

SOLECTRON CORP
Form 10-Q
December 29, 2006

Table of Contents

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

Form 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended November 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 December 22, 2006, 904,041,059 shares of Common Stock of the Registrant were outstanding (including approximately 18.0 million shares of Solectron Global Services Canada, Inc., which are exchangeable on a one-to-one basis for the Registrant's common stock)

SOLECTRON CORPORATION

INDEX TO FORM 10-Q

PART I. FINANCIAL INFORMATION

| | | |
|----------------|--|----|
| <u>Item 1.</u> | <u>Financial Statements (unaudited)</u> | 4 |
| | <u>Condensed Consolidated Balance Sheets at November 30, 2006 and at August 31, 2006</u> | 4 |
| | <u>Condensed Consolidated Statements of Operations for the three months ended November 30, 2006 and 2005</u> | 5 |
| | <u>Condensed Consolidated Statements of Comprehensive Income for the three months ended November 30, 2006 and 2005</u> | 6 |
| | <u>Condensed Consolidated Statements of Cash Flows for the three months ended November 30, 2006 and 2005</u> | 7 |
| | <u>Notes to Condensed Consolidated Financial Statements</u> | 8 |
| <u>Item 2.</u> | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 27 |
| <u>Item 3.</u> | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 40 |
| <u>Item 4.</u> | <u>Controls and Procedures</u> | 40 |

PART II. OTHER INFORMATION

| | | |
|---------------------|--------------------------------------|----|
| <u>Item 1.</u> | <u>Legal Proceedings</u> | 41 |
| <u>Item 1a.</u> | <u>Risk Factors</u> | 41 |
| <u>Item 1b.</u> | <u>Unresolved Staff Comments</u> | 49 |
| <u>Item 2.</u> | <u>Purchase of Equity Securities</u> | 50 |
| <u>Item 6.</u> | <u>Exhibits</u> | 50 |
| <u>Signatures</u> | | 51 |
| <u>EXHIBIT 10.1</u> | | |
| <u>EXHIBIT 31.1</u> | | |
| <u>EXHIBIT 31.2</u> | | |
| <u>EXHIBIT 32.1</u> | | |
| <u>EXHIBIT 32.2</u> | | |

Cautionary Statement Regarding Forward-Looking Statements

With the exception of historical facts, the statements contained in this quarterly report are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), and are subject to the safe harbor provisions set forth in the Exchange Act. These forward-looking statements relate to matters including, but not limited to:

anticipated sales and future operating results;

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

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

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

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

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

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

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

our exposure to foreign currency exchange rate fluctuations;

Table of Contents

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

the impact of any litigation;

the impact of customer defaults or bankruptcies;

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

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

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

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

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

| | November 30 2006 | August 31 2006 |
|--|--------------------------------------|---------------------------|
| | (In millions) (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash, cash equivalents and short-term investments* | \$ 1,061.6 | \$ 1,180.5 |
| Accounts receivable, net | 1,500.8 | 1,429.3 |
| Inventories | 1,599.2 | 1,516.1 |
| Prepaid expenses and other current assets | 299.7 | 225.8 |
| Total current assets | 4,461.3 | 4,351.7 |
| Property and equipment, net | 739.2 | 673.4 |
| Goodwill | 155.1 | 155.2 |
| Other assets | 115.1 | 193.3 |
| Total assets | \$ 5,470.7 | \$ 5,373.6 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Short-term debt | \$ 23.1 | \$ 89.5 |
| Accounts payable | 1,698.9 | 1,616.7 |
| Accrued employee compensation | 199.3 | 170.4 |
| Accrued expenses and other current liabilities | 475.8 | 427.6 |
| Total current liabilities | 2,397.1 | 2,304.2 |
| Long-term debt | 618.8 | 619.4 |
| Other long-term liabilities | 37.4 | 36.3 |
| Total liabilities | 3,053.3 | 2,959.9 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock | 0.9 | 1.0 |
| Additional paid-in capital | 7,581.8 | 7,585.2 |
| Accumulated deficit | (5,067.3) | (5,073.3) |

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| | | |
|--|------------|------------|
| Accumulated other comprehensive loss | (98.0) | (99.2) |
| Total stockholders' equity | 2,417.4 | 2,413.7 |
| Total liabilities and stockholders' equity | \$ 5,470.7 | \$ 5,373.6 |

* Includes \$16.7 million and \$31.6 million of restricted cash balances as of November 30, 2006 and August 31, 2006, respectively, and \$20.5 million and \$22.9 million of short term investments as of November 30, 2006 and August 31, 2006, respectively.

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | Three Months Ended November 30 | |
|---|---|-------------|
| | 2006 | 2005 |
| | (In millions, except per share data) (Unaudited) | |
| Net sales | \$ 2,999.1 | \$ 2,456.4 |
| Cost of sales | 2,849.7 | 2,330.8 |
| Gross profit | 149.4 | 125.6 |
| Operating expenses: | | |
| Selling, general and administrative | 109.8 | 107.4 |
| Restructuring and impairment costs | 34.6 | 0.9 |
| Operating income | 5.0 | 17.3 |
| Interest income | 10.2 | 12.1 |
| Interest expense | (7.3) | (6.7) |
| Other (expense) income, net | (0.9) | 1.9 |
| Operating income from continuing operations before income taxes | 7.0 | 24.6 |
| Income tax expense | 0.4 | 4.4 |
| Income from continuing operations | 6.6 | 20.2 |
| Discontinued operations: | | |
| (Loss) income from discontinued operations before income taxes | (0.6) | 3.8 |
| Income tax expense | | |
| (Loss) income from discontinued operations | (0.6) | 3.8 |
| Net income | \$ 6.0 | \$ 24.0 |
| Basic net income per share: | | |
| Continuing operations | \$ 0.01 | \$ 0.02 |
| Discontinued operations | | 0.01 |
| Basic net income per share | \$ 0.01 | \$ 0.03 |
| Diluted net income per share: | | |
| Continuing operations | \$ 0.01 | \$ 0.02 |
| Discontinued operations | | 0.01 |
| Diluted net income per share | \$ 0.01 | \$ 0.03 |

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| | | |
|---|-------|-------|
| Shares used to compute basic net income per share | 895.4 | 925.2 |
| Shares used to compute diluted net income per share | 897.4 | 925.9 |

See accompanying notes to unaudited condensed consolidated financial statements.

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

| | Three Months Ended November 30 | |
|---|---|-------------|
| | 2006 | 2005 |
| | (In millions) (Unaudited) | |
| Net income | \$ 6.0 | \$ 24.0 |
| Other comprehensive income: | | |
| Foreign currency translation adjustments, net | 1.2 | 0.4 |
| Comprehensive income | \$ 7.2 | \$ 24.4 |

Accumulated unrealized foreign currency translation losses were \$88.7 million at November 30, 2006 and \$89.1 million at August 31, 2006. 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 unaudited condensed consolidated financial statements.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Three Months Ended | |
|---|---------------------------|-------------|
| | November 30 | |
| | 2006 | 2005 |
| | (Revised) | |
| | (In millions) | |
| | (Unaudited) | |
| Cash flows from operating activities: | | |
| Net income | \$ 6.0 | \$ 24.0 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Loss (income) from discontinued operations | 0.6 | (3.8) |
| Depreciation and amortization | 42.0 | 45.1 |
| Impairment of property, equipment, goodwill and other long term assets | 0.5 | 5.2 |
| Stock-based compensation | 6.1 | 4.7 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net of allowance | (71.5) | (106.3) |
| Inventories | (83.1) | (124.3) |
| Prepaid expenses and other assets | (77.1) | (13.2) |
| Accounts payable | 82.2 | 17.2 |
| Accrued expenses and other current liabilities | 86.0 | 37.6 |
| Net cash used in operating activities of continuing operations | (8.3) | (113.8) |
| Net cash used in operating activities of discontinued operations | (0.6) | (1.7) |
| Net cash used in operating activities | (8.9) | (115.5) |
| Cash flows from investing activities: | | |
| Change in restricted cash and cash equivalents | 14.9 | (17.8) |
| Sale of available for sale securities | 2.4 | 9.5 |
| Payments for facilities previously under synthetic lease | (13.2) | |
| Proceeds from disposition of business | | 2.1 |
| Capital expenditures | (33.4) | (58.9) |
| Proceeds from sale of property and equipment | 12.4 | 1.2 |
| Net cash used in investing activities of continuing operations | (16.9) | (63.9) |
| Net cash provided by investing activities of discontinued operations | | 3.8 |
| Net cash used in investing activities | (16.9) | (60.1) |
| Cash flows from financing activities of continuing operations: | | |
| Net repayment on bank lines of credit and other debt arrangements | (2.8) | (2.4) |
| Payments made to redeem ACES and Senior Notes | (64.3) | |
| Common stock repurchase | (10.0) | (180.4) |
| Net proceeds from stock issued under option and employee purchase plans | 0.4 | 0.6 |

| | | |
|--|------------|------------|
| Net cash used in financing activities of continuing operations | (76.7) | (182.2) |
| Net cash provided by (used in) financing activities of discontinued operations | 0.6 | (2.1) |
| Net cash used in financing activities | (76.1) | (184.3) |
| Effect of exchange rate changes on cash and cash equivalents | 0.3 | 0.1 |
| Net decrease in cash and cash equivalents | (101.6) | (359.8) |
| Cash and cash equivalents of continuing operations at beginning of period | 1,126.0 | 1,682.8 |
| Cash and cash equivalents of discontinued operations at beginning of period | | |
| Total cash and cash equivalents at beginning of period | 1,126.0 | 1,682.8 |
| Cash and cash equivalents of continuing operations at end of period | 1,024.4 | 1,323.0 |
| Cash and cash equivalents of discontinued operations at end of period | | |
| Total cash and cash equivalents at end of period | \$ 1,024.4 | \$ 1,323.0 |

SUPPLEMENTAL DISCLOSURES

Non-cash investing activities:

| | |
|---|-----------|
| Purchase price of facilities previously under synthetic lease, net of accrued liabilities | \$ 81.1 |
| Cancellation of receivable as payment for facilities (See note 6 Property and Equipment, net for additional information regarding synthetic leases) | \$ (74.5) |

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

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

NOTE 1 Basis of Presentation and Recent Accounting Pronouncements

Basis of Presentation

The accompanying financial data as of November 30, 2006 and for the three months ended November 30, 2006 and 2005 has been prepared by the management of Solectron, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The August 31, 2006 condensed consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles. However, the management of Solectron believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in Solectron's Annual Report on Form 10-K for the fiscal year ended August 31, 2006.

Solectron's first quarters of fiscal 2007 and 2006 ended on November 24, 2006 and November 25, 2005, respectively. Solectron's fiscal year 2006 ended on August 25, 2006. For clarity of presentation, Solectron has indicated its first quarter of each fiscal year as having ended on November 30 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 November 30, 2006, the results of operations and comprehensive income for the quarters ended November 30, 2006 and 2005 and cash flows for the quarters ended November 30, 2006 and 2005 have been made. The consolidated results of operations for the quarters ended November 30, 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 \$6.8 million and \$7.9 million of research and development expenses for the first quarters of fiscal 2007 and 2006, respectively.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation 48, Accounting for Income Tax Uncertainties (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48

is effective for fiscal years beginning after December 15, 2006. Any differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is currently in the process of determining the impact, if any, of adopting the provisions of FIN 48 on its financial position, results of operations and cash flows.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, (SAB 108). The interpretations in SAB 108 are being issued to address diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. SAB 108 is effective for the first fiscal year ending after November 15, 2006 and must be adopted by the fourth quarter of such fiscal year. Solectron has not yet completed its analysis, however, the company estimates that the expected net reduction to opening retained earnings will be approximately \$10 million as a result of adopting SAB 108. The Company is continuing to evaluate the impact of adopting SAB 108 and, as a result, the actual reduction to the opening retained earnings balance could be different than the \$10 million estimate.

