ADVANCED MICRO DEVICES INC
Form 10-Q
May 05, 2006
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q

**(Mark One)**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 26, 2006**

**OR**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from ______ to ______**

**Commission File Number 001-07882**

# ADVANCED MICRO DEVICES, INC.

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

| Delaware | 94-1692300 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| | 94088 |

**One AMD Place**
**Sunnyvale, California**
**(Address of principal executive offices)** **(Zip Code)**
**Registrant s telephone number, including area code: (408) 749-4000**

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

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

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

Indicate the number of shares outstanding of the registrant s common stock, $0.01 par value, as of May 1, 2006: 484,104,863.

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

**Advanced Micro Devices, Inc. and Subsidiaries**

**Condensed Consolidated Statements of Operations**

| | Quarter Ended | |
|---|---|---|
| | March 26, 2006 | March 27, 2005 |
| | (In thousands except per share amounts) | |
| | (Unaudited) | |
| Net sales | $ 1,332,158 | $ 1,018,769 |
| Net sales to related party (see Note 4) | | 207,859 |
| Total net sales | 1,332,158 | 1,226,628 |
| Cost of sales | 553,340 | 807,449 |
| Gross margin | 778,818 | 419,179 |
| Research and development | 264,176 | 253,122 |
| Marketing, general and administrative | 256,042 | 211,714 |
| Operating income (loss) | 258,600 | (45,657) |
| Interest income | 28,162 | 6,885 |
| Interest expense | (23,247) | (24,245) |
| Other income (expense), net | (19,128) | (2,911) |
| Income (loss) before minority interest, equity in net income (loss) of Spansion Inc., and income taxes | 244,387 | (65,928) |
| Minority interest in consolidated subsidiaries | (6,347) | 46,853 |
| Equity in net income (loss) of Spansion Inc. | (18,243) | |
| Provision (benefit) for income taxes | 35,273 | (1,652) |
| Net income (loss) | $ 184,524 | $ (17,423) |
| Net income (loss) per common share: | | |
| Basic | $ 0.40 | $ (0.04) |
| Diluted | $ 0.38 | $ (0.04) |
| Shares used in per share calculation: | | |
| Basic | 464,080 | 393,077 |
| Diluted | 495,326 | 393,077 |

See accompanying notes to condensed consolidated financial statements.

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**Advanced Micro Devices, Inc. and Subsidiaries**

**Condensed Consolidated Balance Sheets**

| | March 26, 2006 | December 25, 2005* |
|---|---|---|
| | (In thousands except par value and share amounts) (unaudited) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 828,626 | $ 633,067 |
| Short-term investments | 1,636,912 | 1,002,742 |
| Spansion senior subordinated notes | 167,125 | 158,957 |
| Total cash and cash equivalents and short-term investments | 2,632,663 | 1,794,766 |
| Accounts receivable | 832,115 | 818,305 |
| Allowance for doubtful accounts | (12,152) | (12,774) |
| Accounts receivable, net | 819,963 | 805,531 |
| Inventories: | | |
| Raw materials | 12,803 | 17,762 |
| Work-in-process | 196,632 | 225,003 |
| Finished goods | 127,781 | 145,866 |
| Total inventories | 337,216 | 388,631 |
| Deferred income taxes | 104,980 | 92,606 |
| Prepaid expenses and other current assets | 283,171 | 334,016 |
| Receivable from Spansion (see Note 4) | 38,860 | 143,286 |
| Total current assets | 4,216,853 | 3,558,836 |
| Property, plant and equipment: | | |
| Land and land improvements | 28,687 | 28,814 |
| Buildings and leasehold improvements | 1,286,377 | 1,027,822 |
| Equipment | 4,155,548 | 3,309,869 |
| Construction in progress | 307,892 | 1,121,100 |
| Total property, plant and equipment | 5,778,504 | 5,487,605 |
| Accumulated depreciation and amortization | (2,903,617) | (2,786,605) |
| Property, plant and equipment, net | 2,874,887 | 2,701,000 |
| Other assets | 252,066 | 303,294 |
| Receivable from Spansion (see Note 4) | 7,910 | 3,307 |
| Net investment in Spansion Inc. (see Note 3) | 700,329 | 721,342 |
| Total assets | $ 8,052,045 | $ 7,287,779 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 600,544 | $ 622,610 |
| Accounts payable to Spansion (see Note 4) | 246,634 | 233,224 |
| Accrued compensation and benefits | 258,791 | 226,874 |
| Accrued liabilities | 403,116 | 388,998 |

| | | |
|---|---|---|
| Income taxes payable | 33,871 | 3,326 |
| Deferred income on shipments to distributors | 194,940 | 141,898 |
| Current portion of long-term debt and capital lease obligations | 42,408 | 43,224 |
| Other current liabilities | 168,220 | 161,807 |
| Total current liabilities | 1,948,524 | 1,821,961 |
| Deferred income taxes | 104,980 | 92,606 |
| Long-term debt and capital lease obligations | 615,874 | 1,327,065 |
| Other long-term liabilities | 428,074 | 459,322 |
| Minority interest in consolidated subsidiaries | 244,672 | 234,988 |
| Commitments and contingencies (see note 8) | | |
| Stockholders equity: | | |
| Capital stock: | | |
| Common stock, par value $0.01; 750,000,000 shares authorized; shares issued: 490,090,836 as of March 26, 2006 and 442,196,017 as of December 25, 2005; shares outstanding: 483,390,706 as of March 26, 2006 and 435,526,719 as of December 25, 2005 | 4,832 | 4,355 |
| Capital in excess of par value | 3,959,378 | 2,800,306 |
| Treasury stock, at cost (6,700,130 shares as of March 26, 2006 and 6,669,298 shares as of December 25, 2005) | (89,758) | (90,138) |
| Retained earnings | 658,262 | 473,678 |
| Accumulated other comprehensive income | 177,207 | 163,636 |
| Total stockholders equity | 4,709,921 | 3,351,837 |
| Total liabilities and stockholders equity | $ 8,052,045 | $ 7,287,779 |

See accompanying notes to condensed consolidated financial statements.

* Amounts as of December 25, 2005 were derived from the December 25, 2005 audited financial statements.

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**Advanced Micro Devices, Inc. and Subsidiaries**

**Condensed Consolidated Statements of Cash Flows**

| | Quarters Ended March 26, 2006 | Quarters Ended March 27, 2005 |
|---|---|---|
| | (In thousands) | |
| | (unaudited) | |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 184,524 | $ (17,423) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Minority interest of consolidated subsidiaries | 6,347 | (46,853) |
| Depreciation | 159,997 | 318,796 |
| Amortization | 13,560 | 14,085 |
| Provision for doubtful accounts | (622) | (2,377) |
| Equity in loss of Spansion Inc. | 18,243 | |
| Change in deferred income taxes | (3,725) | (7,329) |
| Charge due to partial redemption of 7.75% Senior Notes | 3,822 | |
| Foreign grant and subsidy amortization | (32,033) | (29,713) |
| Forfeited interest on debt conversion | 754 | |
| Net loss on disposal of property, plant and equipment | 3,151 | 5,896 |
| Net gain realized on sale of available-for-sale securities | (2,312) | |
| Stock-based compensation expense recognized under employee stock compensation plans | 15,045 | 146 |
| Recognition of deferred gain on sale of building | (420) | (420) |
| Tax benefit (expense) on minority interest in net loss of subsidiaries | | 4,793 |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in accounts receivable | (13,182) | 25,448 |
| Decrease (increase) in receivables from related parties | 80,132 | (1,807) |
| Decrease in inventories | 52,378 | 28,638 |
| Increase in prepaid expenses and other current assets | (31,754) | (53,022) |
| Decrease (increase) in other assets | 3,047 | (9,803) |
| Increase (decrease) in taxes payable | 30,545 | (27,366) |
| Refund of customer deposits under long-term purchase agreements | | (17,500) |
| Net increase in payables and accrued liabilities | 65,442 | 59,455 |
| Increase in accounts payables and accrued liabilities to related parties | 13,410 | 7,683 |
| Net cash provided by operating activities | 566,349 | 251,327 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (310,326) | (518,472) |
| Proceeds from sale of property, plant and equipment | 2,291 | 216 |
| Repayment of loans by Spansion | 15,000 | |
| Purchases of available-for-sale securities | (1,028,223) | (233,406) |
| Proceeds from sale and maturity of available-for-sale securities | 394,053 | 87,675 |
| Other | 1,858 | (5,625) |
| Net cash used in investing activities | (925,347) | (669,612) |
| Cash flows from financing activities: | | |
| Repayment of debt and capital lease obligations | (211,205) | (54,332) |
| Proceeds from foreign grants and subsidies | 105,435 | 99,043 |
| Proceeds from sale-leaseback transactions | | 78,145 |
| Proceeds from equity offering | 494,618 | |

| | | | | |
|---|---|---|---|---|
| Proceeds from issuance of common stock under share based compensation plans | | 160,214 | | 35,191 |
| Net cash provided by financing activities | | 549,062 | | 158,047 |
| Effect of exchange rate changes on cash and cash equivalents | | 5,495 | | 3,845 |
| Net increase (decrease) in cash and cash equivalents | | 195,559 | | (256,393) |
| Cash and cash equivalents at beginning of period | | 633,067 | | 918,377 |
| Cash and cash equivalents at end of period | $ | 828,626 | $ | 661,984 |
| Supplemental disclosures of cash flow information: | | | | |
| Cash paid (refunded) during the period for: | | | | |
| Interest, net of amounts capitalized | $ | 17,094 | $ | 11,237 |
| Income taxes | $ | (3,482) | $ | 25,280 |
| Non-cash financing activities | | | | |
| Equipment sale-leaseback transaction | $ | | $ | 78,145 |
| Conversion of 4.75% Senior Convertible Debentures | $ | 499,833 | $ | |

See accompanying notes to condensed consolidated financial statements.

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**Advanced Micro Devices, Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements of Advanced Micro Devices, Inc. and subsidiaries (the Company or AMD) have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. The results of operations for the interim periods shown in this report are not necessarily indicative of results to be expected for the full fiscal year ending December 31, 2006. In the opinion of the Company s management, the information contained herein reflects all adjustments necessary for a fair statement of the Company s results of operations, financial position and cash flows. All such adjustments are of a normal recurring nature. The unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements in the Company s Annual Report on Form 10-K for the fiscal year ended December 25, 2005.

The Company uses a 52- to 53-week fiscal year ending on the last Sunday in December. The quarters ended March 26, 2006 and March 27, 2005 each consisted of 13 weeks. The quarter ending July 2, 2006 will consist of 14 weeks.

Certain prior period amounts have been reclassified to conform to the current period presentation. (See Note 6.)

*Principles of Consolidation*

On December 21, 2005, Spansion Inc. completed its initial public offering (IPO) of its Class A common stock. Prior to the IPO, Spansion was the Company s majority owned subsidiary, and the Company held a 60 percent controlling ownership interest in Spansion. Consequently, Spansion s financial position, results of operations and cash flows through December 20, 2005 were included in the Company s consolidated statements of operations and cash flows. Following the IPO, the Company s ownership interest in Spansion was diluted from 60 percent to 37.9 percent. As a result, the Company no longer exercises control over Spansion s operations. Therefore, from December 21, 2005, the Company uses the equity method of accounting to record its proportionate share of Spansion s net income (loss).

*Foreign Currency Translation/Transactions*

Prior to 2006, the functional currency of the Company s foreign subsidiaries was the U.S. dollar, except for AMD Saxony Limited Liability Company & Co. KG (AMD Saxony) and AMD Fab 36 LLC & Co. KG (AMD Fab 36 KG) whose functional currency was the euro. Beginning in 2006, the functional currency of AMD Saxony and AMD Fab 36 KG is the U.S. dollar. The change in the functional currency of these subsidiaries is accounted for in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 52, *Foreign Currency Translation* (SFAS 52), and reflects the changed economic facts and circumstances pertaining to these subsidiaries. Under the requirements of SFAS 52, the Company assessed the various economic factors relating to AMD Saxony and AMD Fab 36 KG and concluded that due to changes in facts, circumstances, scope of operations and business practices, the U.S. dollar is now the currency of the primary economic environment in which these subsidiaries operate, and, therefore, their functional currency. Consequently, beginning in the first quarter of fiscal 2006, assets and liabilities denominated in non-U.S. dollars have been remeasured into U.S. dollars at current exchange rates for monetary assets and liabilities and historical exchange rates for non-monetary assets and liabilities. Net revenue, cost of sales and expenses have been remeasured at average exchange rates in effect during each period. Net revenues, cost of sales and expenses related to the previously noted balance sheet amounts have been, remeasured at historical exchange rates. Gains or losses resulting from foreign currency remeasurements have been included in net income. Translation adjustments from prior periods will continue to remain in accumulated other comprehensive income. The Company will continue to include its proportionate share of the translation adjustments relating to Spansion Japan, a subsidiary of Spansion Inc., whose functional currency is the Japanese yen, based on the equity method of accounting, in accumulated other comprehensive income.

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*Stock-Based Compensation*

On December 26, 2005, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to the Employee Stock Purchase Plan, based on estimated fair values. The Company adopted SFAS 123R using the modified prospective transition method. In accordance with the modified prospective transition method, the Company has not restated its consolidated financial statements for prior periods. Under this transition method, stock-based compensation expense for the first quarter of 2006 includes stock-based compensation expense for all of the Company s stock-based compensation awards granted prior to, but not yet vested as of, December 26, 2005, based on the grant-date fair value estimated in accordance with the provision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Stock-based compensation expense for all stock-based compensation awards granted on or after December 26, 2005 is based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Upon adoption of SFAS 123R, the Company changed its method of attributing the value of stock-based compensation expense from the multiple-option (i.e., accelerated) approach to the single option (i.e., straight-line) method. Compensation expense for share-based awards granted prior to December 26, 2005 will continue to be subject to the accelerated multiple option method specified in FASB Interpretation No. 28 (FIN 28), *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*, while compensation expense for share-based awards granted on or after December 26, 2005 will be recognized using a straight-line, single option method.

Also, upon adoption of SFAS 123R the Company changed its method of valuation for stock option awards from the Black-Scholes-Merton ( Black-Scholes ) option-pricing model, which was previously used for the Company s pro forma information disclosures of stock-based compensation expense as required under SFAS 123, to a lattice-binomial option-pricing model.

SFAS 123R requires that the cash flows resulting from excess tax benefits related to stock compensation be classified as cash flows from financing activities. Prior to the adoption of SFAS 123R, the Company recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*.

In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the SEC s interpretation of SFAS 123R and the valuation of share-based payments for public companies. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R. See Note 2 for a further discussion on stock-based compensation.

The Company s determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company s expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors. Option-pricing models were developed for use in estimating the value of traded options that have no vesting or hedging restrictions and are fully transferable. Because the Company s employee stock options have certain characteristics that are significantly different from traded options, and because changes in the subjective assumptions can materially affect the estimated value, in management s opinion, the existing valuation models may not provide an accurate measure of the fair value of the Company s employee stock options. Although the fair value of employee stock options is determined in accordance with SFAS 123R and SAB 107 using an option-pricing model, that value may not be indicative of the fair value observed in a willing buyer/willing seller market transaction.

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SFAS 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 in order to derive the Company s best estimate of awards ultimately expected to vest. Forfeitures were estimated based on the Company s historical experience. In the Company s pro forma information required under SFAS 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred.

2. Stock-Based Incentive Compensation Plans

*Stock-Based Incentive Program Description*

The Company s stock-based incentive programs are intended to attract, retain and motivate highly qualified employees. These programs are described more fully in the notes to the consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 25, 2005. Equity awards are made from the Company s 2004 Equity Incentive Plan (the 2004 Plan). Under the 2004 Plan, stock options cannot be exercised until they become vested. Generally, stock options vest and become exercisable over a three to four-year period from the date of grant. Stock options expire at the times established by the Company s Compensation Committee of the Board of Directors, but not later than 10 years after the grant date. In addition, shares that are released from or reacquired by the Company from outstanding awards under the 2004 Plan become available for grant under the 2004 Plan and may be reissued as new awards. The Company also has stock options outstanding from previous equity compensation plans. On April 29, 2004, the Company s stockholders approved the 2004 Plan. Stock options available for grant under these prior equity compensation plans that were in effect before April 29, 2004 were consolidated into the 2004 Plan. In conjunction with the adoption of SFAS 123R, the Company reviewed its stock-based incentive programs and decided that going forward it intends to issue primarily restricted stock units in lieu of stock options.

Under the 2004 Plan, the Company can grant stock awards at, above, or below the fair market value of its common stock on the date of grant. Under the 2004 Plan, the Company can currently grant no more than nine million awards where the exercise price is less than the fair market value of its common stock on the date of grant (full value awards). These types of full value awards can consist of restricted stock and restricted stock units. The 2004 Plan also currently permits the grant of non-qualified stock options with per share exercise prices less than the fair market value of the Company s common stock on the date of grant (but not less than 85 percent of the fair market value of the Company s common stock on the date of grant). Following is a description of the material terms of the full value awards that may be granted under the 2004 Plan:

*Restricted Stock.* Restricted stock awards can be granted to any employee, director or consultant. Restricted stock based on continued service may not fully vest for three years from the date of grant. Restricted stock that is performance based may not fully vest for one year from the date of grant.

*Restricted Stock Units.* Restricted stock units are awards that can be granted to any employee, director or consultant and that obligate the Company to issue a specific number of shares of the Company s common stock in the future if the vesting terms and conditions are satisfied. Restricted stock units based on continued service generally vest over three to four years from the date of grant. Restricted stock units based solely on performance conditions generally do not vest for at least one year from the date of grant.

*Discount Stock Options.* Discount stock options are non-qualified stock options with a fixed exercise price that is less than the fair market value of the Company s common stock on the date of grant (but not less than 85 percent of the fair market value of the common stock on the date of grant).

*Valuation and Expense Information under SFAS 123R*

The following table summarizes stock-based compensation expense related to employee stock options, restricted stock and restricted stock units and employee stock purchases under the Company s Employee

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Stock Purchase Plan under SFAS 123R for the quarter ended March 26, 2006, which was allocated in the condensed consolidated statement of operations as follows:

Stock-based compensation included as a component of:

| | (In thousands) |
|---|---|
| Cost of sales | $ 1,789 |
| Research and development | 4,094 |
| Marketing, general, and administrative | 9,162 |
| Total stock-based compensation expense related to employee stock options, restricted stock, restricted stock units, and employee stock purchases | 15,045 |
| Tax benefit | |
| Stock-based compensation expense related to employee stock options, restricted stock, restricted stock units, and employee stock purchases, net of tax | $ 15,045 |

Because the Company maintained a full valuation allowance on its U.S. deferred tax assets, the Company did not recognize any tax benefit related to stock-based compensation expense for the quarter ended March 26, 2006.

As of March 26, 2006, the Company had $35 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock options that will be recognized over the weighted average period of 1.17 years. Also, as of March 26, 2006, the Company had $43 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock awards that will be recognized over the weighted average period of 1.89 years.

Upon adoption of SFAS 123R, the Company began estimating the value of employee stock options on the date of grant using a lattice-binomial option-pricing model (lattice-binomial model). Prior to the adoption of SFAS 123R, for purposes of the pro forma disclosure information that the Company provided in accordance with SFAS 123, the value of each employee stock option was estimated on the date of grant using the Black-Scholes option-pricing model.

The Company s employee stock options have various restrictions including vesting provisions and restrictions on transfer, and they are often exercised prior to their expiration date. The Company believes that the lattice-binomial model is more capable of incorporating the features of the Company s employee stock options than closed-form models such as the Black-Scholes model.

