives and hedging activities, adoption of SFAS 161 will not have an impact on the Company s consolidated financial condition, results of operations or cash flows. The adoption of SFAS 161 will change the Company s disclosures for derivative instruments and hedging activities beginning in the first quarter of fiscal year 2009.

In May 2008, the FASB issued FSP APB No. 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1*)*. This FSP requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer s nonconvertible debt borrowing rate. The effective date of the FSP is for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years and it does not permit earlier application. However, the transition guidance requires retroactive application to all periods presented. This FSP will impact the Company s accounting for its $2.2 billion 6.00% Notes whereby the equity component would be included in the paid-in-capital portion of stockholders equity on the balance sheet and the value of the equity component would be treated as an original issue discount for purposes of accounting for the debt component. Higher interest expense will result by recognizing accretion of the discounted carrying value of the 6.00% Notes to their face amount as interest expense over the term of the 6.00% Notes. The Company expects to have higher interest expense beginning in its first fiscal quarter of 2009 due to the interest accretion, and the interest expense associated with its 6.00% Notes for prior periods will also be higher than previously reported due to the retrospective application of the FSP. Based on the preliminary analysis performed by the Company, the interest expense associated with its 6.00% Notes will be approximately $17 million, $26 million and $30 million higher for fiscal years 2007, 2008 and 2009 respectively, as a result of adopting this FSP.

2. Stock-Based Incentive Compensation Plans

The following table summarizes stock-based compensation expense related to employee stock options, restricted stock, restricted stock units and employee stock purchases for the fiscal quarters and six months ended June 28, 2008 and June 30, 2007, respectively, which was allocated in the condensed consolidated statements of operations as follows:

	Quarter Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)		(In millions)	
Cost of sales	$ 3	$ 2	$ 6	$ 5
Research and development	8	13	23	26
Marketing, general, and administrative	6	14	8	25
Total stock-based compensation expense related to employee stock options, restricted stock, restricted stock units and employee stock purchases	17	29	37	56
Tax benefit				
Stock-based compensation expense related to employee stock options, restricted stock, restricted stock units and employee stock purchases, net of tax	$ 17	$ 29	$ 37	$ 56

Stock Options. The weighted-average assumptions that the Company applied in the lattice-binomial model that the Company uses to value employee stock options are as follows:

	Quarter Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Expected volatility	59.81%	49.81%	64.18%	49.89%
Risk-free interest rate	2.74%	4.65%	2.65%	4.66%
Expected dividends	0.00%	0.00%	0.00%	0.00%

Expected life (in years)	3.19	3.55	3.19	3.55

For the quarters ended June 28, 2008 and June 30, 2007, the Company granted 1,021,822 and 1,625,000 employee stock options, respectively, with average estimated grant date fair values of $3.13 and $6.11. For the six months ended June 28, 2008 and June 30, 2007, the Company granted 10,555,698 and 2,002,000 employee stock options, respectively, with average estimated grant date fair values of $3.04 and $6.07.

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Restricted Stock Units and Awards. For the quarters ended June 28, 2008 and June 30, 2007, the Company granted 6,797,802 and 4,072,000 shares of restricted stock and restricted stock units, respectively, with an average grant date fair value of $7.40 and $15.36. For the six months ended June 28, 2008 and June 30, 2007, the Company granted 7,288,586 and 5,780,000 shares of restricted stock and restricted stock units, respectively, with an average grant date fair value of $7.34 and $15.20.

Employee Stock Purchase Plan. Beginning with the November 2007 purchase period the Company suspended its employee stock purchase plan (ESPP). Therefore, the Company did not issue any shares under the ESPP during the quarter and six months ended June 28, 2008. The Company issued 1,239,000 shares and 1,846,000 shares under the ESPP during the quarter and six months ended June 30, 2007, respectively.

3. Goodwill and Acquisition Related Intangible Assets

The changes in the carrying amount of goodwill by operating segment for the six month period ended June 28, 2008, were as follows:

	Computing Solutions	Graphics	Consumer Electronics	Total
		(In millions)		
Balances at December 29, 2007	$ 162	$ 533	$ 1,212	$ 1,907
Reclassification due to change in segments[1]		254	(254)	
Goodwill adjustments[2]	(1)	(3)	(5)	(9)
Impairment charges[3]			(799)	(799)
Reclassification to discontinued operations[3]			(154)	(154)
Balances at June 28, 2008	$ 161	$ 784	$	$ 945

(1) In the second quarter of 2008, the Company began to include royalties received in connection with the sale of game console systems within the operating results of the Graphics segment. As a result, the $254 million goodwill associated with the game console business is now included with the Graphics segment. (See Note 5)

(2) Adjustments to goodwill primarily represented changes in assumed pre-acquisition income tax liabilities as a result of the ATI acquisition, which will continue to be applied to goodwill until ultimately settled with the tax authorities or until the Company adopts the provisions of Statement No. 141(R) Business Combinations (SFAS 141(R)) at the beginning of fiscal year 2009, after which changes will be recorded in the statement of operations.