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

In June 2006, the EITF reached a consensus on EITF Issue No. 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) (EITF 06-03). EITF 06-03 provides that the presentation of taxes assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer on either a gross basis (included in revenues and costs) or on a net basis (excluded from revenues) is an accounting policy decision that should be disclosed. The provisions of EITF 06-03 will be effective for Solectron in the first interim reporting period beginning after December 15, 2006. The Company is currently evaluating the impact of adopting EITF 06-03 on the consolidated financial statements.

Reclassifications

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

NOTE 2 Stock-Based Compensation

Effective September 1, 2005, Solectron began recording compensation expense associated with stock options and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, (SFAS 123R) as interpreted by SEC Staff Accounting Bulletin No. 107. Solectron adopted the modified prospective transition method provided under SFAS 123R, and consequently has not 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. Under SFAS 123R, benefits of tax deductions in excess of recognized compensation costs are to be recorded as a financing cash inflow rather than as a reduction of taxes paid. For the quarter ended November 30, 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 has recorded no amount for excess tax benefits in additional paid-in capital since the adoption of SFAS 123R. To

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

determine excess tax benefit, the Company used the alternative transition method (short-cut method) as set forth in the FASB Staff Position No. FAS 123R-3 Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.

Total stock compensation expense for the three months ended November 30, 2006 of \$6.1 million was included in cost of sales and selling, general and administrative expense in the amounts of \$1.3 million and \$4.8 million, respectively. Total stock compensation expense for the three months ended November 30, 2005, of \$4.7 million was included in cost of sales and selling, general and administrative expense in the amounts of \$1.7 million and \$3.0 million, respectively.

Stock Options

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

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected life of options is based on observed historical exercise patterns. For the three months ended November 30, 2006 and November 30, 2005 respectively, the expected volatility of stock options is based upon equal weightings of the historical volatility of Solectron stock and, for fiscal periods in which there is sufficient trading volume in options on Solectron's stock, the implied volatility of traded options on Solectron stock having a life of more than six months. The expected volatility of Employee Share Purchase Plan shares is based on the implied volatility of traded options on the Company's stock in periods in which there is sufficient trading volume in those options. Otherwise, historical volatility is utilized. The risk free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that Solectron has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

| | Three Months Ended November 30, 2006 | Three Months Ended November 30, 2005 |
|----------------------|---|---|
| Stock Options | | |
| Expected volatility | 58% | 52% |
| Dividend Yield | zero | zero |
| Expected life | 4.43 years | 4.91 years |
| Risk-free rate | 4.57% | 4.26% |

| Employee Stock Purchase Plan | Three Months Ended November 30, 2006 | Three Months Ended November 30, 2005 |
|-------------------------------------|---|---|
| Expected volatility | 30% | 44% |
| Dividend Yield | zero | zero |
| Expected life | 6 months | 6 months |
| Risk-free rate | 5.10% | 3.94% |

The Company has recorded \$2.5 million of compensation expense relative to stock options (other than discounted stock options) for the quarter ended November 30, 2006 in accordance with SFAS 123R. As of November 30, 2006, there was \$15 million of total unrecognized compensation costs related to stock options. These

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

costs are expected to be recognized over a weighted average period of 1.34 years. A summary of stock option activity under the plans for the three months ended November 30, 2006 is presented as follows:

| | Stock Option Awards Outstanding | Weighted Average Exercise Price |
|----------------------------------|--|--|
| Balance, August 31, 2006 | 45,012,363 | \$ 9.09 |
| Granted | 718,233 | \$ 3.21 |
| Exercised | 13,700 | \$ 2.09 |
| Forfeited | 334,327 | \$ 3.80 |
| Cancelled | 1,902,567 | \$ 28.73 |
| Balance, November 30, 2006 | 43,480,002 | \$ 8.17 |
| Exercisable at November 30, 2006 | 35,139,930 | \$ 9.22 |

The weighted-average fair value of stock options granted during the three months ended November 30, 2006, was \$1.65 per share. The total intrinsic value of stock options exercised during the three months ended November 30, 2006, was negligible.

At November 30, 2006, an aggregate of 60.1 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 50.7 million shares of common stock were available for grant under Solectron's stock option plans as of November 30, 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 Solectron's Board of Directors to purchase 40,000 shares of common stock at the fair value on the date of the grant. On December 1 of each year, each outside member is granted an additional option to purchase 40,000 shares of common stock at the fair market value on such date. These options vest over one year and have a term of seven years.

Employee Stock Purchase Plan

Under Solectron's Employee Stock Purchase Plan, employees meeting specific employment qualifications are eligible to participate and can purchase shares semi-annually through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement or end of the offering period. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation. Solectron has treated the Employee Stock Purchase Plan as a compensatory plan. The Company has recorded compensation expense relative to the Purchase Plan in the quarter ended November 30, 2006 and 2005 of \$0.3 million and \$0.7 million, respectively.

Restricted Stock Awards and Discounted Stock Options

During fiscal 2005 and 2004, Solectron issued discounted stock options under its 2002 stock option plan 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 year ended August 31, 2006, 7.0 million discounted options were granted to certain eligible employees and during the first quarter of fiscal year 2007, an additional 1.2 million discounted options were granted to certain eligible employees. Compensation expense under the fair value method for the three months ended November 30, 2006 and November 30, 2005, is being amortized over the vesting period and was \$3.3 million and \$0.8 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.

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

The weighted-average fair value of the discounted stock options granted in the three-month period ended November 30, 2006 and November 30, 2005 was \$3.21 per share and \$3.85 per share, respectively. At November 30, 2006, unrecognized costs related to restricted stock awards and discounted stock options totaled approximately \$23.6 million and is expected to be recognized over a weighted average period of 2.5 years. The total fair value of restricted stock and discounted stock options vested was zero during the three months ended November 31, 2006 and November 31, 2005, respectively.

NOTE 3 Stock Repurchase

On November 1, 2005, Solectron's Board of Directors approved a stock repurchase program whereby the Company was authorized to repurchase up to \$250 million of the Company's common stock pursuant to a 10b5-1 trading plan. Solectron commenced this \$250 million repurchase program at the end of the quarter ended February 28, 2006. During the first quarter of fiscal 2007, Solectron repurchased and retired 3.0 million shares of its common stock at an average price of \$3.28 for approximately \$10.0 million. In October 2006, the Board of Directors approved a twelve month extension to the stock repurchase program. As of November 30, 2006, Solectron had repurchased and retired a total of 17.8 million shares under the repurchase program for approximately \$61.6 million.

NOTE 4 Inventories

Inventories related to continuing operations as of November 30, 2006 and August 31, 2006, consisted of the following (in millions):

| | November 30 2006 | August 31 2006 |
|-----------------|-----------------------------|---------------------------|
| Raw materials | \$ 1,187.6 | \$ 1,127.0 |
| Work-in-process | 206.0 | 202.2 |
| Finished goods | 205.6 | 186.9 |
| Total | \$ 1,599.2 | \$ 1,516.1 |

NOTE 5 Accounts Receivable, Net

Accounts receivable, net related to continuing operations as of November 30, 2006 and August 31, 2006 consisted of the following (in millions):

| | November 30 2006 | August 31 2006 |
|---------------------------------------|-----------------------------|---------------------------|
| Accounts Receivable | \$ 1,508.0 | \$ 1,443.8 |
| Less: Allowance for doubtful accounts | 7.2 | 14.5 |

| | | | | |
|--------------------------|----|---------|----|---------|
| Accounts Receivable, net | \$ | 1,500.8 | \$ | 1,429.3 |
|--------------------------|----|---------|----|---------|

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 6 Property and Equipment, Net**

Property and equipment, net related to continuing operations as of November 30, 2006 and August 31, 2006, consisted of the following (in millions):

| | November 30 2006 | August 31 2006 |
|---|-----------------------------|---------------------------|
| Land | \$ 63.6 | \$ 43.5 |
| Buildings and improvements | 408.1 | 367.1 |
| Leasehold improvements | 100.0 | 100.8 |
| Furniture, fixtures, equipment and other | 1,054.0 | 1,040.0 |
| Computer equipment and software | 340.0 | 338.3 |
| | 1,965.7 | 1,889.7 |
| Less: Accumulated depreciation and amortization | 1,226.5 | 1,216.3 |
| Property and equipment, net | \$ 739.2 | \$ 673.4 |

On November 1, 2006, Solectron exercised its purchase option granted under synthetic lease agreements and purchased three manufacturing sites. The sites were recorded to property and equipment, net, at an aggregate amount of \$81.1 million, representing the Termination Value of the manufacturing sites of \$87.7 million, less the accumulated loss on synthetic leases being accreted of \$6.6 million. See note 9, *Commitments and Contingencies* for additional information regarding synthetic leases.

During the quarter ended November 30, 2006, the Company recorded a non-cash impairment charge of approximately \$2.2 million to reduce the carrying amount of one of the manufacturing sites formerly under synthetic lease.

NOTE 7 Debt***8.00% Senior Subordinated Notes due 2016***

On February 14, 2006, Solectron's wholly owned subsidiary Solectron Global Finance Ltd (*Solectron Global Finance*) issued \$150 million of senior subordinated notes due 2016 (the *Subordinated Notes*) in reliance on exemption from the registration requirements of the Securities Act. The Subordinated Notes are unconditionally guaranteed by Solectron on a senior subordinated basis, will mature on March 15, 2016, and bear interest at the rate of 8% annually. Cash interest payments on the Subordinated Notes will be made semiannually in arrears on March 15 and September 15 of each year, beginning on September 15, 2006. The Subordinated Notes will be redeemable, in whole or in part, at any time on or after March 15, 2011 at specified redemption prices plus accrued and unpaid interest. Prior to March 15, 2011, Solectron Global Finance or Solectron will have the option to redeem the Subordinated Notes, in whole or in part at a price equal to the greater of (1) 100% of the principal amount of the Subordinated Notes redeemed plus accrued and unpaid interest or (2) the make-whole premium plus accrued and unpaid interest. In addition, subject to

certain conditions, prior to March 15, 2009, Solectron Global Finance or Solectron may redeem up to 35% of the aggregate principal amount of the Subordinated Notes with the net proceeds of a qualified public common stock offering by Solectron at a redemption price of 108% of the principal amount of the Subordinated Notes, plus any accrued and unpaid interest to the redemption date. Solectron used the net proceeds from the offering, together with cash on hand, to repay its 7.375% Senior Notes on March 1, 2006. On September 5, 2006, pursuant to a Registration Rights Agreement, Solectron Global Finance and Solectron completed an exchange offer of \$150 million in aggregate principal amount of Solectron Global Finance's 8.00% Senior Subordinated Notes due 2016 (the Exchange Notes) that have been registered under the Securities Act for the same principal amount of its outstanding unregistered Subordinated Notes. Both the Subordinated Notes and the Exchange Notes are guaranteed by Solectron on a senior subordinated basis and the guarantee with respect

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

to the Exchange Notes has been registered under the Securities Act. As of November 30, 2006 the aggregate carrying amount of the Subordinated Notes was classified as long-term debt.