The use of the lattice-binomial model requires the use of extensive actual employee exercise behavior data and the use of a number of complex assumptions including expected volatility of the Company s common stock, risk-free interest rate, and expected dividends. The weighted-average estimated value of employee

stock options granted during the quarter ended March 26, 2006 was $15.70 per share, using the lattice-binomial model with the following weighted-average assumptions:

| | Quarter Ended March 26, 2006 |
|---|---|
| Expected volatility | 52.10% |
| Risk-free interest rate | 4.58% |
| Expected dividends | 0.00% |

The Company used a combination of the historical volatility of its common stock and the implied volatility for two-year traded options on the Company s common stock as the expected volatility assumption required by the lattice-binomial model, which is consistent with SFAS 123R and SAB 107. The implied volatility was based upon the availability of actively traded options on the Company s common stock. The Company believes that the use of implied volatility is more representative of future stock price trends for the two-year periods covered by the actively traded options maturities than simply using historical volatility alone. The Company believes that this blended approach provides a better estimate of the expected future volatility of the Company s common stock over the expected life of its stock options. Prior to 2006, the Company had used its historical stock price volatility in accordance with SFAS 123 for purposes of its pro forma information disclosures of stock-based compensation expense.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of the Company s employee stock options. The expected dividend yield is zero as the Company does not expect to pay dividends in the future.

The expected term of employee stock options represents the weighted-average period the stock options are expected to remain outstanding and is a derived output of the lattice-binomial model. The expected term of employee stock options is impacted by all of the underlying assumptions and calibration of the lattice-binomial model. The lattice-binomial model assumes that employees exercise behavior is a function of the option s remaining vested term and the extent to which the option is in-the-money. The lattice-binomial model estimates the probability of exercise as a function of these two variables based on the past ten year history of exercises, post-vesting cancellations, and outstanding options on all option grants other than pre-vesting forfeitures made by the Company. The expected term for option grants made during the quarter ended March 26, 2006 derived from the lattice-binomial model was 4.14 years.

The Company uses third-party analyses to assist in developing the assumptions used in, as well as calibrating, its lattice-binomial model. The Company is responsible for determining the assumptions used in estimating the fair value of its share-based payment awards.

*Restricted Stock Awards*

Restricted stock and restricted stock units vest in accordance with the terms and conditions established by the Compensation Committee of the Board of Directors, and are based either on continued service or performance. The cost of these awards is determined using the fair value of the Company s common stock on the date of the grant, and the compensation expense is recognized over the service period.

Certain Company employees have been granted performance-based restricted stock and performance-based restricted stock units. The number of shares ultimately received under these awards depends on actual performance against specified performance targets. The performance period is generally one to three years from the date of grant. At the end of the performance period, the number of shares of stock received by the holder will be determined by adjusting upward or downward from the target in a range between 0% and 200% of the target.

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*Employee Stock Purchase Plan (ESPP)*

Under the ESPP, eligible employees may purchase the Company s common stock through payroll deductions at a price equal to 85 percent of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable three-month purchase period. The Company issued 336,000 shares under the ESPP during the quarter ended March 26, 2006. The ESPP compensation expense is calculated using the fair value of the employees purchase rights at the grant date under the Black-Scholes model.

*Pro Forma Information Under SFAS 123 For Periods Prior to 2006*

The following table presents the effect on net loss and earnings per share as if the Company had applied the fair-value recognition provisions of SFAS 123 to all of its share-based compensation awards for the quarter ended March 27, 2005:

| | Quarter Ended March 27, 2005 |
|---|---|
| Net loss as reported | $ (17,423) |
| Add: employee stock-based compensation expense included in reported net loss net of related tax effects under APB 25 | 143 |
| Less: employee stock-based compensation expense determined under the fair-value based method, net of related tax effects | (26,200) |
| Net loss pro forma | (43,480) |
| Basic and diluted net loss per common share as reported | $ (0.04) |
| Basic and diluted net loss per common share pro forma | $ (0.11) |

The summary of the changes in stock options outstanding under the Company s stock-based compensation plans during the quarter ended March 26, 2006 is presented below:

| | Quarter Ended March 26, 2006 | |
|---|---|---|
| | Number of Shares | Weighted-Average Exercise Price |
| | (In thousands except share price) | |
| **Options:** | | |
| Outstanding at beginning of period | 45,928 | $ 15.14 |
| Granted | 440 | $ 37.01 |
| Canceled | (480) | $ 32.79 |
| Exercised | (11,500) | $ 12.88 |
| Outstanding at end of period | 34,388 | 15.93 |
| Exercisable at end of period | 25,776 | 15.40 |

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The following table summarizes the ranges of the exercise prices of outstanding and exercisable options as of March 26, 2006:

| | Options outstanding | | | Options exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | Number of shares | Weighted-average remaining contractual life (years) | Weighted-Average Exercise Price | Number of shares | Weighted-Average Exercise Price |
| | (Shares in thousands) | | | | |
| $0.01 - $11.69 | 7,582 | 5.38 | $ 9.06 | 5,915 | $ 8.77 |
| $11.70 - $14.86 | 12,444 | 5.74 | 14.42 | 9,523 | 14.54 |
| $14.89 - $22.35 | 10,586 | 5.66 | 17.72 | 7,637 | 16.61 |
| $22.38 - $45.50 | 3,776 | 5.27 | 29.64 | 2,701 | 29.55 |
| Total | 34,388 | 5.59 | $ 15.93 | 25,776 | $ 15.40 |

As of March 26, 2006, the weighted average remaining contractual life of options exercisable was 5.38 years and their aggregate intrinsic value was $539 million. The total intrinsic value of options exercised during the quarters ended March 26, 2006 and March 27, 2005 was $283 million and $76 million, respectively.

The summary of the changes in restricted stock awards outstanding under the Company s 2004 Plan during the quarter ended March 26, 2006 is presented below:

| | Quarter Ended March 26, 2006 | |
|---|---|---|
| | Number of Shares | Weighted-Average Grant Date Fair Value |
| | (In thousands except share price) | |
| Nonvested balance at beginning of period | 1,067 | $ 21.46 |
| Granted | 1,166 | $ 36.84 |
| Forfeited | (1) | $ 38.19 |
| Vested | | $ |
| Nonvested balance at end of period | 2,232 | $ 29.49 |

The total fair value of shares vested during the quarter end March 26, 2006 was zero because no shares vested during the period.

*Non-Employee Stock Options and Restricted Stock Units*

In connection with Spansion s IPO, unvested stock options and restricted stock units of the Company that are held by Spansion employees are subject to variable accounting under Emerging Issues Task Force (EITF) Issue No. 96-18, *Accounting for Equity Investments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. The fair value of unvested options and restricted stock units was measured by the Black-Scholes option pricing model at March 26, 2006 using prevalent market price assumptions because such awards were issued prior to the adoption of SFAS 123R.

The compensation expense for the quarter ended March 26, 2006 related to these awards was approximately $1.6 million. In accordance with EITF Issue No. 00-12, *Accounting by an Investor for Stock-Based Compensation Granted to Employees of an Equity Method Investee*, the compensation expense was recorded in the Company s condensed consolidated statements of operations in the same caption as the equity in net income (loss) of Spansion Inc. As of March 26, 2006, the number of unvested options and restricted stock units outstanding and held by Spansion employees was approximately 674,000.

3. Net Investment in and Equity Interest in Net Income (Loss) of Spansion

On December 21, 2005, Spansion Inc. completed its IPO of 47,264,000 shares of its Class A common stock as well as its offering of notes to the Company and institutional investors with an aggregate principal amount of $425 million. As a result of the IPO, the Company owns a total of 48,529,403 shares, or 37.9 percent, of Spansion s outstanding common stock. The Company cannot transfer any shares of Spansion s common stock, except to majority owned subsidiaries, until the earlier of December 21, 2006 or the conversion of Spansion s Class D common stock into Class A common stock.

Following the IPO, the Company s ownership interest was diluted from 60 percent to 37.9 percent. As a result, the Company no longer exercises control over Spansion s operations and, from December 21, 2005, its financial position, results of operations and cash flows are no longer consolidated with the Company s. Therefore, the Company uses the equity method of accounting to reflect its proportionate share of Spansion s net income or loss in accordance with the provisions of APB Opinion No. 18 (As Amended), *The Equity Method of Accounting for Investments in Common Stock*. Under the equity method of accounting, the Company records its proportionate share of Spansion s net income or loss based on the most recently available quarterly financial statements. For the first quarter of 2006, the Company recorded its proportionate share of Spansion s net loss for Spansion s quarter ended March 26, 2006 in its results of operations.

In determining the Company s share of the net loss from Spansion under the equity method of accounting, certain adjustments, primarily related to the elimination of intercompany profits are made to Spansion s reported results (see Note 4). These net adjustments totaled approximately $1.4 million for the quarter ended March 26, 2006 and are included in the same caption equity interest in net income (loss) of Spansion, Inc. on the Company s condensed consolidated statements of operations. In addition, the Company also reflects its proportionate share of the change in Spansion s accumulated other comprehensive income (loss) on its condensed consolidated balance sheet. The amount of this change for the first quarter of 2006 was not material.

As of March 26, 2006, the carrying value of the Company s net equity investment in Spansion amounted to approximately $700 million, and the fair value of this investment was approximately $729 million based on the closing price of Spansion s Class A common stock on March 24, 2006, the last trading day of the fiscal quarter.

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4. Related-Party Transactions

The following table represents the significant account balances receivable from or payable to Spansion as of March 26, 2006 and December 25, 2005, of which none had the legal right of offset:

| | March 26, 2006 | December 25, 2005 |
|---|---|---|
| | (In thousands) | |
| Other receivable from Spansion (short-term) | $ 33,543 | 121,585 |
| Other receivable from Spansion (long-term) | 7,910 | |
| Notes receivable from Spansion (short-term) | 5,317 | 21,701 |
| Notes receivable from Spansion (long-term) | | 3,307 |
| Accounts payable to Spansion | 246,634 | 233,224 |

In connection with the IPO, the Company entered into various amended and restated service agreements, a non-compete agreement and a patent cross-license agreement with Spansion. Under the amended services agreements, the Company agreed to provide, among other things, information technology, facilities, logistics, tax, finance, human resources, and environmental health and safety services to Spansion for a specified period. Under the amended patent cross-license agreement, Spansion will pay royalties to the Company based on a percentage of Spansion s net sales.

In addition, the Company entered into an agency agreement with Spansion pursuant to which the Company agreed to ship products to and invoice Spansion s customers in the Company s name on behalf of Spansion until Spansion has the capability to do so on its own which will be in the second quarter of 2006. Prior to shipping the product to Spansion s customers, the Company purchases the applicable product from Spansion and pays Spansion the same amount that it invoices Spansion s customers. In performing these services, the Company acts as Spansion s agent for the sale of Spansion s Flash memory products, and the Company does not receive a commission or fees for these services. Under the agreement, Spansion assumes full responsibility for its products and these transactions, including establishing the pricing and determining product specifications. Spansion also assumes credit and inventory risk related to these product sales.

Pursuant to the agency agreement and in accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, the Company records sales of Spansion s Flash memory products sold by the Company on behalf of Spansion and the related cost of sales on a net basis on its condensed consolidated statements of operations. As a result, the net impact to the Company s net sales and cost of sales is zero.

With respect to the Company s balance sheet, sales to Spansion s customers are reflected in the Company s Accounts Receivable line item whereas the payables to Spansion that relate to the products the Company purchased from Spansion are reflected in its Accounts Payable to Spansion line item. These amounts are recorded separately on the balance sheet because there is no legal right of offset in accordance with FIN 39, *Offsetting of Amounts Related to Certain Contracts*.

Prior to Spansion s IPO, Fujitsu was a related party of the Company as a result of the formation of Spansion LLC effective June 30, 2003, in which the Company held a 60 percent interest and Fujitsu held a 40 percent interest. The following table represents certain transactions between the Company (including through Spansion) and Fujitsu for the quarter ended March 27, 2005:

| | Quarter Ended March 27, 2005 |
|---|---|
| | (In thousands) |
| Net sales to Fujitsu | $ 207,859 |
| Commercial die purchases from Fujitsu | 19,192 |
| Subcontract manufacturing purchases from Fujitsu | 10,569 |
| Other purchases of goods and services from Fujitsu | 16,557 |
| Service fees due to Fujitsu | 5,731 |
| Cost of employees seconded from Fujitsu | 2,639 |

| | |
|---|---|
| Rental expense to Fujitsu | 600 |
| Royalty fees due to Fujitsu | 3,522 |

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5. Net Income (Loss) Per Common Share

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

| | Quarter Ended | |
|---|---|---|
| | March 26, 2006 | March 27, 2005 |
| | (In thousands except per share data) | |
| Numerator: | | |
| Numerator for basic income (loss) per common share | $ 184,524 | $ (17,423) |
| Effect of assumed conversion of 4.75% Senior Convertible Debentures due 2022: | | |
| Interest expense, net of tax | 2,412 | |
| Profit sharing expense adjustment, net of tax | (219) | |
| Numerator for diluted income (loss) per common share | $ 186,717 | (17,423) |
| Denominator: | | |
| Denominator for basic income (loss) per share - weighted-average shares | 464,080 | 393,077 |
| Effect of dilutive potential common shares: | | |
| Employee stock options, restricted stock and restricted stock units | 21,848 | |
| Effect of assumed conversion of 4.75% Senior Convertible Debentures due 2022 | 9,397 | |
| Dilutive potential common shares | 31,245 | |
| Denominator for diluted income (loss) per common share-adjusted weighted-average shares | 495,325 | 393,077 |
| Net income (loss) per common share: | | |
| Basic | $ 0.40 | $ (0.04) |
| Diluted | $ 0.38 | $ (0.04) |

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There were no dilutive potential common shares that were not included in the net income per common share calculation for the quarter ended March 26, 2006. Dilutive potential common shares of 62 million for the quarter ended March 27, 2005 were not included in the net loss per common share calculation, as their inclusion would have been antidilutive.

6. Segment Reporting

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

Prior to December 21, 2005, the Company had the following three reportable segments:

- the Computation Products segment, which included microprocessor products for desktop and mobile PCs, servers and workstations and chipset products;
- the Memory Products segment, which included Spansion Flash memory products; and
- the Personal Connectivity Solutions segment, which included embedded processors and products for global commercial and consumer markets.

As a result of Spansion s IPO, the Company s financial results of operations include Spansion s financial results of operations as a consolidated subsidiary through December 20, 2005. From December 21, 2005, Spansion s operating results and financial position are not consolidated as part of the Company s financial results. Instead, the Company applied the equity method of accounting to reflect its proportionate share of Spansion s net income (loss) from December 21, 2005 through March 26, 2006. Accordingly, as of December 21, 2005 the Company no longer has the Memory Products segment, and the operating results for the quarter ended March 26, 2006 are not fully comparable with the results for the quarter ended March 27, 2005.

In addition, because prior to Spansion s IPO the Company held a 60 percent controlling interest in Spansion, Fujitsu s 40 percent share in the net income (loss) of Spansion was reflected as a minority interest adjustment to the Company s consolidated financial statements through December 20, 2005. This minority interest adjustment does not correspond to operating income (loss) of the Memory Products segment because operating income (loss) for the Memory Products segment includes operations incremental to those of Spansion. Furthermore, the minority interest calculation is based on Spansion s net income (loss) rather than its operating income (loss).

As of December 21, 2005, the Company has two reportable segments: the Computation Products segment and the Embedded Products segment, which prior to the first quarter of 2006, the Company referred to as the Personal Connectivity Solutions segment. In the first quarter of 2006, the Company changed the name of the Personal Connectivity Solutions segment to the Embedded Products segment. In addition to its two current reportable segments, the Company also has the All Other category. This category includes the Personal Internet Communicator (PIC) operating segment, which was reviewed separately by the CODM beginning in the third quarter of 2005, as well as certain operating expenses and credits that are not allocated to any of the reportable segments because the CODM does not consider these operating expenses and credits in evaluating the operating performance of the Company s operating segments.

The PIC is not a reportable segment because it does not meet the threshold criteria for a reportable segment as required by SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*. Revenue from sales of PIC products has not been material.

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Also as a result of Spansion s IPO and the deconsolidation of Spansion s operating results effective December 21, 2005, the Company allocated profit sharing and bonus expenses to specific operating segments that earned them. Therefore, these expenses are no longer included in the All Other category. Prior period segment information has been reclassified to conform to the current period s presentation.

The following table is a summary of net sales and operating income (loss) by segment with reconciliations to net income (loss) for the quarters ended March 26, 2006 and March 27, 2005:

| | Quarter Ended | |
|---|---|---|
| | March 26, 2006 | March 27, 2005 |
| | (In thousands except per share data) | |
| Computation Products | | |
| Net sales | $ 1,298,567 | $ 749,601 |
| Operating income | 284,459 | 82,205 |
| Embedded Products | | |
| Net sales | 37,945 | 29,056 |
| Operating loss | (11,349) | (14,067) |
| All Other | | |
| Net sales | (4,354) | 615 |
| Operating loss | (14,510) | (3,951) |
| Memory Products | | |
| Net sales | | 447,356 |
| Operating loss | | (109,844) |
| Total | | |
| Net sales | 1,332,158 | 1,226,628 |
| Operating income (loss) | 258,600 | (45,657) |
| Interest income | 28,162 | 6,885 |
| Interest expense | (23,247) | (24,245) |
| Other income (expense), net | (19,128) | (2,911) |
| Minority interest of consolidated subsidiaries | (6,347) | 46,853 |
| Equity in net income (loss) of Spansion Inc. | (18,243) | |
| Provision (benefit) for income taxes | 35,273 | (1,652) |
| Net income (loss) | $ 184,524 | $ (17,423) |

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7. Comprehensive Income (Loss)

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

| | Quarter Ended | |
|---|---|---|
| | March 26, 2006 | March 27, 2005 |
| | (In thousands) | |
| Net income (loss) | $ 184,524 | $ (17,423) |
| Net change in unrealized gains (losses) on available-for-sale securities, net of taxes | 12,775 | (103) |
| Net change in unrealized gains (losses) on cash flow hedges, net of taxes | 1,320 | (25,954) |
| Net change in cumulative translation adjustments | (524) | (67,212) |
| Other comprehensive income (loss) | 13,571 | (93,269) |
| Total comprehensive income (loss) | $ 198,095 | $ (110,692) |

The change in other comprehensive income (loss) in the first quarter of 2006 compared to the first quarter of 2005 was primarily due to the decrease in net change in cumulative translation adjustments as a result of the change in functional currency in certain of the Company s subsidiaries. See Note 1.

8. Commitments and Contingencies

*Guarantees*

The Company accounts for and discloses guarantees in accordance with FIN 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.*

***Guarantees of Indebtedness Recorded on the Company s Condensed Consolidated Balance Sheet***

The following table summarizes the principal guarantees issued as of March 26, 2006 related to underlying liabilities that are already recorded on the Company s condensed consolidated balance sheet as of March 26, 2006 and their expected expiration dates by year. No incremental liabilities are recorded on the Company s condensed consolidated balance sheet for these guarantees:

| | Amounts Guaranteed | Remaining 2006 | 2007 | 2008 | 2009 | 2010 | 2011 and Beyond |
|---|---|---|---|---|---|---|---|
| | | | (In thousands) | | | | |
| Repurchase Obligations to Fab 36 partners[1] | $ 154,067 | $ 38,517 | $ 38,517 | $ 52,960 | $ 24,073 | $ | $ |

(1) Amounts guaranteed by the Company in connection with the silent partnership contributions that the Company s subsidiaries are required to repurchase from the unaffiliated limited partners of AMD Fab 36 KG. Amounts represent the principal amount of the underlying obligations guaranteed and are exclusive of obligations for interest.