(3) In the second quarter of 2008, the Company evaluated the viability of its non-core businesses and determined that its Handheld and Digital Television business units are not directly aligned with its core strategy. Therefore, the Company decided to divest these units, and as a result, classified them as discontinued operations in the Company s financial statements. As a result, the Company performed an interim impairment test of goodwill and acquired intangible assets and concluded that the carrying amounts of goodwill and certain definite-lived intangible assets associated with its Handheld and Digital Television business units were impaired and recorded an impairment charge. The remaining carrying values of goodwill and acquired intangible assets related to these business units were reclassified to assets of discontinued operations.

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The balances of acquisition-related definite-lived intangible assets as of June 28, 2008, were as follows:

	Intangible Assets, Gross December 29, 2007	Net Book Value December 29, 2007	Amortization Expense Six months ended June 28, 2008	Impairment charge(1)	Reclassification to discontinued operations (1)	Net Book Value June 28, 2008	Weighted Average Amortization Period
			(In millions)				(In months)
Developed product technology	$ 752	$ 240	$ (45)	$ (60)	$ (83)	$ 52	50
Game console royalty agreements	147	113	(15)			98	60
Customer relationships	257	182	(29)	(14)	(66)	73	48
Trademark and trade name	62	52	(4)	(3)	(15)	30	84
Customer backlog	36						14
Total	$ 1,254	$ 587	$ (93)	$ (77)	$ (164)	$ 253	

(1) As a result of the goodwill impairment test pursuant to which the Company concluded that the carrying values of the goodwill associated with its Handheld and Digital Television business units was impaired, the Company performed an impairment test on the acquisition-related intangible assets associated with these business units. Based on the test results the Company concluded that carrying amounts of certain acquisition-related definite-lived intangible assets associated with its Handheld and Digital Television business units exceeded their estimated fair values and recorded an impairment charge. In addition, due to the Company s decision to divest these two business units, the remaining carrying costs of the acquisition-related intangible assets have been reclassified to discontinued operations.

Estimated future amortization expense related to acquisition-related intangible assets is as follows:

Fiscal year	Amortization expense (In millions)
Remaining 2008	$ 58
2009	76
2010	70
2011	38
2012	6
Thereafter	5
Total	$ 253

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4. Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed using the weighted-average number of common shares outstanding. Diluted net income (loss) per common share is computed using the weighted-average number of common shares outstanding plus any dilutive potential common shares outstanding. Potential dilutive common shares include stock options, restricted stock awards, and shares issuable upon the conversion of convertible debt. The following table sets forth the components of basic and diluted income (loss) per common share:

	Quarter Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions except per share data)		(In millions except per share data)	
Numerator:				
Numerator for basic and diluted income (loss) from continuing operations per common share	$ (269)	$ (531)	$ (577)	$ (1,081)
Numerator for basic and diluted income (loss) from discontinued operations per common share	$ (920)	$ (69)	$ (970)	$ (130)
Numerator for basic and diluted net income (loss) per common share	$ (1,189)	$ (600)	$ (1,547)	$ (1,211)
Denominator:				
Denominator for basic net income (loss) per share - weighted-average shares	607	552	606	550
Effect of dilutive potential common shares:				
Denominator for diluted net income (loss) per common - weighted-average shares	607	552	606	550
Basic and diluted income (loss) from continuing operations per common share	$ (0.44)	$ (0.96)	$ (0.95)	$ (1.96)
Basic and diluted income (loss) from discontinued operations per common share	$ (1.52)	$ (0.13)	$ (1.60)	$ (0.24)
Basic and diluted net income (loss) per common share	$ (1.96)	$ (1.09)	$ (2.55)	$ (2.20)

Potential dilutive common shares totaling approximately 63 million and 56 million for the quarters and six months ended June 28, 2008 and June 30, 2007, respectively, were not included in the net loss per common share calculation because their inclusion would have been anti-dilutive.

5. Segment Reporting

Management, including the Chief Operating Decision Maker (CODM), who is the Company s chief executive officer, reviews and assesses operating performance using segment net revenues and operating income (loss) before interest, other income (expense), minority interest, equity in net loss of Spansion Inc. and other and income taxes. These performance measures include the allocation of expenses to the operating segments based on management s judgment.

Prior to the second quarter of 2008, the Company had three reportable operating segments:

the Computing Solutions segment, which included microprocessors, chipsets and embedded processors and related revenue;

the Graphics segment, which included graphics, video and multimedia products and related revenue; and

the Consumer Electronics segment, which included products used in handheld devices, digital televisions and other consumer electronics products, as well as revenue from royalties received in connection with sales of game console systems that incorporate the Company s technology.