0.5% Convertible Senior Notes due 2034

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

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

On or after February 20, 2011, Solectron will have the option to redeem all or a portion of the New Notes that have not been previously purchased, repurchased or converted, at 100% of the principal amount of the New Notes to be redeemed plus accrued and unpaid interest and liquidated damages owed, if any, up to, but excluding, the date of the purchase. Holders of the New Notes may require Solectron to purchase all or a portion of the convertible notes for cash on each of February 15, 2011, 2014, 2019, 2024, and 2029 at a price equal to 100% of the principal amount of the convertible notes to be repurchased plus accrued and unpaid interest, up to, but excluding, the date of repurchase. Holders will have the option, subject to certain conditions, to require Solectron to repurchase any New Notes held by such holder in the event of a *change in control*, as defined, at a price of 100% of the principal amount of the convertible notes plus accrued and unpaid interest up to, but excluding, the date of repurchase. The New Notes are convertible into cash and either common stock or cash at any time prior to maturity, subject to the terms of the notes.

After the exchange offer was 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, subject to certain adjustments in certain circumstances. This is equivalent to a conversion price of \$9.67 per share. As of November 30, 2006 the aggregate carrying amount of the convertible notes was \$450.0 million, and classified as long-term debt.

7.375% Senior Notes

In February 1996, Solectron issued \$150 million aggregate principal amount of 7.375% unsubordinated notes. 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 2006.

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

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

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

Liquid Yield Option Notes (LYONs™)

On November 30, 2006, Solectron had \$8.3 million aggregate accreted value of LYONs™ outstanding with an interest rate of 2.75%. These notes are unsecured and unsubordinated indebtedness of Solectron. Solectron will pay no interest prior to maturity. Each note has a yield of 2.75% with a maturity value of \$1,000 on May 8, 2020. Each note is convertible at any time by the holder to common shares at a conversion rate of 12.3309 shares per note. Holders will be able to require Solectron to purchase all or a portion of their notes on May 8, 2010, at a price of \$761.00 per note. Solectron, at its option, may redeem all or a portion of the notes at any time. As of November 30, 2006, the accreted value of the 2.75% LYONs™ is classified as long-term debt on the consolidated balance sheet.

On November 30, 2006, Solectron had \$1.0 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 November 30, 2006, the accreted value of the 3.25% LYONs™ is classified as long-term debt.

On August 28, 2006, Solectron entered into a \$350 million Credit Agreement (the Credit Agreement) that amends and replaces a \$500 million secured revolving facility. The Credit Agreement provides for a revolving, multicurrency, secured-credit facility, which may be used to borrow revolving loans or issue standby letters of credit, subject to a \$100 million letter of credit sub-limit. The Company may request an increase in the credit facility of up to an additional \$150 million, to provide for an aggregate commitment of up to \$500 million. There are currently no revolving loans outstanding and approximately \$0.7 million in letters of credit outstanding under the Credit Agreement. The revolving loans under the Credit Agreement bear interest, at the Company's option, at either (i) the base rate, which is defined as a fluctuating rate per annum equal to the greater of (A) Bank of America N.A.'s prime rate, or (B) the average rate on overnight federal funds plus one-half of one percent, or (ii) a rate equal to (A) the London Inter-bank Offered Rate (LIBOR) plus (B) an applicable margin of ranging from 1.0% to 2.0% based on Solectron's non-credit-enhanced senior unsecured long-term debt ratings. The Credit Agreement matures on August 28, 2009 and may be prepaid at any time without penalty or premium at the option of the Company.

NOTE 8 Derivative Instruments

Solectron enters into foreign exchange forward contracts intended to reduce the short-term impact of foreign currency fluctuations on foreign currency receivables, investments, payables and indebtedness. The gains and losses on the foreign exchange forward contracts are intended largely to offset the transaction gains and losses on the foreign currency receivables, investments, payables, and indebtedness recognized in operating results. Solectron does not

enter into foreign exchange forward contracts for speculative purposes. Solectron's foreign exchange forward contracts related to current assets and liabilities are generally six months or less in original maturity. The Company does not designate these as accounting hedges and the changes in the values of the Company's foreign exchange forward contracts are included in other (expense) income net.

As of November 30, 2006, Solectron had outstanding foreign exchange forward contracts with a total notional amount of approximately \$388 million related to continuing operations.

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

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

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

NOTE 9 Commitments and Contingencies***Synthetic Leases***

On November 1, 2006, Solectron exercised its purchase option granted under synthetic lease agreements and terminated those agreements relating to three manufacturing sites in continuing operations. The synthetic leases had expiration dates in September 2007. At the end of the lease terms, Solectron had an option, subject to certain conditions, to purchase or to cause a third party to purchase the sites subject to the synthetic leases for the Termination Value, which approximates the lessor's original cost for each site, or may market the property to a third party at a different price. Solectron had provided loans to the lessor equaling approximately 85% of the Termination Value for each synthetic lease. These loans were repayable solely from the sale of the sites to third parties in the future, were subordinated to the amounts payable to the lessor at the end of the synthetic leases, and could be credited against the Termination Values payable if Solectron purchases the sites. The approximate aggregate Termination Values and loan amounts were \$87.7 million and \$74.5 million, respectively, as of August 31, 2006. Solectron purchased the three sites for the Termination Value of \$87.7 million and funded the transaction by offsetting the carrying value of the synthetic lease loans of \$74.5 million against a portion of the purchase price and paid the remaining balance of \$13.2 million in cash. See note 6 Property and Equipment, net for additional information.

Future Minimum Lease Obligations

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

| | Total | Short-Term | Payments Due by Period | | | | | Thereafter |
|------------------|----------|------------|------------------------|---------|---------|---------|---------|------------|
| | | | Q2 08-Q4 08 | FY09 | FY10 | FY11 | FY12 | |
| Operating leases | \$ 152.3 | \$ 36.4 | \$ 23.9 | \$ 25.0 | \$ 21.1 | \$ 13.1 | \$ 11.8 | \$ 21.0 |

(In millions)

Legal Proceedings

Solectron is from time to time involved in various litigation and legal matters arising in the normal course of its business operations. Management believes that the final resolution of these matters will not have a material adverse effect on the Company's consolidated financial position, cash flows, or results of operations. By describing any

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

NOTE 10 Taxes

SFAS No. 109, Accounting for Income Taxes, requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence needs to be considered, including the Company's performance, the market environment in which the Company operates, the utilization of past tax credits, length of carryback and carryforward periods, and existing contracts or sales backlog that will result in future profits, among other factors. It

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

further states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. Therefore, cumulative losses weigh heavily in the overall assessment. As a result of the review undertaken after the end of the third quarter of fiscal 2003, Solectron concluded that it was appropriate to establish a full valuation allowance for most of the net deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. The total valuation allowance is approximately \$1.6 billion as of November 30, 2006. In addition, Solectron expects to continue to provide a full valuation allowance on future tax benefits until it can demonstrate a sustained level of profitability that establishes its ability to utilize the assets in the jurisdictions to which the assets relate. Solectron incurred tax expense in certain countries that are not subject to the aforementioned valuation allowance during the three months ended November 30, 2006.

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

The income tax provision for the interim periods is based on the best estimate of the effective tax rate expected to be applicable for the full fiscal year. Changes in the interim period for the tax (or benefit) related to items other than ordinary income are individually computed and recognized when the items occur. During the three months ended November 30, 2006, the Company recorded income tax benefits of \$4.2 million associated with a refund of taxes paid on the reinvested earnings of a foreign subsidiary of which \$2.3 million of the tax benefit was included in the computation of the foreign entity's estimated annual effective tax rate. The remaining portion was individually computed and recognized in the three months ended November 30, 2006.

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

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

In addition, Solectron has established contingency reserves for income taxes in various jurisdictions. The estimate of appropriate tax reserves is based upon the amount of prior tax benefit that is at risk upon audit and upon the reasonable estimate of the amount at risk. Solectron periodically reassesses the amount of such reserves and adjusts reserve balances as necessary. During fiscal year 2006, the Company recorded accruals related to a transfer pricing adjustment assessed by a foreign tax authority. The recorded amount represented management's best estimate of the cost it would incur in relation to the exposure, but there was a reasonable possibility that the final settlement could differ from the estimate. During the three months ended November 30, 2006, a final settlement was reached with the foreign tax authority for an amount that was slightly less than the recorded amount.

During the three months ended November 30, 2006, a foreign jurisdiction issued a final assessment related to indirect taxes for the period from July 1, 2002, through July 19, 2005. Solectron recorded an accrual for the amount determined to be a reasonable estimate of the loss; however, there is at least a reasonable possibility that additional amounts will be incurred.

For the quarter ended November 30, 2006, the Company recorded a benefit to the tax provision of \$5.8 million, which was established for loss contingencies related to tax matters in two foreign jurisdictions. During the quarter,

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

the tax matters were closed either because the statute of limitations expired or a closing agreement was executed with the government authority.

Significant judgment is required in determining Solectron's provision for income taxes. The calculation of Solectron's tax liabilities involves dealing with uncertainties in the application of complex tax rules and regulations. In determining the adequacy of its provision for income taxes, Solectron has assessed the likelihood of adverse outcomes resulting from these examinations, including the IRS RAR for fiscal years 2001 and 2002. Although the ultimate outcome of tax examinations cannot be predicted with certainty, including the total amount payable and the timing of such payments, the Company believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result. Solectron, however, cannot be certain that such amount will not be materially different than what is reflected in its historical income tax provisions and accruals. Should the tax authorities assess additional taxes as a result of any current or future examinations, Solectron may be required to record changes to operations in future periods that could have a material adverse effect on its results of operations, financial position or cash flows in the period or periods recorded.

