ADVANCED MICRO DEVICES INC
Form 10-K
March 01, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended December 31, 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.)**
One AMD Place, Sunnyvale, California	**94088**
(Address of principal executive offices)	**(Zip Code)**

(408) 749-4000

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

(Title of each class)	**(Name of each exchange on which registered)**
Common Stock per share $0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

As of June 30, 2006, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was approximately $10.6 billion based on the reported closing sale price of $24.42 per share as reported on the New York Stock Exchange on June 30, 2006, which was the last business day of the registrant s most recently completed second fiscal quarter.

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date. 554,929,028 shares of common stock, $0.01 par value per share, as of February 16, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 3, 2007, are incorporated into Part II and III hereof.

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For The Fiscal Year Ended December 31, 2006

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PART I

ITEM 1. BUSINESS

Cautionary Statement Regarding Forward-Looking Statements

The statements in this report include forward-looking statements. These forward-looking statements are based on current expectations and beliefs and involve numerous risks and uncertainties that could cause actual results to differ materially from expectations. These forward-looking statements should not be relied upon as predictions of future events as we cannot assure you that the events or circumstances reflected in these statements will be achieved or will occur. You can identify forward-looking statements by the use of forward-looking terminology including believes, expects, may, will, should, seeks, intends, plans, pro forma, estimates, or anticipates or the negative of these words and phrases or other variations of these words and phrases or comparable terminology. The forward-looking statements relate to, among other things: the features of new products and technologies and the timing of new product releases; the growth and competitive landscape of the markets in which we participate; our supply chain; our revenues; our level of international sales; our capital expenditures; our operating expenses; our stock-based compensation expenses; acquisition related integration charges in connection with the acquisition of ATI Technologies Inc. (ATI); our aggregate contractual obligations; our capacity expansion plans for Fab 36; the conversion of Fab 30 from a 200-millimeter manufacturing facility to a 300-millimeter facility; the addition of a potential new fabrication facility in Luther Forest, New York; availability of external financing; the adequacy of resources to fund operations and capital expenditures; the timing of manufacturing process technology transitions; the impact of our acquisition of ATI on us; our exposure to interest rate risk; our interest income; and our interest expense. The material factors and assumptions that were applied in making these forward-looking statements include, without limitation, the following: (1) the expected rate of market growth and demand for our products and technologies (and the mix thereof); (2) our expected market share; (3) our expected product and manufacturing costs and average selling prices; (4) our overall competitive position and the competitiveness of our current and future products; (5) our ability to expand our capacity and effect transitions to more advanced manufacturing process technologies, consistent with our current plans in terms of timing and capital expenditures; (6) our ability to raise sufficient capital on favorable terms; and (7) our ability to make additional investment in research and development and that such opportunities will be available. The material factors that could cause actual results to differ materially from current expectations include, without limitation, the following: (1) that Intel Corporation s pricing, marketing and rebating programs, product bundling, standard setting, new product introductions or other activities may negatively impact sales; (2) any inability to realize all of the anticipated benefits of our recent acquisition of ATI because, among other things, the revenues, cost savings, growth prospects and any other synergies expected from the transaction may not be fully realized or may take longer to realize than expected; (3) additional capital requirements and any inability to raise sufficient capital, on favorable terms or at all, particularly in light of the requirement that we repay our credit facility with Morgan Stanley Senior Funding Inc. using, among other things, 100 percent of the net cash proceeds from any debt incurred by us or a restricted subsidiary, 50 percent of net cash proceeds from the issuance of any capital stock by us and 50 percent of any excess cash flow; (4) unexpected variations in market growth and demand for our products and technologies in light of the product mix that we may have available at any particular time or even a decline in demand; (5) uncertainty with respect to the impact of the recent release of Microsoft ® Windows Vista on the demand for our products in 2007; (6) any inability to transition to advanced manufacturing process technologies in a timely and effective way, consistent with planned capital expenditures; (7) any inability to develop, launch and ramp new products and technologies in the volumes and mix required by the market at mature yields and on a timely basis; (8) any inability to maintain the level of investment in research and development and capacity that is required to remain competitive; (9) any inability to obtain sufficient manufacturing capacity (either in our own facilities or at foundries) or components to meet demand for our products or that we may under-utilize our microprocessor manufacturing facilities; and (10) the effect of political or economic instability internationally on our sales or production.

For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see Part I, Item 1A Risk Factors and the Financial Condition section set forth in Part II,

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Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, or MD&A, beginning on page 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.

General

We are a global semiconductor company with facilities around the world. We provide processing solutions for the computing, graphics and consumer electronics markets.

On October 25, 2006, we completed our acquisition of ATI pursuant to an Acquisition Agreement, dated as of July 23, 2006, by and among AMD, 1252986 Alberta ULC, and ATI, whereby ATI became our indirect, wholly-owned subsidiary. As a result of the acquisition, we began to supply 3D graphics, video and multimedia products and chipsets for personal computers, or PCs, including desktop and notebook PCs, professional workstations and servers and products for consumer electronic devices such as mobile phones, digital TVs and game consoles.

Additional Information

We were incorporated under the laws of Delaware on May 1, 1969 and became a publicly held company in 1972. Since 1979 our common stock has been listed on the New York Stock Exchange under the symbol AMD. Our mailing address and executive offices are located at One AMD Place, Sunnyvale, California 94088, and our telephone number is (408) 749-4000. References in this report to AMD, we, us, management, ou or the Company means Advanced Micro Devices, Inc. and our consolidated subsidiaries, including ATI and its subsidiaries.

AMD, the AMD Arrow logo, AMD Athlon, AMD Opteron, AMD Sempron, AMD Turion, AMD LIVE!, Geode, and combinations thereof, ATI and the ATI logo and ATI Avivo, TV Wonder, Fire, Imageon, Radeon, Xilleon, Crossfire and AMD PowerNow! are trademarks of Advanced Micro Devices, Inc. Spansion and MirrorBit are trademarks of Spansion Inc. Microsoft, Windows and Windows Vista are either registered trademarks or trademarks of Microsoft Corporation in the United States and/or other jurisdictions. MIPS is a registered trademark of MIPS Technologies, Inc. in the United States and/or other jurisdictions. HyperTransport is a licensed trademark of the HyperTransport Technology Consortium. NetWare is a registered trademark of Novell, Inc. in the United States and/or other jurisdictions. Other names are for informational purposes only and used to identify companies and products and may be trademarks of their respective owners

Website Access to Company Reports and Corporate Governance Documents

We post on the Investor Relations pages of our Web site, www.amd.com, a link to our filings with the SEC, our Principles of Corporate Governance, our Code of Ethics for our Chief Executive Officer, Chief Financial Officer, Corporate Controller and other senior finance executives, our Worldwide Standards of Business Conduct, which applies to our directors and all our employees, and the charters of our Audit, Compensation, Finance and Nominating and Corporate Governance committees of our board of directors. Our filings with the SEC are posted as soon as reasonably practical after they are electronically filed with, or furnished to, the SEC. You can also obtain copies of these documents by writing to us at: Corporate Secretary, AMD, One AMD Place, M/S 68, Sunnyvale, California 94088, or emailing us at: Corporate.Secretary@amd.com. All these documents and filings are available free of charge. Please note that information contained on our Web site is not incorporated by reference in, or considered to be a part of, this report. For financial information about geographic areas and for segment information with respect to revenues and operating results, refer to the information set forth in Note 11 of our consolidated financial

statements, beginning on page 127 below.

Our Industry

Semiconductors are components used in a variety of electronic products and systems. An integrated circuit, or IC, is a semiconductor device that consists of many interconnected transistors on a single chip. Since the

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invention of the transistor in 1948, improvements in IC process and design technologies have led to the development of smaller, more complex and more reliable ICs at a lower cost per function. In order to satisfy the demand for faster, smaller and lower-cost ICs, semiconductor manufacturers have continually developed improvements in manufacturing and process technology. ICs are increasingly being manufactured using smaller geometries on larger silicon wafers. Use of smaller process geometries can result in products that are higher performing, use less power and cost less to manufacture on a per unit basis. Use of larger wafers can contribute further to a decrease in manufacturing costs per unit and to an increase in capacity by yielding more chips per wafer.

The availability of low-cost semiconductors, together with increased customer demand for sophisticated electronic systems, has led to the proliferation of semiconductors. Today, virtually all electronic products use semiconductors, including PCs and related peripherals, wired and wireless voice and data communications and networking products including mobile telephones, facsimile and photocopy machines, home entertainment equipment, industrial control equipment and automobiles.

During most of 2006, within the global semiconductor industry, we offered primarily:

- x86 microprocessors for the commercial and consumer markets, which are used for control and computing tasks; and
- embedded microprocessors for commercial, commercial client and consumer markets.

As a result of our acquisition of ATI in October 2006, we began to supply 3D graphics, video and multimedia products and chipsets for desktop and notebook PCs, professional workstations, and servers as well as products for consumer electronic devices such as mobile phones, digital TVs and game consoles. Therefore, since this acquisition, we have actively participated in the semiconductor graphics and chipset markets as well as in the semiconductor market for consumer electronics devices.

Computation Products

The x86 Microprocessor Market

A microprocessor is an IC that serves as the central processing unit, or CPU, of a computer. It generally consists of millions of transistors that process data and control other devices in the system, acting as the brain of the computer. The performance of a microprocessor is a critical factor impacting the performance of a computer and numerous other electronic systems. The principal indicators of CPU performance are work-per-cycle, or how many instructions are executed per cycle, clock speed, representing the rate at which a CPU s internal logic operates, measured in units of hertz, or cycles per second, and power consumption. Other factors impacting microprocessor performance include the number of CPUs, or cores, on a microprocessor, the bit rating of the microprocessor, memory size and data access speed.

Developments in circuit design and manufacturing process technologies have resulted in significant advances in microprocessor performance. For approximately the last ten years, microprocessors have had 32-bit computing capabilities. The bit rating of a microprocessor generally denotes the largest size of numerical data that a microprocessor can handle. While 32-bit processors have historically been sufficient, we believe that they will face increasing challenges as new data and memory-intensive consumer and enterprise software applications gain popularity. Microprocessors with 64-bit processing capabilities enable systems to have greater performance by allowing software applications and operating

systems to access more memory.

Moreover, as businesses and consumers require greater performance from their computer systems due to the exponential growth of digital data and increasingly sophisticated software applications, semiconductor manufacturers have transitioned from manufacturing single-core microprocessors to also manufacturing multi-core processors, where multiple processor cores are placed on a single die or in a single processor. Multi-core

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processors offer enhanced overall system performance and efficiency because computing tasks can be spread across two or more processing cores each of which can execute a task at full speed. Moreover, two or more processor cores packaged together can increase performance of a computer system without greatly increasing the total amount of power consumed and the total amount of heat emitted. This type of symmetrical multiprocessing is effective in both multi-tasking environments where multiple cores can enable operating systems to prioritize and manage tasks from multiple software applications simultaneously and also for multi threaded software applications where multiple cores can process different parts of the software program, or threads, simultaneously thereby enhancing performance of the application. Businesses and consumers also require computer systems with improved power management technology, which allows them to reduce the power consumption of their computer systems thereby reducing the total cost of ownership. With the recent release of Microsoft® Windows Vista and with the proliferation of applications for multimedia and gaming, grid computing and extensive enterprise databases, we believe the demand for 64-bit computing, multi-core technology and improved power management technology will continue to increase.