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

The following table summarizes the principal guarantees issued as of March 26, 2006, for which the related underlying liabilities are not recorded on the Company s condensed consolidated balance sheet as of March 26, 2006 and their expected expiration dates.

| | Amounts Guaranteed(1) | Remaining 2006 | 2007 | 2008 | 2009 | 2010 | 2011 and Beyond |
|---|---|---|---|---|---|---|---|
| | | | (In thousands) | | | | |
| AMTC revolving loan guarantee | $ 38,517 | $ | $ 38,517 | $ | $ | $ | $ |
| AMTC rental guarantee (2) | 114,266 | | | | | | 114,266 |
| Spansion capital lease guarantees (3) | 23,253 | 20,008 | 3,245 | | | | |
| Spansion operating lease guarantees (3) | 6,381 | 2,962 | 2,345 | 1,074 | | | |

(1) Amounts represent the principal amount of the underlying obligations guaranteed and are exclusive of obligations for interest, fees and expenses.
(2) Amount of the guarantee diminishes as the rent is paid.
(3) Notwithstanding the Spansion IPO, the Company agreed to maintain its guarantees of these Spansion obligations.

*AMTC and BAC Guarantees*

The Advanced Mask Technology Center GmbH & Co. KG (AMTC) and Maskhouse Building Administration GmbH & Co., KG (BAC) are joint ventures formed by AMD, Infineon Technologies AG and DuPont Photomasks, Inc. for the purpose of constructing and operating an advanced photomask facility in Dresden, Germany. In April 2005, DuPont Photomasks, Inc. was acquired by Toppan Printing Co., Ltd. and became a wholly owned subsidiary of Toppan, named Toppan Photomasks, Inc. The Company procures advanced photomasks from AMTC and uses them in manufacturing its microprocessors. To finance the project, BAC and AMTC entered into a $144 million revolving credit facility and a $90 million term loan in December 2002. Also in December 2002, in order to occupy the photomask facility, AMTC entered into a rental agreement with BAC. With regard to these commitments by BAC and AMTC, as of March 26, 2006, the Company guaranteed up to $39 million plus interest and expenses under the revolving loan, and up to $19 million, initially, under the rental agreement. The obligations under the rental agreement guarantee diminish over time through 2011 as the term loan is repaid. However, under certain circumstances of default by the other tenant of the photomask facility under its rental agreement with BAC and certain circumstances of default by more than one joint venture partner under its rental agreement guarantee obligations, the maximum potential amount of the Company s obligations under the rental agreement guarantee is $114 million. As of March 26, 2006, $84 million was drawn under the revolving credit facility, and $58 million was drawn under the term loan. The Company has not recorded any liability in its consolidated financial statements associated with the guarantees because they were issued prior to December 31, 2002, the effective date of FIN 45.

*Spansion Capital Lease Guarantee*

The Company guaranteed certain capital leases entered into by Spansion and its subsidiaries totaling $23 million as of March 26, 2006. The amounts guaranteed are reduced by the actual amount of lease payments made by Spansion over the terms of the leases.

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*Spansion Operating Lease Guarantees*

The Company guaranteed certain operating leases entered into by Spansion and its subsidiaries totaling $6 million as of March 26, 2006. The amounts guaranteed are reduced by the actual amount of lease payments made by Spansion over the terms of the leases.

The Company has not recognized any liability for these guarantees under the provisions of FIN 45 because the Company concluded the fair values of the guarantees are not significant. In making the decision, the Company considered various factors including the recent IPO of Spansion, its credit rating, the ability of Spansion to make the payments on these obligations and the short maturity of the indebtedness.

*Warranties and Indemnities*

The Company generally offers a three-year limited warranty to end users for microprocessor products that are commonly referred to as processors in a box , a one-year limited warranty to direct purchasers for all other microprocessor products that are commonly referred to as tray microprocessor products, and a one-year limited warranty to direct purchasers of embedded processor products. The Company has offered extended limited warranties to certain customers of tray microprocessor products who have written agreements with the Company and target their computer systems at the commercial market. Prior to Spansion s IPO and the related deconsolidation, the Company also offered a one-year limited warranty to direct purchasers for all Flash memory products. Under limited circumstances, the Company also offered an extended limited warranty to direct purchasers of Flash memory products that were intended for systems targeted at the embedded end market.

Changes in the Company s potential liability for product warranty during the quarters ended March 26, 2006 and March 27, 2005 are as follows:

| | **Quarter Ended** | |
|---|---|---|
| | **March 26, 2006** | **March 27, 2005** |
| | **(In thousands)** | |
| Balance, beginning of period | $ 18,792 | $ 22,043 |
| New warranties issued during the period | 8,904 | 9,572 |
| Settlements during the period | (5,770) | (7,959) |
| Changes in liability for pre-existing warranties during the year, including expirations | (3,601) | (2,641) |
| Balance, end of period | $ 18,325 | $ 21,015 |

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

*Contingencies*

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

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9. Restructuring and Other Special Charges

*2002 Restructuring Plan*

In December 2002, the Company began implementing a restructuring plan (the 2002 Restructuring Plan) to further align its cost structure to the industry conditions at that time, including weak customer demand and industry-wide excess inventory. With the exception of the exit costs consisting primarily of remaining lease payments on abandoned facilities, net of estimated sublease income that are payable through 2011, the Company has completed the activities associated with the 2002 Restructuring Plan.

The accruals under the 2002 Restructuring Plan at December 25, 2005 were $85 million. During the first quarter of 2006, the Company paid an aggregate amount of $5 million related to facility exit costs. As a result, the accruals at March 26, 2006 were $80 million.

As of March 26, 2006 and December 25, 2005, $61 million and $66 million of the total restructuring accruals of $80 million and $85 million were included in other long-term liabilities on the condensed consolidated balance sheets. See Note 10.

10. Other Long-Term Liabilities

The Company s other long-term liabilities at March 26, 2006 and December 25, 2005 consisted of:

| | Quarter Ended | |
|---|---|---|
| | **March 26, 2006** | **December 25, 2005** |
| | **(In thousands)** | |
| Fab 30/Fab 36 deferred grants and subsidies | $ 327,378 | $ 341,502 |
| Restructuring accrual (see Note 9) | 61,278 | 66,288 |
| Deferred gain on sale leaseback of building | 19,706 | 20,126 |
| Other | 19,712 | 31,406 |
| | $ 428,074 | $ 459,322 |

11. Equity Offering

On January 27, 2006, the Company closed the offering of 14,096,000 shares of its common stock. The net proceeds from this equity offering, after deducting underwriting commissions, discounts and offering expenses, were $495 million. The Company used $231 million of the net proceeds from this offering to fund the redemption of 35 percent (or $210 million) of the aggregate principal amount outstanding of its 7.75% Notes, including a 7.75% redemption premium and accrued interest. See Note 12.

12. Debt

*Conversion of 4.75% Convertible Senior Debentures*

In February 2006, holders of the Company s 4.75% Convertible Senior Debentures due 2022 (4.75% Debentures) elected to convert their debentures into 21,378,605 shares of the Company s common stock pursuant to the original terms of the 4.75% Debentures. Upon conversion, the principal amount of the debentures of $500 million plus $12 million of unamortized finance costs were reclassified and reflected in stockholders equity.

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*Partial Redemption of 7.75% Senior Notes*

In February 2006, the Company redeemed 35 percent (or $210 million) of the aggregate principal amount outstanding of its 7.75% Senior Notes due 2012. The holders of the 7.75% Senior Notes received 107.75 percent of the principal amount of the 7.75% Senior Notes plus accrued interest. In connection with this redemption, the Company recorded an expense of approximately $16 million, which represents the 7.75% redemption premium paid by the Company, and a charge of $4 million, which represents 35 percent of the unamortized issuance costs incurred in connection with the original issuance of the 7.75% Senior Notes. The Company included these charges in the other income (expense), net line on the condensed consolidated statement of operations for the quarter ended March 26, 2006.

13. Income Taxes

The Company recorded an income tax provision of $35 million at a projected annual effective tax rate of 15 percent of pre-tax income in the first quarter of 2006 and an income tax benefit of $2 million, or nine percent of pre-tax loss, in the first quarter of 2005.

The income tax provision recorded in the first quarter of 2006 was for taxes on income generated in both the U.S. and foreign jurisdictions. The U.S. income tax in the first quarter 2006 projected annual effective tax rate estimate arose because the net operating losses and federal tax credits available to reduce the tax provision are less than the total net operating losses and federal tax credits available, as a result of deductions under the Company s stock option plans that will increase capital in excess of par value when realized. Realization of the benefits associated with these equity related deductions has not yet occurred and is dependent upon generating sufficient future taxable income. The projected annual effective tax rate of 15 percent of pre-tax income in the first quarter of 2006 was less than the expected U.S. statutory rate primarily as a result of deferred tax assets under valuation allowances being available to reduce the estimated current year tax provision.

The income tax benefit recorded in the first quarter of 2005 was primarily for foreign tax benefits on losses in certain foreign jurisdictions. The income tax benefit in the first quarter of 2005 differed from the expected U.S. statutory tax rate primarily as a result of the tax benefit of foreign losses associated with Spansion Japan off-setting foreign income taxes in other jurisdictions and the use of U.S. valuation allowance to reduce the projected U.S. tax provision.

As of March 26, 2006 all of the Company s U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance that was initially established in the fourth quarter of 2002. The realization of these assets is dependent on substantial future taxable income which at March 26, 2006, in management s estimate, is not more likely than not to be achieved.

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

*The statements in this report include forward-looking statements. These forward-looking statements are based on current expectations and beliefs and involve numerous risks and uncertainties that could cause actual results to differ materially from expectations. These forward-looking statements should not be relied upon as predictions of future events as we cannot assure you that the events or circumstances reflected in these statements will be achieved or will occur. You can identify forward-looking statements by the use of forward-looking terminology including believes, expects, may, will, should, seeks, intends, plans, pro forma, estimates, or anticipates or the negative of these words and phrases or other variations of these words and phrases or comparable terminology. The forward-looking statements relate to, among other things: our sales; capital expenditures; depreciation and amortization expenses; the adequacy of resources to fund operations and capital expenditures; operating expenses; tax rate; the development and timing of the introduction of new products and technologies; customer and market acceptance of our microprocessors; our ability to remain competitive and maintain or increase our market position; our ability to maintain and develop key relationships with our existing and new customers and suppliers; the ability to produce our products in the volumes and mix required by the market either in our own facilities or at foundries, at mature yields and on a timely basis; our ability to maintain the level of investment in research and development and capacity that is required to remain competitive; our ability to transition to advanced manufacturing process technologies in a timely and effective way; the process technology transitions in our wafer fabrication facilities; and our ability to gain market share in high-growth global markets such as China, Latin America, India and Eastern Europe.*

*For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see the Financial Condition and Risk Factors sections set forth below and such other risks and uncertainties as set forth below in this report or detailed in our other Securities and Exchange Commission (SEC) reports and filings. We assume no obligation to update forward-looking statements.*

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes included in this report and our audited consolidated financial statements and related notes as of December 25, 2005 and December 26, 2004, and for each of the three years in the period ended December 25, 2005 as filed in our Annual Report on Form 10-K for the year ended December 25, 2005.

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**Overview**

We design, manufacture and market microprocessor solutions for the computing, communications and consumer electronics markets. These solutions include embedded microprocessors for personal connectivity devices and other consumer markets. Prior to the closing of the initial public offering, or IPO, of Spansion Inc. on December 21, 2005, we also manufactured and sold Flash memory devices through our formerly consolidated, majority owned subsidiary, Spansion LLC.

The first quarter of 2006 was characterized by continued solid execution of our corporate strategy. This quarter was also our first full quarter after the completion of Spansion s IPO, and therefore, does not include the results of operations of what was formerly called our Memory Products segment. During this quarter, Computation Products net sales of $1.3 billion increased by 73 percent compared to the first quarter of 2005 due to increased unit shipments and average selling prices. Computation Products net sales of $1.3 billion were relatively flat compared to the fourth quarter of 2005 because lower overall unit

shipments were offset by increased blended average selling prices. Moreover, gross margin as a percentage of net sales for the first quarter of 2006 improved from comparable gross margin percentage in the first quarter of 2005 and the fourth quarter of 2005 due to the fact that during the first quarter of 2006, we did not consolidate Spansion s results of operations with ours.

Our balance sheet as of March 26, 2006 also improved. Cash, cash equivalents and short-term investments at March 26, 2006 were $2.6 billion, an increase of $838 million from December 25, 2005. The increase was primarily due to $566 million of cash flow from operations and net proceeds of $495 million from the sale of 14,096,000 shares of our common stock in a public equity offering. We also decreased our debt-to-capital ratio due to the conversion of $500 million of our outstanding 4.75% Convertible Senior Debentures due 2022 (4.75% Debentures) and our redemption of $210 million of the aggregate principal amount outstanding of our 7.75% Senior Notes due 2012 (7.75% Notes).

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

**Critical Accounting Policies**

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

Management believes there have been no significant changes during the quarter ended March 26, 2006 to the items that we disclosed as our critical accounting policies and estimates in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the fiscal year ended December 25, 2005.

**Results of Operations**

We review and assess operating performance using segment revenues and operating income (loss) before interest, other income (loss), equity in net income (loss) of Spansion Inc., income taxes and minority interest. These performance measures include the allocation of expenses to the operating segments based on management s judgment.

Prior to December 21, 2005, we had the following three reportable segments:

- the Computation Products segment, which included microprocessor products for desktop and mobile PCs, servers and workstations and chipset products;
- the Memory Products segment, which included Spansion Flash memory products; and
- the Personal Connectivity Solutions segment, which included embedded processors and products for global commercial and consumer markets.

As a result of the completion of Spansion s IPO on December 21, 2005, our financial results of operations include Spansion s financial results of operations as a consolidated subsidiary through December 20, 2005. From December 21, 2005, Spansion s operating results and financial position are not consolidated as part of our financial results. Instead, we applied the equity method of accounting to reflect our proportionate

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share of Spansion s net income (loss) from December 21, 2005 through March 26, 2006. Accordingly, as of December 21, 2005 we no longer have the Memory Products segment, and our operating results for the quarter ended March 26, 2006 are not fully comparable with our results for the quarter ended December 25, 2005 or the quarter ended March 27, 2005.

In addition, because prior to Spansion s IPO we held a 60 percent controlling interest in Spansion, Fujitsu s 40 percent share in the net income (loss) of Spansion was reflected as a minority interest adjustment to our consolidated financial statements through December 20, 2005. This minority interest adjustment does not correspond to operating income (loss) of our Memory Products segment because operating income (loss) for our Memory Products segment includes operations incremental to those of Spansion. Furthermore, the minority interest calculation is based on Spansion s net income (loss) rather than operating income (loss).

As of December 21, 2005, we have two reportable segments: the Computation Products segment and the Embedded Products segment, which prior to the first quarter of 2006, we referred to as our Personal Connectivity Solutions segment. In the first quarter of 2006, we changed the name of our Personal Connectivity Solutions segment to the Embedded Products segment. In addition to our two reportable segments, we also have the All Other category. This category includes our Personal Internet Communicator (PIC) operating segment, which was reviewed separately by our Chief Operating Decision Maker, or CODM beginning in the third quarter of 2005, as well as certain operating expenses and credits that are not allocated to any of our reportable segments because our Chief Executive Officer, who is our CODM, does not consider these operating expenses and credits in evaluating the operating performance of our reportable segments. The PIC is not a reportable segment because it does not meet the threshold criteria for a reportable segment as required by SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*. Revenue from sales of PIC products has not been material.

Also as a result of Spansion s IPO and the deconsolidation of Spansion s operating results effective December 21, 2005, we allocated profit sharing and bonus expenses to the specific operating segments that earned them. Therefore, these expenses are no longer included in the All Other category. Prior period segment information has been reclassified to conform to the current period s presentation.

We use a 52- to 53-week fiscal year ending on the last Sunday in December. The quarters ended March 26, 2006, December 25, 2005 and March 27, 2005 each included 13 weeks. The quarter ending July 2, 2006 will include 14 weeks.

The following is a summary of our net sales and operating income (loss) by segment and category for the periods presented below:

| | Quarter Ended | | |
|---|---|---|---|
| | **March 26, 2006** | **December 25, 2005** | **March 27, 2005** |
| | | **(In millions)** | |
| Net sales | | | |
| Computation Products | $ 1,299 | $ 1,307 | $ 750 |
| Embedded Products | 38 | 41 | 30 |
| All Other | (5) | 3 | |
| Memory Products | | 487 | 447 |
| Total Net Sales | $ 1,332 | $ 1,838 | $ 1,227 |
| Operating income (loss) | | | |
| Computation Products | $ 284 | $ 287 | $ 82 |
| Embedded Products | (11) | (15) | (14) |
| All Other | (14) | (4) | (4) |
| Memory Products | | (62) | (110) |
| Total Operating Income (Loss) | $ 259 | $ 206 | $ (46) |

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***Computation Products***

Computation Products net sales of $1.3 billion in the first quarter of 2006 increased 73 percent compared to net sales of $750 million in the first quarter of 2005 primarily as a result of a 44 percent increase in unit shipments and a 21 percent increase in average selling prices. Unit shipments increased due to greater demand for desktop, mobile and server products across all geographic regions. The increase in average selling prices was primarily due to increased sales of our higher priced, high-performance AMD64-based processors, including dual-core processors, which contributed to a richer product mix. Moreover, our introduction of AMD Turion 64 processors for notebook PCs in March 2005, AMD Opteron dual-core processors for servers and workstations in April 2005 and AMD Athlon 64 dual-core processors for desktop PCs in May 2005 helped drive increasing customer adoption of our products in the first quarter of 2006.

Computation Products net sales of $1.3 billion in the first quarter of 2006 were relatively flat compared to the fourth quarter of 2005. An increase of seven percent in average selling prices was offset by a seven percent decrease in unit shipments.

Computation Products operating income of $284 million in the first quarter of 2006 improved from $82 million in the first quarter of 2005 and was relatively flat compared to the fourth quarter of 2005. The improvement from the first quarter of 2005 was primarily due to a 73 percent increase in net sales, while operating expenses increased 54 percent. Operating expenses increased for the reasons set forth below under Expenses.

***Embedded Products***

Embedded Products net sales of $38 million in the first quarter of 2006 increased 27 percent compared to net sales of $30 million in the first quarter of 2005 primarily due to an $8 million increase in net sales of one of our embedded processor product lines, which increased due to increased unit shipments for this product line, while net sales of our other embedded processor product lines remained relatively flat. Embedded Products net sales of $38 million in the first quarter of 2006 decreased 9 percent compared to net sales of $41 million in the fourth quarter of 2005 primarily as a result of a $2 million decrease in net sales of one of our embedded processor product lines, which decreased due to decreased unit shipments for this product line, while net sales of our other embedded processor product lines remained relatively flat.

Embedded Products operating loss of $11 million in the first quarter of 2006 improved compared to operating loss of $14 million in the first quarter of 2005 primarily due to an increase in net sales of $8 million, partially offset by an increase in cost of sales of $4 million and an increase in research and development expenses of $3 million. Embedded Products operating loss of $11 million in the first quarter of 2006 improved compared to an operating loss of $15 million in the fourth quarter of 2005 primarily due to a decrease in cost of sales of $10 million, partially offset by a decrease in net sales of $3 million and an increase in marketing, sales and administrative expenses of $3 million.