NOTE 11 Segment Information and Geographic Information

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

Solectron's chief operating decision maker is the 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 information for continuing operations as of and for the periods presented is as follows (in millions):

| | Three Months Ended November 30 | |
|-------------------------------|---|-------------|
| | 2006 | 2005 |
| Geographic net sales: | | |
| United States | \$ 922.7 | \$ 796.6 |
| Other North and Latin America | 452.2 | 358.1 |
| Europe | 359.9 | 313.9 |
| Malaysia | 596.5 | 496.8 |
| China | 382.7 | 259.5 |
| Other Asia Pacific | 285.1 | 231.5 |

\$ 2,999.1 \$ 2,456.4

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

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

| | November 30 2006 | August 31 2006 |
|-------------------------------|-----------------------------|---------------------------|
| Long-lived assets: | | |
| United States | \$ 370.1 | \$ 292.0 |
| Other North and Latin America | 156.9 | 167.7 |
| Europe | 182.8 | 142.6 |
| Asia Pacific | 280.7 | 287.5 |
| | \$ 990.5 | \$ 889.8 |

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

| | Three Months Ended November 30 | |
|---------------------|---|-------------|
| | 2006 | 2005 |
| Computing & Storage | 31.8% | 33.8% |
| Networking | 26.2% | 25.6% |
| Communications | 19.7% | 18.3% |
| Consumer | 10.8% | 8.6% |
| Industrial | 7.9% | 8.2% |
| Automotive | 1.8% | 3.6% |
| Other | 1.8% | 1.9% |
| Total | 100.0% | 100.0% |

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 November 30 | |
|---|-------------|
| 2006 | 2005 |

| | | |
|-----------------|-------|-------|
| Cisco Systems | 18.9% | 16.7% |
| Nortel Networks | * | 10.2% |

(*) Less than 10%

Solectron has concentrations of credit risk due to sales to the customers listed above as well as to Solectron's other significant customers. As of November 30, 2006, Hewlett-Packard accounted for approximately 13.5% of total accounts receivable related to continuing operations.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****NOTE 12 Restructuring and Impairment**

Over the past few years, Solectron has recorded restructuring and impairment costs as it rationalized operations in light of customer demand declines. The measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, was largely intended to align Solectron's capacity and infrastructure to anticipated customer demand and transition its operations to lower-cost regions. The restructuring and impairment costs include employee severance and benefit costs, costs related to leased facilities abandoned and subleased, impairment of owned facilities no longer used by Solectron which will be disposed, costs related to leased equipment that has been abandoned, and impairment of owned equipment that will be disposed. For owned facilities and equipment, the impairment loss recognized was based on the fair value less costs to sell, with fair value estimated based on existing market prices for similar assets. Severance and benefit costs are recorded in accordance with SFAS No. 112, *Employer's Accounting for Postemployment Benefits*, as Solectron has concluded that it has a substantive severance plan. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the estimated lease loss accrued for leased facilities abandoned and subleased after December 31, 2002 represents the fair value of the lease liability as measured by the present value of future lease payments subsequent to abandonment less the present value of any estimated sublease income. For those facilities abandoned and subleased before January 1, 2003, as part of restructuring activities under EITF Issue No. 94-3, the estimated lease loss represents payments subsequent to abandonment less any estimated sublease income. In order to estimate future sublease income, Solectron works with real estate brokers to estimate the length of time until it can sublease a facility and the amount of rent it can expect to receive. Estimates of expected sublease income could change based on factors that affect Solectron's ability to sublease those facilities such as general economic conditions and the real estate market, among others. At each reporting date, the Company evaluates its accruals for exit costs and employee separation costs to ensure the accruals are still appropriate. In certain circumstances, accruals are no longer required because of efficiencies in carrying out the plans or because employees previously identified for separation resigned from the Company and did not receive severance or were redeployed due to circumstances not foreseen when the original plans were initiated. The Company reverses accruals through the income statement line item where the original charges were recorded when it is determined that they are no longer required.

Overview of Restructuring Plans***Fiscal Year 2007 Restructuring Plan***

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

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

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

be in the range provided, primarily as a result of higher than expected severance agreements with local workers councils and changes to certain statutory provisions at several European locations.

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

Table of Contents

SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Continued)

Cumulative restructuring costs recorded under the 2007 restructuring plan as of November 30, 2006 were \$34.8 million. This consists of \$29.3 million in severance, \$5.2 million in impairment charges on facilities and equipment (which includes \$3.1 million booked in the last quarter of Fiscal Year 2006), and \$0.3 million of transfer costs and other expenses.

As of November 30, 2006, Solectron has reduced its workforce by 200 personnel in connection with this plan and expects to reduce headcount by an additional 1,000 to 1,200 personnel prior to the completion of this plan. The remaining accrual balance of \$26.5 million is primarily related to existing severance commitments for 900 personnel, the majority of which will be paid by December 31, 2007. The severance costs for the remaining 100 to 300 personnel are yet to be incurred.

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

Fiscal Year 2005 Restructuring Plan

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

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

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

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

Cumulative restructuring costs recorded under the 2005 restructuring plan as of November 30, 2006 were \$58.3 million. As of November 30, 2006, Solectron has reduced its workforce by 2,400 personnel in connection with

this plan and expect to reduce headcount by an additional 100 personnel prior to the completion of this plan. The remaining accrual balance of \$6.9 million is largely related to severance payouts for the additional 100 personnel, of which \$5.6 million is expected to be paid during the second quarter of Fiscal Year 2007. This plan was substantially completed as of the end of fiscal 2006.

Fiscal Year 2004 Restructuring Plan

In the fourth quarter of fiscal 2004, in order to drive savings in its human resources and information technology functions, as well as reduce labor costs in certain high cost facilities, Solectron committed to a plan to eliminate

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

approximately 2,100 full-time positions primarily in Europe and North America, consolidate certain facilities, and impair certain long-lived assets.

This plan was expected to result in total restructuring charges of \$20.0 million. Through November 30, 2006, Solectron had recorded restructuring charges of approximately \$25.6 million related to this plan. This amount consisted of \$10.0 million of severance charges, \$10.2 million relating to the impairment of certain long-lived assets, and \$5.4 million of facility lease obligation and other expenses. This restructuring plan is substantially complete. The remaining accrual balance of \$2.6 million as of November 30, 2006 is primarily related to an ongoing facility lease obligation. The facility lease obligation currently expires in 2011. However, Solectron may incur additional restructuring costs as it revises estimates due to changes in assumptions used for the facility lease loss accrual.

Legacy Restructuring Plans

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

Solectron continued to incur expected restructuring charges in the first quarter of fiscal 2007 in accordance with previously announced plans. Total net restructuring and impairment costs of \$34.6 million were charged against continuing operations as a result of these planned actions as well as revisions to previous estimates. Included in the \$3.2 million lease loss accrual amount below is \$0.3 million lease facility expense related to an accrual established under acquisition accounting.

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

| | Three Months Ended November 30 | | |
|--|---|-------------|---------------|
| | 2006 | 2005 | Nature |
| Loss on disposal of and impairment of equipment and facilities | \$ 1.4 | \$ 3.4 | non-cash |
| Intangible asset impairment charge, net | | 1.9 | non-cash |
| Severance and benefit costs (adjustment) | 29.6 | (7.1) | cash |
| Net adjustment to facility lease loss accrual | 3.2 | 2.4 | cash |
| Other exit costs | 0.4 | 0.3 | cash |

Total \$ 34.6 \$ 0.9

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

The following table summarizes the restructuring accrual balance for continuing operations as of November 30, 2006 (in millions). The amounts presented include remaining obligations under both the 2005 Restructuring Plan and prior plans.

| | Severance and Benefits | Lease Facilities & Equipment | Other | Total |
|---|---------------------------------------|---|--------------|--------------|
| Balance of accrual at August 31, 2006 | \$ 7.1 | \$ 23.1 | \$ 0.1 | \$ 30.3 |
| Provision | 29.8 | 2.9 | 0.4 | 33.1 |
| Q1-FY07 Provision Adjustments | (0.2) | | | (0.2) |
| Q1-FY07 Cash Payments | (3.3) | (9.7) | (0.5) | (13.5) |
| Balance of accrual at November 30, 2006 | \$ 33.4 | \$ 16.3 | \$ | \$ 49.7 |

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

Restructuring Activity by Plan

The restructuring and impairment charges incurred by restructuring plan during the three month period ended November 30, 2006, (in millions) were as follows:

| | Fiscal 2007 Plan | Fiscal 2005 Plan | Fiscal 2004 Plan | Legacy Plans | Total |
|---|---------------------------------|---------------------------------|---------------------------------|-------------------------|--------------|
| Balance of accrual at August 31, 2006 | \$ | \$ 7.1 | \$ 2.1 | \$ 21.1 | \$ 30.3 |
| FY2007 Provision | 29.6 | 0.7 | 0.7 | 2.1 | 33.1 |
| FY2007 Provision adjustments | | (0.1) | | (0.1) | (0.2) |
| FY2007 Cash payments | (3.1) | (0.8) | (0.2) | (9.4) | (13.5) |
| Balance of accrual at November 30, 2006 | \$ 26.5 | \$ 6.9 | \$ 2.6 | \$ 13.7 | \$ 49.7 |
| FY2007 non-cash items | \$ 2.1 | \$ | \$ | \$ (0.7) | \$ 1.4 |

NOTE 13 Goodwill and Intangible Assets

Goodwill information is as follows (in millions):

| | Goodwill |
|------------------------------|-----------------|
| Balance at August 31, 2006 | \$ 155.2 |
| Goodwill adjustments | (0.1) |
| Balance at November 30, 2006 | \$ 155.1 |

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

Solectron's intangible assets are classified as other assets on the condensed consolidated balance sheets and categorized into three main classes: supply agreements, intellectual property and contractual and non-contractual customer relationships obtained in asset purchases or business combinations. The following table summarizes the intangible asset balance at November 30, 2006 and August 31, 2006 (in millions):

| | Supply Agreements | Intellectual Property Agreements | Other | Total |
|--------------------------|------------------------------|---|--------------|--------------|
| November 30, 2006 | | | | |
| Gross amount | \$ 88.6 | \$ 78.9 | \$ 70.3 | \$ 237.8 |
| Accumulated amortization | (86.5) | (72.6) | (64.2) | (223.3) |
| Carrying value | \$ 2.1 | \$ 6.3 | \$ 6.1 | \$ 14.5 |
| August 31, 2006 | | | | |
| Gross amount | \$ 89.2 | \$ 78.9 | \$ 70.3 | \$ 238.4 |
| Accumulated amortization | (86.3) | (71.9) | (63.9) | (222.1) |
| Carrying value | \$ 2.9 | \$ 7.0 | \$ 6.4 | \$ 16.3 |

During the first quarter of fiscal 2007, gross supply agreements related to intangible assets decreased by \$0.6 million as a result of a favorable sublease of a lease obligation assumed in an acquisition.

Amortization expense for the three months ended November 30, 2006 was approximately \$1.2 million. Amortization expense for the three months ended November 30, 2005 was approximately \$2.2 million. The Company anticipates that annual amortization expense for these intangibles over the next five years to be approximately \$3.9 million, \$3.7 million, \$3.2 million, \$1.5 million and \$0.9 million, respectively.

NOTE 14 Discontinued Operations

During fiscal 2004, as a result of a full review of its portfolio of businesses, Solectron committed to a plan to divest a number of business operations that are outside its core competencies. These businesses are Dy 4 Systems Inc., Kavlico Corporation, Solectron's MicroTechnology division, SMART Modular Technologies Inc., Stream International Inc., Solectron's 63% interest in US Robotics Corporation, and Force Computers, Inc. The divestiture of these companies allows Solectron to offer a more focused and integrated set of supply chain solutions for its customers.

These businesses each qualify as a discontinued operation component of Solectron under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Solectron has reported the results of operations and consolidated financial position of these businesses in discontinued operations within the consolidated statements of operations and the balance sheets for all periods presented.

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

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

| | Three Months Ended November 30 | |
|--|---|-------------|
| | 2006 | 2005 |
| Net sales | \$ | \$ |
| Cost of sales | | |
| Gross profit | | |
| Operating expense (income) net | 0.6 | (1.7) |
| Operating (loss) income | (0.6) | 1.7 |
| Other income net | | 2.1 |
| (Loss) income before income taxes | (0.6) | 3.8 |
| Income tax expense | | |
| (Loss) income from discontinued operations, net of tax | \$ (0.6) | \$ 3.8 |

During the first quarter of fiscal 2007, Solectron recorded \$0.6 million of costs related to a sales tax assessment and ongoing facility carrying costs.