In the second quarter of 2008, the Company decided to divest its Handheld and Digital Television businesses, which were previously part of the Consumer Electronics segment. As a result, the Company classified them as discontinued operations in the Company s financial statements. The CODM began reviewing and assessing operating performance using the following reportable operating segments:

the Computing Solutions segment, which includes microprocessors, chipsets and embedded processors and related revenue;

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the Graphics segment, which includes graphics, video and multimedia products and related revenue, as well as revenue from royalties received in connection with sales of game console systems that incorporate the Company s graphics technology.

In addition to the reportable segments, the Company has an All Other category, which is not a reportable segment. This category consists of certain expenses and credits that are not allocated to any of the operating segments because the CODM does not consider these expenses and credits in evaluating the performance of the operating segments. These expenses and credits include employee stock-based compensation expense, amortization of acquired intangible assets, integration charges, restructuring charges and charges for goodwill and intangible asset impairment.

The following table provides a summary of the Company s net revenue and operating income (loss) by segment with reconciliations to income (loss) from continuing operations for the quarters ended and six months ended June 28, 2008 and June 30, 2007:

	Quarter Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			
Computing Solutions				
Net revenue	$ 1,101	$ 1,098	$ 2,295	$ 2,017
Operating income (loss)	(9)	(269)	(173)	(600)
Graphics				
Net revenue	248	211	510	422
Operating income (loss)	(38)	(39)	(25)	(65)
All Other				
Net revenue				
Operating income (loss)	(96)	(88)	(159)	(182)
Total				
Net revenue	1,349	1,309	2,805	2,439
Operating income (loss)	(143)	(396)	(357)	(847)
Interest income	10	19	25	35
Interest expense	(95)	(99)	(190)	(177)
Other income (expense), net	(10)	(9)	(11)	(7)
Minority interest in consolidated subsidiaries	(7)	(9)	(20)	(17)
Equity in net loss of Spansion Inc. and other	(24)	(13)	(24)	(29)
Income (loss) before income taxes	(269)	(507)	(577)	(1,042)
Provision for income taxes		24		39
Income (loss) from continuing operations	$ (269)	$ (531)	$ (577)	$ (1,081)

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6. Comprehensive Income (Loss)

The following are the components of comprehensive income (loss):

	Quarter Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			
Net income (loss)	$ (1,189)	$ (600)	$ (1,547)	$ (1,211)
Net change in unrealized gains (losses) on available-for-sale securities	18		(2)	
Net change in unrealized gains (losses) on cash flow hedges, net of taxes	(13)	6	(8)	9
Net change in cumulative translation adjustments		(5)		(4)
Other comprehensive income (loss)	5	1	(10)	5
Total comprehensive income (loss)	$ (1,184)	$ (599)	$ (1,557)	$ (1,206)

7. Other Long-Term Liabilities

The Company s other long-term liabilities balances at June 28, 2008 and December 29, 2007 were $695 million and $633 million, respectively. Included in these balances were deferred grants and subsidies related to the manufacturing facilities in Dresden in the amounts of $401 million for both June 28, 2008 and December 29, 2007.

8. Commitments and Contingencies

Guarantees

Guarantees of Indebtedness Recorded on the Company s Consolidated Balance Sheet

As of June 28, 2008, the principal guarantee recorded on the Company s consolidated balance sheet was $63 million, which represents the amount of silent partnership interest that the Company is required to repurchase from Leipziger Messe and is exclusive of the guaranteed rate of return of an aggregate of approximately $158 million. Of this amount, $31 million is expected to expire by the end of 2008, and $32 million is expected to expire by the end of 2009. No incremental liabilities are recorded on the Company s condensed consolidated balance sheet for this guarantee.

Guarantees of Indebtedness Not Recorded on the Company s Condensed Consolidated Balance Sheet

AMTC and BAC Guarantees

The Advanced Mask Technology Center GmbH & Co. KG (AMTC) and Maskhouse Building Administration GmbH & Co. KG (BAC) are joint ventures initially formed by AMD, Infineon Technologies AG (Infineon) and DuPont Photomasks, Inc. (Dupont) for the purpose of constructing and operating an advanced photomask facility in Dresden, Germany. The Company procures advanced photomasks from AMTC and uses them in manufacturing its microprocessors. In April 2005, DuPont was acquired by Toppan Printing Co., Ltd. and became a wholly owned subsidiary of Toppan, named Toppan Photomasks, Inc. In December 2007, Infineon entered into an assignment agreement to transfer its interest in AMTC and BAC to Qimonda AG, with the exception of certain AMTC/BAC related payment guarantees. The assignment became effective in January 2008.