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***All Other Category***

All Other net sales in the first quarter of 2006 decreased $8 million from $3 million in the fourth quarter of 2005 primarily due to returns of PIC products. We did not generate sales from PIC products in the first quarter of 2005.

All Other operating loss of $14 million in the first quarter of 2006 increased from an operating loss of $4 million in the first quarter of 2005 and $4 million in the fourth quarter of 2005 primarily due to an increase in cost of sales primarily due to an inventory write off and a decrease in net sales.

***Memory Products Group***

As a result of Spansion s IPO, we no longer have a Memory Products segment.

***Comparison of Gross Margin, Expenses, Interest Income, Interest Expense, Other Income (Expense), Net, and Income Taxes***

The following is a summary of certain consolidated statement of operations data for the periods indicated:

| | Quarter Ended | | |
|---|---|---|---|
| | March 26, 2006 | December 25, 2005 | March 27, 2005 |
| | (In millions except for percentages) | | |
| Cost of sales | $ 553 | $ 986 | $ 807 |
| Gross margin | 779 | 852 | 419 |
| Gross margin percentage | 58% | 46% | 34% |
| Gross margin percentage excluding Memory Products | 58% | 57% | 53% |
| Research and development | $ 264 | $ 329 | $ 253 |
| Marketing, general and administrative | 256 | 317 | 212 |
| Interest income | 28 | 14 | 7 |
| Interest expense | 23 | 24 | 24 |
| Other income (expense), net | (19) | (13) | (3) |
| Loss on disposition of equity interest in Spansion Inc. | | 110 | |
| Income tax provision (benefit) | 35 | (1) | (2) |

***Gross Margin***

Gross margin as a percentage of net sales increased to 58 percent in the first quarter of 2006 compared to 34 percent in the first quarter of 2005 and 46 percent in the fourth quarter of 2005 primarily due to the fact that during the first quarter of 2006, we did not consolidate Spansion s results of operations with ours.

Gross margin as a percentage of net sales, excluding the Memory Products segment, was 53 percent in the first quarter of 2005 and 57 percent in the fourth quarter of 2005. The improvement in gross margin percentage, excluding the Memory Products segment, from the first quarter of 2005 was primarily due to an increase of 21 percent in average selling prices for our microprocessor products, partially offset by increased manufacturing costs caused by the shift in our product mix to higher-end microprocessor products. The improvement in gross margin, excluding the Memory Products segment, from the fourth quarter of 2005 was primarily due to an increase of seven percent in average selling prices for our microprocessor products due to an improvement in the mix of microprocessors sold and manufacturing efficiencies at Fab 30.

We record grants and allowances that we receive from the State of Saxony and the Federal Republic of Germany for Fab 30 or Fab 36 as long-term liabilities on our financial statements. We amortize these amounts as they are earned as a reduction to operating expenses. We record the amortization of the production related grants and allowances as a credit to cost of sales. The credit to cost of sales totaled $26 million in the first quarter of 2006, $17 million in the fourth quarter of 2005 and $18 million in the first quarter of 2005. The fluctuations in the recognition of these credits have not significantly impacted our gross margins.

In 2005 and 2004 we capitalized construction, equipment and facilitization costs related to Fab 36. In the first quarter of 2006, we produced revenue-generating products in Fab 36, and we began recognizing depreciation expense on Fab 36-related production assets to cost of sales. At the beginning of the second quarter of 2006, we began shipping and recognizing revenue on products produced in Fab 36.

***Expenses***

**Research and Development Expenses**

Research and development expenses of $264 million in first quarter of 2006 increased four percent from $253 million in the first quarter of 2005 due to an increase in research and development expenses attributable to our Computation Products segment. Partially offsetting this increase in research and development expenses is the fact that during the first quarter of 2006, we did not consolidate Spansion s results of operations into ours. In the first quarter of 2005, Spansion s research and development expenses were $70 million.

Computation Products research and development expenses in the first quarter of 2006 increased 47 percent compared to the first quarter of 2005 primarily as a result of a $35 million increase in product design and process improvement costs for new generations of our microprocessors and a $24 million increase in corporate bonus and profit sharing expenses.

Research and development expenses of $264 million in first quarter of 2006 decreased 20 percent from $329 million in the fourth quarter of 2005 due primarily to the fact that during the first quarter of 2006, we did not consolidate Spansion s results of operations into ours. In the fourth quarter of 2005, the amount of Spansion s research and development expenses that we consolidated was $73 million.

Computation Products research and development expenses in the first quarter of 2006 were relatively flat compared to the fourth quarter of 2005. Research and development expenses associated with the Fab 36 project decreased $12 million in the first quarter of 2006 compared to the fourth quarter of 2005 because we produced revenue-generating products in Fab 36 during the first quarter of 2006. Therefore, certain expenses that were previously classified as research and development expenses were captured in inventory or classified as cost of sales during the first quarter of 2006.

We also apply for and obtain subsidies from the State of Saxony, the Federal Republic of Germany and the European Union for certain research and development projects. We record the amortization of the research and development related grants and allowances as well as the research and development subsidies as a reduction of research and development expenses when all conditions and requirements set forth in the subsidy grant are met. The credit to research and development expenses totaled $6 million in the first quarter of 2006, $11 million in the fourth quarter of 2005 and $14 million in the first quarter of 2005.

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**Marketing, General and Administrative Expenses**

Marketing, general and administrative expenses of $256 million in first quarter of 2006 increased 21 percent from $212 million in the first quarter of 2005 due to an increase in marketing, general and administrative expenses attributable to our Computation Products segment. Partially offsetting this increase in marketing, general and administrative expenses is the fact that during the first quarter of 2006 we did not consolidate Spansion s results of operations into ours. In the first quarter of 2005, Spansion s marketing, general and administrative expenses were $48 million.

Computation Products marketing, general and administrative expenses in the first quarter of 2006 increased 61 percent compared to the first quarter of 2005 primarily as a result of an increase of $51 million in sales and cooperative advertising and marketing expenses associated with our AMD 64-based processors, an increase of $15 million in corporate bonus and profit sharing expenses and an increase of $9 million in stock compensation expense in connection with the adoption of SFAS No. 123R, *Share-Based Payment*, which we are required to record beginning in the first quarter of 2006.

Marketing, general and administrative expenses of $256 million in first quarter of 2006 decreased 19 percent from $317 million in the fourth quarter of 2005 due primarily to the fact that during the first quarter of 2006, we did not consolidate Spansion s results of operations into ours. In the fourth quarter of 2005, the amount of Spansion s marketing, general and administrative expenses that we consolidated was $68 million.

Computation Products marketing, general and administrative expenses in the first quarter of 2006 increased two percent compared to the fourth quarter of 2005 primarily as a result of the stock compensation expense discussed above and an increase of $8 million in cooperative advertising and marketing expenses in the first quarter of 2006 compared with the fourth quarter of 2005.

**Interest Income**

Interest income of $28 million in the first quarter of 2006 increased from $7 million in the first quarter of 2005 and $14 million in the fourth quarter of 2005. The increase from the first quarter of 2005 and the fourth quarter of 2005 was due to an increase in average interest rates as well as increased average cash and short-term investment balances.

**Interest Expense**

Interest expense of $23 million in the first quarter of 2006 decreased from $24 million in the first quarter and the fourth quarter of 2005.

Interest expense decreased $1 million from the first quarter of 2005 for the following reasons: During the first quarter of 2006 we did not consolidate Spansion s results of operations with ours, and, therefore, interest expense on Spansion s third party debt was not included. In the first quarter of 2005, Spansion s third party interest expense was $6 million. Moreover, interest expense incurred on our 4.75% Debentures decreased by $3 million because holders of the 4.75% Debentures converted their debentures into shares our common stock by February 3, 2006. Also, interest expense incurred on our 7.75% Notes decreased by $2 million because we redeemed $210 million of the aggregate principal amount outstanding of the 7.75% Notes on February 26, 2006. These factors were offset by a decrease of $7 million of capitalized interest expense related to Fab 36 in the first quarter of 2006 compared to the first quarter of 2005.

Interest expense decreased $1 million from the fourth quarter of 2005 for the following reasons: During the first quarter of 2006 we did not consolidate Spansion s results of operations with ours, and, therefore, interest expense on Spansion s third party debt was not included. In the fourth quarter of 2005, the amount of Spansion s third party interest expense that we consolidated was $5 million. Moreover, interest expense incurred on our 4.75% Debentures decreased by $3 million because holders of the 4.75% Debentures

converted their debentures into shares our common stock by February 3, 2006. Interest expense incurred on our 7.75% Notes decreased by $2 million because we redeemed $210 million of the aggregate principal amount outstanding of the 7.75% Notes on February 26, 2006. These factors were offset by a decrease of $10 million of capitalized interest expense related to Fab 36, in the first quarter of 2006 compared to the fourth quarter of 2005.

**Other Income (Expense), Net**

Other income (expense), net, of $19 million expense in the first quarter of 2006 consisted primarily of a redemption premium charge of $16 million, or 7.75%, and a charge of $4 million, which represents 35 percent of the unamortized issuance costs incurred in connection with our redemption of 35 percent of the principal outstanding amount, or $210 million, of our 7.75% Notes.

Other income (expense), net, of $13 million expense in the fourth quarter of 2005 consisted primarily of a loss of approximately $10 million from the mark-to-market to earnings of certain foreign currency forward contracts which became ineffective in hedging against certain forecasted foreign currency transactions that did not occur due to the change of functional currency for AMD Fab 36 KG from the euro to the U.S. dollar on December 26, 2005, the beginning of our first quarter of 2006.

Other income (expense), net, of net expense of $3 million in the first quarter of 2005 consisted primarily of approximately $3 million of commitment and guarantee fees incurred in connection with the Fab 36 Loan Agreements, which are described in more detail below.

**Income Taxes**

We recorded an income tax provision of $35 million at a projected annual effective tax rate of 15 percent of pre-tax income in the first quarter of 2006, an income tax benefit of $1 million, or -1 percent of pre-tax income, in the fourth quarter of 2005 and an income tax benefit of $2 million, or 9 percent of pre-tax loss in the first quarter of 2005.

The income tax provision recorded in the first quarter of 2006 was for taxes on income generated in both the U.S. and foreign jurisdictions. The U.S. income tax in the first quarter 2006 projected annual effective tax rate estimate arose because the net operating loss and federal tax credits available to reduce the provision are less than the total net operating loss and federal tax credits available as a result of deductions under our stock option plans that will increase capital in excess of par value when realized. Realization of the benefits associated with these equity related deductions has not yet occurred and is dependent upon generating sufficient future taxable income. The projected annual effective tax rate of 15 percent of pre-tax income in the first quarter of 2006 was less than the expected U.S. statutory rate primarily as a result of deferred tax assets under valuation allowances being available to reduce the estimated current year tax provision.

The income tax benefit recorded in the fourth quarter of 2005 primarily reflects foreign tax benefits generated in certain jurisdictions. The income tax benefit in the fourth quarter of 2005 differed from a tax provision at the expected U.S. statutory tax rate primarily as a result of deferred tax assets under valuation allowances being available to reduce the tax provision on income generated in the quarter.

The income tax benefit recorded in the first quarter of 2005 was primarily for foreign tax benefits on losses in certain foreign jurisdictions. The income tax benefit in the first quarter of 2005 differed from the expected U.S. statutory tax rate primarily as a result of the tax benefit of foreign losses associated with Spansion Japan off-setting foreign income taxes in other jurisdictions and the use U.S. valuation allowance to reduce the projected U.S. tax provision.

As of March 26, 2006 all of our U.S. deferred tax assets, net of deferred tax liabilities, continue to be subject to a full valuation allowance that was initially established in the fourth quarter of 2002. The realization of these assets is dependent on substantial future taxable income which at March 26, 2006, in management s estimate, is not more likely than not to be achieved.

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**Stock-Based Compensation Expense**

On December 26, 2005, we adopted SFAS 123R, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options and employee stock purchases related to our Employee Stock Purchase Plan, based on estimated fair values. We adopted SFAS 123R using the modified prospective transition method. The following table summarizes our stock-based compensation expense related to employee stock options, restricted stock, restricted stock units and employee stock purchases under the Employee Stock Purchase Plan under SFAS 123R for the quarter ended March 26, 2006, which was allocated in our condensed consolidated results of operations as follows:

Stock-based compensation included as a component of:

| | March 26, 2006 (In thousands) |
|---|---|
| Cost of sales | $ 1,789 |
| Research and development | 4,094 |
| Marketing, general, and administrative | 9,162 |
| Total stock-based compensation expense related to employee stock options, restricted stock, restricted stock units, and employee stock purchases | 15,045 |
| Tax benefit | |
| Stock-based compensation expense related to employee stock options, restricted stock, restricted stock units, and employee stock purchases, net of tax | $ 15,045 |

We did not realize any tax benefit in connection with the expenses reflected in the table above, because we maintain a full valuation allowance on our U.S. deferred tax assets.

We recognized minimal stock-based compensation expense for the quarter ended March 27, 2005.

In anticipation of the adoption of SFAS 123R, we changed the quantity and type of instrument we primarily use in share-based payment programs for our employees by shifting from granting primarily stock options to granting primarily restricted stock units. Restricted stock units are awards that obligate us to issue a specific number of shares of our common stock in the future if the vesting terms and conditions are satisfied. Restricted stock units based on continued service generally vest over three to four years from the date of grant. Restricted stock units based solely on performance conditions generally do not vest for at least one year from the date of grant. Following December 26, 2005, all employees below the level of vice president receive restricted stock units. Future equity incentives for employees at the vice president level and above shall consist of grants of restricted stock units and stock options. For 2006, the amount of the compensation expense will depend on the levels of these stock-based grants and the market price of our common stock on the date of these grants.

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For additional information on stock-based compensation expense, see Note 2 to our condensed consolidated financial statements.

**International Sales**

International sales as a percent of worldwide net sales were 70 percent in the first quarter of 2006, 76 percent in the fourth quarter of 2005 and 78 percent in the first quarter of 2005. During the first quarter of 2006, none of our net sales were denominated in currencies other than the U.S. dollar because we no longer consolidate Spansion s net sales with ours. In the first and fourth quarter of 2005, 17 percent and 11 percent of net sales were denominated in the Japanese yen, which consisted primarily of sales by Spansion to Fujitsu. We expect that international sales will continue to be a significant portion of total sales in the foreseeable future.

**FINANCIAL CONDITION**

Our cash, cash equivalents and short-term investments at March 26, 2006 totaled $2.6 billion, an increase of $838 million from December 25, 2005. The increase was primarily due to $566 million of cash flow from operations and net proceeds of $495 million from the sale of 14,096,000 shares of our common stock, of which we used $231 million to redeem 35 percent of the aggregate principal amount of the outstanding 7.75% Notes, including a 7.75% redemption premium and accrued interest.

**Net Cash Provided by Operating Activities**

Net cash provided by operating activities was $566 million in first quarter of 2006. Net income of $185 million was adjusted for non-cash charges consisting primarily of $174 million of depreciation and amortization expense and a non-cash charge of approximately $15 million of stock-based compensation expense in connection with our adoption of SFAS 123R. The net changes in operating assets at March 26, 2006 compared to December 25, 2005 included a decrease in receivables from Spansion as a result of a $98 million payment to settle amounts owed by Spansion to us, a decrease in inventories of 13 percent from the fourth quarter of 2005 due primarily to a reduction in microprocessor inventory caused by increased sales and an increase in payables and accrued liabilities primarily due to an increase in deferred income on unit shipments to distributors.

Net cash provided by operating activities was $251 million in the first quarter of 2005. Our net loss of $17 million for the period was adjusted for non-cash charges consisting primarily of $333 million of depreciation and amortization expense. The increase in prepaid and other current assets included an increase of $41 million in value added tax and receivables from grants and allowances from the State of Saxony and the Federal Republic of Germany related to Fab 36. The net changes in other liabilities in the first quarter of 2005 included refunds of $17.5 million of customer deposits under long-term purchase agreements. Accounts payable and accrued liabilities increased in the first quarter of 2005 primarily due to purchases of equipment for Fab 36.

**Net Cash Used in Investing Activities**

Net cash used in investing activities was $925 million in first quarter of 2006, primarily as a result of $310 million used to purchase property, plant and equipment, including $197 million used to further facilitize Fab 36, and a net cash outflow of $634 million from purchases and maturities of available-for-sale securities.

Net cash used in investing activities was $670 million in the first quarter of 2005. Cash was used primarily to purchase short-term investments and property, plant and equipment, including $356 million for completing the construction and continuing the facilitization of Fab 36.

**Net Cash Provided by Financing Activities**

Net cash provided by financing activities was $549 million in first quarter of 2006. This amount included proceeds of $495 million from the sale of 14,096,000 shares of our common stock in an equity offering, $160 million in proceeds from purchases of stock under our employee stock purchase plan and upon employee stock option exercises, and $105 million of capital investment grants and allowances received from the Federal Republic of Germany and the Free State of Saxony for the Fab 36 project. These amounts were partially offset by $211 million in payments on debt and capital lease obligations, primarily due to our redemption of 35 percent of the aggregate principal amount outstanding (or $210 million) of our 7.75% Notes. During the first quarter of 2006, we realized no excess tax benefits related to stock-based compensation, and therefore, did not record any financing cash flows due to our net operating loss carryforward and 100 percent valuation allowance on our U.S. deferred tax assets.

Net cash provided by financing activities was $158 million in the first quarter of 2005, primarily from proceeds from an equipment sale leaseback transaction, capital investment grants and allowances from the Federal Republic of Germany and the State of Saxony for the Fab 36 project, and purchases of stock under our employee stock purchase plan and upon employee stock option exercises, partially offset by payments on outstanding debt and capital lease obligations.

**Liquidity**

We believe that cash flows from operations and current cash, cash equivalents and short-term investment balances, together with available external financing, will be sufficient to fund our operations and capital investments in the short term and long term, including the estimated additional $1.7 billion in capital expenditures that we plan to incur for the Fab 36 project from 2006 through 2008. See Fab 36 Term Loan and Guarantee and Fab 36 Partnership Agreements, below. Should additional funding be required, such as to meet payment obligations of our long-term debt when due, we may need to raise the required funds through borrowings or public or private sales of debt or equity securities, which may be issued from time to time under an effective registration statement; through the issuance of securities in a transaction exempt from registration under the Securities Act of 1933; or a combination of one or more of the foregoing. We believe that, in the event of such requirements, we will be able to access the capital markets on terms and in amounts adequate to meet our objectives. However, given the possibility of changes in market conditions or other occurrences, there can be no certainty that such funding will be available on terms favorable to us or at all.

**Contractual Cash Obligations and Guarantees**

The following table summarizes our principal contractual cash obligations at March 26, 2006, and is supplemented by the discussion following the table.