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

The sale agreements for the divestitures contain certain indemnification provisions pursuant to which Solectron may be required to indemnify the buyer of the divested business for a limited period subsequent to the completion of the sale for liabilities, losses, or expenses arising out of breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. As of November 30, 2006, most of these indemnification provisions have expired, and there were no significant liabilities recorded under these indemnification obligations. Additionally, Solectron may be required to indemnify a buyer for environmental remediation costs until 2011, such indemnification is not to exceed \$13 million. Solectron maintains an insurance policy to cover environmental remediation liabilities in excess of reserves previously established upon the acquisition of these properties. Solectron did not record any environmental charges upon disposition of these properties.

NOTE 15 Net Income Per Share Calculation

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

The computation of diluted net income per share calculates the effect of dilutive securities on weighted average shares. Dilutive securities include options to purchase common stock and shares issuable upon conversion of Solectron's LYONs and Series A Convertible Senior Notes are excluded in both periods as anti-dilutive.

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

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

| | Three Months Ended November 30 | |
|--|---|-------------|
| | 2006 | 2005 |
| Basic earnings per share: | | |
| Income from continuing operations | \$ 6.6 | \$ 20.2 |
| Shares used in computation: | | |
| Weighted average ordinary shares outstanding | 895.4 | 925.2 |
| Basic earnings per share | \$ 0.01 | \$ 0.02 |
| Diluted earnings per share: | | |
| Income from continuing operations | \$ 6.6 | \$ 20.2 |
| Shares used in computation: | | |
| Weighted average ordinary shares outstanding | 895.4 | 925.2 |
| Employee stock options | 0.1 | 0.2 |
| Restricted stock | 1.9 | 0.5 |
| Weighted average number of shares | 897.4 | 925.9 |
| Diluted earnings per share | \$ 0.01 | \$ 0.02 |

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

| | Three Months Ended November 30 | |
|---|---|-------------|
| | 2006 | 2005 |
| Anti-dilutive securities: | | |
| Employee stock options | 44.0 | 48.5 |
| Shares issuable upon conversion of convertible securities | 0.5 | 0.2 |
| Total anti-dilutive shares | 44.5 | 48.7 |

NOTE 16 Related Party Transactions

In January 2006, Paul Tufano became Executive Vice President and Chief Financial Officer of Solectron. Mr. Tufano is also a member of the Board of Directors of Teradyne, a customer of Solectron. Solectron has for the past 10 years, in the ordinary course of business, sold printed circuit board assemblies to Teradyne and purchased in-circuit testers from Teradyne. During the quarter ended November 30, 2006, Solectron had sales of \$48.5 million to Teradyne, all of which were made on an arms-length basis.

NOTE 17 Guarantee of Subsidiary Notes

Solectron's 8% Senior Subordinated Notes due 2016 were issued in February 2006 by Solectron Global Finance LTD, an indirect 100%-owned finance subsidiary of Solectron Corporation. The notes are fully and unconditionally guaranteed on a senior subordinated basis by Solectron Corporation. No other subsidiary of Solectron Corporation guarantees the notes.

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

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

Summary of Results and Key Performance Indicators

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

| | Three Months Ended November 30 | |
|---|---|-------------|
| | 2006 | 2005 |
| Net sales | \$ 2,999.1 | \$ 2,456.4 |
| Gross profit | 149.4 | 125.6 |
| Selling, general and administrative expense | 109.8 | 107.4 |
| Income from continuing operations | 6.6 | 20.2 |

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

| | Three Months Ended | | | | |
|------------------------------------|------------------------------|----------------------------|-------------------------|------------------------------|------------------------------|
| | November 30, 2006 | August 31, 2006 | May 31, 2006 | February 28, 2006 | November 30, 2005 |
| Inventory turns | 7.3 turns | 7.3 turns | 7.2 turns | 7.4 turns | 8.0 turns |
| Days sales outstanding (DSO) | 44 days | 43 days | 42 days | 44 days | 45 days |
| Days payable outstanding (DPO) | 52 days | 53 days | 54 days | 54 days | 53 days |
| Cash-to-cash cycle (C2C) | 41 days | 39 days | 38 days | 40 days | 37 days |
| Capital expenditures (in millions) | \$33.4 | \$40.9 | \$46.0 | \$50.2 | \$58.9 |

Inventory turns are calculated as the ratio of cost of sales compared to the average inventory for the quarter. DSO is calculated as the ratio of average accounts receivable, net, for the quarter compared to average daily net sales for the quarter. DPO is calculated as the ratio of average accounts payable during the quarter compared to average daily cost of sales for the quarter. The C2C cycle is determined by taking the ratio of 360 days compared to inventory turns plus DSO minus DPO. Capital expenditures are primarily related to equipment purchases supporting replacement of aged

equipment, increased demand in certain products, new programs and information technology projects.

Critical Accounting Policies and Estimates

Management is required to make judgments, assumptions and estimates that affect the amounts reported when we prepare consolidated financial statements and related disclosures in conformity with generally accepted accounting principles in the United States. Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended August 31, 2006, describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. Estimates are used for, but not limited to, our accounting for revenue recognition, inventory valuation, allowance for doubtful accounts, goodwill, intangible assets, restructuring and related impairment costs,

Table of Contents

income taxes, loss contingencies and stock-based compensation. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

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

We record reductions to revenue for customer incentive programs in accordance with the provisions of Emerging Issues Task Force (EITF) Issue No. 01-09, Accounting for Consideration Given from a Vendor to a Customer (Including a Reseller of the Vendor's Products). Such incentive programs include premium payments and rebates. Premium payments are up-front payments to customers at program inception, made as a part of a competitive bidding arrangement, and sometimes in lieu of acquiring manufacturing assets and workforce from the customer. Premium payments are recognized either up-front or over time based on the terms of the customer agreement. In order to recognize a premium over time, the customer agreement must clearly state that we are entitled to a refund of the premium payment from the customer, either pro rata or otherwise, if certain production levels are not achieved. Where such contractual recovery provisions exist, we believe that a probable future economic benefit exists and, thus, establish an asset, which is amortized against revenue as product or service delivery occurs under the contract. When the contractual recovery provisions do not exist, we record the premium payment as an immediate up-front reduction of revenues. For those incentives that require the estimation of future sales, such as for rebates, we use historical experience and internal and customer data to estimate the sales incentive at the time revenue is recognized. In the event that the actual results of these items differ from the estimates, adjustments to the sales incentive accruals are recorded. To date, these adjustments have not been material.

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

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

Inventory Valuation

Our inventories are stated at the lower of weighted average cost or market. Our industry is characterized by rapid technological change, short-term customer commitments and rapid changes in demand, as well as other factors that may influence the recoverability of inventories. We make provisions for estimated excess and obsolete inventory based on our regular reviews of inventory quantities on hand and the latest forecasts of product demand and production requirements from our customers. Our provisions for excess and obsolete inventory are also impacted by our contractual arrangements with our customers including our ability or inability to re-sell such inventory to them. If actual market conditions or our customers' product demands are less favorable than those

Table of Contents

projected or if our customers are unwilling or unable to comply with any contractual arrangements related to excess and obsolete inventory, additional provisions may be required. If an additional 0.2% to 0.5% of our inventory were determined to be excess and obsolete at November 30, 2006, our gross profit and operating income from continuing operations before income taxes for the three months ended November 30, 2006 would have each decreased by \$3.2 million to \$8.0 million.

Allowance for Doubtful Accounts

Another area of judgment affecting reported revenue and net income is management's estimate of receivables that will ultimately be collected. We evaluate the collectibility of our accounts receivable based on a combination of factors. This risk is mitigated by (i) sales to well-established companies, (ii) ongoing credit evaluation of our customers, and (iii) frequent contact with our customers, especially our most significant customers, which enables us to monitor current changes in business operations and to respond accordingly. When we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations to us, we record a specific allowance against amounts due to us and thereby reduce the net receivable to the amount we reasonably believe is likely to be collected. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are outstanding, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, additional allowances may be required. Using this information, management reserves an amount that is believed to be uncollectible. Based on management's analysis of uncollectible accounts, reserves totaling \$7.2 million or 0.5% of the gross accounts receivable balance were established at November 30, 2006, compared with \$14.5 million or 1.0% of the gross accounts receivable balance at August 31, 2006. The decrease in the allowance for doubtful accounts when comparing the balance at August 31, 2006 to November 30, 2006 was primarily attributable to new reserves of approximately \$2.6 million offset by \$4.3 million of reserve reversals and reserve write-offs approximating \$5.6 million.

Goodwill

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

Impairment of Long-Lived Assets

Solectron evaluates long-lived assets, such as property, plant and equipment and intangible assets obtained in acquisitions such as supply agreements, intellectual property, and contractual non-contractual customer relationships for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be

recoverable in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). When conducting our impairment analysis, assets are grouped at the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets or liabilities. Intangible assets subject to impairment testing whenever events or

Table of Contents

changes in circumstances indicate total \$14.5 million as of November 30, 2006. We assess the fair value of the assets based on the undiscounted future cash flow the assets are expected to generate and recognize an impairment loss when estimated undiscounted future cash flow expected to result from the use of the asset plus net proceeds expected from disposition of the asset, if any, are less than the carrying value of the asset. When we identify an impairment, we reduce the carrying amount of the asset to its estimated fair value based on a discounted cash flow approach, or, when available and appropriate, to comparable market values. There is significant judgment involved in determining these cash flows.

Restructuring and Related Impairment Costs

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

Severance and benefit costs have been recorded in accordance with SFAS No. 112, *Employer's Accounting for Postemployment Benefits*, as we concluded that we had a substantive severance plan based on past restructuring actions in many of the geographies in which we operate. These costs are recognized when Solectron management has committed to a formal restructuring plan and the severance costs are probable and estimable. We apply the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* relating to one-time termination benefits to both (1) severance activities in geographies where we do not have a substantive severance plan and (2) situations in which the severance benefits offered to employees within a given geography are in excess of those offered under prior restructuring plans. Severance costs accounted for under SFAS No. 146 are recognized when Solectron management having the appropriate authorization has committed to a restructuring plan and communicated those actions to employees. Our estimate of severance and benefit costs assumptions are subjective as they are based on estimates of employee attrition and assumptions about future business opportunities.

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

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

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

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

Table of Contents

Income Taxes

We currently have significant deferred tax assets in certain jurisdictions resulting from tax credit, if any, carry forwards, net operating losses and other deductible temporary differences, which will reduce taxable income in such jurisdictions in future periods. We have provided valuation allowances for future tax benefits resulting from U.S. and certain foreign net operating loss carry forwards and for certain other U.S. and foreign deductible temporary differences where we believe future realizability is in doubt. SFAS No. 109 requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized, and further provides that it is difficult to conclude that a valuation allowance is not needed when there is negative evidence in the form of cumulative losses in recent years. Therefore, cumulative losses weigh heavily in the overall assessment. In the third quarter of fiscal year 2003, we established a valuation allowance for most of our deferred tax assets. This was primarily due to cumulative losses from prior years and uncertainty regarding our ability to generate certain minimum levels of taxable income within the next three years. We have not yet established a sustained level of profitability since that time in those countries in which the deferred tax assets arose and thus expect to record a full valuation allowance on future tax benefits. Our ability to realize sustained profitability in those jurisdictions in the near term is uncertain as Solectron derives the majority of its revenue from low-cost locations. It is these low-cost locations where Solectron anticipates reporting taxable profits. Solectron will not be able to offset any tax expense associated with these taxable profits with the unrecognized deferred tax assets described above. As a result of our assessment, our total valuation allowance on deferred tax assets arising from continuing operations is approximately \$1.6 billion at November 30, 2006.