Microprocessor Products

We currently offer single-core and dual-core microprocessor products for servers, workstations, notebooks and desktop PCs. Our microprocessors currently are designed with both 32-bit and 64-bit processing capabilities. We based our microprocessors on the x86 instruction set architecture and most of these processors are also based on the AMD64 technology platform with direct connect architecture. Direct connect architecture connects an on-chip memory controller and input/output, or I/O, channels directly to one or more microprocessor cores. For dual-core processors, we integrate two processor cores onto a single die and each core has its own dedicated cache, which is memory that is located on the semiconductor die. We believe this architecture, and, in particular, the integrated memory controller, enables substantially higher performance because memory can be accessed more directly rather than traversing a traditional front-side bus, which results in increased bandwidth and reduced memory latencies. Our processors support HyperTransport technology, which is a high-bandwidth communications interface we initially developed that enables substantially higher performance and supports our I/O virtualization technology. In designing our processors, we also focus on continuously improving power management technology, or performance-per-watt. To that end, we offer processors that feature AMD PowerNow! technology, which we designed to reduce system level energy consumption, with multiple levels of lower clock speed and voltage states that can significantly reduce processor power consumption during idle times. We design our microprocessors to be compatible with operating system software such as the Microsoft® Windows® family of operating systems, Linux®, NetWare®, Solaris and UNIX. We also designed the AMD64 architecture to enhance the security of a user s computing environment by integrating security features that are designed to prevent the spread of certain viruses when enabled by the anti-virus features of current versions of certain operating systems, including Linux, the Microsoft® Windows® family of operating systems and Solaris operating systems.

Servers and Workstations. Our microprocessors for servers and workstations consist primarily of our single-core and dual-core AMD Opteron processors. A server is a powerful computer on a network, often with multiple microprocessors working together, that is dedicated to a particular purpose, stores large amounts of information and performs the critical functions for that purpose. A workstation is essentially a heavy-duty desktop, designed for tasks such as computer-aided design and digital content creation. We based our AMD Opteron processors for servers and workstations on the AMD64 technology platform, which extends the industry-standard x86 instruction set architecture to 64-bit computing, and designed them to allow simultaneous 32-bit and 64-bit computing. These processors can be used in a variety of server applications, including business processing (enterprise resource planning, customer relationship management, and supply chain management) and business intelligence. They can also be used in workstation applications such as engineering and digital content creation software and other information technology infrastructure applications such as intensive Web serving and messaging.

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Our dual-core AMD Opteron processors offer improved overall performance on many applications compared to single-core AMD processors by executing more operations simultaneously during each clock cycle, and improved performance-per-watt, which can reduce the operational costs related to power usage. At the same time, servers based on dual-core AMD Opteron processors are easier to manage because more processing capacity can be concentrated into fewer servers. For the same reason, servers based on dual-core processors are less costly to operate.

Dual-core AMD Opteron processors also allow our enterprise customers to more easily implement virtualization across their business. Virtualization is the use of software to allow workloads to be shared at the processor level by providing the illusion of multiple processors. Virtualization enables running different operating systems and applications on the same server, thereby consolidating workloads and reducing hardware requirements.

In August 2006 we introduced a new generation of AMD Opteron dual-core processors. These processors provide several new features including improved virtualization support and energy efficient DDR2 memory. In addition, these processors can be replaced by AMD quad-core processors in the same socket and thermal envelope. Our quad-core x86 processors for servers, which we expect to begin shipping in mid-2007, will incorporate four processor cores on a single die of silicon. DDR2, or double data rate two, is a type of random access memory technology used for high speed storage of the working data of a computer.

Notebook PCs. Our microprocessors for notebook PCs consist primarily of AMD Turion 64 processors and mobile AMD Sempron processors. We designed our mobile processor products for high-performance, longer battery life and wireless connectivity.

AMD Turion 64 processors represent our most advanced family of Windows-compatible processors for thinner and lighter notebook PCs, and provide performance improvements such as longer battery life, reduced heat generation, enhanced security and compatibility with current wireless and graphics solutions.

In May 2006 we introduced AMD Turion 64 X2 dual-core mobile technology, which is our most advanced dual-core processor family for notebook PCs. We designed this technology to enable leading-edge graphics for the more visual experience provided by the Microsoft® Windows Vista operating system, longer battery life, enhanced security and compatibility with the latest wireless technologies. In addition, we have designed the process used to manufacture AMD Turion 64 mobile technology for more thermally efficient processor operation and reduced power consumption.

Desktop PCs. Our microprocessors for desktop PCs consist primarily of the following tiered product brands: AMD Athlon 64 FX, AMD Athlon 64 and AMD Sempron processors. We designed the AMD Athlon 64 FX processor specifically for gamers, PC enthusiasts and digital content creators who require processors that can perform graphic-intensive tasks. We designed our AMD Athlon 64 processors for enterprises and sophisticated PC users that seek to access large amounts of data and memory. For value-conscious consumers of desktop and notebook PCs, we offer the AMD Sempron microprocessor, which we designed to provide core computing needs at affordable prices. We also offer AMD Athlon 64 X2 dual-core processors and AMD Athlon 64 FX X2 dual-core processors, which like the dual-core AMD Opteron processors, contain two processor cores on one semiconductor die. The performance advantages of AMD Athlon 64 X2 dual-core processors enable operating systems to prioritize and manage tasks from multiple software applications simultaneously. For example, users are able to simultaneously download audio files such as MP3s, record to digital media devices, check and write email, edit a digital photo and run virus protection without compromising the performance of their PC. AMD Athlon 64 X2 dual-core processors also have an integrated DDR2 memory controller, which is designed to increase performance on memory-intensive applications. We designed the AMD Athlon 64 X2 dual-core processors for prosumer and digital media enthusiasts or other users who routinely run multiple processor-intensive software applications simultaneously.

In December 2006, we introduced a new generation of AMD Athlon 64 X2 dual-core processors which are manufactured using 65-nanometer technology. We designed these processors to deliver improved

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performance-per-watt by maintaining the performance of the previous generation of AMD Athlon 64 X2 dual-core processors and reducing power consumption. To aid in reducing power consumption, these new processors incorporate a feature called C1 Enhanced, a power management feature that slows selected system functions when not in use to reduce overall power consumption.

On October 25, 2006, we completed our acquisition of ATI. We believe that the acquisition of ATI will allow us to deliver products that better fulfill the increasing demand for more integrated computing solutions. We plan to deliver a range of integrated platforms to serve key markets, including commercial clients, mobile computing, and gaming and media computing. We believe that these integrated platforms will bring customers improved system stability, better time-to-market and increased performance and energy efficiency. We also plan to develop and offer monolithic silicon solutions for specialized uses that are comprised of microprocessors, graphics processors and video processors. We refer to these design initiatives as Fusion. At the same time, we plan to continue to develop discrete microprocessor and graphics processor products and to maintain open interface and software standards in order to allow our customers to choose the combination of technologies that best serve their needs.

Embedded Products

The Embedded Processor Market

During 2006, we offered embedded microprocessors for high end commercial markets, commercial client markets and certain consumer markets. The high end commercial markets that we address include communication servers, networking equipment, storage servers, and imaging systems. The applications in these markets typically require high-performance, enterprise-class products that include embedded server-class products. Customers use commercial client products to address specialized needs within a variety of industries, including computer devices such as thin clients, single board computers, blade PCs, points of sale terminals, commercial value clients, and access devices such as gateways and access points. Devices for specific consumer markets are used in ultra mobile PC s, ultra value clients and entertainment devices such as media players and set top boxes. The applications in these devices typically require highly integrated systems-on-chip, or SoCs, that include high-performance, low-power embedded processors and microcontrollers.

Embedded Processors

Our products range from low-power x86 architecture-based embedded processors to high-performance, enterprise class, harsh environment-capable x86 architecture-based products. We design embedded connectivity devices to address customer needs in non-PC markets where low power, Internet connectivity and/or low power processing is a priority. Typically these embedded processors are used in products that require high to moderate levels of performance where key features include low cost, mobility, low power and small form factor. We target some products that use our embedded processors for specific markets using SoC design techniques.

Our embedded microprocessor products include the AMD Geode product family. AMD Geode microprocessors are 32-bit processors based on the x86 instruction set architecture. These processors integrate functionality such as processing, system logic, graphics, audio and video decompression onto one integrated device. We also offer embedded processors based on AMD64 technology, which consists of low-power versions of our AMD Athlon, AMD Turion, AMD Sempron and AMD Opteron families of products. These low power products deliver the same performance as their corresponding full power parts while offering the added benefit of reduced power consumption and thermal output. These processors are configured specifically for demanding embedded applications traditionally served by custom silicon designs. We believe these processors also offer our customers the ability to leverage the AMD64 infrastructure. In addition, a distinguishing characteristic of our AMD64-based embedded processors is our AMD64 Longevity Program. The AMD64 Longevity Program offers a select set of AMD64

processors with an extended standard availability period of five years. The extended availability period addresses the requirements of customers designing products for network, storage, blade and

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telecommunications servers; digital imaging; and military and industrial controls systems. Such markets have lengthy design and qualification cycles and longer life spans in the marketplace than typical mainstream computing products.

Prior to July 2006, we also provided MIPS® architecture-based Alchemy embedded processors. In July 2006 we sold the Alchemy family of products to Raza Microelectronics, Inc.

Our embedded processor products, from AMD Opteron to AMD Geode, exemplify our x86 Everywhere microprocessor strategy, which is our goal for utilizing the x86 instruction set architecture to power a wide variety of devices in diverse places such as the home, office or car, in the supply chain, in storage networks, in the data center, and/or in global communications networks. We believe that when a greater number of devices are standardized with an x86-based platform, end-users can benefit from the ability to run their existing x86-based software on devices that interoperate with each other. This can accelerate and simplify the process of enabling faster, easier connectivity and data sharing between a wide range of products, from portable consumer electronics to PCs and servers. With our full range of embedded microprocessors, we are able to extend our x86-based product offerings to serve markets from embedded appliances to embedded server-class products.

Graphics and Chipset Products

Graphics and Chipset Market

The semiconductor graphics market addresses the need for visual processing in various computing and entertainment platforms such as desktop and notebook PCs, workstations and game consoles. The strength of the semiconductor graphics market is heavily dependent upon the market for PCs. Visual realism and graphical display capabilities are key elements of product differentiation among various product platforms. PC users value a rich visual experience, particularly in the high-end enthusiast market where consumers seek out the fastest and highest performing visual processing products to deliver the most compelling and immersive gaming experiences. Moreover, for some consumers, the PC market is evolving from a traditional data and communications processing machine to an entertainment platform. This has led to the increasing creation and use of processing intensive multimedia content for PCs and PC manufacturers creating more PCs designed for playing games, displaying photos and capturing TV and other multimedia content. In turn, the trend has contributed to the development of higher performance graphics solutions. For example, we believe that the enhanced 3D graphics capabilities enabled by Microsoft® Windows Vista and the increasing availability of media center PCs will spur development of advanced graphics applications intended for mainstream users, which will contribute to increased demand for graphics and chipset products.