Principal contractual cash obligations at March 26, 2006 were:

| | Total | Remaining Fiscal 2006 | Fiscal 2007 | Fiscal 2008 | Fiscal 2009 | Fiscal 2010 | Fiscal 2011 and beyond |
|---|---|---|---|---|---|---|---|
| | | | (In thousands) | | | | |
| 7.75% Senior Notes | 390,000 | | | | | | 390,000 |
| Repurchase Obligations to Fab 36 Partners [1] | 154,067 | 38,517 | 38,517 | 52,960 | 24,073 | | |
| Capital Lease Obligations | 114,214 | 2,870 | 4,265 | 4,717 | 5,154 | 5,866 | 91,342 |
| Other Long-term Liabilities | 61,278 | | 12,223 | 18,023 | 15,121 | 15,097 | 814 |
| Operating Leases [2] | 329,039 | 42,041 | 50,884 | 45,242 | 37,277 | 35,861 | 117,734 |
| Unconditional Purchase Commitments [2] | 1,306,843 | 388,860 | 292,218 | 230,424 | 61,985 | 56,863 | 276,493 |
| Total principal contractual cash obligations | $ 2,355,441 | $ 472,288 | $ 398,107 | $ 351,366 | $ 143,610 | $ 113,687 | $ 876,383 |

(1) This amount represents the amount of silent partnership contributions that our subsidiaries are required to repurchase from the unaffiliated limited partners of AMD Fab 36 KG. See Fab 36 Term Loan and Guarantee and Fab 36 Partnership Agreements, below.

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(2) We have unconditional purchase commitments for goods and services where payments are based, in part, on volume or type of services we require. In those cases, we only included the minimum volume of purchase commitment in the table above. Also, purchase orders for good and services that are cancelable upon notice and without significant penalties are not included in the amounts above.

**7.75% Senior Notes Due 2012**

On February 26, 2006, we redeemed 35 percent (or $210 million) of the aggregate principal amount outstanding of our 7.75% Senior Notes due 2012. Holders received 107.75 percent of the principal amount plus accrued interest. In connection with this redemption, we recorded an expense of approximately $16 million, which represents the 7.75% redemption premium, and a charge of $4 million, which represents 35 percent of the unamortized issuance costs incurred in connection with the original issuance of the 7.75% Notes discussed below.

On October 29, 2004, we issued $600 million of 7.75% Senior Notes due 2012 in a private offering pursuant to Rule 144A and Regulation S under the Securities Act of 1933, as amended. On April 22, 2005, we exchanged these notes for publicly registered notes which have substantially identical terms as the old notes except that the publicly registered notes (the 7.75% Notes) are registered under the Securities Act of 1933, and, therefore, do not contain legends restricting their transfer. The 7.75% Notes mature on November 1, 2012. Interest on the 7.75% Notes is payable semiannually in arrears on May 1 and November 1, beginning May 1, 2005. Prior to November 1, 2008, we may redeem some or all of the 7.75% Notes at a price equal to 100 percent of the principal amount plus accrued and unpaid interest plus a make-whole premium, as defined in the agreement. Thereafter, we may redeem the 7.75% Notes for cash at the following specified prices plus accrued and unpaid interest:

| Period | Price as Percentage of Principal Amount |
|---|---|
| Beginning on November 1, 2008 through October 31, 2009 | 103.875% |
| Beginning on November 1, 2009 through October 31, 2010 | 101.938% |
| Beginning on November 1, 2010 through October 31, 2011 | 100.000% |
| On November 1, 2011 | 100.000% |

Holders have the right to require us to repurchase all or a portion of our 7.75% Notes in the event that we undergo a change of control, as defined in the indenture governing the 7.75% Notes at a repurchase price of 101 percent of the principal amount plus accrued and unpaid interest.

The indenture governing the 7.75% Notes contains certain covenants that limit, among other things, our ability and the ability of our restricted subsidiaries, which include all of our subsidiaries from:

- incurring additional indebtedness;
- paying dividends and making other restricted payments;
- making certain investments, including investments in our unrestricted subsidiaries;
- creating or permitting certain liens;
- creating or permitting restrictions on the ability of the restricted subsidiaries to pay dividends or make other distributions to us;

- using the proceeds from sales of assets;
- entering into certain types of transactions with affiliates; and
- consolidating, merging or selling our assets as an entirety or substantially as an entirety.

Issuance costs incurred in connection with this transaction in the amount of approximately $13 million are being amortized ratably over the term of the 7.75% Notes as interest expense, approximating the effective interest method. As a result of the redemption described above, we included $4 million of the unamortized issuance costs in the redemption loss calculation and reflected this amount in the Other Income (Expense), Net line of our condensed consolidated statements of operations.

We may elect to purchase or otherwise retire our 7.75% Notes with cash, stock or other assets from time to time in open market or privately negotiated transactions, either directly or through intermediaries, or by tender offer, when we believe the market conditions are favorable to do so. Such purchases may have a material effect on our liquidity, financial condition and results of operations.

***Fab 36 Term Loan and Guarantee and Fab 36 Partnership Agreements***

Our new 300-millimeter wafer fabrication facility, Fab 36, is located in Dresden, Germany adjacent to our other wafer manufacturing facility, Fab 30. Fab 36 is owned by AMD Fab 36 KG, a German limited partnership. We control the management of AMD Fab 36 KG through a wholly owned Delaware subsidiary, AMD Fab 36 LLC, which is a general partner of AMD Fab 36 KG. AMD Fab 36 KG is our indirect consolidated subsidiary. Fab 36 manufactures advanced microprocessor products.

To date, we have provided the majority of financing for the Fab 36 project. In addition, Leipziger Messe GmbH, a nominee of the State of Saxony, Fab 36 Beteiligungs GmbH, an investment consortium arranged by M+W Zander Facility Engineering GmbH, the general contractor for the project, and a consortium of banks are providing financing for the project. Leipziger Messe and Fab 36 Beteiligungs are limited partners in AMD Fab 36 KG. We anticipate receiving an aggregate amount of up to approximately $653 million in grants and allowances from federal and state German authorities for the Fab 36 project. We expect that capital expenditures for Fab 36 from 2006 through 2008 will be approximately $1.7 billion in the aggregate.

The funding to construct and facilitize Fab 36 consists of:

- equity contributions from us of $704 million under the partnership agreements, revolving loans from us of up to approximately $903 million, and guarantees from us for amounts owed by AMD Fab 36 KG and its affiliates to the lenders and unaffiliated limited partners;
- investments of up to approximately $385 million from Leipziger Messe and Fab 36 Beteiligungs;
- loans of up to approximately $843 million from a consortium of banks, under which nothing was drawn as of March 26, 2006;
- up to approximately $653 million of subsidies consisting of grants and allowances, from the Federal Republic of Germany and the State of Saxony; depending on the level of capital investments by AMD Fab 36 KG, of which $275 million of cash has been received as of March 26, 2006; and
- a loan guarantee from the Federal Republic of Germany and the State of Saxony of 80 percent of the losses sustained by the lenders referenced above after foreclosure on all other security.

As of March 26, 2006, we had contributed to AMD Fab 36 KG the full amount of equity required under the partnership agreements and $116 million principal amount of intercompany revolving loans were outstanding. These amounts have been eliminated in our condensed consolidated

financial statements.

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On April 21, 2004, AMD, AMD Fab 36 KG, AMD Fab 36 LLC, AMD Fab 36 Holding GmbH, a German company and wholly owned subsidiary of AMD that owns substantially all of our limited partnership interest in AMD Fab 36 KG, and AMD Fab 36 Admin GmbH, a German company and wholly owned subsidiary of AMD Fab 36 Holding that owns the remainder of our limited partnership interest in AMD Fab 36 KG, (collectively referred to as the AMD companies) entered into a series of agreements (the partnership agreements) with the unaffiliated limited partners of AMD Fab 36 KG, Leipziger Messe and Fab 36 Beteiligungs, relating to the rights and obligations with respect to their limited partner and silent partner contributions in AMD Fab 36 KG. The partnership has been established for an indefinite period of time. A partner may terminate its participation in the partnership by giving twelve months advance notice to the other partners. The termination becomes effective at the end of the year following the year during which the notice is given. However, other than for good cause, a partner s termination will not be effective before December 31, 2015.

Also on April 21, 2004, AMD Fab 36 KG entered into a term loan agreement and other related agreements (the Fab 36 Loan Agreements) with a consortium of banks led by Dresdner Bank AG, a German financial institution, to finance the purchase of equipment and tools required to operate Fab 36. The consortium of banks agreed to make available up to $843 million in loans to AMD Fab 36 KG upon its achievement of specified milestones, including attainment of technical completion at Fab 36, which requires certification by the banks technical advisor that AMD Fab 36 KG has a wafer fabrication process suitable for high-volume production of advanced microprocessors and has achieved specified levels of average wafer starts per week and average wafer yields, as well as cumulative capital expenditures of approximately $1.2 billion. Although AMD Fab 36 KG attained these milestones in January 2006, several conditions must still be fulfilled before AMD Fab 36 KG can draw on the loans. We anticipate that these conditions will be fulfilled in the second half of 2006. The amounts borrowed under the Fab 36 Loan Agreements are repayable in quarterly installments commencing in September 2007 and terminating in March 2011.

AMD Fab 36 KG pledged substantially all of its current and future assets as security under the Fab 36 Loan Agreements, we pledged our equity interest in AMD Fab 36 Holding and AMD Fab 36 LLC, AMD Fab 36 Holding pledged its equity interest in AMD Fab 36 Admin and its partnership interest in AMD Fab 36 KG and AMD Fab 36 Admin and AMD Fab 36 LLC pledged all of their partnership interests in AMD Fab 36 KG. We guaranteed the obligations of AMD Fab 36 KG to the lenders under the Fab 36 Loan Agreements. We also guaranteed repayment of grants and allowances by AMD Fab 36 KG, should such repayment be required pursuant to the terms of the subsidies provided by the federal and state German authorities. Pursuant to the terms of the guarantee, we have to comply with specified adjusted tangible net worth and EBITDA financial covenants if the sum of our and our subsidiaries cash, cash equivalents and short-term investments, less the amount outstanding under any third-party revolving credit facility or term loan agreement with an original maturity date for amounts borrowed of up to one year (group consolidated cash), declines below the following amounts:

| **Amount (in thousands)** | **if Moody s Rating is at least** | | **if Standard & Poor s Rating is at least** |
|---|---|---|---|
| $500,000 | B1 or lower | and | B+ or lower |
| 425,000 | Ba3 | and | BB- |
| 400,000 | Ba2 | and | BB |
| 350,000 | Ba1 | and | BB+ |
| 300,000 | Baa3 or better | and | BBB-or better |

As of March 26, 2006, group consolidated cash was greater than $500 million, and therefore, the preceding financial covenants were not applicable.

The partnership agreements set forth each limited partner s aggregate capital contribution to AMD Fab 36 KG and the milestones for such contributions. Pursuant to the terms of the partnership agreements, AMD, through AMD Fab 36 Holding and AMD Fab 36 Admin, agreed to provide an aggregate of $704 million, Leipziger Messe agreed to provide an aggregate of $241 million and Fab 36 Beteiligungs agreed to provide an aggregate of $144 million. The capital contributions of Leipziger Messe and Fab 36 Beteiligungs are comprised of limited partnership contributions and silent partnership contributions. As of March 26, 2006, all capital contributions were made in full.

The partnership agreements also specify that the unaffiliated limited partners will receive a guaranteed rate of return of between 11 percent and 13 percent per annum on their total investment depending upon the monthly wafer output of Fab 36. We guaranteed these payments by AMD Fab 36 KG.

In April 2005, we amended the partnership agreements in order to restructure the proportion of Leipziger Messe s silent partnership and limited partnership contributions. Although the total aggregate amount that Leipziger Messe has agreed to provide remained unchanged, the portion of its contribution that constitutes limited partnership interests was reduced by $60 million while the portion of its contribution that constitutes silent partnership interests was increased by a corresponding amount. In this report, we refer to this additional silent partnership contribution as the New Silent Partnership Amount.

Pursuant to the terms of the partnership agreements and subject to the prior consent of the Federal Republic of Germany and the State of Saxony, AMD Fab 36 Holding and AMD Fab 36 Admin have a call option over the limited partnership interests held by Leipziger Messe and Fab 36 Beteiligungs, first exercisable three and one-half years after the relevant partner has completed the applicable capital contribution and every three years thereafter. Also, commencing five years after completion of the relevant partner s capital contribution, Leipziger Messe and Fab 36 Beteiligungs each have the right to sell their limited partnership interest to third parties (other than competitors), subject to a right of first refusal held by AMD Fab 36 Holding and AMD Fab 36 Admin, or to put their limited partnership interest to AMD Fab 36 Holding and AMD Fab 36 Admin. The put option is thereafter exercisable every three years. Leipziger Messe and Fab 36 Beteiligungs also have a put option in the event they are outvoted at AMD Fab 36 KG partners meetings with respect to certain specified matters such as increases in the partners capital contributions beyond those required by the partnership agreements, investments significantly in excess of the business plan, or certain dispositions of the limited partnership interests of AMD Fab 36 Holding and AMD Fab 36 Admin. The purchase price under the put option is the partner s capital account balance plus accumulated or accrued profits due to such limited partner. The purchase price under the call option is the same amount, plus a premium of $4.2 million to Leipziger Messe and a premium of $2.5 million to Fab 36 Beteiligungs. The right of first refusal price is the lower of the put option price or the price offered by the third party that triggered the right. We guaranteed the payments under the put options.

In addition, AMD Fab 36 Holding and AMD Fab 36 Admin are obligated to repurchase the silent partnership interest of Leipziger Messe s and Fab 36 Beteiligungs contributions over time. This mandatory repurchase obligation does not apply to the New Silent Partnership Amount. Specifically, AMD Fab 36 Holding and AMD Fab 36 Admin are required to repurchase Leipziger Messe s silent partnership interest of $96 million in annual 25 percent installments commencing in December 2006, and Fab 36 Beteiligungs silent partnership interest of $72 million in annual 20 percent installments commencing in October 2005. On September 30, 2005, AMD Fab 36 Holding and AMD Fab 36 Admin repurchased $14 million of Fab 36 Beteiligungs silent partnership contributions.

For accounting and financial reporting purposes under U.S. generally accepted accounting principles, we initially classified the portion of the silent partnership contribution that is mandatorily redeemable as debt at its fair value at the time of issuance because of the mandatory redemption features described in the prior paragraph. Each accounting period, we increase the carrying value of this debt towards our ultimate redemption value of the silent partnership contributions by the guaranteed annual rate of return of between 11 percent and 13 percent. We record this periodic accretion to redemption value as interest expense.

The limited partnership contributions that AMD Fab 36 KG received from Leipziger Messe and Fab 36 Beteiligungs and the New Silent Partnership Amount described above are not mandatorily redeemable, but rather are subject to redemption outside of the control of AMD Fab 36 Holding and AMD Fab 36 Admin. Upon consolidation, we initially record these contributions as minority interest, based on their fair value. Each accounting period, we increase the carrying value of this minority interest toward our ultimate redemption value of these contributions by the guaranteed rate of return of between 11 percent and 13 percent. We classify this periodic accretion of redemption value as an additional minority interest allocation. No separate accounting is required for the put and call options because they are not freestanding instruments and not considered derivatives under SFAS 133, Accounting for Derivative Instruments and Hedging Activities.

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As of March 26, 2006, AMD Fab 36 KG had received $169 million of silent partnership contributions and $217 million of limited partnership contributions, which includes a New Silent Partnership Amount of $60 million, from the unaffiliated limited partners. These contributions were recorded as debt and minority interest, respectively, in the accompanying condensed consolidated balance sheet.

In addition to support from us and the consortium of banks referred to above, the Federal Republic of Germany and the State of Saxony have agreed to support the Fab 36 project in the form of:

- a loan guarantee equal to 80 percent of the losses sustained by the lenders after foreclosure on all other security; and
- subsidies consisting of grants and allowances totaling up to approximately $653 million, depending on the level of capital investments by AMD Fab 36 KG.

In connection with the receipt of subsidies for the Fab 36 project, AMD Fab 36 KG is required to attain a certain employee headcount by December 2007 and maintain this headcount through December 2012. We record the subsidies as long-term liabilities on our condensed consolidated balance sheet and amortize them to operations ratably starting from December 2004 through December 2012. For allowances, we amortize the amounts ratably over the life of the equipment and building. We amortize the production related grants and allowances as a reduction to cost of sales and the development related grants and allowances as a reduction to research and development expenses. Noncompliance with the covenants contained in the subsidy grant documents could result in forfeiture of all or a portion of the future amounts to be received, as well as the repayment of all or a portion of amounts received to date.

As of March 26, 2006, AMD Fab 36 KG had received cash allowances of $68 million for capital investments made in 2003 and 2004 as well as cash grants of $207 million for capital investments made in 2003, 2004 and 2005 and a prepayment for capital investments planned through 2007.

The Fab 36 Loan Agreements also require that we:

- provide funding to AMD Fab 36 KG if cash shortfalls occur, including funding shortfalls in government subsidies resulting from any defaults caused by AMD Fab 36 KG or its affiliates; and
- guarantee 100 percent of AMD Fab 36 KG s obligations under the Fab 36 Loan Agreements until the loans are repaid in full.

Under the Fab 36 Loan Agreements, AMD Fab 36 KG, AMD Fab 36 Holding and AMD Fab 36 Admin are generally prevented from paying dividends or making other payments to us. In addition, AMD Fab 36 KG would be in default under the Fab 36 Loan Agreements if we or any of the AMD companies fail to comply with certain obligations thereunder or upon the occurrence of certain events and if, after the occurrence of the event, the lenders determine that their legal or risk position is adversely affected. Circumstances that could result in a default include:

- our failure to provide loans to AMD Fab 36 KG as required under the Fab 36 Loan Agreements;
- failure to pay any amount due under the Fab 36 Loan Agreements within five days of the due date;
- occurrence of any event which the lenders reasonably believe has had or is likely to have a material adverse effect on the business, assets or condition of AMD Fab 36 KG or AMD or their ability to perform under the Fab 36 Loan Agreements;
- filings or proceedings in bankruptcy or insolvency with respect to us, AMD Fab 36 KG or any limited partner;

occurrence of a change in control (as defined in the Fab 36 Loan Agreements) of AMD;

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AMD Fab 36 KG s noncompliance with certain affirmative and negative covenants, including restrictions on payment of profits, dividends or other distributions except in limited circumstances and restrictions on incurring additional indebtedness, disposing of assets and repaying subordinated debt; and

AMD Fab 36 KG s noncompliance with certain financial covenants, including minimum tangible net worth, minimum interest cover ratio, loan to fixed asset value ratio and a minimum cash covenant.

In general, any default with respect to other indebtedness of AMD or AMD Fab 36 KG that is not cured, would result in a cross-default under the Fab 36 Loan Agreements.

The occurrence of a default under the Fab 36 Loan Agreements would permit the lenders to accelerate the repayment of all amounts outstanding under the Fab 36 Loan Agreements. In addition, the occurrence of a default under these agreements could result in a cross-default under the indenture governing our 7.75% Notes. We cannot provide assurance that we would be able to obtain the funds necessary to fulfill these obligations. Any such failure would have a material adverse effect on us.

Generally, the amounts under the Fab 36 Loan Agreements and the partnership agreements are denominated in euros. However, we report these amounts in U.S. dollars, which are subject to change based on applicable exchange rates. We used the exchange rate at March 26, 2006, of 0.831 euro to one U.S. dollar, to translate the amounts denominated in euros into U.S. dollars. However, with respect to amounts of equity contributions, investment grants, allowances and subsidies received by AMD Fab 36 KG through March 26, 2006, we used the historical exchange rates that were in effect at the time AMD Fab 36 KG received these amounts to convert amounts denominated in euros into U.S. dollars.

***Capital Lease Obligations***

As of March 26, 2006, we had aggregate outstanding capital lease obligations of $114 million. These capital lease obligations primarily represent obligations under certain energy supply contracts which AMD Fab 36 KG entered into with local energy suppliers to provide Fab 36 with utilities (gas, electricity, heating and cooling) to meet the energy demand for our manufacturing needs. We accounted for certain fixed payments due under these energy supply arrangements as capital leases pursuant to EITF Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease* and SFAS 13, *Accounting for Leases*. These capital lease obligations are payable in monthly installments through 2020.