We are subject to income taxes in the U.S. and numerous foreign jurisdictions. Significant judgment is required in determining our worldwide income tax provision and evaluating tax positions. There are many transactions and calculations where the ultimate tax determination is uncertain and we are regularly under audit by tax authorities. Accordingly, we have established contingency reserves for income taxes in various jurisdictions in accordance with SFAS No. 5 Accounting for Contingencies .

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

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

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business (for example, environmental and legal matters). We consider the likelihood of the loss occurring and our ability to reasonably estimate the amount of loss in determining the necessity for, and amount of, any loss contingencies. Estimated loss contingencies are accrued when it is probable that a liability has been incurred and the amount of loss can be

reasonably estimated. We regularly evaluate information available to us to determine whether any such accruals should be adjusted. Such revisions in the estimates of the potential loss contingencies could have a material impact on our consolidated results of operations and financial position.

Table of Contents***Stock-Based Compensation***

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

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

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

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

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

Results of Operations

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

| | Three Months Ended November 30 | |
|-------------------------------------|---|-------------|
| | 2006 | 2005 |
| Net sales | 100.0% | 100.0% |
| Cost of sales | 95.0 | 94.9 |
| Gross profit | 5.0 | 5.1 |
| Operating expenses: | | |
| Selling, general and administrative | 3.7 | 4.4 |
| Restructuring and impairment costs | 1.0 | |
| Operating income | 0.3 | 0.7 |
| Interest income | 0.3 | 0.5 |
| Interest expense | (0.2) | (0.3) |
| Other (expense) income net | (0.1) | 0.1 |

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| | | |
|---|------|------|
| Operating income from continuing operations before income taxes | 0.3 | 1.0 |
| Income tax expense | | 0.2 |
| Income from continuing operations | 0.3% | 0.8% |
| Discontinued operations: | | |
| (Loss) income from discontinued operations | | 0.2 |
| Income tax expense | | |
| (Loss) income from discontinued operations | % | 0.2% |
| Net income | 0.3% | 1.0% |

Table of Contents**Net Sales Continuing Operations**

For the first quarter of fiscal 2007, net sales increased \$543 million or 22% as compared to the same period of fiscal 2006. Computing and storage end market revenues increased by \$125 million or 15%, consumer end market revenues increased by \$112 million or 53%, communication market revenues increased by \$143 million or 32%, industrial and other revenues increased by \$43 million or 34.1% and networking revenues increased by \$155 million or 25%, when comparing the first quarter of fiscal 2007 to the corresponding period in fiscal 2006. The increase in computing and storage revenues was driven by increased sales of mid-range servers, storage and high-end servers. Revenues in the consumer end market increased as a result of new product launches. Revenue increases in the communications market were primarily due to end customer demand. The increase in networking revenues was driven by higher sales of networking equipment. Partially offsetting the revenue increase for the quarter was a decrease in the automotive market of approximately \$35 million, representing a 40% decrease when comparing the first quarter of fiscal 2007 to the corresponding period in fiscal 2006.

For the first quarter of fiscal 2006, net sales declined \$234 million or 8.7% as compared to the same period of fiscal 2005. The decline was concentrated in the consumer end market which decreased by \$258 million due to a significant drop in sales of 3G cellular handsets and set-top boxes. The communications end market declined by \$104 million due to lower customer demand and certain program transfers. These declines were partially offset by increases in the computing end market of \$58 million largely due to higher sales of computer servers, and in the industrial end market of \$59 million, largely due to increased sales of semiconductor manufacturing equipment.

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

| | Three Months Ended November 30 | |
|---------------------|---|-------------|
| | 2006 | 2005 |
| Computing & Storage | 31.8% | 33.8% |
| Networking | 26.2% | 25.6% |
| Communications | 19.7% | 18.3% |
| Consumer | 10.8% | 8.6% |
| Industrial | 7.9% | 8.2% |
| Automotive | 1.8% | 3.6% |
| Other | 1.8% | 1.9% |
| Total | 100.0% | 100.0% |

International Sales Continuing Operations

In the three months ended November 30, 2006, our international locations contributed approximately 69.2% of net sales compared to approximately 67.6% for the corresponding period of fiscal 2006.

Major Customers Continuing Operations

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

| | Three Months Ended November 30 | |
|-----------------|---|-------------|
| | 2006 | 2005 |
| Cisco Systems | 18.9% | 16.7% |
| Nortel Networks | * | 10.2% |

(*) Less than 10%

Our top ten customers accounted for approximately 64.1% of net sales for the three months ended November 30, 2006, compared to approximately 61.9% in the corresponding period of fiscal 2006. We cannot guarantee

Table of Contents

that these or any other customers will not increase or decrease as a percentage of our consolidated net sales either individually or as a group. Consequently, any material decrease in sales to these or other customers could materially harm our consolidated results of operations.

We believe our ability to grow depends on increasing sales to existing customers and on successfully attracting new customers. Customer contracts can be canceled and volume levels can be changed or delayed by our customers. The timely replacement of delayed, canceled or reduced orders with new business cannot be assured. In addition, we cannot assume that any of our current customers will continue to utilize our services. Consequently, our consolidated results of operations may be materially adversely affected.

Cisco Systems launched its Lean initiative as part of its ongoing effort to improve accuracy of demand forecasting and planning in its supply chain. Cisco Systems is in the midst of a phased implementation of the Cisco Systems Lean initiative amongst its manufacturing partners, with the Solectron transition scheduled to begin during fiscal 2007. In the initial stages of this implementation, Solectron expects inventory to increase by approximately \$200 million \$300 million.

Gross Profit Continuing Operations

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

Our gross profit percentage decreased to 5.0% for the three months ended November 30, 2006 as compared to 5.1% for the corresponding period in fiscal 2006. The 0.1% decrease in gross profit is primarily attributable to an increase in revenue in the consumer market and a decrease in the industrial market revenue, representing a shift in revenue mix from higher gross margin business to lower gross margin business. Also, contributing to the decline in gross profit was the performance of our services operation which experienced higher than expected costs in inventory management of its repair operation.

Sales of inventory previously written down or written off have not been significant and have not had any material impact on our gross profits for the months ended November 30, 2006.

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

SG&A expenses increased \$2.4 million, or 2.2%, for the three months ended November 30, 2006 compared to the corresponding period in fiscal 2006. As a percentage of net sales, SG&A expenses decreased to 3.7% for the three months ended November 30, 2006 as compared to 4.4% in the corresponding period in fiscal 2006. The decrease as a percentage of net sales was primarily attributable to a \$1.0 million decrease in bad debt expense and a \$543 million increase in net sales.

Restructuring and Impairment Continuing Operations

During the first quarter of fiscal 2007, the Company incurred restructuring costs of approximately \$34.6 million primarily related to \$29.6 million of severance expenses resulting from the adoption of the Fiscal Year 2007 restructuring plan. In addition, restructuring costs included the following; \$3.2 million of charges arising from the disposition of a leased facility and changes in estimates for leases termination costs on restructured facilities; \$0.4 million of transfer and other exit costs; and \$1.4 million of equipment and facilities impairment charges. Included in the \$3.2 million facility amount is a \$0.3 million lease facility expense related to an accrual established under

acquisition accounting.

During the first quarter of fiscal 2006, restructuring and impairment costs of \$0.9 million were charged against operations. This amount included charges incurred under previously announced restructuring programs as well as a net reduction in the provision for severance of \$7.1 million due to new business opportunities resulting in changes to planned severance actions, differences between actual and estimated payment obligations and employee turnover. Restructuring costs and impairments also included \$3.4 million from the impairment of buildings, and \$2.4 million in connection with early lease terminations and changes in estimates relative to restructured lease facilities.

Table of Contents

Fiscal Year 2007 Restructuring Plan

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

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

Reducing approximately 1,200 to 1,400 employees at the facilities being closed or consolidated. Although there may be a potential decrease from the original plan estimate of 1,400 employees, severance costs will still be in the range provided primarily as a result of higher than expected severance agreements with local workers councils and changes to certain statutory provisions at several European locations.

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

Cumulative restructuring costs recorded under the 2007 restructuring plan as of November 30, 2006 were \$34.8 million. This consists of \$29.3 million in severance, \$5.2 million in impairment charges on facilities and equipment (which includes \$3.1 million booked in the last quarter of Fiscal Year 2006), and \$0.3 million of transfer costs and other expenses.

As of November 30, 2006, Solectron has reduced its workforce by 200 personnel in connection with this plan and expects to further reduce headcount by an additional 1,000 to 1,200 personnel prior to the completion of this plan. The remaining accrual balance of \$26.5 million is primarily related to existing severance commitments for 900 personnel, the majority of which will be paid by December 31, 2007. The severance costs for the remaining 100 to 300 personnel are yet to be incurred.

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

Currently, Solectron estimates that the Fiscal Year 2007 restructuring plan will realize a savings of approximately \$0.01 per share quarterly once fully implemented due to reductions in workforce, facility, lease and depreciation expenses. Cash payments associated with the fiscal year 2007 plan scheduled in the next 12 months, which have already been accrued for, are expected to be \$26.5 million.

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

Interest Income Continuing Operations

Interest income decreased \$1.9 million to \$10.2 million for the three months ended November 30, 2006 from \$12.1 million in the corresponding period in fiscal 2006. The increase was primarily due to lower cash balances in the

first quarter of fiscal 2007 when compared to the corresponding period in fiscal 2006.

Interest Expense Continuing Operations

Interest expense increased \$0.6 million to \$7.3 million for the three months ended November 30, 2006 from \$6.7 million in the corresponding period in fiscal 2006. The increase in the quarter ended November 30, 2006 when compared to the corresponding period in fiscal 2006, was primarily due to the Company's increased balances resulting from increased use of local bank debt to finance certain activities.

Table of Contents

Other (Expense) Income net Continuing Operations

Other (expense) income net decreased \$2.8 million to an expense of \$0.9 million for the three months ended November 30, 2006 from an income of \$1.9 million in the corresponding period in fiscal 2006. The fluctuation is primarily due to foreign currency gains and losses.

Income Taxes Continuing Operations

Our income tax expense was \$0.4 million for the three months ended November 30, 2006 as compared to \$4.4 million for the three months ended November 30, 2005. We incurred net tax expense in certain countries in which we had profitable operations during the period ended November 30, 2006. Income tax expense for the three months ended November 30, 2006 includes the recognition of benefits of \$4.2 million associated with a refund of taxes paid on the earnings by reinvesting the earnings of a foreign subsidiary.