The primary product of a semiconductor graphics supplier is the graphics processing unit, or GPU, a semiconductor chip that increases the speed and complexity of images that can be displayed on a graphical interface and improves image resolution and color definition. The GPU off-loads the burden of graphics processing from the CPU. In this way, a dedicated graphics processor and CPU work in tandem to increase overall speed and performance of the system. A graphics solution can be in the form of either a stand-alone graphics chip or an integrated chipset solution. Recently, to further improve graphics processing performance, semiconductor graphics suppliers have introduced multi-GPU technologies which increase graphics processing speed by dividing graphics rendering and display among two or more graphics processors.

Graphics and Chipset Products

We provide our graphics solution for both desktop and notebook PCs by adding either one or more discrete graphics processors, which are stand-alone graphics chips, or by integrating the graphics hardware into the motherboard chipset. Discrete graphics chips tend to provide higher levels of performance and speed, while integrated chipsets generally offer a lower cost solution, improved power consumption and smaller form factors. The demand for integrated graphics solutions has grown in recent years as the performance of integrated chipsets has advanced. Also, customers of graphics products such as original equipment manufacturers, or OEMs, and PC system integrators, or SIs, who are continually pressured to meet lower price and power consumption targets

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while still maintaining reasonable profit margins, are increasingly using integrated chipsets over discrete graphics chips in their products because of the lower cost of integrated graphics solutions.

Our customers generally use our graphics and chipset products to increase the speed of rendering images and to improve image resolution and color attributes. Our products include 3D graphics, video and multimedia products and chipsets developed for use in desktop and notebook PCs, including home media PCs, professional workstations and servers. With each of our graphics products, we provide drivers and supporting software packages that enable the effective use of these products under a variety of operating systems and applications. Our latest generation of graphics, chipset and related software offer full support for the Microsoft® Windows Vista operating system. In addition to the Microsoft® Windows® family of operating systems, our graphics products support Apple s Mac OS X as well as Linux®-based applications.

Discrete Desktop Products. Our discrete GPUs for desktop PCs include our ATI Radeon X1000 family of products which we introduced in October 2005. From our current enthusiast level product, the ATI Radeon X1950 to the value-based ATI Radeon X1300, this product family includes offerings that incorporate features and price-performance characteristics for the enthusiast, performance, mainstream and value categories of the desktop PC market. These products support our CrossFire dual-GPU technology, first introduced in May 2005. Crossfire technology increases graphics processing power and speed by combining two GPUs in the same PC platform. The ATI Radeon X1000 family of products incorporates our proprietary ATI Avivo platform technology. ATI Avivo technology is a video and display platform that enables high-definition (HD) video playback and display.

Although an increasing percentage of desktop PCs rely on integrated chipsets for graphics, we believe that discrete graphic solutions will continue to offer higher performance and be the preferred solution for several types of desktop PC configurations, such as platforms designed for gaming enthusiasts, CAD professionals and animation as well as for applications such as multimedia, photo and video editing, and other graphic-intensive applications.

Discrete Notebook Products. Our discrete GPUs for the notebook PC market include our ATI Mobility Radeon X1000 series of products which we introduced in December 2005. When selecting a graphics solution, the key considerations for notebook PC manufacturers are visual performance, power consumption, form factor and cost. We designed our products to provide the mix of performance, features and flexibility desired by the major categories of the notebook PC market, including the thin and light, performance, desktop replacement and value categories.

Our high-end ATI Mobility Radeon X1900 products deliver 3D graphics performance and video playback quality and vibrant image quality for performance notebook PCs. An ultra-threaded 3D architecture with advanced power management provides high-definition video and display enhancements. At the value end, we offer the ATI Mobility Radeon X1300 with features such as enhanced 3D gaming, high-quality video playback and longer battery life for price-conscious consumers.

Chipset Products. Our integrated chipset solutions, also known as core logic on the motherboard, include our Radeon Xpress and Crossfire families. We target our Radeon Xpress series chipsets to motherboard manufacturers and offer a high degree of performance, stability and connectivity for mainstream and commercial desktop and notebook PCs. Radeon Xpress chipsets contain integrated graphics while our Crossfire chipsets are discrete chipsets without integrated graphics and are intended to be used in systems targeting the higher end markets, such as gaming, that use multiple add-in graphics boards. Our chipset solutions include products that are compatible with Intel platforms. We expect to continue to ship existing chipsets for Intel CPUs throughout 2007 and beyond to the extent there is demand for these products. However, we expect that sales of these products will continue to decline and will eventually cease.

Home Media PC Products. Our home media PC products incorporate a wide variety of features for consumers that intend to use their PCs for multimedia applications. For example, our family of TV Wonder

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products allows consumers to watch and record TV on their PC, listen to FM radio stations and watch DVD movies. Our latest generation of these products also incorporates our ATI Avivo technology which enables PCs to record and playback in HD.

Workstation and Server Products. Our products for the professional workstation market consist of our FireGL and FireMV product families. We designed our FireGL products for demanding 3D applications such as computer-aided design, while we designed our FireMV multi-view 2D workstation cards for financial and corporate environments. We also provide products for the server market, where we leverage our graphics expertise and align our offerings to provide stability, video quality and bus architectures that our server customers desire.

Consumer Electronics Products

Consumer Electronics Market

The semiconductor market for video, graphics and media processors in consumer electronics products addresses the need for enhancing the visual experience provided by devices such as mobile phones, digital TVs and game consoles. Consumers value entertainment and communications products that can deliver an engaging multimedia experience. Accordingly, semiconductor suppliers of video, graphics and media processors strive to deliver products that improve visual realism and allow manufacturers of mobile phones, digital TVs and game consoles the opportunity to differentiate their products.

Handheld Market. In recent years, mobile phones have transitioned towards color displays with higher resolutions that deliver a variety of multimedia features. Manufacturers are offering functionality such as built-in digital cameras and camcorders, MP3 audio playback, video playback, mobile-TV reception and 3D gaming in an increasing percentage of mobile phones, thereby increasing the opportunity to supply media processors to mobile phone manufacturers.

Digital TV Market. The market for digital TVs is growing, driven in part by the transition of terrestrial broadcast television transmissions from analog to digital in many different regions throughout the world. For example, on February 18, 2009, full power television stations in the United States will stop analog broadcasting and transition to digital broadcasting. This conversion is supported by a U.S. Federal Communications Commission mandate that requires electronics manufacturers to include digital tuners in all new television sets by March 2007.

There is also a worldwide shift in the television industry from analog cathode ray tube, or CRT, displays to digital flat panel displays such as LCD and plasma. These flat panel displays are able to support larger screen sizes and higher resolutions. Producing the highest quality images on these advanced televisions is fundamental to television manufacturers. Semiconductor graphics solutions play an integral role in improving video image quality to enhance the user viewing experience.

Game Consoles. Semiconductor graphics suppliers have leveraged their core visual and graphics processing technologies developed for the PC market by providing solutions to game console manufacturers. In this market, semiconductor graphics suppliers work alongside game console manufacturers to enhance the visual experience for users of sophisticated video games.

Consumer Electronics Products

We continue to leverage our core technology, visual processing expertise and power management know-how to meet the needs of certain consumer electronics markets. We have initially targeted three categories of the consumer electronics market: (i) handheld devices, including mobile phones; (ii) digital TVs; and (iii) game consoles.

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Our products for consumer electronics devices include media processors used in handheld devices such as mobile phones and video processors used in digital TVs. We also receive royalties from game console manufacturers in connection with sales of systems that incorporate our graphics intellectual property and designs. With each of these products we provide drivers and supporting software that enable the effective use of these products by our customers.

Handheld Devices. The latest generation of handheld devices, particularly mobile phones, are driving demand for more advanced multimedia processors. Higher resolution displays, higher performing embedded processors, increased internal and removable storage, mobile email and PDA-like features as well as multimedia functionality such as built-in digital cameras, MP3 audio playback, video playback, mobile TV and 3D gaming are all contributing to rapid changes in handheld and mobile communication devices.

Our AMD Imageon product line provides visual processing, high quality audio and power saving technologies. We offer products for each category of the mobile phone media processor market: entry level, feature phones, performance phones and fully loaded multimedia and gaming phones. The AMD Imageon video engine enables a mobile digital camcorder/player and supports advanced features such as video-telephony and video-streaming. We also provide AMD Imageon products that include a programmable audio engine that enables features such as positional 3D sound, CD-quality ring-tones and music phones with high-quality stereo recording and playback.

Digital TVs. As television broadcasters in North America and other parts of the world transition their analog television signals to digital transmissions, we believe increased consumer interest in digital TV will spur demand for more advanced systems. Digital transmission standards provide significant advantages compared to analog standards, including greater picture clarity and resolution as well as opportunities for more channels, e-commerce and enhanced TV viewing.

We offer two groups of products that target two major silicon blocks inside an integrated digital TV: the digital video receiver and the decoder. An integrated digital TV is one where a digital receiver and digital video decoder are integrated inside the TV rather than externally, such as via a set top box. Our AMD Xilleon and Theater product lines are used in integrated digital TVs to demodulate and decode digital broadcast signals. AMD Xilleon products also provide video, graphics and audio processing. The drivers and supporting software that we provide with our digital TV products allow deployment in multiple worldwide markets with either customer designed applications or AMD supplied Customer Application Ready Design (CARD) software applications.

In September 2006, we announced the AMD Xilleon® 260, an SoC product that supports full high-definition for worldwide digital TV standards including Europe, Japan, Korea and North America. The AMD Xilleon 260 includes a powerful video pipeline for both standard-definition and HD content. Advanced features which enhance image quality include HD de-interlacing, a 3D comb filter, dynamic contrast, noise reduction, sharpness, and color control.

Game Consoles. We also leverage our core visual processing technology into the game console market. Our customized GPUs process the graphics in the Microsoft® Xbox 360, Nintendo Wii and Nintendo GameCube videogame consoles.

Marketing and Sales

We sell our products through our direct sales force and through independent sales representatives in both domestic and international markets pursuant to non-exclusive agreements. Our sales arrangements generally operate on the basis of product forecasts provided by the particular

customer, but do not typically include any commitment or requirement for minimum product purchases. We primarily use binding purchase orders, sales order acknowledgments, and contractual agreements as evidence of our sales arrangements. Our agreements typically contain standard terms and conditions covering matters such as payment terms, warranties and indemnities for issues specific to our products.