In December 2002, BAC obtained a $118 million term loan to finance the construction of the photomask facility. At the same time, AMTC and BAC, as lessor, entered into a lease agreement. The term of the lease agreement is ten years. Each joint venture partner guaranteed a specific percentage of AMTC s rental payments. Pursuant to an agreement between AMTC, BAC and DuPont (now Toppan), AMTC may exercise a step-in right, in which it would assume Toppan s remaining rental payments in connection with the rental agreement between Toppan and BAC. As of June 28, 2008, the Company s guarantee of AMTC s portion of the rental obligation was approximately $10 million and its maximum liability in the event AMTC exercises its step-in right and the other joint venture partners default under the guarantee was approximately $98 million. These estimates are based upon forecasted rents to be charged in the future and are subject to change based upon the actual usage of the facility by the tenants and foreign currency exchange rates.

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In December 2007, AMTC entered into a new $107 million revolving credit facility, of which $99 million was outstanding as of June 28, 2008. The proceeds were used to repay all amounts outstanding under a previous $189 million revolving credit facility and to provide additional financing for the acquisition of new tools. Subject to certain conditions under the revolving credit facility, AMTC may request that the loan amount be increased by an additional $63 million. The term of the revolving credit facility is three years. Upon request by AMTC and subject to certain conditions, the term of the revolving credit facility may be extended by two additional one-year periods. Pursuant to a guarantee agreement, each joint venture partner guaranteed one third of AMTC s outstanding loan balance under the revolving credit facility. As of June 28, 2008, the Company s liability under this guarantee was $33 million plus its portion of accrued interest and expenses. The Company s maximum liability under this guarantee is $36 million plus its portion of accrued interest and expenses. Under the terms of the guarantee, if the Company s group consolidated cash (which is defined as cash, cash equivalents and marketable securities less the aggregate amount outstanding under any revolving credit facility) is less than or expected to be less than $500 million, the Company will be required to provide cash collateral equal to one third of the balance outstanding under the revolving credit facility. The Company evaluated its guarantee under the provisions of FIN 45 and concluded it was immaterial to its financial position or results of operations.

Warranties and Indemnities

The Company generally warrants that microprocessor products sold to its customers will, at the time of shipment, be free from defects in workmanship and materials and conform to its approved specifications. Subject to certain exceptions, the Company generally offers a three-year limited warranty to end users for microprocessor products that are commonly referred to as processors in a box, a one-year limited warranty to direct purchasers of all other microprocessor products that are commonly referred to as tray microprocessor products, and a one-year limited warranty to direct purchasers of embedded processor products. The Company has offered extended limited warranties to certain customers of tray microprocessor products who have written agreements with the Company and target their computer systems at the commercial and/or embedded markets.

The Company generally warrants that its graphics, and chipsets and certain products for consumer electronics devices will conform to the Company s approved specifications and be free from defects in material and workmanship under normal use and service for a period of one year beginning on shipment of such products to its customers. The Company generally warrants that ATI-branded PC workstation products will conform to the Company s approved specifications and be free from defects in material and workmanship under normal use and service for a period of three years, beginning on shipment of such products to its customers.

Changes in the Company s potential liability for product warranties during the six months ended June 28, 2008 and June 30, 2007 are as follows:

	Six Months Ended	
	June 28, 2008	June 30, 2007
	(In millions)	
Balance, beginning of the period	$ 25	$ 26
New warranties issued during the period	20	12
Settlements during the period	(18)	(18)
Changes in liability for pre-existing warranties during the period, including expirations	(8)	(7)
Balance, end of the period	$ 19	$ 13

In addition to product warranties, the Company, from time to time in its normal course of business, indemnifies other parties, with whom it enters into contractual relationships, including customers, lessors and parties to other transactions with the Company, with respect to certain matters. The Company has agreed to hold the other party harmless against specified losses, such as those arising from a breach of representations or covenants, third-party claims that the Company s products when used for their intended purpose(s) infringe the intellectual property rights of a third party or other claims made against certain parties. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim and indemnification provision. Historically, payments made by the Company under these obligations have not been material.

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Contingencies

The Company is a defendant or plaintiff in various actions that arose in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company s financial condition or results of operations.

9. Income Taxes

The Company recorded an income tax benefit of less than $1 million in the second quarter of 2008 and an income tax provision of $24 million in the second quarter of 2007. For the six months ended June 28, 2008, the Company recorded an income tax benefit of less than $1 million and an income tax provision of $39 million for the six months ended June 30, 2007.

For the second quarter and first six months of 2008, foreign taxes in profitable locations were substantially offset by discrete tax benefits. The income tax provisions in the second quarter and first six months of 2007 were primarily for deferred U.S. taxes related to indefinite-lived goodwill and foreign taxes in profitable locations.