***Operating Leases***

We lease certain of our facilities, including our executive offices in Sunnyvale, California, and in some jurisdictions we lease the land on which these facilities are built, under non-cancelable lease agreements that expire at various dates through 2021. We lease certain of our manufacturing and office equipment for terms ranging from one to five years. Our total future non-cancelable lease obligations as of March 26, 2006, were $329 million, of which $87 million was recorded as a liability for certain facilities that were included in our 2002 Restructuring Plan.

***Unconditional Purchase Commitments***

Total non-cancelable purchase commitments as of March 26, 2006, were $1.3 billion for periods through 2020. These purchase commitments included $552 million related to contractual obligations of Fab 30 and Fab 36 to purchase silicon-on-insulator wafers and purchases of energy and gas and up to $207 million representing future payments to IBM pursuant to our joint development agreement. As IBM s services are being performed ratably over the life of the agreement, we expense the payments as incurred. In August 2005, we amended this agreement, and among other things, extended its termination date through December 2011. However, capital purchases by IBM necessary for the continued development of process development projects past December 31, 2008 are conditioned upon the approval of IBM s board of directors. If such approval is not received by September 30, 2007, either party has the right to terminate the agreement effective December 31, 2008 without liability. Accordingly, the table set forth in the Contractual Cash Obligations and Guarantees section only reflects our obligations through December 31, 2008. If such

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approval is received from IBM, the additional obligations from January 2009 through 2011 would be between $276 million and $306 million. In addition, unconditional purchase commitments also include $95 million for software maintenance agreements that require periodic payments through 2009. The remaining commitments primarily consist of non-cancelable contractual obligations to purchase raw materials, natural resources and office supplies. Purchase orders for goods and services that are cancelable without significant penalties are not included in the amount set forth in the table above.

***Other Long-Term Liabilities***

One component of Other Long-Term Liabilities that requires us to make cash payments is a net restructuring accrual of $61 million relating to the net future operating lease payments on certain facilities that were included in our 2002 Restructuring Plan. We will make these payments through 2011. We included these amounts in the operating lease total in the table above. The other components of Other Long-Term Liabilities do not require us to make cash payments and primarily consist of $327 million of deferred grants and subsidies related to the Fab 30 and Fab 36 projects and a $20 million deferred gain as a result of the sale and leaseback of our corporate marketing, general and administrative facility in Sunnyvale, California in 1998.

**Guarantees**

***Guarantees of Indebtedness Recorded on Our Condensed Consolidated Balance Sheet***

The following table summarizes the principal guarantees issued as of March 26, 2006 related to underlying liabilities that are already recorded on our condensed consolidated balance sheet as of March 26, 2006 and their expected expiration dates by year. No incremental liabilities are recorded on our condensed consolidated balance sheet for these guarantees. For more information on these guarantees, see Contractual Cash Obligations and Guarantees, above.

| | Amounts Guaranteed | Remaining 2006 | 2007 | 2008 | 2009 | 2010 | 2011 and Beyond |
|---|---|---|---|---|---|---|---|
| | | | (In thousands) | | | | |
| Repurchase Obligations to Fab 36 partners[1] | $ 154,067 | $ 38,517 | $ 38,517 | $ 52,960 | $ 24,073 | $ | $ |

(1) Amounts guaranteed in connection with the silent partnership contributions that our subsidiaries are required to repurchase from the unaffiliated limited partners of AMD Fab 36 KG. Amounts represent the principal amount of the underlying obligations guaranteed and are exclusive of obligations for interest.

***Guarantees of Indebtedness Not Recorded on Our Condensed Consolidated Balance Sheet***

The following table summarizes the principal guarantees issued as of March 26, 2006 related to underlying liabilities that are not recorded on our condensed consolidated balance sheet as of March 26, 2006 and their expected expiration dates by year.

| | Amounts Guaranteed[1] | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 and Beyond |
|---|---|---|---|---|---|---|---|
| | | | (In thousands) | | | | |
| AMTC revolving loan guarantee | $ 38,517 | $ | $ 38,517 | $ | $ | $ | $ |
| AMTC rental guarantee [2] | 114,266 | | | | | | 114,266 |
| Spansion capital lease guarantees [3] | 23,253 | 20,008 | 3,245 | | | | |
| Spansion operating lease guarantees [3] | 6,381 | 2,962 | 2,345 | 1,074 | | | |
| Total guarantees | $ 182,417 | $ 22,970 | $ 44,107 | $ 1,074 | $ | $ | $ 114,266 |

(1) Amounts represent the principal amount of the underlying obligations guaranteed and are exclusive of obligations for interest, fees and expenses.

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(2) Amount of the guarantee diminishes as the rent is paid.
(3) Notwithstanding the Spansion IPO, we agreed to maintain our guarantees of these Spansion obligations.

***AMTC and BAC Guarantees***

The Advanced Mask Technology Center GmbH & Co. KG (AMTC) and Maskhouse Building Administration GmbH & Co., KG (BAC) are joint ventures formed by us, Infineon Technologies AG and DuPont Photomasks, Inc. for the purpose of constructing and operating an advanced photomask facility in Dresden, Germany. In April 2005 DuPont Photomasks, Inc. was acquired by Toppan Printing Co., Ltd. and became a wholly owned subsidiary of Toppan, named Toppan Photomasks, Inc. We procure advanced photomasks from AMTC and use them in manufacturing our microprocessors. To finance the project, BAC and AMTC entered into a $144 million revolving credit facility and a $90 million term loan in December 2002. Also in December 2002, in order to occupy the photomask facility, AMTC entered into a rental agreement with BAC. With regard to these commitments by BAC and AMTC, as of March 26, 2006, we guaranteed up to $39 million plus interest and expenses under the revolving loan, and up to $19 million, initially, under the rental agreement. The obligations under the rental agreement guarantee diminish over time through 2011 as the term loan is repaid. However, under certain circumstances of default by the other tenant of the photomask facility under its rental agreement with BAC and certain circumstances of default by more than one joint venture partner under its rental agreement guarantee obligations, the maximum potential amount of our obligations under the rental agreement guarantee is $114 million. As of March 26, 2006, $84 million was drawn under the revolving credit facility, and $58 million was drawn under the term loan. We have not recorded any liability in our condensed consolidated financial statements associated with the guarantees because they were issued prior to December 31, 2002, the effective date of FIN 45.

***Spansion Capital Lease Guarantee***

We guaranteed certain capital leases entered into by Spansion and its subsidiaries totaling $23 million as of March 26, 2006. The amounts guaranteed are reduced by the actual amount of lease payments made by Spansion over the terms of the leases.

***Spansion Operating Lease Guarantees***

We guaranteed certain operating leases entered into by Spansion and its subsidiaries totaling $6 million as of March 26, 2006. The amounts guaranteed are reduced by the actual amount of lease payments made by Spansion over the terms of the leases.

We have not recognized any liability for these guarantees under the provisions of FIN 45 because we concluded that the fair values of the guarantees are not significant. In making this decision, we considered various factors including the recent IPO of Spansion, its credit rating, the ability of Spansion to make the payments on these obligations and the short maturity of the indebtedness.

**Other Financial Matters**

*Spansion Agency Agreement.* We have entered into an agency agreement with Spansion pursuant to which we agreed to ship products to and invoice Spansion s customers in our name on behalf of Spansion until Spansion has the capability to do so on its own which will be in the second quarter of 2006. Prior to shipping the product to Spansion s customers, we purchase the applicable product from Spansion and pay Spansion the same amount that we invoice Spansion s customers. In performing these services, we act as Spansion s agent for the sale of Spansion s Flash memory products, and we do not receive a commission or fees for these services. Under the agreement, Spansion assumes full responsibility for its products and these transactions, including establishing the pricing and determining product specifications. Spansion also assumes credit and inventory risk related to these product sales.

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In accordance with EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, we record sales of Spansion s Flash memory products and the related cost of sales on a net basis on our condensed consolidated statements of operations. As a result, the net impact to our net sales and cost of sales is zero. With respect to our condensed consolidated balance sheets, sales to Spansion s customers are reflected in our Accounts Receivable line item whereas the payables to Spansion that relate to the products we purchased from Spansion are reflected in our Accounts Payable to Spansion line item. These amounts are recorded separately on the balance sheet because there is no legal right of offset in accordance with FIN 39, *Offsetting of Amounts Related to Certain Contracts*.

*AMD/Spansion Service Agreements.* We are party to various service agreements with Spansion. Under our IT Services Agreement and General Services Agreement, we provide, among other things, information technology, facilities, logistics, tax, finance, human resources, and environmental health and safety services to Spansion. For services rendered, we are paid fees in an amount equal to cost plus five percent except for services procured by us from third parties, which are provided to Spansion at cost.

Unless otherwise earlier terminated, each of these service agreements expires on June 30, 2007, but each of us may extend the term by mutual agreement. Spansion has the ability to terminate individual services under the general services agreements at any time and for any reason upon at least six months advance notice. With respect to the IT service agreements and general service agreements, if we failed to comply with applicable service levels for a particular service and have not rectified such performance failure, Spansion may terminate such service after 60 days have elapsed since Spansion first notified us of the failure to perform the service. Moreover, Spansion may terminate an entire IT service agreement or general services agreement if we breach our material obligations under the respective agreement and do not cure the default within 90 days after receipt of a notice of default from Spansion. Similarly, we can terminate the respective agreement for Spansion s failure to make payments when due if Spansion fails to cure such default within 90 days after receipt of notice of default.

*Conversion of 4.75% Convertible Senior Debentures*. In February 2006, holders of our 4.75% Debentures elected to convert their debentures into 21,378,605 shares of our common stock pursuant to the original terms of the 4.75% Debentures.

**Outlook**

We expect sales during the second quarter of 2006 to be flat to slightly down seasonally from the first quarter of 2006. The second quarter of 2006 will consist of 14 weeks. Also, during the second quarter of 2006, we expect operating expenses, which include research and development expenses and marketing, sales and administrative expenses, to increase eight percent from comparable operating expenses in the first quarter of 2006.

In 2006, we expect capital expenditures to be approximately $1.7 billion and depreciation and amortization expense to be approximately $825 million. We also expect that our effective tax rate for 2006 will be approximately 15 percent.

Spansion s results of operations will continue to impact our results of operations in 2006. These results will be reflected in the Equity in Income (Loss) of Spansion Inc. line item on our condensed consolidated statements of operations, and for 2006 will be based on our ownership interest of Spansion, which was 37.9 percent as of March 26, 2006.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Reference is made to Part II, Item 7A, Quantitative and Qualitative Disclosures about Market Risk, in our Annual Report on Form 10-K for the fiscal year ended December 25, 2005. As indicated therein, we

changed the functional currency for our German subsidiaries, AMD Saxony Limited Liability Company & Co. KG and AMD Fab 36 Limited Liability Company & Co KG, from the euro to the U.S. dollar effective December 26, 2005. However, we cannot give any assurance as to the effect that future changes in foreign currency rates will have on our condensed consolidated financial position, results of operations or cash flows because certain locally incurred expenses of these subsidiaries continue to be denominated in euro, thereby still subjecting us to foreign currency risk. We will continue to monitor and to hedge this foreign risk exposure as appropriate.

In addition, during the first quarter of 2006, we reduced our long-term debt obligations by redeeming 35 percent (or $210 million) of the aggregate principal amount of our outstanding 7.75% Notes. Also, in February 2006, holders of $500 million aggregate principal amount of our 4.75% Debentures converted their debentures into common stock pursuant to the original terms of the debentures.

**ITEM 4. CONTROLS AND PROCEDURES**

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

As of March 26, 2006, the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There was no change in our internal control over financial reporting during the first quarter of 2006 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting except that as a result of the completion of Spansion s IPO on December 21, 2005, we eliminated the Spansion specific key controls during the first quarter of 2006 because they are no longer applicable.

**PART II. OTHER INFORMATION**

**ITEM 1A. RISK FACTORS**

**Risks Related to Our Business**

**Intel Corporation s dominance of the microprocessor market and its aggressive business practices may limit our ability to compete effectively.**

Intel has dominated the market for microprocessors used in desktop and mobile PCs for many years. Intel is also a dominant competitor in the server category of the microprocessor market. Intel s significant financial resources enable it to market its products aggressively, to target our customers and our channel partners with special incentives, and to discipline customers who do business with us. These aggressive activities can result in lower unit sales and average selling prices for our products and adversely affect our margins and profitability. As long as Intel remains in this dominant position, we may be materially adversely affected by Intel s:

- business practices, including pricing and allocation strategies and actions, such as aggressive pricing for microprocessors to increase market share;

product mix and introduction schedules;

product bundling, marketing and merchandising strategies;

exclusivity payments to its current and potential customers;

control over industry standards, PC manufacturers and other PC industry participants, including motherboard, memory, chipset and basic input/output system, or BIOS, suppliers; and

marketing and advertising expenditures in support of positioning the Intel brand over the brand of its OEM customers.

For example, Intel exerts substantial influence over computer manufacturers and their channels of distribution through various brand and other marketing programs. Because of its dominant position in the microprocessor market, Intel has been able to control x86 microprocessor and computer system standards and dictate the type of products the microprocessor market requires of Intel s competitors. Intel also dominates the computer system platform, which includes core logic chipsets, graphics chips, motherboards and other components necessary to assemble a computer system. As a result, OEMs that purchase microprocessors for computer systems are highly dependent on Intel, less innovative on their own and, to a large extent, are distributors of Intel technology. Additionally, Intel is able to drive de facto standards for x86 microprocessors that could cause us and other companies to have delayed access to such standards.

We expect Intel to maintain its dominant position in the microprocessor market and to continue to invest heavily in marketing, research and development, new manufacturing facilities and other technology companies.

Intel has substantially greater financial resources than we do and accordingly spends substantially greater amounts on research and development and production capacity than we do. Moreover, Intel currently manufactures certain of its microprocessor products on 300-millimeter wafers using 65-nanometer process technology. We expect to begin commercial shipments of microprocessors manufactured using 65-nanometer technology in the second half of 2006. To the extent Intel manufactures its microprocessor products on larger wafers and smaller process technologies earlier than we do, we may be more vulnerable to Intel s aggressive marketing and pricing strategies for microprocessor products, which may result in market share gains for Intel. Intel s dominant position in the microprocessor market, its existing relationships with top-tier OEMs and its aggressive marketing and pricing strategies could result in lower unit sales and average selling prices for our products, which could have a material adverse effect on us.

**We must achieve further market acceptance of our 64-bit technology, AMD64, or we will be materially adversely affected.**

Our AMD Opteron processors are critical to our strategy of increasing market share in the server category of the microprocessor market. Similarly, our AMD Turion 64 processors are critical to our strategy of increasing market share in the mobile category of the microprocessor market, and particularly the thin and light category. Accordingly, we are making substantial investments in our roadmaps and our platforms for our processors for mobile and server computers. Increasing market acceptance of these processors, our AMD Athlon 64 processors for desktops and the AMD64 technology on which they are based is subject to risks and uncertainties including:

the continued support of operating system and application program providers for our 64-bit instruction set, including timely development of 64-bit software applications and applications that can take advantage of the functionality of our dual-core processors;

our ability to produce these processors in a timely manner on advanced process technologies, in the volume and with the performance and feature set required by customers; and

the availability, performance and feature set of motherboards, memory and chipsets designed for these processors, in the volume and with the performance and feature set required by our customers.

If we are unable to achieve further market acceptance of our AMD64 technology, we would be materially adversely affected.

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

We make substantial investments in research and development for process technologies in an effort to design and manufacture leading-edge microprocessors. We cannot be certain that we will be able to develop, obtain or successfully implement leading-edge process technologies needed to manufacture future generations of our products profitably or on a timely basis or that our competitors will not develop new technologies, products or processes that render our products uncompetitive or obsolete. Furthermore, we cannot assure you that we will have sufficient resources to maintain the level of investment in research and development that is required for us to remain competitive.

For example, we have a joint development agreement with IBM, pursuant to which we have agreed to work together to develop new process technologies through December 31, 2011. However, capital purchases by IBM necessary for the continued development of process development projects past December 31, 2008 are conditioned upon the approval by IBM s board of directors. If such approval is not received by September 30, 2007, either party has the right to terminate the agreement effective December 31, 2008 without liability. We anticipate that under this agreement, from March 26, 2006 through December 25, 2011, we would pay fees to IBM of between $483 million and $541 million in connection with joint development projects. In addition, from the beginning of 2002 through March 26, 2006, we paid $370 million to IBM in connection with agreements and services related to license grants and research and development activities.

If this agreement were to be terminated, we would either have to resume certain research and development activities internally or find an alternate partner. In either case, our research and development costs could increase, and we could experience delays or other setbacks in the development of new process technologies, any of which would materially adversely affect us. Moreover, the timely achievement of the milestones set forth in the joint development agreement is critical to our ability to continue to manufacture microprocessors at Fab 36 using advanced process technologies.

**The semiconductor industry is highly cyclical and has experienced severe downturns that materially adversely affected, and may in the future materially adversely affect, our business.**

The semiconductor industry is highly cyclical and has experienced significant downturns, often in conjunction with constant and rapid technological change, wide fluctuations in supply and demand, continuous new product introductions, price erosion and declines in general economic conditions. Our historical financial results have also been subject to substantial fluctuations. Our financial performance has been, and may in the future be, negatively affected by these downturns. We incurred substantial losses in recent downturns, due to:

the cyclical nature of supply/demand imbalances in the semiconductor industry;

a decline in demand for end-user products that incorporate our semiconductors;

excess inventory levels in the channels of distribution, including our customers;

excess production capacity; and

substantial declines in average selling prices.

For example, in 2001 and 2002 we implemented restructuring plans due to weak customer demand associated with the downturn in the semiconductor industry. If the semiconductor industry were to experience a downturn in the future, we would be materially adversely affected.

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

Our business is dependent upon the market for mobile and desktop PCs, and servers. Industry-wide fluctuations in the computer marketplace have materially adversely affected us in the past and may materially adversely affect us in the future. Depending on the growth rate of computers sold, sales of our microprocessors may not grow and may even decrease. If demand for computers is below our expectations, we could be materially adversely affected**.**

The growth of our business is also dependent on continued demand for our products from high-growth global markets. In 2005, sales of our products to high-growth markets such as China, Eastern Europe and India increased compared to 2004, and these markets are an important area of future growth for us. If demand from these markets is below our expectations, sales of our products may not grow, and may even decrease, which would have a material adverse effect on us.

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

Our competitor in the microprocessor market is Intel Corporation. Microprocessor products compete on performance, quality, reliability, cost, selling price, adherence to industry standards, software and hardware compatibility, brand recognition and availability. After a product is introduced, costs and average selling prices normally decrease over time as production efficiency improves, and successive generations of products are developed and introduced for sale.

We may not be able to compete effectively if we fail to reduce our manufacturing costs and develop, introduce and sell on a timely basis, new products or enhanced versions of existing products at competitive prices.

**We depend on third-party companies for the design, manufacture and supply of core-logic chipsets, graphics chips, motherboards, BIOS software and other components.**

We depend on third-party companies for the design, manufacture and supply of core-logic chipsets, graphics chips, motherboards, BIOS software and other components that support our microprocessor offerings. Our microprocessors are not designed to function with motherboards and chipsets designed to work with Intel microprocessors because our patent-cross license agreement with Intel does not extend to Intel s proprietary bus interface protocol. If we are unable to secure sufficient support for our microprocessor products from these designers and manufacturers, or if suppliers of chipsets cannot provide us with sufficient quantities of chipset products to meet our demand, our business would be materially adversely affected.