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We generally warrant that microprocessor products sold to our customers will, at the time of shipment, be free from defects in workmanship and materials and conform to our approved specifications. Subject to certain exceptions, we offer 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. We have offered extended limited warranties to certain customers of tray microprocessor products who have written agreements with us and target their computer systems at the commercial and/or embedded markets.

We generally warrant that graphics, chipsets, and certain products for consumer electronics devices will be free from defects in material and workmanship under normal use and service for a period of one year, beginning on the date first sold to an end user but not later than 90 days after shipment of such products to our customers. We generally warrant that ATI-branded PC workstation products will be free from defects in material and workmanship under normal use and service for a period of three years, beginning on the date first sold to an end user but not later than 90 days after shipment of such products to our customers. Generally, our microprocessor and embedded processor customers may cancel orders 30 days prior to shipment without incurring a penalty. Under our standard terms and conditions, graphics and chipset customers may cancel orders by providing 30 days prior written notice to us without incurring a penalty, while certain customers of products for consumer electronic devices may cancel orders by providing 90 days prior advance notice to us without incurring a penalty.

We market and sell our microprocessor and embedded processor products under the AMD trademark. Our product brands for microprocessors consist primarily of AMD Athlon 64, AMD Athlon 64 FX and AMD Sempron processor brands for desktop PCs, the AMD Opteron processor brand for servers and workstations, the AMD Turion 64 mobile technology and AMD Sempron processor brands for notebook PCs. We also have the AMD LIVE! brand through which we promote our entertainment platform solutions for desktop and notebook PCs as well as film, broadcast and music professional artists that use AMD64 technology. Our product brands for our embedded processors consist of AMD Geode processors. We also sell low-power versions of our AMD Athlon, AMD Turion, AMD Sempron and AMD Opteron processors as embedded processor solutions.

With respect to our graphics and chipset products, we intend to continue to market and sell GPUs and graphics chipsets for the Intel platform under the ATI trademark. We market and sell other chipset products and our products for consumer electronics devices under the AMD trademark.

We market our products through our direct marketing and co-marketing programs. Our direct marketing activities include print and Web-based advertising as well as consumer and trade events and other industry and consumer communications. We also sponsor teams such as the Discovery Channel Pro Cycling Team and the Scuderia Ferrari. We work with these groups to determine their technology needs and how our AMD64 technology can help support those needs. The goal of these sponsorships is to increase awareness of our brand and AMD64 technology.

In addition, we have cooperative advertising and marketing programs with customers or third parties, including market development programs, pursuant to which we may provide product information, training, marketing materials and funds. Under our marketing development programs, eligible customers can use market development funds as partial reimbursement for advertisements and marketing programs related to our products, subject to meeting defined criteria. Customers may qualify for market development funds based on purchases of eligible products.

Customers

Our microprocessor customers consist primarily of OEMs, original design manufacturers, or ODMs, and third-party distributors in both domestic and international markets. ODMs provide design and/or manufacturing services to branded and unbranded private label resellers.

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Customers of our graphics and chipset products consist primarily of: PC OEMs, often through ODMs or other contract manufacturers who build GPUs into their PC motherboard and graphics board products, add-in-board, or AIB, manufacturers who incorporate GPUs into their graphics board products, SIs, who build GPUs into their PC products, third party distributors, retail stores and e-commerce retailers.

Customers of our products for consumer electronic devices consist primarily of OEMs and ODMs.

Our sales and marketing teams work closely with our customers to define product features, performance and timing of new products so that the products we are developing meet the needs of our customers. We also employ application engineers to assist our customers in designing, testing and qualifying system designs that incorporate our products in order to assist in optimizing product compatibility. We believe that our commitment to customer service and design support improves our customers time-to-market and fosters relationships that encourage customers to use the next generation of our products.

Original Equipment Manufacturers

We focus on three types of OEMs: multi-nationals, selected regional accounts and target market customers. Large multi-nationals and regional accounts are our core OEM customers. Our OEM customers include numerous foreign and domestic manufacturers of servers and workstations, desktop and notebook PCs, PC motherboards and consumer electronics products such as mobile phones and digital TVs. Under our standard terms and conditions, OEMs do not have a right to return our products other than pursuant to the standard limited warranty. However, from time to time we may agree to repurchase a portion of some categories of products pursuant to negotiated terms.

In 2006, Hewlett-Packard Company accounted for greater than 10 percent of our consolidated net revenues. Sales to Hewlett-Packard consisted primarily of products from our Computation Products segment. In addition, one handset manufacturer accounted for more than half of the revenue attributable to our Consumer Electronics segment and one game console provider accounted for a significant portion of revenue attributable to our Consumer Electronics segment. Moreover, two customers accounted for approximately one third of the revenue attributable to our Graphics and Chipsets segment. A loss of any of these customers could have a material adverse effect on our business.

Third-Party Distributors

Our authorized distributors resell to sub-distributors and mid-sized and smaller OEMs and ODMs. Typically, distributors handle a wide variety of products, including those that compete with our products. Distributors typically maintain an inventory of our products. In most instances, our agreements with distributors protect their inventory of our products against price reductions and provide return rights with respect to any product that we have removed from our price book and that is not more than twelve months older than the manufacturing code date. In addition, some agreements with our distributors may contain standard stock rotation provisions permitting limited levels of product returns.

In 2006, Avnet, Inc. and its subsidiaries and affiliated companies accounted for approximately 10 percent of our consolidated net revenue. Avnet is a distributor of our products and sales to Avnet consisted primarily of products, from our Computation Products segment.

AIB Manufacturers and System Integrators

We strive to establish and broaden our relationships with AIB manufacturers. We offer component-level graphics and chipset products to AIB manufacturers who in turn build and sell board-level products using our technology to SIs and at retail. We also work directly with our SI customers. SIs typically sell from positions of regional or product-based strength in the market. They usually operate on short design cycles and can respond quickly with new technologies. SIs often use discrete graphics solutions as a means to differentiate their products and add value to their customers.

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Competition

Generally, the IC industry is intensely competitive. Products typically compete on product quality, power consumption, reliability, speed, size (or form factor), cost, selling price, adherence to industry standards, software and hardware compatibility and stability, brand recognition, timely product introductions and availability. Technological advances in the industry result in frequent product introductions, regular price reductions, short product life cycles and increased product capabilities that may result in significant performance improvements. Our ability to compete depends on our ability to develop, introduce and sell new products or enhanced versions of existing products on a timely basis and at competitive prices, while reducing our manufacturing costs.

Competition in the Microprocessor Market

Intel Corporation has dominated the market for microprocessors for many years. Intel s market power and 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 have in the past and are likely in the future to 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 rebating, and allocation strategies and pricing actions, designed to limit our 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 software companies as well as the graphics interface for Intel platforms; and
- marketing and advertising expenditures in support of positioning the Intel brand over the brand of its OEM customers.

Intel exerts substantial influence over computer manufacturers and their channels of distribution through various brand and marketing programs. Because of its dominant position in the microprocessor market, Intel has been able to control x86 microprocessor and computer system standards and to 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. We expect intense competition from Intel to continue.

Competition in the Embedded Processor Market

With respect to our embedded processors for personal connectivity devices, our principal competitors are Freescale Semiconductor Inc., Hitachi, Ltd., Intel Corporation, NEC Corporation, Toshiba Corporation and Via Technologies, Inc. We expect competition in the market for these devices to increase as our principal competitors focus more resources on developing low-power embedded processor solutions.

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Competition in the Graphics and Chipset Market

In the graphics and chipset market, our competitors include discrete graphics suppliers and suppliers of integrated graphics chipsets. A recent trend in the graphics processing market is that PC manufacturers are increasingly choosing to use integrated chipsets, particularly for notebook computers, over discrete GPUs because integrated chipsets cost significantly less than discrete GPUs while offering acceptable graphics performance for most mainstream PC users. Intel manufactures and sells integrated graphics chipsets bundled with their microprocessors and is a dominant competitor in this market. It is possible that Intel could leverage its dominance in the microprocessor market to sell its integrated chipsets, which could shrink the total available market for certain of our discrete GPUs, that Intel could re-enter the discrete GPU market, or that Intel will take other actions that place our discrete GPUs and integrated chipsets at a competitive disadvantage such as designing a proprietary graphics interface.

Other than Intel, our principal competitor is Nvidia Corporation, and to a lesser extent, Matrox Electronic Systems Ltd., Silicon Integrated Systems Corp. and Via Technologies, Inc. Other competitors include a number of smaller companies which may have greater flexibility to address specific market needs. However, we believe that the growing complexity of visual processors and the associated research and development costs represent an increasingly high barrier to entry in this market.

Competition in the Consumer Electronics Market

In the semiconductor market for consumer electronics products we have different competitors in each of our product categories. With respect to our products for handheld devices, we have three primary categories of competitors: vendors of baseband processors, vendors of applications processors and vendors of media co-processors. The baseband processor provides the basic voice and communication processing functionality in mobile phones. For certain value categories of the market, baseband processor vendors are integrating the multimedia processing required for feature-rich mobile phones. Baseband processor vendors incorporating this basic level of graphics processing include Analog Devices, Inc., Agere Systems Inc., Broadcom Corporation, Freescale Semiconductor Inc., Infineon Technologies AG, Koninklijke Phillips Electronics N.V., Qualcomm Incorporated and Texas Instruments Incorporated. Another category of competitor, application processor vendors, target manufacturer of high-end feature and smart phones whose products require large amounts of general purpose processing capability as well as multimedia processing. These vendors include Freescale Semiconductor Inc., Marvell Technology Group Ltd., Nvidia Corporation, Qualcomm Incorporated, Samsung Electronics Co., Ltd., STMicroelectronics N.V. and Texas Instruments Incorporated. The third category of competitor provides dedicated processors to drive a high level of multimedia functionality. This approach is most comparable to our strategy, and our competitors in this category include Core Logic Incorporated, Epson Corp., MTEK Vision Co. Ltd., Nvidia Corporation and Renesas Technology Corp.

With respect to our products for digital TVs, our primary competitors include Broadcom Corporation, Genesis Microchip Inc., MediaTek Inc., NEC Corporation, NXP Semiconductors, STMicroelectronics N.V., Trident Microsystems Inc. and Zoran Corporation, as well as in-house semiconductor development divisions at companies such as LG Electronics, Inc., Matsushita Electric Industrial Co., Ltd. (a brand of Panasonic Electronic Devices Co., Ltd.), Samsung Electronics Co. Ltd. and Toshiba Corporation.

In the game console category, we compete primarily against Nvidia. Other competitors include Intel and IBM.

Research and Development

We focus our research and development activities on product design and system and manufacturing process development. One main area of focus is on delivering the next generation of microprocessors with improved system performance and performance-per-watt characteristics. We have devoted significant resources to product

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design and to developing and improving manufacturing process technologies and plan to do so in the future. We also work with other industry leaders, public foundations, universities and industry consortia to conduct early stage research and development.