As of June 28, 2008, substantially all of the Company s U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a valuation allowance. The realization of these assets is dependent on substantial future taxable income which at June 28, 2008 in management s estimate, is not more likely than not to be achieved.

The Company s gross unrecognized tax benefits increased by $14 million during the quarter due to the receipt of certain proposed tax adjustments in foreign locations net of the expiration of certain statutes of limitation. As a result, the Company has now recognized $118 million of long-term deferred tax assets, previously under a valuation allowance, with $162 million of liabilities for unrecognized tax benefits as of June 28, 2008. The net impact on the effective tax rate of the increase in the gross unrecognized tax benefits in the second quarter of 2008 was not material because of the valuation allowance. There were no material changes in interest and penalties in the second quarter.

The IRS commenced the audit of the Company s 2004 to 2006 tax years during the second quarter of 2008.

During the 12 months beginning June 29, 2008 the Company does not believe it is reasonably possible that other unrecognized tax benefits will materially change in the next 12 months.

10. Fair Value Measurements

Assets and liabilities measured at fair value are summarized below (in millions):

		Fair value measurement at reporting date using		
	June 28, 2008	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
			(In millions)	
Money market mutual funds[1]	$ 524	$ 524	$	$
Commercial paper[2]	539		539	
Time deposits[1]	178		178	
Certificates of deposit[1]	15		15	
Auction rate securities[3]	180			180
Marketable equity securities[4]	33	33		
Foreign currency derivative contracts[5]	26		26	
Total assets	$ 1,495	$ 557	$ 758	$ 180

(1) Included in cash and cash equivalents on the Company s condensed consolidated balance sheet.

(2) $509 million included in cash and cash equivalents and $30 million included in marketable securities on the Company s condensed consolidated balance sheet.

(3) Included in marketable securities on the Company s condensed consolidated balance sheet.

(4) $32 million included in marketable securities and $1 million included in other assets on the Company s condensed consolidated balance sheet.

(5) Included in prepaid expenses and other current assets on the Company s condensed consolidated balance sheet.

The Company measures its cash equivalents, marketable securities and foreign currency derivative contracts at fair value, which does not materially differ from the carrying values of these instruments in the financial statements. Cash equivalents and marketable securities are primarily classified within Level 1 or Level 2, with the exception of auction rate security (ARS) investments. This is

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because cash equivalents and marketable securities are valued primarily using quoted market prices or alternative pricing sources and models utilizing market observable inputs, as provided to the Company by its brokers. The ARS investments are classified within Level 3 because they are valued using a discounted cash flow model. Some of the inputs to this model are unobservable in the market and are significant. Our foreign currency derivative contracts are classified within Level 2 because the valuation inputs are based on quoted prices and market observable data of similar instruments in inactive markets.

The Company recorded an other-than-temporary impairment charge of $24 million in June 2008 for its investment in Spansion Inc. This impairment charge is included in the caption Equity in net loss of Spansion Inc. and other on the Company s second quarter 2008 consolidated statement of operations. (See Note 13). There was no charge recorded for Equity in net loss of Spansion Inc. and other in the first quarter of 2008.

The recent uncertainties in the credit markets have affected all of the Company s ARS and auctions for these securities have failed to settle on their respective settlement dates. As a result, reliable Level 1 or Level 2 pricing is not available for these ARS. In light of these developments, to determine the fair value for its ARS, the Company obtained broker reports and discussed with brokers the critical inputs that they used in their proprietary models to assess fair value, which included liquidity, credit rating, and discounted cash flows associated with these ARS. In addition, the Company performed its own discounted cash flow analyses. Based on the outcomes of these activities, the Company concluded that the fair value of its ARS was lower than their carrying value and, as a result, recorded an other than temporary impairment charge for $12 million for the period ended June 28, 2008. In the second calendar quarter of 2008, in markets where similar securities are traded, there has been an increase in securities called. As of June 28, 2008, the Company classified its investments in ARS as current assets because it reasonably expects that it will be able to sell these securities and have the proceeds available for use in its operations within the next twelve months through a future successful auction, a sale to a buyer found outside the auction process, or through a redemption by which issuers establish a different form of financing to replace these securities. However, the Company is not dependant on liquidating its ARS in the next twelve months in order to meet its liquidity needs.

The Company s investments in ARS include approximately $136 million of student loan ARS, $32 million of municipal and corporate ARS and $12 million ARS in preferred shares of closed end mutual funds. Approximately 97 percent of the Company s ARS holdings are AAA rated investments and all the $136 million student loan ARS are guaranteed by the Federal Family Educational Loan Program. Until the first quarter of 2008, the fair values of the Company s ARS were determinable by reference to frequent successful Dutch auctions of such securities, which settled at par.