**If we are ultimately unsuccessful in any of our antitrust lawsuits against Intel, our business may be materially adversely affected.**

On June 27, 2005, we filed an antitrust complaint against Intel Corporation and Intel s Japanese subsidiary, Intel Kabushiki Kaisha, which we refer to collectively as Intel, in the United States District Court for the District of Delaware under Section 2 of the Sherman Antitrust Act, Sections 4 and 16 of the Clayton Act, and the California Business and Professions Code. Our complaint alleges that Intel has unlawfully maintained a monopoly in the x86 microprocessor market by engaging in anti-competitive financial and exclusionary business practices that limit the ability and/or incentive of Intel s customers in dealing with

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AMD. Also, on June 30, 2005, our subsidiary in Japan, AMD Japan K.K., filed an action in Japan against Intel K.K. in the Tokyo High Court and the Tokyo District Court for damages arising from violations of Japan s Antimonopoly Act.

If our antitrust lawsuits against Intel are ultimately unsuccessful, our business, including our ability to increase market share in the microprocessor market, could be materially adversely affected.

**The loss of a significant customer may have a material adverse effect on us.**

Collectively, our top five OEM and distributor Computation Products customers accounted for a significant percentage of our total net sales in 2005 and the first quarter of 2006. If one of these customers decided to stop buying our products, or if one of these customers were materially to reduce its operations or its demand for our products, we would be materially adversely affected.

**If we fail to keep pace with new product designs and improvements or if we pursue technologies that do not become commercially accepted, customers may not buy our products and we may be adversely affected.**

Our success depends to a significant extent on the development, qualification, implementation and acceptance of new product designs and improvements that provide value to our customers. Our ability to develop and qualify new products and related technologies to meet evolving industry requirements, at prices acceptable to our customers and on a timely basis are significant factors in determining our competitiveness in our target markets. If we are delayed in developing or qualifying new products or technologies we could be materially adversely affected.

**Our operating results are subject to quarterly and seasonal sales patterns.**

A substantial portion of our quarterly sales have historically been made in the last month of the quarter. This uneven sales pattern makes prediction of net sales for each financial period difficult and increases the risk of unanticipated variations in quarterly results and financial condition. In addition, our operating results tend to vary seasonally. For example, demand in the retail sector of the PC market is often stronger during the fourth quarter as a result of the winter holiday season. European sales are often weaker during the summer months. Many of the factors that create and affect seasonal trends are beyond our control.

**Manufacturing capacity constraints and manufacturing capacity utilization rates may have a material adverse affect on us.**

There may be situations in which our manufacturing facilities are inadequate to meet the demand for certain of our products. Our inability to obtain sufficient manufacturing capacity to meet demand, either in our own facilities or through foundry or similar arrangements with third parties, could have a material adverse effect on us.

In November 2004, we entered into sourcing and manufacturing technology agreements with Chartered Semiconductor Manufacturing whereby Chartered agreed to become a contract manufacturer for our AMD64-based microprocessors. We expect that Chartered will begin production in 2006. The ability of Chartered to begin production on a timely basis depends on several factors beyond our control, including Chartered s ability to implement our technology at their facilities on a timely basis.

In addition, the additional capacity gained through the use of 300-millimeter wafers at Fab 36 plays a fundamental role in our growth plans for the next several years. If we are not able to achieve our production plans at Fab 36 on a timely basis, we may not have sufficient manufacturing capacity to meet demand for our products. If we cannot obtain sufficient manufacturing capacity to meet demand for our products, either in our own facilities or through foundry or similar arrangements, we could be materially adversely affected.

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

Our manufacturing operations depend upon obtaining deliveries of equipment and adequate supplies of materials on a timely basis. We purchase equipment and materials from a number of suppliers. From time to time, suppliers may extend lead times, limit supply to us or increase prices due to capacity constraints or other factors. Because the equipment that we purchase is complex, it is difficult for us to substitute one supplier for another or one piece of equipment for another. Certain raw materials we use in manufacturing our products are available only from a limited number of suppliers.

For example, we are largely dependent on one supplier for our 200-millimeter and 300-millimeter silicon-on-insulator (SOI) wafers. Although we are in the process of qualifying alternate sources, we do not believe that they currently have sufficient capacity to meet our requirements for SOI wafers. We are also dependent on key chemicals from a limited number of suppliers and rely on a limited number of foreign companies to supply the majority of certain types of integrated circuit packages. Interruption of supply or increased demand in the industry could cause shortages and price increases in various essential materials. If we are unable to procure certain of these materials, we may have to reduce our manufacturing operations. Such a reduction has in the past and could in the future have a material adverse effect on us.

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

Both we and our competitor, Intel Corporation, have added significant capacity in recent years, both by expanding capacity at wafer fabrication facilities and by transitioning to more advanced manufacturing technologies, and we expect that this trend will continue. In the past, capacity additions sometimes exceeded demand requirements leading to oversupply situations and downturns in the industry. Fluctuations in the growth rate of industry capacity relative to the growth rate in demand for our products contribute to cyclicality in the semiconductor market, which may in the future put pressure on our average selling prices and materially adversely affect us.

It is difficult to predict future growth or decline in the markets we serve, making it very difficult to estimate requirements for production capacity. If our target markets do not grow as we anticipate, we may under-utilize our manufacturing facilities, which may result in write-downs or write-offs of inventories and losses on products whose demand is lower than we anticipate.

In addition, during periods of industry overcapacity, customers do not generally order products as far in advance of the scheduled shipment date as they do during periods when our industry is operating closer to capacity, which can exacerbate the difficulty in forecasting capacity requirements. Many of our costs are fixed. Accordingly, during periods in which we under-utilize our manufacturing facilities as a result of reduced demand for certain of our products, our costs cannot be reduced in proportion to the reduced revenues for such a period. When this occurs, our operating results are materially adversely affected. We have substantially increased our manufacturing capacity by facilitizing Fab 36, transitioning to smaller manufacturing process technologies and larger wafers and making significant capital investments in our existing manufacturing facilities. We plan to continue to make these types of investments. We also entered into sourcing and manufacturing technology agreements with Chartered whereby Chartered agreed to become a contract manufacturer for our AMD64-based microprocessors. If the demand for our products is not consistent with our increased expectations, we may underutilize our manufacturing facilities or we may not fully utilize the reserved capacity at Chartered s foundry. This may have a material adverse effect on us.

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

Manufacturing our products involves highly complex processes that require advanced equipment. Our manufacturing efficiency is an important factor in our profitability, and we cannot be sure that we will be able to maintain or increase our manufacturing efficiency to the same extent as our competitors. We continually modify manufacturing processes in an effort to improve yields and product performance and decrease costs. We may fail to achieve acceptable yields or experience product delivery delays as a result

of, among other things, capacity constraints, construction delays, delays in the development or implementation of new process technologies, changes in our process technologies, upgrades or expansion of existing facilities, or impurities or other difficulties in the manufacturing process.

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

- develop advanced product and process technologies;
- successfully transition to advanced process technologies;
- ramp product and process technology improvements rapidly and effectively to commercial volumes across our facilities; and
- achieve acceptable levels of manufacturing wafer output and yields, which may decrease as we implement more advanced technologies.

For example, we plan to begin 65-nanometer production in the second half of 2006. Our goal is to be substantially converted to 65-nanometer in Fab 36 by mid-2007. During periods when we are implementing new process technologies, manufacturing facilities may not be fully productive. A substantial delay in the technology transitions to smaller process technologies could have a material adverse effect on us, particularly if our competitors transition to more cost effective technologies earlier than we do. Our results of operations would also be adversely affected by the increase in fixed costs and operating expenses related to increases in production capacity if revenues do not increase proportionately.

**If we lose Microsoft Corporation s support for our products, our ability to sell our microprocessors could be materially adversely affected.**

Our ability to innovate beyond the x86 instruction set controlled by Intel depends partially on Microsoft designing and developing its operating systems to run on or support our microprocessor products. If Microsoft does not continue to design and develop its operating systems so that they work with our x86 instruction sets, independent software providers may forego designing their software applications to take advantage of our innovations and customers may not purchase PCs with our microprocessors. If we fail to retain the support of Microsoft, our ability to market our microprocessors would be materially adversely affected.

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

For 2006, we plan to make approximately $1.7 billion of capital expenditures. Our ability to fund capital expenditures in accordance with our business plan depends on generating sufficient cash flow from operations and the availability of external financing.

Moreover, under the revolving credit agreement among AMD, AMD Fab 36 Holding and AMD Fab 36 KG, we or AMD Fab 36 Holding are required to provide up to $903 million to AMD Fab 36 KG (based on an exchange rate of 0.831 euros to one U.S. dollar as of March 26, 2006). Loans provided to AMD Fab 36 KG under this revolving credit agreement are unsecured and subordinated to the rights of the consortium of banks that will also be providing financing to AMD Fab 36 KG.

Our capital expenditures, together with ongoing operating expenses, will be a substantial drain on our cash flow and may decrease our cash balances. The timing and amount of our capital requirements cannot be precisely determined at this time and will depend on a number of factors including future demand for products, product mix, changes in semiconductor industry conditions and market competition. We regularly assess markets for external financing opportunities, including debt and equity. Additional debt or equity financing may not be available when needed or, if available, may not be available on satisfactory terms. Our inability to obtain needed debt and/or equity financing or to generate sufficient cash from operations may require us to abandon projects or curtail capital expenditures. If we curtail capital expenditures or abandon projects, we could be materially adversely affected.

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**We may not be able to generate sufficient cash to service our debt obligations.**

Our ability to make payments on and to refinance our debt, or our guarantees of other parties debts, will depend on our financial and operating performance, which may fluctuate significantly from quarter to quarter, and is subject to prevailing economic conditions and financial, business and other factors, many of which are beyond our control. We cannot assure you that we will continue to generate sufficient cash flow or that we will be able to borrow funds in amounts sufficient to enable us to service our debt or to meet our working capital and capital expenditure requirements. If we are not able to generate sufficient cash flow from operations or to borrow sufficient funds to service our debt, we may be required to sell assets or equity, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing. We cannot assure you that we will be able to refinance our debt, sell assets or equity or borrow more funds on terms acceptable to us, if at all.

**Our debt instruments impose restrictions on us that may adversely affect our ability to operate our business.**

The indenture governing our 7.75% Notes contains various covenants that limit our ability to:

- incur additional indebtedness;
- pay dividends and make other restricted payments;
- make certain investments;
- create or permit certain liens;
- create or permit restrictions on the ability of certain restricted subsidiaries to pay dividends or make other distributions to us;
- use the proceeds from sales of assets;
- enter into certain types of transactions with affiliates; and
- consolidate or merge or sell our assets as an entirety or substantially as an entirety.

In addition, the Fab 36 Loan Agreements contain restrictive covenants, including a prohibition on the ability of AMD Fab 36 KG and its affiliated limited partners to pay us dividends and other payments and also require us to maintain specified financial ratios when group consolidated cash is below specified amounts. Our ability to satisfy these covenants, financial ratios and tests can be affected by events beyond our control. We cannot assure you that we will meet those requirements. A breach of any of these covenants, financial ratios or tests could result in a default under the applicable agreement.

Moreover, our agreements contain cross-default provisions whereby a default under one agreement would likely result in cross default under agreements covering other borrowings. For example, the occurrence of a default with respect to any indebtedness that results in acceleration of the maturity date or any failure to repay debt when due in an amount in excess of $50 million would cause a cross default under the indenture governing our 7.75% Notes. The occurrence of a default under any of these borrowing arrangements would permit the applicable lenders or note holders to declare all amounts outstanding under those borrowing arrangements to be immediately due and payable. If the note holders or the trustee under the indenture governing our 7.75% Notes accelerates the repayment of borrowings, we cannot assure you that we will have sufficient assets to repay those borrowings and our other indebtedness.

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**If we are unable to comply with the covenants in the subsidy grant documents that we receive from the State of Saxony, the Federal Republic of Germany and/or the European Union for Fab 30, Fab 36 or other research and development projects we may undertake in Germany, we may forfeit or have to repay our subsidies, which could materially adversely affect us.**

We receive capital investment grants and allowances from the State of Saxony and the Federal Republic of Germany for Fab 36. We have also received capital investment grants and allowances as well as interest subsidies from these governmental entities for Fab 30. From time to time, we also apply for and obtain subsidies from the State of Saxony, the Federal Republic of Germany and the European Union for certain research and development projects. The subsidy grant documents typically contain covenants that must be complied with, and noncompliance with the conditions of the grants, allowances and subsidies could result in the forfeiture of all or a portion of any future amounts to be received, as well as the repayment of all or a portion of amounts received to date. If we are unable to comply with any of the covenants in the grant documents, we may be materially adversely affected.

**If our microprocessors are not compatible with some or all industry-standard software and hardware, we could be materially adversely affected.**

Our microprocessors may not be fully compatible with some or all industry-standard software and hardware. Further, we may be unsuccessful in correcting any such compatibility problems in a timely manner. If our customers are unable to achieve compatibility with software or hardware after our products are shipped in volume, we could be materially adversely affected. In addition, the mere announcement of an incompatibility problem relating to our products could have a material adverse effect on us.

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

If one or more of our products were found to be defective after the product had been shipped to customers in volume, we may have difficulty and the cost of product replacements or product returns could be substantial and our reputation with our customers could be damaged. In addition, we may have difficulty identifying the end customers of our products or the defective products in the field. As a result, we could incur substantial costs to implement modifications to fix defects. Any of these problems could materially adversely affect us.

**Our inability to continue to attract and retain qualified personnel may hinder our product development programs.**

Our future success depends upon the continued service of numerous qualified engineering, manufacturing, marketing, sales and executive personnel. If we are not able to continue to attract, retain and motivate qualified personnel necessary for our business, the progress of our product development programs could be hindered, and we could be materially adversely affected.

**We outsource to third parties certain supply-chain logistics functions, including physical distribution of our products, and co-source some information technology services.**

We rely on a third-party provider to deliver our products to our customers and to distribute materials for our manufacturing facilities. In addition, we rely on a third party in India to provide certain information technology services to us, including helpdesk support, desktop application services, business and software support applications, server and storage administration, data center operations, database administration, and voice, video and remote access. Our relationships with these providers are governed by fixed term contracts. We cannot guarantee that these providers will fulfill their respective responsibilities in a timely manner in accordance with the contract terms, in which case our internal operations, the distribution of our products to our customers and the distribution of materials for our facilities could be materially adversely affected. Also, we cannot guarantee that our contracts with these third-party providers will be renewed, in which case we would have to transition these functions in-house or secure new providers, which could have a material adverse effect on us.

In addition, we decided to outsource or co-source these functions to third parties primarily to lower our operating expenses and to create a more variable cost structure. However, if the costs related to administration, communication and coordination of these third-party providers are greater than we expect, then we will not realize our anticipated cost savings.

**Uncertainties involving the ordering and shipment of, and payment for, our products could materially adversely affect us.**

We typically sell our products pursuant to individual purchase orders. We generally do not have long-term supply arrangements with our customers. Generally, our customers may cancel orders 30 days or more prior to shipment without incurring a significant penalty. We base our inventory levels on customers estimates of demand for their products, which are difficult to predict. This difficulty may be compounded when we sell to OEMs indirectly through distributors, as our forecasts for demand are then based on estimates provided by multiple parties. In addition, our customers may change their inventory practices on short notice for any reason. The cancellation or deferral of product orders, the return of previously sold products or overproduction due to failure of anticipated orders to materialize could result in excess or obsolete inventory, which could result in write-downs of inventory. Because market conditions are uncertain, these and other factors could materially adversely affect us.

**Our reliance on third-party distributors subjects us to certain risks.**

We market and sell our products directly and through third-party distributors pursuant to agreements that can generally be terminated for convenience by either party upon prior notice to the other party. These agreements are non-exclusive and permit our distributors to offer our competitors products. Our third party distributors have been a significant factor in our ability to increase sales of our products in certain high growth international markets. Accordingly, we are dependent on our distributors to supplement our direct marketing and sales efforts. If any significant distributor or a substantial number of our distributors terminated their relationship with us or decided to market our competitors products over our products, our ability to bring our products to market would be impacted and we would be materially adversely affected.

Additionally, distributors typically maintain an inventory of our products. In most instances, our agreements with distributors protect their inventory of our products against price reductions, as well as provide return rights for any product that we have removed from our price book or that is not more than twelve months older than the manufacturing code date. Some agreements with our distributors also contain standard stock rotation provisions permitting limited levels of product returns. We defer the gross margins on our sales to distributors, resulting from both our deferral of revenue and related product costs, until the applicable products are re-sold by the distributors. However, in the event of an unexpected significant decline in the price of our products, the price protection rights we offer to our distributors would materially adversely affect us because our revenue would decline.

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

All of our wafer fabrication capacity for microprocessors is located in Germany. Nearly all product assembly and final testing of our products is performed at manufacturing facilities in China, Malaysia and Singapore. We also depend on foreign foundry suppliers for the production of certain of our embedded microprocessors for personal connectivity devices and we depend on an international joint venture for the manufacture of optical photomasks for use in manufacturing our microprocessors. In addition, we have international sales operations and as part of our business strategy, we are continuing to seek expansion of product sales in high growth markets. Our international sales as a percentage of our total consolidated net sales was 70 percent in the first quarter of 2006 and China was one of our largest and fastest growing markets.

The political and economic risks associated with our operations in foreign countries include, without limitation:

- expropriation;

- changes in a specific country s or region s political or economic conditions;
- changes in tax laws, trade protection measures and import or export licensing requirements;
- difficulties in protecting our intellectual property;
- difficulties in achieving headcount reductions;
- changes in foreign currency exchange rates;
- restrictions on transfers of funds and other assets of our subsidiaries between jurisdictions;
- changes in freight and interest rates;
- disruption in air transportation between the United States and our overseas facilities; and
- loss or modification of exemptions for taxes and tariffs.

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

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

Worldwide economic conditions may adversely affect demand for our products. For example, China s economy has been growing at a fast pace over the past several years, and the Chinese government introduced various measures to slow down the pace of economic growth. A decline in economic conditions in China could lead to declining worldwide economic conditions. If economic conditions decline, whether in China or worldwide, we could be materially adversely affected.

The occurrence and threat of terrorist attacks and the consequences of sustained military action in the Middle East have in the past, and may in the future, adversely affect demand for our products. Terrorist attacks may negatively affect our operations, directly or indirectly, and such attacks or related armed conflicts may directly impact our physical facilities or those of our suppliers or customers. Furthermore, these attacks may make travel and the transportation of our products more difficult and more expensive, which could materially adversely affect us.

The United States has been and may continue to be involved in armed conflicts that could have a further impact on our sales, and our supply chain. Political and economic instability in some regions of the world may also result and could negatively impact our business. The consequences of armed conflicts are unpredictable, and we may not be able to foresee events that could have a material adverse effect on us.

More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the United States economy and worldwide financial markets. Any of these occurrences could have a material adverse effect on us and also may result in volatility of the market price for our securities.

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

As a result of our foreign operations, we have costs, assets and liabilities that are denominated in foreign currencies, primarily the euro. For example, some fixed asset purchases and certain expenses of our German subsidiaries, AMD Saxony and AMD Fab 36 KG, are denominated in

euros while sales of products are denominated in U.S. dollars.