With respect to graphics and chipsets and products for consumer electronics devices, our primary research and development objective is to develop products and technologies that meet the ever-changing demands of the PC and consumer electronics industries on a timely basis so as to meet market windows. We are also focusing on delivering a range of integrated platforms to serve key markets, including commercial clients, mobile computing, and gaming and media computing. We believe that these integrated platforms will bring customers improved system stability, better time-to-market and increased performance and energy efficiency. Longer-term, our research and development efforts are focused on developing monolithic silicon solutions for specialized uses that are comprised of microprocessors, graphics processors and video processors.

Our research and development expenses for 2006, 2005, and 2004 were $1,205 million, $1,144 million and $934 million. Research and development expenses for 2006 included ATI s research and development expenses from October 25, 2006 through December 31, 2006. For more information, see Part II, Item 7, MD&A.

We conduct product and system research and development activities for our microprocessor products in the United States with additional design and development engineering teams located in Germany, Singapore, China, Japan, Penang, Taiwan and India. In August 2006 we announced the opening of a new research and development facility in Shanghai, China. Also, in September 2006 we announced the opening of a new advanced microprocessor development facility in Fort Collins, Colorado.

We conduct our microprocessor manufacturing process development activities primarily through our joint development agreement with IBM. Under this agreement, we jointly develop new process technologies, including 45-nanometer, 32-nanometer, 22-nanometer and certain other advanced technologies, to be implemented on silicon wafers. Our relationship also includes laboratory-based research of emerging technologies such as new transistor, interconnect, lithography and die-to-package connection technologies. We pay fees to IBM for joint development projects. The actual amounts we pay to IBM are dependent upon the number of partners, including us and IBM, engaged in related development projects under the agreement. In addition, we agreed to pay IBM specified royalties upon the occurrence of specified events, including in the event that we sublicense the jointly developed process technologies to specified third parties or if we bump wafers for a third party. For more information on the fees paid or payable to IBM, see Part II, Item 7, Contractual Cash Obligations and Guarantees Unconditional Purchase Commitments, and Part I, Item 1A, Risk Factors We cannot be certain that our substantial investments in research and development will lead to timely improvements in product designs or technology used to manufacture our products or that we will have sufficient resources to invest in the level of research and development that is required to remain competitive.

Under the agreement, our joint development relationship continues through December 31, 2011. However, the continuation of capital purchases by IBM necessary for process development projects under the agreement past December 31, 2008 is conditioned upon the approval of IBM s board of directors. If IBM s board of directors does not approve our agreement by September 30, 2007, either party has the right to terminate the agreement effective December 31, 2008 without liability. In addition, our agreement with IBM may be extended further by the mutual agreement of the parties and can also be terminated immediately by either party if the other party permanently ceases doing business, becomes bankrupt or insolvent, liquidates or undergoes a change of control or can be terminated by either party upon 30 days written notice upon a failure of the other party to perform a material obligation thereunder. Under our agreement, research and development takes place in IBM s Watson Research Center in Yorktown Heights, N.Y., the Center for Semiconductor Research at Albany NanoTech, and at IBM s 300-millimeter manufacturing facility in East Fishkill, N.Y.

We conduct research and development activities for our graphics and chipset products and products for consumer electronics devices at design centers located throughout the world, including in the United States,

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Canada, India, Finland and China. Due to the rapid pace of technological change in the graphics industry, our strategy is to focus on developing the newest generation of products that meet market and customer requirements on a timely basis so as to meet each market window.

Manufacturing, Assembly and Test Facilities

We own and operate five manufacturing facilities, of which two are microprocessor wafer fabrication facilities and three are microprocessor assembly and test facilities. We developed an approach to manufacturing called Automated Precision Manufacturing, or APM. APM comprises a suite of automation, optimization and real-time data analysis technologies which automate the way decisions are made within our fabrication facilities. We use APM during process technology transitions, and believe APM enables greater efficiency, higher baseline yields, better binning and faster yield learning.

Our microprocessor manufacturing is conducted at the facilities described in the chart below. These facilities are the cornerstone of our flexible capacity growth plan, which focuses on bringing the right amount of capacity online at the right time through ongoing, incremental increases in total output.

Facility Location	Wafer Size (diameter in millimeters)	Principal Production Technology (in nanometers)	Approximate Clean Room Square Footage
Dresden, Germany			
Fab 30	200	90	150,000
Fab 36	300	90/65	140,000

During 2006, we manufactured our microprocessor products at Fab 30 and Fab 36 primarily on 90-nanometer process technology. In December 2006, we began manufacturing using 65-nanometer technology at Fab 36. Our goal is to have substantially all of the wafers out of Fab 36 being manufactured on 65-nanometer technology by mid-2007 and to begin manufacturing using 45-nanometer technology in mid-2008.

In May 2006, we announced plans to significantly expand our 300-millimeter manufacturing capacity in Dresden, Germany. The expansion includes the conversion of Fab 30 from manufacturing on 200-millimeter wafers to 300-millimeter wafers, capacity expansion in Fab 36, and the addition of a new facility to support bump and test activities. Bump and test is the final stage of the manufacturing process in which wafers are prepared for assembly and test.

We anticipate that after being converted to a 300-millimeters facility, Fab 30 will be able to handle approximately up to 20,000 300-millimeter wafer starts per month. We intend to begin to decrease 200-millimeter production at Fab 30 in mid 2007, and to bring up 300-millimeter production in early 2008. Use of 300-millimeter wafers can contribute to decreasing manufacturing costs per unit and helps increase capacity by yielding significantly more chips per wafer than 200-millimeter wafers. Use of smaller process geometries allows us to put more transistors on an equivalent size chip, which can result in products that are higher performing, use less power and/or cost less to manufacture.

Another facet of our flexible capacity growth strategy involves working with third-party foundries, and to this end, we have sourcing and manufacturing technology agreements with Chartered Semiconductor Manufacturing pursuant to which Chartered is an additional manufacturing source for our AMD64-based microprocessors. In June 2006, we began our first revenue shipments of microprocessors manufactured at

Chartered. We also have foundry arrangements with third parties for the production of our embedded processors, graphics and chipset products and products for consumer electronics devices.

In anticipation of the potential need for increased manufacturing capacity over the longer term, on December 22, 2006, we entered into a Grant Disbursement Agreement with the New York State Urban

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Development Corporation d/b/a Empire State Development Corporation, or ESDC, in connection with a potential new 300-millimeter wafer fabrication facility on the Luther Forest Technology Campus in Saratoga County, New York. Under the agreement, AMD would be able to construct a new facility designed to produce 300-millimeter wafers using 32-nanometer process technology between July 2007 and July 2009. However, we are not obligated to commence construction, and our decision regarding proceeding with the construction is dependent on business conditions and market demand. Should we choose to build the facility, the State of New York is required to issue bonds or otherwise fund the project and related research and development in the amount of $650 million. Actual disbursement of funds occurs as we submit appropriate documentation verifying that expenditures on the project have been incurred. If we move forward with the project, we must complete the construction of the facility in accordance with the final plans and specifications approved in writing by ESDC and must maintain business operations on the Luther Forest Technology Campus for a minimum of seven years after the date full employment at the facility is first achieved. Funds disbursed to us may be subject to repayment, in whole or part, if we do not attain and or maintain certain levels of employment for specified periods of time.

Our current microprocessor assembly and test facilities are described in the chart set forth below:

Facility Location	Approximate Manufacturing Area Square Footage	Activity
Penang, Malaysia	206,000	Assembly
Singapore	194,000	Test, Mark & Packaging
Suzhou, China	44,310	Test, Mark & Packaging

Some assembly and final testing of our microprocessor and embedded processor products is performed by subcontractors in the United States and Asia.

With respect to our graphics and chipset products and products for consumer electronics devices, we have strategic relationships with three semiconductor foundries, Taiwan Semiconductor Manufacturing Company, United Microelectronics Corp. and Chartered. Currently, we are in volume production in TSMC s and UMC s 300-millimeter fabrication facilities. As of December 31, 2006, our graphics and chipset products and products for consumer electronics devices were manufactured on 80-, 90-, 110-, 130-, 150 or 180-nanometer process technologies at third party foundries. Smaller process geometries can lead to gains in graphics processing performance, lower power consumption and lower per unit manufacturing costs. We intend to transition to 65-nanometer process technology for some of these products in 2007.

From the foundry, wafers for our graphics products are delivered to our test, assembly and packaging partners including Advanced Semiconductor Engineering Group, Amkor, King Yuan Electronics, Siliconware Precision Industries and STATS-Chippac, who package and test the final application-specific integrated circuit.

We outsource board-level graphics product manufacturing to third-party manufacturers. These include Celestica, Fairway and PC Partner with locations in China. Our facility in Markham, Ontario, Canada is primarily devoted to prototyping and trial runs for new graphics product introductions.

Raw Materials

Our manufacturing processes require many raw materials, such as silicon wafers, IC packages, mold compound, substrates and various chemicals and gases, and the necessary equipment for manufacturing. We obtain these materials and equipment from a large number of suppliers located throughout the world. Certain raw materials we use in manufacturing our microprocessor products or that are used in the manufacture of our graphics products are available only from a limited number of suppliers. Interruption of supply or increased demand in the industry could cause shortages and price increases in various essential materials.

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Intellectual Property and Licensing

We rely on contracts and intellectual property rights to protect our products and technologies from unauthorized third-party copying and use. Intellectual property rights include copyrights, patents, patent applications, trademarks, trade secrets and maskwork rights. As of December 31, 2006, we had more than 6,000 patents in the United States and over 1,600 patent applications pending in the United States, including more than 600 patents in the United States and 400 patent applications in the United States that we acquired from ATI. In certain cases, we have filed corresponding applications in foreign jurisdictions. We expect to file future patent applications in both the United States and abroad on significant inventions, as we deem appropriate. We do not believe that any individual patent, or the expiration thereof, is or would be material to our business.

In connection with the formation of Spansion LLC as of June 2003 and the closing of Spansion s initial public offering, or IPO, in December 2005, we and Fujitsu transferred to Spansion various intellectual property rights pursuant to an Intellectual Property Contribution and Ancillary Matters Agreement, or IPCAAMA. Under the IPCAAMA, Spansion became the owner or joint owner with each of us and Fujitsu, of specified patents, patent applications, trademarks and other intellectual property rights and technology. The patents that we transferred included patents and patent applications covering Flash memory products and technology, the processes necessary to manufacture Flash memory products, and the operation and control of Flash memory products. We reserved rights, on a royalty free basis, to practice the contributed patents and to license these patents to our affiliates and successors-in-interest. We also have the right to use the jointly-owned intellectual property for our internal purposes and to license such intellectual property to others to the extent consistent with our non-competition obligations to Spansion.

In addition, for as long as our ownership interest in Spansion remains above 12.5 percent, Spansion is required to identify its technology to us and to provide copies of, and training with respect to, that technology. Spansion also granted a non-exclusive, perpetual, irrevocable, fully paid and royalty-free license of its rights in this technology to us. We may grant licenses under Spansion s patents, provided that these licenses are of no broader scope than, and are subject to the same terms and conditions that apply to, any license of our patents granted in connection with such license, and the recipient of such license grants to Spansion a license of similar scope under its patents.