Reconciliation of the financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	Quarter ended June 28, 2008 Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Securities (In millions)	Six months ended June 28, 2008 Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Auction Rate Securities (In millions)
Beginning balance	$ 202	$
Transfers of ARS into Level 3		210
Redemption at par	(10)	(18)
Other than temporary impairment	(12)	(12)
Ending balance, June 28, 2008	$ 180	$ 180
Loss for period included in earnings attributable to the Level 3 financial assets still held at June 28, 2008	$ 12	$ 12

Total financial assets at fair value classified within Level 3 were 1.8% of total assets on the Company s condensed consolidated balance sheet as of June 28, 2008.

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11. Restructuring

In the second quarter of fiscal 2008, the Company initiated a restructuring plan, which included a reduction-in-force (RIF) and certain contract termination costs related to technologies it was no longer pursuing and recorded a total charge of $32 million. The RIF component, which is comprised primarily of severance and costs related to the continuance of certain employee benefits, totaled approximately $23 million. Other exit-related costs, including $6 million of non-cash charges, totaled approximately $9 million. These charges have been aggregated and appear on the line item entitled Restructuring Charges in the Company s condensed consolidated statement of operations except for $2 million classified as discontinued operations.

During the second quarter of fiscal 2008, the Company paid approximately $18 million of severance and benefits to employees affected by this action. The Company anticipates recording approximately $9 million of additional severance in the third and fourth quarters of fiscal 2008 and to substantially complete this action by the end of fiscal 2008.

The following table provides a summary of the restructuring activities and the liability remaining as of June 28, 2008:

(In millions)	Severance and related benefits	Other exit-related costs
Balance December 29, 2007	$	$
Second quarter charges	23	9
Cash payments	(18)	
Non-cash charges		(6)
Balance June 28, 2008	$ 5	$ 3

12. Discontinued Operations

During the second quarter of 2008, the Company decided to divest its Handheld and Digital Television business units and classified them as discontinued operations in the Company s financial statements. The Company discontinued amortization and depreciation related to the assets of these business units in the second quarter of 2008. Consequently, the Company has segregated the assets and liabilities related to discontinued operations from those assets and liabilities related to continuing operations on the Company s balance sheet, the Company has segregated the operating results of discontinued operations from those of continuing operations on the Company s statement of operations for all periods presented.

As a result of its decision to divest its Handheld and Digital Television business units, the Company performed an interim impairment test of goodwill and acquired intangible assets and concluded that the carrying amounts of goodwill and certain definite-lived intangible assets associated with its Handheld and Digital Television business units were impaired and recorded an impairment charge. For goodwill, the impairment charge was determined by comparing the carrying value of goodwill assigned to the Company s reporting units with the implied fair value of the goodwill. The Company considered the income approach in determining the implied fair value of the goodwill, which requires estimates of future operating results and cash flows of each of the reporting units discounted using estimated discount rates taking into consideration the estimated proceeds that the Company expects to receive in connection with any potential divestiture. For acquired intangible assets, the Company assessed the recoverability of the unamortized balances by comparing the undiscounted future net cash flows. For those acquired intangible assets where the unamortized balances exceed the undiscounted future net cash flows, the Company measured the amount of impairment by calculating the amount by which the carrying values exceeded the estimated fair values, which were based on projected discounted future net cash flows. The remaining carrying values of goodwill related to these business units was reclassified to assets of discontinued operations.

The results from discontinued operations are as follows:

	Quarter Ended		Six Months Ended	
(In millions)	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007

Revenue	$ 37	$ 69	$ 86	$ 172
Operating expenses	(79)	(138)	(178)	(302)
Impairment of goodwill and acquired intangible assets	(876)		(876)	
Restructuring charges	(2)		(2)	
Loss from discontinued operations	$ (920)	$ (69)	$ (970)	$ (130)

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The carrying value of the assets of discontinued operations was $372 million and $1.3 billion as of June 28, 2008 and December 29, 2007, respectively. Included in these balances is goodwill and acquired intangible assets in the amounts of $318 million and $1.2 billion as of June 28, 2008 and December 29, 2007, respectively. The carrying value of the liabilities for discontinued operations was $23 million and $43 million as of June 28, 2008 and December 29, 2007, respectively. Cash flows from discontinued operations are not material and are combined with cash flows from continuing operations within condensed consolidated statement of cash flows categories.