As a consequence, movements in exchange rates could cause our euro-denominated expenses to increase as a percentage of net sales, affecting our profitability and cash flows. Whenever we believe appropriate, we hedge a portion of our foreign currency exchange exposure to protect against fluctuations in currency exchange rates. We determine our total foreign currency exchange exposure using projections of long-term expenditures for items such as equipment and materials used in manufacturing. We cannot assure you that these activities will be effective in reducing foreign exchange rate exposure. Failure to do so could have an adverse effect on our business, financial condition, results of operations and cash flow.

**Our inability to effectively control the sales of our products on the gray market could have a material adverse effect on us.**

We market and sell our products directly to OEMs and through authorized third-party distributors. From time to time, our products are diverted from our authorized distribution channels and are sold on the gray market. Gray market products entering the market result in shadow inventory that is not visible to us, thus making it difficult to forecast demand accurately. Also, when gray market products enter the market, we and our distribution channel compete with heavily discounted products, which adversely affects demand for our products. In addition, our inability to control gray marketing activities could result in customer satisfaction issues, because any time products are purchased outside our authorized distribution channel, there is a risk that our customers are buying counterfeit or substandard products, including products that may have been altered, mishandled or damaged, or used products represented as new. Our inability to control sales of our products on the gray market could have a material adverse effect on us.

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

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

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

From time to time we are a defendant or plaintiff in various legal actions. Litigation can involve complex factual and legal questions and its outcome is uncertain. Any claim that is successfully asserted against us may cause us to pay substantial damages.

With respect to intellectual property litigation, from time to time, we have been notified, or third parties may bring actions against us, based on allegations that we are infringing the intellectual property rights of others. If any such claims are asserted against us, we may seek to obtain a license under the third party s intellectual property rights. We cannot assure you that we will be able to obtain all of the necessary licenses on satisfactory terms, if at all. In the event that we cannot obtain a license, these parties may file lawsuits against us seeking damages (potentially including treble damages) or an injunction against the sale of our products that incorporate allegedly infringed intellectual property or against the operation of our business as presently conducted, which could result in our having to stop the sale of some of our products

or to increase the costs of selling some of our products or could damage our reputation. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture and sale of some or all of our products, would have a material adverse effect on us. We could decide, in the alternative, to redesign our products or to resort to litigation to challenge such claims. Such challenges could be extremely expensive and time-consuming and could have a material adverse effect on us. We cannot assure you that litigation related to our intellectual property rights or the intellectual property rights of others can always be avoided or successfully concluded.

Even if we were to prevail, any litigation could be costly and time-consuming and would divert the attention of our management and key personnel from our business operations, which could have a material adverse effect on us.

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

Our operations and properties are subject to various U.S. and foreign environmental laws and regulations, including those relating to materials used in our products and manufacturing processes, discharge of pollutants into the environment, the treatment, transport, storage and disposal of solid and hazardous wastes, and remediation of contamination. These laws and regulations require us to obtain permits for our operations, including the discharge of air pollutants and wastewater. Our management systems are designed to maintain compliance. However, we cannot assure you that we have been or will be at all times in complete compliance with such laws, regulations and permits. If we violate or fail to comply with any of them, a range of consequences could result, including fines, suspension of production, alteration of manufacturing processes, import/export restrictions, sales limitations, criminal and civil liabilities or other sanctions. We could also be held liable for any and all consequences arising out of exposure to hazardous materials used, stored, released, disposed of by us or located at or under our facilities or other environmental or natural resource damage.

Certain environmental laws, including the U.S. Comprehensive, Environmental Response, Compensation and Liability Act of 1980, or the Superfund Act, impose strict, joint and several liability on current and previous owners or operators of real property for the cost of removal or remediation of hazardous substances and impose liability for damages to natural resources. These laws often impose liability even if the owner or operator did not know of, or was not responsible for, the release of such hazardous substances. These environmental laws also assess liability on persons who arrange for hazardous substances to be sent to disposal or treatment facilities when such facilities are found to be contaminated. Such persons can be responsible for cleanup costs even if they never owned or operated the contaminated facility. We have been named as a responsible party on Superfund clean-up orders for three sites in Sunnyvale, California. Although we have not yet been, we could be named a potentially responsible party at other Superfund or contaminated sites in the future. In addition, contamination that has not yet been identified could exist at our other facilities.

Environmental laws are complex, change frequently and have tended to become more stringent over time. For example, the European Union has enacted in recent years restrictions on the use of lead, among other chemicals, in electronic products, which affects semiconductor packaging. Other regulatory requirements potentially affecting our manufacturing processes and the design and marketing of our products are in development throughout the world. While we have budgeted for foreseeable associated expenditures, we cannot assure you that future environmental legal requirements will not become more stringent or costly in the future. Therefore, we cannot assure you that our costs of complying with current and future environmental and health and safety laws, and our liabilities arising from past and future releases of, or exposure to, hazardous substances will not have a material adverse effect on us.

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

Our worldwide operations could be subject to natural disasters and other business disruptions, which could harm our future revenue and financial condition and increase our costs and expenses. For example, our corporate headquarters are located near major earthquake fault lines in California.

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In the event of a major earthquake, or other natural or manmade disaster, we could experience loss of life of our employees, destruction of facilities or business interruptions, any of which could materially adversely affect us.

**Risks Related to Our Ownership of Spansion Inc. Common Stock**

*Spansion s financial position, results of operations and cash flows were consolidated with ours through December 20, 2005, but as a result of its initial public offering, we currently report our interest in Spansion using the equity method of accounting. We currently own 48,529,403 shares, or approximately 37.9 percent, of Spansion s outstanding common stock. As a result, our 37.9 percent share of Spansion s net income (loss) will impact our net income (loss). The following risks and uncertainties that Spansion faces could affect Spansion s financial position or results of operations and correspondingly our financial position and results of operations. These are not the only risks and uncertainties that Spansion faces. Spansion also faces many of the risks and uncertainties that we face as described above in this Risk Factors section, as well as those set forth in Spansion s Annual Report on Form 10-K and other SEC filings, to which we refer you.*

**The demand for Spansion s products depends in part on continued growth in the industries and geographies into which they are sold. A market decline in any of these industries or geographies would have a material adverse effect on Spansion s results of operations.**

Spansion is dependent to a large degree upon demand for mobile telephones, consumer electronics such as set top boxes and DVD players, automotive electronics, industrial electronics such as networking equipment, and PC peripheral equipment such as printers. Sales of Spansion products are also dependent on OEMs including increasing amounts of NOR Flash memory content in their products. In 2004, 2005, and the first quarter of 2006 demand from the wireless category of the Flash memory market drove a majority of Spansion s sales. If demand for these products, or NOR Flash memory content in these products, is below Spansion s expectations, or if the functionality of successive generations of these products does not require increasing NOR Flash memory density, Spansion would be materially adversely affected.

**Spansion has lost, and will continue to lose, rights to key intellectual property arrangements once it is no longer a beneficiary of our patent cross-license agreements and other licenses, which creates a greatly increased risk of patent or other intellectual property infringement claims against Spansion.**

As a majority owned subsidiary, Spansion had been the beneficiary of our intellectual property arrangements with third parties, including patent cross-license agreements with other major semiconductor companies such as Intel, Motorola and IBM, and licenses from third parties for technology incorporated in Spansion s products and software used to operate its business. Following Spansion s initial public offering in December 2005, it was no longer a beneficiary under a number of those agreements. As a result, it lost rights to use important intellectual property that it was previously licensed to use and may therefore be subject to claims that it is infringing intellectual property rights of third parties through the manufacture and sale of its products and the operation of its business. Therefore, absent negotiating its own license agreements with third parties who own such intellectual property, Spansion will be vulnerable to claims by such parties that its products or operations infringe such parties patents or other intellectual property rights. In addition, third parties may have refrained from asserting intellectual property infringement claims against Spansion because it had been a majority owned subsidiary of ours. In addition, we believe that Spansion will lose additional rights under our patent cross-license agreements and other licenses once we no longer hold a majority of Spansion s shares entitled to vote for the election of Spansion s directors, assuming we are still party to such agreements and licenses at such time. The parties to these agreements and licenses, and other third parties with whom we had no prior intellectual property arrangement, may file lawsuits against Spansion seeking damages (potentially including treble damages) or an injunction against the sale of Spansion s products that incorporate allegedly infringed intellectual property or against the operation of Spansion s business as presently conducted. Such litigation could be extremely expensive. The award of material damages, including material royalty payments, or the entry of an injunction, would have a material adverse effect on Spansion.

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**A lack of market acceptance of MirrorBit technology could have a material adverse effect on Spansion.**

Market acceptance of products based on Spansion s MirrorBit technology is a critical factor impacting Spansion s ability to increase revenues and market share as well as to enter new markets. MirrorBit technology is a memory cell architecture that enables Flash memory products to store two bits of data in a single memory cell thereby doubling the density or storage capacity of each memory cell. If adoption of Spansion s MirrorBit technology occurs at a slower rate than Spansion anticipates, Spansion s ability to compete will be reduced, and Spansion would be materially adversely affected..

**Spansion Flash memory products are based on NOR architecture, and a significant market shift to NAND architecture could materially adversely affect Spansion.**

Flash memory products are generally based either on NOR architecture or NAND architecture. To date, Spansion s Flash memory products have been based on NOR architecture, which are typically produced at a higher cost-per-bit than NAND-based products. Spansion does not currently manufacture products based on NAND architecture. From 2003 through 2005, industry sales of NAND-based products grew at higher rates than sales of NOR-based products, resulting in NAND vendors in aggregate gaining a greater share of the overall Flash memory market and NOR vendors in aggregate losing overall market share. In fact, in 2005, sales of NAND-based Flash memory products represented a majority of the Flash memory products sold in the overall Flash memory market. Moreover, the removable storage category of the Flash memory market, which is currently the second largest category after wireless, and is predominantly served by NAND vendors, is expected to be the fastest growing portion of the Flash memory market for the foreseeable future. As mobile phones and other consumer electronics become more advanced, they will require higher density Flash memory to meet the increased data storage requirements associated with music downloads, photos and videos. Because storage requirements will increase to accommodate data-intensive applications, OEMs may increasingly choose NAND-based products over NOR-based products for their applications. Moreover, some NAND vendors are manufacturing on 300-millimeter wafers or are utilizing more advanced manufacturing process technologies than Spansion is today, which results in an ability to offer products with a lower cost-per bit at a given product density. If NAND vendors continue to increase their share of the Flash memory market, Spansion s market share may decrease, which would materially adversely affect Spansion.

**If Spansion fails to successfully develop products based on its new ORNAND architecture, or if there is a lack of market acceptance of products based on its ORNAND architecture, Spansion s future operating results would be materially adversely affected.**

As mobile phones become more advanced, they will require higher density Flash memory to meet increased data storage requirements. Spansion has stated its intention to position itself to address the increasing demand for higher density Flash memory within the wireless category of the Flash memory market by offering products based on its ORNAND architecture, which Spansion has recently developed. The success of its ORNAND architecture requires that Spansion timely and cost effectively develop, manufacture and market ORNAND-based products that are competitive with NAND-based Flash memory products in the wireless category of the Flash memory market. Spansion began production of ORNAND-based products in the first quarter of 2006. However, if Spansion fails to develop and commercialize additional products based on its ORNAND architecture on a timely basis or if Spansion s ORNAND-based products fail to achieve acceptance in the wireless market, Spansion s operating results would be materially adversely affected.

**The loss of a significant mobile phone customer may have a material adverse effect on Spansion.**

Sales of Spansion products are dependent to a large extent on demand for mobile phones. Historically, a small number of customers in the wireless category have driven a substantial portion of net sales. If one of these customers decided to stop buying Spansion s products, or if one of these customers were materially to reduce its operations or its demand for Spansion s products, Spansion would be materially adversely affected.

**Spansion has a substantial amount of indebtedness which could materially adversely affect its financial condition.**

Spansion has a substantial amount of indebtedness. This substantial indebtedness may:

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

**If Spansion cannot generate sufficient operating cash flow and obtain external financing, it may be unable to make all of its planned capital expenditures.**

Spansion s ability to fund anticipated capital expenditures depends on generating sufficient cash flow from operations and the availability of external financing, which may not be available on favorable terms, if at all. Spansion s capital expenditures, together with ongoing operating expenses, will be a substantial drain on Spansion s cash flow and may decrease its cash balances. Spansion s inability to obtain needed financing or to generate sufficient cash from operations may require it to abandon projects or curtail capital expenditures. However, if it cannot generate sufficient operating cash flow or obtain external financing, Spansion may be delayed in achieving such capacity, and Spansion would be materially adversely affected.

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

Average selling prices for Spansion s products historically have declined over relatively short time periods. Spansion is unable to predict pricing conditions for future periods. Even in the absence of downturns or oversupply in the industry, average selling prices of Spansion s products have decreased during the products lives. When Spansion s average selling prices decline, its net sales and net income decline unless it is able to compensate by selling more units, reducing its manufacturing costs or introducing new, higher margin products that have higher densities and/or incorporate advanced features. If Spansion s average selling prices continue to decline, its operating results could be materially adversely affected.

**If Spansion s cost reduction efforts are not effective, Spansion could be materially adversely affected.**

Spansion continues to undertake a number of actions in an effort to significantly reduce its expenses. These actions include streamlining operations and continuing to align manufacturing utilization to the level of demand for Spansion products, controlling increasing testing costs and working with us and Fujitsu to reduce costs under services agreements. We cannot assure you that any of these actions will occur as anticipated or at all, or that Spansion will be able to achieve significant cost reductions. If Spansion s cost reduction efforts are unsuccessful, Spansion would be materially adversely affected.

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**Manufacturing capacity constraints may have a material adverse affect on Spansion.**

There may be situations in which Spansion s manufacturing facilities are inadequate to meet the demand for certain of Spansion s products. Spansion s inability to obtain sufficient manufacturing capacity to meet demand, either in its own facilities or through foundry or similar arrangements with third parties, could have a material adverse effect on Spansion. For example, in the first half of 2004, Spansion was not able to meet demand for certain of its lower density embedded Flash memory products because in 2003 it underestimated demand for these products, and was unable to install additional wafer fabrication capacity on a timely basis. Spansion has stated its belief that this adversely impacted its relationships with customers who received reduced allocations, or did not receive allocations, of its embedded products, and Spansion has stated its belief that its competitors were able to take advantage of this situation to increase their market share. More recently, in the third and fourth quarters of 2005, Spansion experienced capacity constraints for final test and assembly of certain products. While Spansion is working internally and with subcontractors to increase capacity to meet anticipated demand, Spansion cannot give any assurance that it will not experience similar constraints in the future. These capacity constraints limit Spansion s ability to respond to rapid and short-term surges in demand for its products. Spansion s inability to obtain sufficient manufacturing capacity to meet demand, either in its own facility or through foundry, subcontractor or similar arrangements with third parties, could have a material adverse effect on Spansion.

**Spansion is party to intellectual property litigation and may become party to other intellectual property claims or litigation that could cause it to incur substantial costs or pay substantial damages or prohibit it from selling its products.**

Tessera, Inc. filed a lawsuit against Spansion alleging that it has infringed certain of Tessera s patents. Tessera has sought to enjoin such alleged infringement and to recover an unspecified amount of damages. In addition, Fujitsu has informed Spansion that it has been informed by Texas Instruments that Texas Instruments believes that several of Spansion s products infringe some of Texas Instruments patents. Fujitsu has also informed Spansion that it expects Spansion to defend and indemnify Fujitsu against Texas Instruments claims in accordance with the terms of Spansion s distribution agreement with Fujitsu. Defending these claims and similar claims could be extremely expensive and time-consuming for Spansion, and defending these claims or others or the award of damages or an injunction could have a material adverse effect on Spansion.

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

Spansion s principal competitors in the Flash memory market are Intel Corporation, Samsung Electronics Co., Ltd., STMicroelectronics, Silicon Storage Technology, Inc., Macronix International Co., Ltd., Toshiba Corporation, Sharp Electronics Corp. and Renesas Technology Corp. and may also include the joint venture between Intel and Micron Technology, Inc. The principal bases of competition in the Flash memory market are cost, selling price, performance, quality and customer relationships. In particular, in the past, Spansion s competitors have aggressively priced their products in order to increase market share, which resulted in decreased average selling prices for Spansion s products and adversely impacted Spansion s results of operations. In addition, recent capital investments by competitors have resulted in substantial industry manufacturing capacity, which may further contribute to a competitive pricing environment.

Also, Spansion and certain of its competitors have licensed Flash memory technology called NROM technology from a third party. NROM technology has similar characteristics to Spansion s MirrorBit technology which may allow these competitors to develop new Flash memory technology that is competitive with Spansion s MirrorBit technology.

Spansion may not be able to compete effectively if it fails to reduce its manufacturing costs and develop, introduce and sell on a timely basis, new products or enhanced versions of existing products at competitive prices.

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**If Spansion is unable to timely and efficiently implement 300-millimeter wafer capacity for the manufacture of its Flash memory products, Spansion could be materially adversely affected.**

Spansion has stated its intention to develop manufacturing capacity on 300-millimeter wafers for its Flash memory products. The timing for implementing 300-millimeter capacity will depend in part on the demand for Spansion s Flash memory products and the ability to fund the construction of such a facility if Spansion chooses to develop capacity internally or Spansion s ability to enter into a foundry manufacturing agreement if it chooses to work with a foundry manufacturer. If Spansion is delayed in having this capacity or is unable to obtain foundry services at competitive rates or is unable to timely and efficiently ramp production on 300-millimeter wafers, Spansion would not achieve anticipated cost savings associated with this technology, and Spansion could be materially adversely affected.

**If essential equipment or materials are not available to manufacture Spansion s products, Spansion could be materially adversely affected.**

Spansion s manufacturing operations depend upon obtaining deliveries of equipment and adequate supplies of materials on a timely basis. From time to time, suppliers may extend lead times, limit supply to Spansion or increase prices due to capacity constraints or other factors. Because the equipment that Spansion purchases is complex, it is difficult for it to substitute one supplier for another or one piece of equipment for another. Certain raw materials Spansion uses in manufacturing its products are available from a limited number of suppliers.

For example, Spansion purchases commercial memory die, such as SRAM, pSRAM, 1pSDRAM and NAND from third-party suppliers and incorporates these die into its multi-chip package products. Spansion s production of Flash memory products was constrained in the first half of 2004 because of difficulties in procuring adequate supply of pSRAM. Some of Spansion s major suppliers, including Samsung, are also its competitors in the Flash memory market. Interruption of supply or increased demand in the industry could cause shortages and price increases in various essential materials. If Spansion is unable to procure certain of these materials, Spansion may have to reduce its manufacturing operations. Such a reduction has in the past and could in the future have a material adverse effect on Spansion.

**If the market value of our shares of Spansion common stock remains below our book value of such shares for an extended period of time, then our results of operations may be adversely affected.**

If the market value of our shares of Spansion common stock remains below our book value of such shares and the decline in the market value level is deemed other than temporary, then we may be required to take an impairment charge in the amount of the difference between the book value and the market value. For the quarter in which we take any such impairment charge, our results of operations could be adversely affected by the amount of such impairment charge. In addition, the carrying value of our investment in Spansion on our balance sheet would also be reduced. Therefore, sustained decreases in the market price of Spansion s common stock could have an adverse effect on us and our results of operations.

**ITEM 6. EXHIBITS**

31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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## SIGNATURE

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.

ADVANCED MICRO DEVICES, INC.

Date: May 4, 2006

By: /s/ ROBERT J. RIVET
Robert J. Rivet
Executive Vice President,
Chief Financial Officer

Signing on behalf of the registrant and as the principal accounting officer