The effective income tax rate is largely a function of the balance between income and losses from international and domestic operations. Our international operations, taken as a whole, have been subject to tax at a lower rate than operations in the United States, primarily due to tax holidays granted to certain of our overseas sites in Malaysia and Singapore and from benefits resulting from reinvesting the earnings of three of our international operations. The Malaysian tax holiday is effective through January 2012, and the Singapore tax holiday is effective through March 2011. Both tax holidays are subject to certain conditions, including maintaining levels of research and development expenditures, incremental fixed asset expenditures, or qualifying headcount. During the three months ended November 30, 2006, the Company included in its computation of its estimated annual effective income tax rate for fiscal 2007 a \$1.9 million discrete benefit (included in the \$4.2 million above) resulting from taxes paid on the earnings by reinvesting the earnings of one of the international operations. It is anticipated that the annual effective tax rate for the foreign subsidiaries will be favorably impacted in future periods as the Company intends to continue to apply for refunds of taxes paid on the reinvested earnings of the foreign subsidiaries.

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

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

In the quarter ended May 31, 2006, the IRS completed its field examination of the Company's federal income tax returns for fiscal years 2001 and 2002 and issued a Revenue Agent's Report (RAR). The RAR is not a final Statutory Notice of Deficiency, and the Company filed a protest during the quarter ended August 25, 2006 to protest certain of the proposed adjustments with the Appeals Office of the IRS. Although the outcome of the Appeals process is always uncertain, the Company believes that adequate amounts of tax and interest have been provided for any adjustments that are expected to result for these years.

Table of Contents**Liquidity and Capital Resources*****Cash***

Cash, cash equivalents and short-term investments decreased to approximately \$1.1 billion at November 30, 2006 from approximately \$1.2 billion at August 31, 2006. The table below, for the periods indicated, provides selected condensed consolidated cash flow information (in millions):

| | Three Months Ended November 30 | |
|--|---|-------------|
| | 2006 | 2005 |
| Net cash used in operating activities of continuing operations | \$ (8.3) | \$ (113.8) |
| Net cash used in operating activities of discontinued operations | (0.6) | (1.7) |
| Net cash used in operating activities | \$ (8.9) | \$ (115.5) |
| Net cash used in investing activities of continuing operations | \$ (16.9) | \$ (63.9) |
| Net cash provided by investing activities of discontinued operations | | 3.8 |
| Net cash used in investing activities | \$ (16.9) | \$ (60.1) |
| Net cash used in financing activities of continuing operations | \$ (76.7) | \$ (182.2) |
| Net cash provided by (used in) financing activities of discontinued operations | 0.6 | (2.1) |
| Net cash used in financing activities | \$ (76.1) | \$ (184.3) |

Net cash used in operating activities of continuing operations was \$8.3 million during the three months ended November 30, 2006. The change in net cash used in operating activities was primarily due to an \$83.1 million increase in inventories; a \$71.5 million increase in accounts receivable and a \$77.1 million increase in prepaid expenses and other assets. This was partially offset by net income of \$6.0 million, non-cash depreciation and amortization charges of \$42.0 million; an \$82.2 million increase in accounts payable, an \$86.0 million increase in accrued expenses and other liabilities, and \$6.1 million in stock based compensation. The inventory increase was attributable to new program ramps and certain program launch delays.

Net cash used in investing activities of continuing operations of \$16.9 million during the three months ended November 30, 2006 primarily consisted of \$33.4 million in capital expenditures offset by cash provided from other activities including proceeds from sale of property and equipment and use of restricted cash to acquire three facilities previously under synthetic lease.

Net cash used in financing activities of continuing operations of \$76.7 million during the three months ended November 30, 2006 primarily consisted of \$10.0 million of share repurchases and \$64.3 million of payments made to redeem the 7.97% Adjustable Conversion-Rate Equity Securities (ACES).

We currently anticipate that during the next twelve months our cash expenditures associated with restructuring plans are expected to be in the range of \$60 to \$70 million. In addition, during the next twelve months, we expect to implement Cisco Systems Lean initiative, at which time we will purchase additional inventory in the range of \$200 to \$300 million.

Debt

On August 28, 2006, Solectron entered into a \$350 million Credit Agreement (the Credit Agreement) that amends and replaces a \$500 million secured revolving facility. The Credit Agreement provides for a revolving, multicurrency, secured-credit facility, which may be used to borrow revolving loans or issue standby letters of credit, subject to a \$100 million letter of credit sub-limit. The Company may request an increase in the credit facility of up to an additional \$150 million, to provide for an aggregate commitment of up to \$500 million. There are currently no revolving loans outstanding and approximately \$0.7 million in letters of credit outstanding under the Credit Agreement. The revolving loans under the Credit Agreement bear interest, at the Company's option, at either (i) the base rate, which is defined as a fluctuating rate per annum equal to the greater of (A) Bank of America N.A.'s prime rate, or (B) the average rate on overnight federal funds plus one-half of one percent, or (ii) a rate equal to (A) the London Inter-bank Offered Rate (LIBOR) plus (B) an applicable margin of ranging from 1.0% to 2.0%

Table of Contents

based on Solectron's non-credit-enhanced senior unsecured long-term debt ratings. The Credit Agreement matures on August 28, 2009 and may be prepaid at any time without penalty or premium at the option of the Company.

The obligations under the Credit Agreement are guaranteed by the Company's existing and future material domestic subsidiaries, and such obligations, including the guarantees, are secured by: (i) the Company's and its domestic subsidiaries' accounts receivable, equipment and inventory, (ii) a pledge of the capital stock of the Company's material domestic subsidiaries, (iii) a pledge of 65% of the capital stock of the Company's material first-tier foreign subsidiaries, and (iv) a pledge of certain inter-company indebtedness among the Company and certain of its subsidiaries. In the event that the Company's non-credit-enhanced senior unsecured long-term debt achieves a rating of BB/Ba3 (stable/stable) or BB-/Ba2 (stable/stable) or higher from Standard & Poor's Ratings Services and Moody's Investors Service, Inc., respectively, the liens on the collateral described in clause (i) above will be released. Solectron is subject to compliance with certain financial covenants set forth in this facility including, but not limited to, capital expenditures, cash interest coverage ratio and leverage ratio. Solectron was in compliance with all applicable covenants as of November 30, 2006.

In addition, we had no committed foreign lines of credit and \$23.2 million in uncommitted foreign lines of credit and other bank facilities as of November 30, 2006. A committed line of credit obligates a lender to loan us amounts under the credit facility as long as we adhere to the terms of the credit agreement. An uncommitted line of credit is extended to us at the sole discretion of a lender. The interest rates range from the bank's prime lending rate to the bank's prime rate plus 1.0%. As of November 30, 2006, we had no borrowings under uncommitted foreign lines of credit and \$2.1 million of guaranteed amounts under uncommitted foreign lines of credit.

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

Synthetic Leases

On November 1, 2006, Solectron exercised its purchase option granted under synthetic lease agreements and terminated those agreements relating to three manufacturing sites in continuing operations. The synthetic leases had expiration dates in September 2007. At the end of the lease terms, Solectron had an option, subject to certain conditions, to purchase or to cause a third party to purchase the sites subject to the synthetic leases for the Termination Value, which approximates the lessor's original cost for each site, or may market the property to a third party at a different price. Solectron had provided loans to the lessor equaling approximately 85% of the Termination Value for each synthetic lease. These loans were repayable solely from the sale of the sites to third parties in the future, were subordinated to the amounts payable to the lessor at the end of the synthetic leases, and may have been credited against the Termination Values payable if Solectron purchased the sites. The approximate aggregate Termination Values and loan amounts were \$87.7 million and \$74.5 million, respectively, as of August 31, 2006. Solectron purchased the three sites for the Termination Value of \$87.7 million and funded the transaction by offsetting the carrying value of the synthetic lease loans of \$74.5 million against a portion of the purchase price and paid the remaining balance of \$13.2 million from restricted cash.

Restricted Cash

During the first quarter of fiscal 2006, Solectron elected to put in place a line of credit for the issuance of standby letters of credit. The letters of credit are principally related to self-insurance for workers compensation liability coverage. These standby letters of credit were previously issued under Solectron's revolving credit facility. Solectron opted to post cash collateral totaling 105% of the standby letter of credit balances in order to reduce annual issuance commissions of the standby letters of credit. Total cash collateral of \$16.7 million at November 30, 2006, is classified as restricted cash and cash equivalents in the condensed consolidated balance sheets.

Off-Balance Sheet Arrangements and Contractual Obligations

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

Table of Contents

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

Contractual Obligations and Commitments

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

The following is a summary of certain contractual obligations and commitments as of November 30, 2006 for continuing operations:

| | Total | Short-Term | Payments Due by Period | | | | | Thereafter |
|--|------------|------------|------------------------|---------|---------|----------|---------|------------|
| | | | Q2 Q4 | 08-08 | FY09 | FY10 | FY11 | |
| Debt | \$ 641.9 | \$ 23.1 | \$ 0.9 | \$ 0.6 | \$ 9.1 | \$ 451.1 | \$ | \$ 157.1 |
| Interest Expense on Long-Term Debt | 95.9 | 15.1 | 14.7 | 14.5 | 14.5 | 13.1 | 12.0 | 12.0 |
| Capital Lease | 2.1 | 0.3 | 1.2 | 0.6 | | | | |
| Operating lease | 152.3 | 36.4 | 23.9 | 25.0 | 21.1 | 13.1 | 11.8 | 21.0 |
| Operating leases for restructured facilities and equipment | 20.7 | 11.8 | 2.9 | 2.0 | 1.5 | 1.4 | 0.6 | 0.5 |
| Purchase obligations(1) | 133.3 | 132.6 | | | 0.7 | | | |
| | \$ 1,046.2 | \$ 219.3 | \$ 43.6 | \$ 42.7 | \$ 46.9 | \$ 478.7 | \$ 24.4 | \$ 190.6 |

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

Other long-term liabilities of \$37.4 million disclosed on the condensed consolidated balance sheet includes deferred tax liabilities related to timing differences and non-US pension liabilities, which due to their nature are not projected.

Discontinued Operations

During fiscal 2004, as a result of a full review of our portfolio of businesses, we committed to a plan to divest a number of business operations that are no longer part of our strategic plan for the future. In accordance with SFAS No. 144, we have reported the results of operations and financial position of these businesses in discontinued operations within the consolidated statements of operations and balance sheets for all periods presented. The companies that we have divested and that are included in discontinued operations are: Dy 4 Systems Inc., Kavlico Corporation, Solectron's MicroTechnology division, SMART Modular Technologies Inc., Stream International Inc., our 63% interest in US Robotics Corporation, and Force Computers, Inc.

Table of Contents

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

| | Three Months Ended November 30 | |
|--|---|-------------|
| | 2006 | 2005 |
| Net sales | \$ | \$ |
| Cost of sales | | |
| Gross profit | | |
| Operating expense (income) net | 0.6 | (1.7) |
| Operating (loss) income | (0.6) | 1.7 |
| Other income net | | 2.1 |
| (Loss) income before income taxes | (0.6) | 3.8 |
| Income tax expense | | |
| (Loss) income from discontinued operations, net of tax | \$ (0.6) | \$ 3.8 |

During the first quarter of fiscal 2007, Solectron recorded \$0.6 million of costs to discontinued operations representing expenses resulting from a sales tax assessment and facility carrying costs.