13. Equity in net loss of Spansion Inc. and other

Equity in net loss of Spansion Inc. and other for the three and six months ended June 28, 2008 consists of an other than temporary impairment charge on the Company s investment in Spansion s common stock recorded in the second quarter. After giving consideration to Spansion s recent operating results and its stock price trends in the preceding six months, the Company concluded that the unrealized loss, which represents the difference between the carrying amounts of this investment at December 29, 2007 and June 28, 2008, was other than temporary. At June 28, 2008, the Company owned a total 14,037,910 shares, or approximately 8 percent, of Spansion s outstanding common stock. The Company s carrying cost of the investment was $32 million, which represented the fair value of this investment based on the closing market price of Spansion s common stock on June 27, 2008.

Equity in net loss of Spansion Inc. and other for the three and six months ended June 30, 2007 consists of the Company s share of the operating losses of Spansion Inc. under the equity method of accounting.

In the third quarter of 2007, the Company changed its accounting for this investment from the equity method of accounting to accounting for this investment as available-for-sale marketable securities under SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

14. Sale of Receivables Classified as Other Short-Term Obligations

On March 26, 2008, the Company entered into a Sale of Receivables Supplier Agreement with IBM Credit LLC, or IBM Credit, and one of its wholly-owned subsidiaries, AMD International Sales & Service, Ltd., or AMDISS, entered into the same sales agreement with IBM United Kingdom Financial Services Ltd., or IBM UK, pursuant to which the Company and AMDISS agreed to sell to each of IBM Credit and IBM UK certain receivables. Pursuant to the sales agreements, the IBM parties agreed to purchase from the AMD parties invoices of specified AMD customers up to credit limits set by the IBM parties for any applicable AMD customer. As of June 28, 2008, only certain distributor customers have participated in this program. Because the Company does not recognize revenue until its distributors sell its products to their customers, the Company classified funds received from the IBM parties as debt according to the requirement of EITF 88-18, *Sales of Future Revenues*. The debt is reduced as the IBM parties receive payments from the distributors. As of June 28, 2008, $60 million was outstanding under these agreements. This amount appears as other short-term obligations on the Company s consolidated balance sheet and is not considered a cash commitment.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The statements in this report include forward-looking statements. These forward-looking statements are based on current expectations and beliefs and involve numerous risks and uncertainties that could cause actual results to differ materially from expectations. These forward-looking statements should not be relied upon as predictions of future events as we cannot assure you that the events or circumstances reflected in these statements will be achieved or will occur. You can identify forward-looking statements by the use of forward-looking terminology including believes, expects, may, will, should, seeks, intends, plans, pro forma, estimates, or anticipates or the negative of these words and phrases or other variations of these words and phrases or comparable terminology. The forward-looking statements relate to, among other things: the demand for our new products; the growth and competitive landscape of the markets in which we participate; our revenues; our cost reduction efforts and anticipated savings from the restructuring; our ability to achieve operating profitability in the second half of 2008; impairment amounts for goodwill and acquired intangible assets; our intended divestiture of our Handheld and Digital Television businesses; our ability to liquidate our auction rate securities in the next twelve months; our capital expenditures; our operating expenses; our depreciation and amortization expense; our aggregate contractual obligations; and availability of external financing. Material factors and assumptions that were applied in making these forward-looking statements include, without limitation, the following: (1) the expected rate of market growth and demand for our products and technologies (and the mix thereof); (2) our expected market share; (3) our expected product and manufacturing costs and average selling prices; (4) our overall competitive position and the competitiveness of our current and future products; (5) our ability to introduce new products and effect transitions to more advanced manufacturing process technologies, consistent with our current plans in terms of timing and capital expenditures; (6) our ability to raise sufficient capital on favorable terms; (7) our ability to make additional investment in research and development and that such opportunities will be available; and (8) the expected demand for computers. Material factors that could cause actual results to differ materially from current expectations include, without limitation, the following: (1) that Intel Corporation s pricing, marketing and rebating programs, product bundling, standard setting, new product introductions or other activities may negatively impact sales; (2) that our substantial indebtedness could adversely affect our financial position and prevent us from implementing our strategy or fulfilling our contractual obligations; (3) that we will require additional funding and may be unable to raise sufficient capital, on favorable terms, or at all; (4) that we may be unable to realize the anticipated benefits of our acquisition of ATI because, among other things, the revenues, cost savings, growth prospects and any other synergies expected from the transaction may not be fully realized or may take longer to realize than expected; (5) that we may be unable to maintain the level of investment in research and development and capacity that is required to remain competitive; (6) that we may be unable to develop, launch and ramp new products and technologies in the volumes that is required by the market at mature yields on a timely basis; (7) that we may be unable to transition to advanced manufacturing process technologies in a timely and effective way, consistent with planned capital expenditures; (8) that there may be unexpected variations in market growth and demand for our products and technologies in light of the product mix that we may have available at any particular time or a decline in demand; (9) that demand for computers will be lower than currently expected; (10) that we may be unable to obtain sufficient manufacturing capacity (either in our own facilities or at foundries) or components to meet demand for our products; (11) that we may under-utilize our microprocessor manufacturing facilities; (12) that we will be unable to divest our Handheld and Digital Television businesses in the expected timeframe if at all, or in a manner contemplated by us; and (13) the effect of political or economic instability, domestically or internationally, on our sales or production.