We also have a patent cross-license agreement with Fujitsu whereby each party was granted a non-exclusive license under certain of the other party s respective semiconductor-related patents. This patent cross-license agreement terminates on June 30, 2013, unless earlier terminated upon 30 days notice following a change of control of the other party. We also have a patent cross-license agreement with Spansion. The patents and patent applications that are licensed are those with an effective filing date prior to the termination of the patent cross-license agreement. The agreement will automatically terminate on the later of June 30, 2013 and the date we sell our entire equity interest in Spansion. The agreements may be terminated by a party on a change in control of the other party or its semiconductor group.

In addition, as is typical in the semiconductor industry, we have numerous cross-licensing and technology exchange agreements with other companies under which we both transfer and receive technology and intellectual property rights. One such agreement is the patent cross-license agreement with Intel which was effective as of January 1, 2001. Under this agreement we granted each other a non-exclusive license under each party s patents for the manufacture and sale of semiconductor products worldwide. We pay Intel a royalty for certain licensed microprocessor products sold by us or any AMD affiliate anywhere in the world. The license applies to each party s patents that have a first effective filing date during the capture period, which is the period from January 1, 2001 through January 1, 2010. Either party may terminate the agreement if the other party commits a material breach of the agreement and does not correct the breach within 60 days after receiving written notice thereof. In addition, either party may terminate the agreement upon 60 days written notice in the event of a filing by the other party of a petition in bankruptcy or insolvency, or any adjudication thereof, the filing of any petition seeking reorganization under any law relating to bankruptcy, the appointment of a receiver, the making of any

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assignment for the benefit of creditors, the institution of any proceedings for the liquidation or winding up of the other party s business, or in the event of a change of control. For purposes of our agreement with Intel, change of control means a transaction or a series of related transactions in which (i) one or more related parties who did not previously own at least a 50 percent interest in a party obtain at least a 50 percent interest in such party, and, in the reasonable business judgment of the other party, such change in ownership will have a material effect on the other party s business, or (ii) a party acquires, by merger, acquisition of assets or otherwise, all or any portion of another legal entity such that either the assets or market value of such party after the close of such transaction are greater than one and one third of the assets or market value of such party prior to such transaction.

Backlog

We manufacture and sell standard lines of products. Consequently, a significant portion of our sales are made from inventory on a current basis. Sales are made primarily pursuant to purchase orders for current delivery or agreements covering purchases over a period of time. These orders or agreements may be revised or canceled without penalty. Generally, in light of current industry practice and experience and the fact that substantially our entire order backlog is cancelable, we do not believe that such agreements provide meaningful backlog figures or are necessarily indicative of actual sales for any succeeding period.

Employees

As of December 31, 2006, we had approximately 16,500 employees.

Environmental Regulations

Many aspects of our business operations and products are regulated by domestic and international environmental laws and regulations. These regulations include limitations on discharge of pollutants to air, water, and soil; remediation requirements; product chemical content limitations; manufacturing chemical use and handling restrictions; pollution control requirements; waste minimization considerations; and requirements with respect to treatment, transport, storage and disposal of solid and hazardous wastes. If we fail to comply with any of the applicable environmental regulations we may be subject to fines, suspension of production, alteration of our manufacturing processes, import/export restrictions, sales limitations, and/or criminal and civil liabilities. Existing or future regulations could require us to procure expensive pollution abatement or remediation equipment; to modify product designs; or to incur other expenses to comply with environmental regulations. Any failure to adequately control the use, disposal or storage, or discharge of hazardous substances could expose us to future liabilities that could have a material adverse effect on our business. We believe we are in material compliance with applicable environmental requirements and do not expect those requirements to result in material expenditures in the foreseeable future.

Environmental laws are complex, change frequently and have tended to become more stringent over time. For example, the European Union and China are two among a growing number of jurisdictions that have enacted in recent years restrictions on the use of lead, among other chemicals, in electronic products. These regulations affect 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.

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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 for many years. 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 have in the past and are likely in the future to result in lower unit sales and average selling prices for our products and adversely affect our margins and profitability.

Intel also manufactures and sells integrated graphics chipsets bundled with their microprocessors and is a dominant competitor with respect to this portion of our new semiconductor graphics business that we have added through the acquisition of ATI. It is possible that Intel could leverage its dominance in the microprocessor market to sell its integrated chipsets, which could shrink the total available market for certain of our discrete GPUs, that Intel could re-enter the discrete GPU market, or that Intel will take other actions that place our discrete GPUs and integrated chipsets at a competitive disadvantage such as designing a proprietary graphics interface. Moreover, computer manufacturers are increasingly using integrated graphics chipsets, particularly for notebooks, because they cost significantly less than traditional discrete graphics components while offering reasonably good graphics performance for most mainstream PCs. The success of our graphics business is dependent, in part, upon the success of our integrated chipset products. If our graphics products do not successfully address the discrete GPU and integrated chipset markets, our graphics business could be adversely affected.

As long as Intel remains in this dominant position, we may be materially adversely affected by Intel s:

- business practices, including rebating and allocation strategies and pricing actions, designed to limit our 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 software companies as well as the graphics interface for Intel platforms; and
- marketing and advertising expenditures in support of positioning the Intel brand over the brand of its OEM customers.

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 to 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 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 a large portion of its processors using 65-nanometer technology whereas we only began commercial shipments of processors

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manufactured using 65-nanometer technology in the fourth quarter of 2006. To the extent Intel manufactures a significantly larger portion of its microprocessor products using smaller process technologies, 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 and integrated graphics chipset 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 may not realize all of the anticipated benefits of our acquisition of ATI.

The success of our recent acquisition of ATI depends, in part, on our ability to realize the anticipated synergies, cost savings and growth opportunities from integrating the businesses of ATI with the businesses of AMD, and failure to realize these anticipated benefits could cause our business to be materially adversely affected. Our success in realizing these benefits and the timing of this realization depends upon our successful integration of ATI s operations. The integration of two independent companies is a complex, costly, and time-consuming process. The difficulties of combining the operations of the companies include, among others:

- retaining key employees;
- bridging possible differences in cultures and management philosophies;
- consolidating corporate and administrative infrastructures and systems;
- coordinating sales and marketing functions;
- preserving our and ATI s customer, supplier, ecosystem partner and other important relationships;
- aligning and executing on new products roadmaps;
- minimizing the diversion of management s attention from ongoing business concerns; and
- coordinating geographically separate organizations.

We cannot assure you that our integration of ATI will result in the realization of the full benefits that we anticipate will result from the acquisition. For example, it is possible that as a result of the acquisition, previous ATI customers of discrete GPUs may decide to purchase products that can be used with Intel platforms from one of our competitors or that ecosystem partners will be wary of continuing to do business with us because they view the former ATI operations as competitive with portions of their business. Any inability to integrate successfully, or a delay in integrating, ATI could have a material adverse effect on us.

We cannot be certain that our substantial investments in research and development will lead to timely improvements in product designs or technology used to manufacture 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. We also make substantial investments in research and development related to product design and anticipate that we will continue to do so in the future. For example, we recently opened a research and development facility in Shanghai and an advanced microprocessor development facility in Fort Collins, Colorado. Similarly, in connection with the recent acquisition of ATI, we plan to continue to invest in research and development related to our graphics and chipset products and products for consumer electronics devices, including new integrated platforms and our design initiative called Fusion. Moreover, in connection with the acquisition, we committed to the Minister of Industry of Canada to increase total expenditures on research and development in Canada when compared to

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ATI s expenditures in this area in prior years. However, we cannot assure you that we will have sufficient resources to achieve planned investments in research and development or to otherwise maintain the level of investment in research and development that is required for us to remain competitive.

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. We anticipate that under this agreement, we will pay fees to IBM of between $473 million and $523 million in connection with joint development projects from 2007 to 2011.

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. 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 using advanced process technologies.

The success of our business is dependent upon our ability to introduce products on a timely basis with required features and performance levels that provide value to our customers and support and coincide with significant industry transitions.

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, such as what occurred with the multiple delays in the launch of our R600 GPU for the high-end category of the PC market, we may lose credibility and our competitors may be able to take advantage of these delays by launching higher performing products before we do, which could cause us to lose market share and force us to discount the selling price of our products. Delays in developing or qualifying new products can also cause us to miss our customers product design windows.

Market demand requires that products incorporate new features and performance standards on an industry-wide basis. Over the life of a specific product, the average selling price undergoes regular price reductions. The introduction of new products and enhancements to existing products is necessary to maintain overall corporate average selling prices. If we are unable to introduce new products such as quad-core processors or launch new products with sufficient increases in average selling price or increased unit sales volumes capable of offsetting these reductions in average selling prices of existing products, our revenues, inventories, gross margins and operating results could be adversely affected.

Our ability to design and introduce new graphics products in a timely manner is dependent upon third party intellectual property.

In the design and development of new graphics products and graphics product enhancements, we rely on third-party intellectual property such as software development tools. Historically, ATI has experienced delays in the introduction of products as a result of the inability of then available software development tools to fully simulate the complex features and functionalities of its products. The design requirements necessary to meet consumer demands for more features and greater functionality from graphics products in the future may exceed the capabilities of the software development tools available to us. If the third-party intellectual property that we use becomes unavailable or fails to produce designs that meet consumer demands, our business could be materially adversely affected.

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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:

- substantial declines in average selling prices;
- the cyclical nature of supply/demand imbalances in the semiconductor industry;
- a decline in demand for end-user products (such as PCs) that incorporate our products;
- excess inventory levels in the channels of distribution, including those of our customers; and
- excess production capacity.

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 microprocessor 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 products may not grow and may even decrease. If demand for computers is below our expectations, we could be materially adversely affected**.**

The business we acquired from ATI is also dependent upon the market for mobile and desktop PCs, the consumer electronics market and, in particular, the markets for digital TVs, handheld devices, such as multimedia-enabled mobile phones, and game consoles. A market decline in any of these industries would have a material adverse effect on our results of operations.

The growth of our business is also dependent on continued demand for our products from high-growth global markets. In 2006, sales of our products to high-growth markets such as China increased significantly compared to 2005, 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.

The markets in which our products are sold are highly competitive.

The markets in which our products are sold are very competitive and delivering the latest and best products to market on a timely basis is critical to achieving revenue growth. We expect competition to intensify due to rapid technological changes, frequent product introductions and aggressive pricing by competitors. We believe that the main factors that determine our competitiveness are product quality, power consumption, reliability, speed, size (or form factor), cost, selling price, adherence to industry standards, software and hardware compatibility and stability, brand recognition, timely product introductions 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 expect that competition will intensify in these markets and our competitors products may be less costly, provide better performance or

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include additional features that render our products uncompetitive. With respect to our graphics products in particular, some competitors may have greater access or rights to companion technologies, including interface, processor and memory technical information. In addition, as a result of the ATI acquisition, Intel may discriminate against us and put us as a competitive disadvantage by giving our competitors in the graphics market preferential access to interface or other useful information. Generally, we may not be able to compete effectively because of Intel s market dominance and business practices designed to maintain it.