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

The sale agreements for all the divestitures contain certain indemnification provisions pursuant to which Solectron may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. In aggregate, Solectron is contingently liable for up to \$94.8 million for a period of 12 to 24 months subsequent to the completion of the sale. As of November 30, 2006, most of these indemnification provisions have expired, and there were no significant liabilities recorded under these indemnification obligations. Additionally, Solectron may be required to indemnify a buyer for environmental remediation costs for a period up to 10 years and not to exceed \$13 million. Solectron maintains an insurance policy to cover environmental remediation liabilities in excess of reserves previously established upon the acquisition of these properties. Solectron did not record any environmental charges upon disposition of these properties.

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

See Management's Discussion and Analysis of Financial Condition and Results of Operations for factors related to fluctuations in the exchange rates of foreign currency and fluctuations in interest rates under Risk Factors. We are exposed to fluctuations in foreign currency exchange rates, and We are exposed to interest rate fluctuations.

Item 4. *Controls and Procedures*

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

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

Table of Contents

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

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

Item 1a. *Risk factors*

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

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

Most of our annual net sales come from a small number of our customers. Our ten largest customers accounted for approximately 64.1% and 61.9% of net sales from continuing operations in the first quarter of fiscal 2007 and 2006, respectively. During the first quarter of fiscal 2007, one of these customers individually accounted for more than ten percent of our net sales. Any material delay, cancellation or reduction of orders from these or other major customers could cause our sales to decline significantly, and we may not be able to reduce the accompanying expenses at the same time. We cannot guarantee that we will be able to retain any of our largest customers or any other accounts, or that we will be able to realize the expected revenues under existing or anticipated supply agreements with these customers. Our earnings per share, cash flow and results of operations will continue to depend significantly on our ability to obtain orders from new customers, retain existing customers, realize expected revenues under existing and anticipated agreements, as well as on the consolidated financial condition and success of our customers and their customers.

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

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

Such transfers, if unanticipated or not properly executed, could result in various inefficiencies and increased costs, including excess capacity and overhead at one facility and capacity constraints and related strains on our resources at the other, disruption and delays in product deliveries and sales, deterioration in product quality and customer satisfaction, and increased manufacturing and scrap costs all of which would have the effect of reducing our profits.

Table of Contents

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

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

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

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

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

We are exposed to risks associated with operating internationally.

Approximately 69.2% and 67.6% of our net sales from continuing operations are the result of services and products manufactured in countries outside the United States during the first quarter of fiscal 2007 and 2006, respectively. As a result of our foreign sales and facilities, our operations are subject to a variety of risks and costs that are unique to international operations, including the following:

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

import and export duties, and value added taxes;

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

potential restrictions on the transfer of funds;

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

disruption of local labor supply or transportation services;

Table of Contents

inflexible employee contracts in the event of business downturns;

the burden and cost of compliance with import and export regulations and foreign laws;

economic and political risks in emerging or developing economies;

risks of conflict and terrorism that could disrupt our or our customers' and suppliers' businesses; and

increased risk of improper payments or inappropriate business activities.

We have been granted tax holidays, which are effective through 2012 and 2011, respectively, subject to some conditions, for our Malaysian and Singapore sites. It is possible that the current tax holidays will be terminated or modified or that future tax holidays that we may seek will not be granted. If the current tax holidays are terminated or modified, or if additional tax holidays are not granted in the future or when our current tax holidays expire, our future effective income tax rate could increase.

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

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

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

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

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

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

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

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

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

fluctuations in the availability and pricing of components;

timing of expenditures in anticipation of increased sales;

cyclicality in our target markets;

fluctuations in our market share;

fluctuations in currency exchange rates;

expenses and disruptions associated with acquisitions and divestitures;

announcements of operating results and business conditions by our customers;

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

economic developments in the electronics industry as a whole;

credit rating and stock analyst downgrades;

our ability to successfully implement changes to our enterprise resource planning systems;

Table of Contents

political and economic developments in countries in which we have operations; and
general market conditions.

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

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

We incurred approximately \$34.6 million of restructuring and impairment costs relating to continuing operations in the first quarter of fiscal 2007 and approximately \$0.9 million during the first quarter of fiscal 2006, and we anticipate incurring approximately \$50 to \$60 million of restructuring and impairment costs in total under the Fiscal 2007 Restructuring Plan during the next twelve months. If our estimates about previous and currently contemplated restructuring charges prove to be incorrect, our consolidated financial condition and results of operations may suffer. While we believe our capacity is appropriate for current revenue levels, we continue to evaluate our cost structure relative to future financial results and customer demand. If our estimates about future financial results and customer demand prove to be incorrect, our consolidated financial condition and consolidated results of operations may suffer.

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

Our continued success depends to a large extent upon the efforts and abilities of key managerial and technical associates. Losing the services of key personnel could harm us. Our business also depends upon our ability to continue to attract and retain key executives, senior managers and skilled associates. Our failure to attract and retain key personnel and a high rate of turnover could harm our business. The difficult business environment associated with the EMS industry in general and the results generated by the Company in particular have made it increasingly difficult to attract and retain key personnel at compensation levels proportionate to the return provided to the Company's shareholders. This risk is particularly high as we compete for talent from a broad range of industries. There is no guarantee that the Company will be able to attract and retain the necessary personnel in the future in a manner that does not impact the Company's profitability.

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

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

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

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

Table of Contents

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

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

We depend on the continuing trend of OEMs to outsource.

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

Our strategic relationships with major customers create risks.

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

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

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

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

we may not achieve anticipated cost reductions and efficiencies;

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

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

Table of Contents

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

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

Business disruptions could seriously harm our future revenue and financial condition and increase our costs and expenses.

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

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

Our ability to manage and integrate future acquisitions will require successful integration of such acquisitions into our manufacturing and logistics infrastructure, and may require enhancements or upgrades of accounting and other internal management systems and the implementation of a variety of procedures and controls. We cannot guarantee that significant problems in these areas will not occur. Any failure to enhance or expand these systems and implement such procedures and controls in an efficient manner and at a pace consistent with our business activities could harm our consolidated financial condition and results of operations. In addition, we may experience inefficiencies from the management of geographically dispersed facilities and incur substantial infrastructure and working capital costs. We incurred approximately \$34.6 million of restructuring and impairment costs relating to continuing operations in the first quarter of fiscal 2007 and approximately \$0.9 million in the corresponding period of fiscal 2006. See also the Risk Factor entitled "If we incur more restructuring-related charges than currently anticipated, our consolidated financial condition and results of operations may suffer."

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

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

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

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

reputation.

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

Table of Contents

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

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

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

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

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

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

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

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

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

As of November 30, 2006, we had outstanding foreign exchange forward contracts with a total notional amount of approximately \$388 million related to continuing operations. The change in value of the foreign exchange forward contracts resulting from a hypothetical 10% change in foreign exchange rates would be offset by the remeasurement

of the related balance sheet items, the result of which would not be significant.

The primary objective of our investment activities is to preserve principal, while at the same time maximize yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents in a variety of securities, including government and corporate obligations, certificates of deposit and money market funds. As of November 30, 2006, substantially our entire portfolio was scheduled to mature in less than three

Table of Contents

months. A hypothetical 10% change in interest rates would not have a material effect on the fair value of our investment portfolios.

Failure to comply with environmental regulations could harm our business.

As a company in the electronics manufacturing services industry, we are subject to a variety of environmental regulations, including those relating to the use, storage, discharge and disposal of hazardous chemicals used during our manufacturing process as well as air quality and water quality regulations, restrictions on water use, and storm water regulations. We are also required to comply with laws and regulations relating to occupational safety and health, product disposal and product content and labeling. Although we have never sustained any significant loss as a result of non-compliance with such regulations, any failure by us to comply with environmental laws and regulations could result in liabilities or the suspension of production. In addition, these laws and regulations could restrict our ability to expand our facilities or require us to acquire costly equipment or incur other significant costs to comply with regulations.

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

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

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

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

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

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

Table of Contents

disputes could have a material adverse effect on our business, consolidated financial condition and results of operations.

Our ability to effectively compete may be affected by our ability to protect our proprietary information. We hold a number of patents, patent applications, and various trade secrets and license rights. These patents, trade secrets, and license rights may not provide meaningful protection for our proprietary manufacturing processes, equipment innovations and products, or we might find it necessary to initiate litigation proceedings to protect our intellectual property rights. Any such litigation could be lengthy and costly and could harm our consolidated financial condition.

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

Our senior unsecured debt was recently rated as BB- with a stable outlook by Standard and Poors and as B3 with a positive outlook by Moody's. These credit ratings are subject to change at the discretion of the rating agencies. If our credit ratings were downgraded, it would increase our cost of capital should we borrow under our revolving lines of credit, and it may make it more expensive for us to raise additional capital in the future. Such capital raising may be on terms that may not be acceptable to us or otherwise not available. Any future adverse rating agency actions with respect to our ratings could have an adverse effect on the market price of our securities, our ability to compete for new business, our cost of capital, and our ability to access capital markets.

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

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

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

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

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

recorded.

Item 1b. *Unresolved Staff Comments*

None.

Table of Contents**Item 2. Purchase of Equity Securities**

On November 1, 2005, Solectron's Board of Directors approved a stock repurchase program whereby the Company was authorized to repurchase up to \$250 million of the Company's common stock pursuant to a 10b5-1 trading plan. Solectron commenced this \$250 million repurchase program at the end of the quarter ended February 28, 2006. During the first quarter of fiscal 2007, Solectron repurchased and retired 3.0 million shares of its common stock at an average price of \$3.28 for approximately \$10.0 million. In October 2006, the Board of Directors approved a twelve month extension to the stock repurchase program. As of November 30, 2006, Solectron had repurchased and retired a total of 17.8 million shares under the repurchase program for approximately \$61.6 million.

The following table summarizes the Company's monthly repurchases of its common stock during the quarter ended November 30, 2006 (in millions, except per share price):

| Period | Total Number of Shares Purchased | Average Price Paid per share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs |
|----------------|---|-------------------------------------|---|---|
| September 2006 | 2.3 | \$ 3.29 | 17.1 | \$ 190.8 |
| October 2006 | 0.7 | \$ 3.26 | 17.8 | \$ 188.4 |
| November 2006 | 0 | \$ 0.00 | 0 | \$ 0.0 |

Item 6. Exhibits**INDEX TO EXHIBITS**

| Exhibit No | Exhibit Description |
|-------------------|---|
| 3.1* | Certificate of Incorporation of the Registrant, as amended |
| 3.2** | Amended and Restated Bylaws of the Registrant |
| 10.1 | Amendment to Restricted Stock Agreement dated October 11, 2006 by and between Registrant and Michael Cannon |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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- * Incorporated by reference from Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 28, 2001, Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 25, 2000, and Exhibit 3.1 filed with Registrant's Form 10-Q for the quarter ended February 26, 1999.
- ** Incorporated by reference from Exhibit 3.2 filed with Registrant's Form 10-Q for the quarter ended November 28, 2003.

Table of Contents

SOLECTRON CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOLECTRON CORPORATION
(Registrant)

By: /s/ PAUL J. TUFANO
Paul J. Tufano
Executive Vice President, Chief Financial Officer
(Principal Financial Officer)

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

Date: December 29, 2006

Table of Contents

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