For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see Part II, Item 1A Risk Factors section beginning on page 40 and the Financial Condition section beginning on page 29 and such other risks and uncertainties as set forth below in this report or detailed in our other SEC reports and filings. We assume no obligation to update forward-looking statements.

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In this section, we will describe the general financial condition and the results of operations for Advanced Micro Devices, Inc. and its consolidated subsidiaries, including a discussion of our results of operations for the quarter and six months ending June 28, 2008 compared to the quarter and six months ending June 30, 2007, an analysis of changes in our financial condition and a discussion of our contractual obligations and off balance sheet arrangements.

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included in this report and our audited consolidated financial statements and related notes as of December 29, 2007 and December 31, 2006, and for each of the three years in the period ended December 29, 2007 as filed in our Annual Report on Form 10-K for our fiscal year ended December 29, 2007.

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Overview

We are a global semiconductor company with facilities around the world. During the second quarter of 2008, we decided to divest our Handheld and Digital Television businesses, which prior to the second quarter of 2008 were reported in our Consumer Electronics segment, and as a result, we classified them as discontinued operations in our financial statements. The discussion in this Management s Discussion and Analysis of Financial Condition and Results of Operations section focuses on our continuing operations which consist of:

- x86 microprocessors, for the commercial and consumer markets, embedded microprocessors for commercial, commercial client and consumer markets and chipsets for desktop and notebook personal computers or PCs, professional workstations and servers; and

- graphics, video and multimedia products for desktop and notebook computers, including home media PCs, professional workstations and servers and technology for game consoles.

The following discussion is limited to our continuing operations, unless otherwise noted.

The second quarter of 2008 was another challenging quarter. Net revenue from continuing operations increased 3 percent compared to the second quarter of 2007 and declined 7 percent compared to first quarter of 2008. Revenue increased compared to the second quarter of 2007 primarily because of an increase in unit shipments in both the Computing Solutions and Graphics segments as well as an increase in royalties from sales of game consoles that incorporate our technology. Revenue declined compared to the first quarter of 2008 primarily because of lower microprocessor average selling prices and lower overall unit shipments. Average selling prices declined primarily due to a competitive pricing environment for our microprocessors as well as the shift in the product mix within the Graphics segment and for our microprocessors. Gross margin, as a percentage of net revenue, for the second quarter of 2008 was 52 percent, an increase of 11 percentage points compared to 41 percent in the first quarter of 2008 and an 18 percent increase compared to 34 percent in the second quarter of 2007. However, during the second quarter of 2008 we recorded in cost of sales a gain of $193 million from the sale of 200 millimeter equipment which favorably impacted the gross margin by approximately 14 percentage points. Lower unit volumes and microprocessor average selling prices in the second quarter of 2008 compared to the first quarter of 2008 adversely impacted gross margin.

Operating loss for the second quarter of 2008 was $143 million compared to an operating loss of $214 million in the first quarter of 2008 and an operating loss of $396 million in the second quarter of 2007. However, the improvement in operating performance in the second quarter of 2008 compared to the first quarter of 2008 and the second quarter of 2007 was primarily attributable to the gain on the tool sale referenced above. Our cash, cash equivalents and marketable securities at June 28, 2008 were $1.6 billion, a decrease of $322 million compared to December 29, 2007. Capital expenditures were $104 million in the second quarter of 2008 compared to $322 million in the first quarter of 2008 and $414 million in the second quarter of 2007.

We continue to work towards improving our operating results with the goal of achieving operating profitability in the second half of 2008. We believe that we will be able to improve our financial performance in the second half of the year through the impact of the cost reduction actions we have taken during the first half of 2008, potential future cost reduction measures and an improved product mix from recently introduced products and anticipated new product introductions.

We intend the discussion of our financial condition and results of operations that follows to provide information that will assist you in understanding our financial statements, the changes in certain key items in those financial statements from period to period, the primary factors that resulted in those changes and how certain accounting principles, policies and estimates affect our financial statements.

Critical Accounting Policies

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

Management believes there have been no significant changes during the six months ended June 28, 2008 to the items that we disclosed as our critical accounting policies and estimates in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended December 29, 2007 other than the following:

Fair Value. Effective December 30, 2007, we adopted SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosure of fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and accordingly, does not require any new fair value measurements.

The fair values of our financial instruments reflect the estimates of amounts that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The fair value estimates presented in our consolidated financial statements are based on information available to us as of June 28, 2008 and Decem