We depend on third-party companies for the design, manufacture and supply of motherboards, BIOS software and other components.

We depend on third-party companies for the design, manufacture and supply of motherboards, BIOS software and other components that support our microprocessor offerings. In addition, despite our recent acquisition of ATI, we continue to work with other third parties for graphics chips in order to provide our customers with a greater choice of technologies to best meet their needs.

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 designers and manufacturers of motherboards and chipsets, our business would be materially adversely affected. Our recent acquisition of ATI could exacerbate this problem because we plan to design and supply a significantly greater amount of graphics products ourselves. Doing so could cause third-party designers, manufacturers and suppliers to be less willing to do business with us or to support our products out of a perceived risk that we will be less willing to support their products or because we may compete with them. As a result, these third-party designers, manufacturers and suppliers could forge relationships, or strengthen their existing relationships, with our competitors. If the designers, manufacturers and suppliers of graphics chips, motherboards, and other components decrease their support for our product offerings and increase their support for the product offerings of our competitors, our business could be materially adversely affected.

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

We are making substantial investments in our microprocessor roadmaps and platforms, particularly as we transition from dual-core to multi-core processors. Increasing market acceptance of our processors, and the AMD64 technology on which they are based, is subject to risks and uncertainties including:

- the continued support of 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 multi-core processors;
- our ability to produce these processors in a timely manner using advanced process technologies, in the volume and with the performance and feature set required by customers; and
- the availability, performance and feature set of components 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.

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

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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 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. On September 26, 2006, the United States District Court for the District of Delaware granted Intel s motion to dismiss foreign conduct claims. The effect of that decision was clarified by the Court s January 12, 2007, adoption of the Special Master s decision on our motion to compel foreign conduct discovery. As a result of these two decisions, we will be permitted to develop evidence of Intel s exclusionary practices wherever they occur, including practices foreclosing AMD from foreign customers or in foreign market segments. However, the court s ruling limits our damages to lost sales in the United States and lost sales abroad that would have originated from the United States. The Court also set an immovable trial date of April 27, 2009.

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 customers accounted for almost half of our total revenue in 2006. Moreover, historically a significant portion of ATI s revenues were derived from sales to a small number of customers, and we expect that a small number of customers will continue to account for a substantial part of revenues from our graphics and consumer electronics businesses in the future. For example, for the period from October 25, 2006 to December 31, 2006, one handset manufacturer accounted for more than half of the revenue, and one game console provider accounted for a significant portion of the revenue, of our Consumer Electronics segment. Moreover, two customers accounted for approximately one third of the revenue of our Graphics and Chipsets segment. If one of our top microprocessor, graphics business or consumer electronics customers decided to stop buying our products, or if one of these customers were to materially reduce its operations or its demand for our products, we would 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 revenues 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 microprocessor manufacturing facilities are inadequate to meet the demand for certain of our microprocessor 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 result in an adverse effect on our relationships with customers, which 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. Although Chartered has begun production, the ability of Chartered to continue to ramp production on a timely basis depends on several factors beyond our control, including Chartered s ability to continue 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 and our plans to increase capacity at Fab 36 and convert Fab 30 into a 300-millimeter wafer manufacturing facility play a

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fundamental role in our growth plans for the next several years. In order to transition Fab 30 to a 300-millimeter facility, we plan to incrementally bring down its 200-millimeter output beginning in mid 2007, and we do not expect to have any 300-millimeter output until early 2008. If we are not able to achieve our production plans on a timely basis, we may not have sufficient manufacturing capacity to meet anticipated demand for our microprocessor products. If we cannot obtain sufficient manufacturing capacity to meet demand for our microprocessor products, either in our own facilities or through foundry or similar arrangements, we could be materially adversely affected.

We rely on third party foundries and other contractors to manufacture certain products.

We rely on independent foundries such as Taiwan Semiconductor Manufacturing Company and United Microelectronics Corp. to manufacture our graphics and chipset products. Chartered Semiconductor manufactures some of our microprocessor products and products for consumer electronics devices. Independent contractors also perform the assembly, testing and packaging of these products. We obtain these manufacturing services for our graphics and chipset products and products for consumer electronics devices on a purchase order basis and these foundries are not required to provide us with any specified minimum quantity of product. Accordingly, our graphics and consumer electronics businesses depend on these suppliers to allocate to us a portion of their manufacturing capacity sufficient to meet our needs, to produce products of acceptable quality and at acceptable manufacturing yields and to deliver those products to us on a timely basis at acceptable prices. We cannot assure you that these manufacturers will be able to meet our near-term or long-term manufacturing requirements. The manufacturers we use fabricate wafers for other companies, including certain of our competitors. With respect to our graphics and chipset products and products for consumer electronics devices, they could choose to prioritize capacity for other users, reduce or eliminate deliveries to us, or increase the prices that they charge us on short notice.

We must have reliable relationships with our wafer manufacturers and subcontractors to ensure adequate product supply to respond to customer demand. If we move production of our products to new manufacturers or if current manufacturers implement new process technology or design rules, any transition difficulties may result in lower yields or poorer performance of our products. Because it could take several quarters to establish a strategic relationship with a new manufacturing partner, we may be unable to secure an alternative supply for any specific graphics product in a short time frame. Other risks associated with our dependence on third-party manufacturers include reduced control over delivery schedules, quality assurance, manufacturing yields and cost, lack of capacity in periods of excess demand, misappropriation of our intellectual property, dependence on several small undercapitalized subcontractors, reduced ability to manage inventory and parts, and exposure to foreign countries and operations. If we are unable to secure sufficient or reliable supplies of wafers, our ability to meet customer demand for our graphics and consumer electronics businesses may be adversely affected and this could have an adverse effect on us.

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

Our microprocessor 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 microprocessor products or that are used in the manufacture of our graphics 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 that we use to manufacture our microprocessor products. 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 for our microprocessor products. Similarly, certain non-proprietary materials or components such as memory, PCBs, substrates and capacitors

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used in the manufacture of our graphics products are currently available from only a limited number of sources and often subject to rapid changes in price and availability. 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.

If we fail to improve the efficiency of our supply chain in order to respond to increases or changes in customer demand for our products, our business could be materially adversely affected.

Our ability to meet customer demand for our products depends, in part, on our ability to deliver the products our customers want on a timely basis. Accordingly, we must continually improve the management of our supply chain by synchronizing the entire supply chain, from sourcing through manufacturing, distribution and fulfillment. As we continue to grow our business, acquire new OEM customers and strengthen relationships with existing OEM customers, the efficiency of our supply chain will become increasingly important because OEMs tend to have specific requirements for particular products, and specific time-frames in which they require delivery of these products. In the second half of 2006, we experienced challenges in the ability of our supply chain to keep up with the significant ramp in microprocessor units sold across a diverse set of customers and geographies and to deliver products on a timely basis. Also, the breadth of our product portfolio increased significantly as a result of our acquisition of ATI, which put stress on our supply chain. If we fail to adequately improve the efficiency of our supply chain and adjust our operations in response to future increases or changes in OEM demand for our products, our business could be materially adversely affected.

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

Both we and our competitor, Intel, 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 plan on further increasing our capacity by expanding the production capacity of Fab 36 and converting Fab 30 into a 300-millimeter wafer manufacturing facility. 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 for which 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. If the demand for our microprocessor products is not consistent with our increased expectations, we may under-utilize 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

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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, and 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. For example, beginning in mid-2007 we plan to incrementally bring down 200-millimeter output at Fab 30 in order to transition this facility to 300-millimeter manufacturing. While this facility is being converted, we will have some fixed costs that cannot be scaled down in proportion.

Improving our microprocessor 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.

We have begun to ramp 65-nanometer production and 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.

Similarly, the operating results of our graphics and consumer electronics businesses are dependent upon achieving planned semiconductor manufacturing yields. Our graphics and chipset products and products for consumer electronics devices are manufactured at independent foundries, but we have the responsibility for product design and the design and performance of the tooling required for manufacturing. Semiconductor manufacturing yields are a function of both product design and process technology, which is typically proprietary to the manufacturer, and low yields can result from either design or process technology failures. In addition, yield problems require cooperation by and communication between us and the manufacturer and sometimes the customer as well. The offshore location of our principal manufacturers compounds these risks, due to the increased effort and time required to identify, communicate and resolve manufacturing yield problems. We cannot assure you that we or our foundries will identify and fix problems in a timely manner, and achieve acceptable manufacturing yields in the future. Our inability, in cooperation with our independent foundries, to achieve planned production yields for these products could have a material adverse effect on us. In particular, failure to reach planned production yields over time could result in us not having sufficient product supply to meet demand and/or higher production costs and lower gross margins for our graphics and consumer electronics businesses. This could materially adversely affect us.

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.

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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 2007, we plan to make approximately $2.5 billion of capital expenditures, primarily related to expanding production capacity at Fab 36, beginning the conversion of Fab 30 from manufacturing on 200-millimeter wafers to 300-millimeter wafers and purchasing equipment for a new facility to support bump and test activities. However, our ability to fund these capital expenditures in accordance with our business plan depends on generating sufficient cash flow from operations and the availability of external financing, if necessary.

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 financing. Additional debt or equity financing may not be available when needed or, if available, may not be available on satisfactory terms. In addition, in order to finance our acquisition of ATI, we borrowed $2.5 billion pursuant to a Credit Agreement with Morgan Stanley Senior Funding Inc. dated October 24, 2006 (October 2006 Term Loan). While amounts remain outstanding under this agreement, we are required to prepay these amounts with (i) 100 percent of the net cash proceeds from any debt incurred by us or a restricted subsidiary, (ii) 50 percent of net cash proceeds from the issuance of any capital stock by us (subject to specified exceptions); (iii) 100 percent of extraordinary receipts (as defined in the October 2006 Term Loan) in excess of $30 million; (iv) 100 percent of net cash proceeds from asset sales outside of the ordinary course in excess of $30 million, subject to a reinvestment allowance; (v) commencing with the fiscal year ending December 30, 2007, 50 percent of excess cash flow; and (vi) 100 percent of net cash proceeds from sales of capital stock of Spansion Inc. See Part II, Item 7, MD&A Liquidity, for additional information on the definition of excess cash flow. These mandatory prepayment requirements limit our ability to use our cash flow, borrow additional funds or conduct equity offerings for future working capital, capital expenditures, acquisitions or other general corporate purposes. Our inability to obtain needed 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.

We have a substantial amount of indebtedness that could adversely affect our financial position.

As of December 31, 2006 we had consolidated debt of approximately $3.8 billion. In addition, a significant portion of our consolidated debt bears a variable interest rate, which increases our exposure to interest rate fluctuations. Our substantial indebtedness may:

- make it difficult for us to satisfy our financial obligations, including making scheduled principal and interest payments;
- limit our ability to borrow additional funds for working capital, capital expenditures, acquisitions and general corporate and other purposes;
- limit our ability to use our cash flow or obtain additional financing for future working capital, capital expenditures, acquisitions or other general corporate purposes;
- require us to use a substantial portion of our cash flow from operations to make debt service payments;
- limit our flexibility to plan for, or react to, changes in our business and industry;

place us at a competitive disadvantage compared to our less leveraged competitors; and

increase our vulnerability to the impact of adverse economic and industry conditions.

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,

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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.

In addition, amounts outstanding under our October 2006 Term Loan are secured by, among other things, our accounts receivable, a pledge of the capital stock of specific material subsidiaries, specific intercompany debt, and proceeds from any sale of our equity interest in Spansion Inc. Moreover, as a result of the security interest granted to Morgan Stanley, holders of our outstanding 7.75% Senior Notes due 2012 (7.75% Notes) received an equal and ratable security interest. These assets are not available to be used as security in other borrowing arrangements, which may also have a material adverse effect on our ability to borrow additional 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 October 2006 Term Loan and the indenture governing our 7.75% Notes contain various covenants that limit our ability to:

- incur additional indebtedness, except specified permitted debt;
- pay dividends and make other restricted payments;
- make certain investments if a default or an event of default exists, or if specified financial conditions are not satisfied;
- 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;
- consolidate, merge or sell assets as an entirety or substantially as an entirety unless specified conditions are met;
- enter into certain types of transactions with affiliates;
- make or commit to make any capital expenditures in the ordinary course of business exceeding a certain amount;
- issue or sell any shares of capital stock of our restricted subsidiaries;
- permit domestic wholly-owned restricted subsidiaries to guarantee our indebtedness unless they also guarantee the October 2006 Term Loan; and

permit our Consolidated Net Senior Secured Leverage Ratio (as defined in the October 2006 Term Loan) to exceed 2.25 to 1.00.

In addition, the Fab 36 Loan Agreements contain restrictive covenants, including a prohibition on the ability of our Germany subsidiary, AMD Fab 36 Limited Liability Company & Co. KG, or 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.

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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 or any failure to repay debt when due in an amount in excess of $50 million would cause a cross default under the October 2006 Term Loan or 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 lenders under the October 2006 Term Loan or 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.

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 could 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.

Products as complex as those we offer may contain defects or failures when first introduced or when new versions or enhancements to existing products are released. We cannot assure you that, despite our testing procedures, errors will not be found in new products or releases after commencement of commercial shipments in the future, which could result in loss of or delay in market acceptance of our products, material recall and replacement costs, delay in recognition or loss of revenues, writing down the inventory of defective products, the diversion of the attention of our engineering personnel from product development efforts, defending against litigation related to defective products or related property damage or personal injury, and damage to our reputation in the industry and could adversely affect our relationships with our customers. In addition, we may have difficulty identifying the end customers of the defective products in the field. As a result, we could incur substantial costs to implement modifications to correct defects. Any of these problems could materially adversely affect us.

In addition, because we sell directly to consumers, we could be subject to potential product liability claims if one of our products causes, or merely appears to have caused, an injury. Claims may be made by consumers or others selling our products, and we may be subject to claims against us even if an alleged injury is due to the actions of others. A product liability claim, recall or other claim with respect to uninsured

liabilities or for amounts in excess of insured liabilities could have a material adverse effect on our business.

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Our receipt of royalty revenues is dependent upon the success of third-party products.

Our graphics technology for the game console market is being used in the Nintendo GameCube, Nintendo Wii and Microsoft® Xbox 360 game consoles. The only revenues that we receive from these technology platforms are in the form of non-recurring engineering revenues, as well as royalties paid to us by Nintendo and Microsoft based upon the market success of their products. Accordingly, our royalty revenues will be directly related to the sales of these products. We anticipate royalties in future years resulting from our agreements with Nintendo and Microsoft. However, we have no control over the marketing efforts of Nintendo and Microsoft and we cannot assure you that sales of those products will achieve expected levels in the current or future fiscal years. Consequently, the revenues from royalties expected by us from these technology platforms may not be fully realized, and our operating results may be adversely affected.

Our entry into new consumer markets is subject to a number of uncertainties.

As a result of the ATI acquisition, we sell products for the consumer electronics market, including digital TVs and color mobile phones. There are a significant number of competitors targeting this market. The delay in acceptance of digital TV technology has also provided further opportunities for competitors to enter this market. In addition, as the telecommunications, cable and consumer electronics industries and their suppliers undergo a period of convergence, we expect that competition will increase in these markets. Our ability to succeed in these new consumer markets is subject to a number of uncertainties, including acceptance of our graphics and multimedia processors, the development of new technologies sufficient to meet market demand, the need to develop customer relationships, different sales strategies and channels, new and different industry standards from those in the PC market and changing strategic alliances. We cannot assure you that we will be able to successfully compete in this new market. If we are unable to successfully introduce products and compete in this market, we could be materially adversely affected.

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, including the more than 4,000 employees we acquired through the ATI acquisition. 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 some of 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 some 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.

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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 or minimum purchase requirements. Generally, our customers may cancel orders more than 30 days 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. Moreover, PC and consumer markets are characterized by short product lifecycles, which can lead to rapid obsolescence and price erosion. In addition, our customers may change their inventory practices on short notice for any reason. We may build inventories during periods of anticipated growth, and 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 and an adverse effect on profit margins. 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 and 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.

We maintain operations around the world, including in the United States, Canada, Europe and Asia. For example, all of our wafer fabrication capacity for microprocessors is located in Germany. Nearly all product assembly and final testing of our microprocessor products is performed at manufacturing facilities in China, Malaysia and Singapore. In addition, our graphics and chipset products and products for consumer electronics devices are manufactured, assembled and tested by independent third parties in the Asia-Pacific region and inventory related to those products is stored there. We also 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 revenue was 75 percent in 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;

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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, natural disasters or general economic factors, could have a material adverse effect on our business. Any of the above risks, should they occur, could result in an increase in the cost of components, production delays, general business interruptions, delays from difficulties in obtaining export licenses for certain technology, tariffs and other barriers and restrictions, potentially longer payment cycles, potentially increased taxes, restrictions on the repatriation of funds and the burdens of complying with a variety of foreign laws, any of which could ultimately 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.

We have costs, assets and liabilities that are denominated in foreign currencies, primarily the euro and yen, and as a result of our recent acquisition of ATI, the Canadian dollar. As a consequence, movements in exchange rates could cause our Canadian dollar and euro-denominated expenses and yen-based raw material purchases to increase as a percentage of revenue, affecting our profitability and cash flows. Whenever we believe appropriate, we hedge a portion of our foreign currency exposure to protect against fluctuations in currency exchange rates. We determine our total foreign currency exposure using projections of expenditures for items such as payroll,

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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.

In addition, the majority of our product sales are denominated in U.S. dollars. Fluctuations in the exchange rate between the U.S. dollar and the local currency can cause increases or decreases in the cost of our products in the local currency of such customers. An appreciation of the U.S. dollar relative to the local currency could reduce sales of our products.

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 gray market products, which adversely affect demand for our products. In addition, our inability to control gray market 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. In addition, as a result of our acquisition of ATI, we have assumed responsibility for ATI s legal proceedings which include a securities litigation proceeding and a consumer class action. In November 2006, we received a subpoena for documents and information in connection with the U.S. Department of Justice s criminal investigation into potential antitrust violations related to graphics processing units and cards. We also sell products to consumers, which could increase our exposure to consumer actions such as product liability claims. Any claim that is successfully asserted against us may cause us to pay substantial damages.

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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 United States 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. Although our management systems are designed to maintain compliance, 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 and China are two among a growing number of jurisdictions that have enacted restrictions on the use of lead, among other chemicals, in electronic products. These regulations affect semiconductor packaging, and we continue our work to ensure compliance across product lines. There is a risk that the cost, quality and manufacturing yields of lead-free products may be less favorable compared to lead-based products or that the transition to lead-free products may produce sudden changes in demand, which may result in excess inventory. Other regulatory requirements potentially affecting our manufacturing processes and the design and marketing of our products are in development throughout the world. We have management

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systems in place to identify and ensure compliance with such requirements and have budgeted for foreseeable associated expenditures. However, 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.

All of our wafer fabrication capacity for microprocessors is located in Germany. Nearly all product assembly and final testing of our microprocessor products is performed at manufacturing facilities in China, Malaysia and Singapore. The independent foundries used to manufacture our graphics and chipset products and products for consumer electronics devices are located in Hsin Chiu and Tainan, Taiwan. A significant amount of our inventories for our graphics and consumer electronics businesses are stored in Taiwan prior to delivery to customers. Many of our assembly, testing and packaging suppliers for our graphics products are also located in southern Taiwan. On September 22, 1999, Taiwan suffered a major earthquake that measured 7.6 on the Richter scale and disrupted the operations of these manufacturing suppliers and contributed to a temporary shortage of graphics processors. Additional earthquakes, fires or other occurrences that disrupt our manufacturing suppliers may occur in the future. To the extent that the supply from our independent foundries or suppliers is interrupted for a prolonged period of time or terminated for any reason, we may not have sufficient time to replace our supply of products manufactured by those foundries.

Moreover, our corporate headquarters are located near major earthquake fault lines in California. 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.

Our business is subject to potential tax liabilities.

We are subject to income taxes in the United States, Canada and other foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our tax estimates are reasonable, we cannot assure you that the final determination of any tax audits and litigation will not be materially different from that which is reflected in historical income tax provisions and accruals. Should additional taxes be assessed as a result of an audit or litigation, there could be a material effect on our cash, income tax provision and net income in the period or periods for which that determination is made.

For example, the Canadian Revenue Agency, or CRA, is in the process of auditing ATI for the years 1999 - 2004 with respect to transactions between ATI and its subsidiaries. We could be subject to significant tax liability as well as a loss of certain tax credits and other tax attributes as a result of the CRA audit.

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. Following Spansion s IPO, we owned approximately 38 percent of Spansion s outstanding common stock. In November 2006 we sold shares of Spansion s common stock, and

as a result, as of December 31, 2006, we owned approximately 21 percent of Spansion s outstanding common stock. Our 21 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.

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

Sales of Spansion s Flash memory products are dependent to a large degree upon consumer demand for mobile phones. In fiscal 2006, wireless customers, which primarily consist of mobile phone OEMs represented the largest market for NOR Flash memory. In fiscal 2006 and fiscal 2005, sales to wireless Flash memory customers drove a majority of Spansion s sales.

Similarly, sales of Spansion s products targeting embedded Flash memory customers are dependent upon demand for consumer electronics such as set top boxes, or STBs, and DVD players, automotive electronics, industrial electronics such as networking equipment, PCs and PC peripheral equipment such as printers. Sales of Spansion s products are also dependent upon the inclusion of increasing amounts of Flash memory content in some of these products. In fiscal 2005 and fiscal 2006, sales to embedded Flash memory customers drove a significant portion of Spansion s sales.

If demand for mobile phones or products in the embedded portion of the Flash memory market, or the Flash memory content of these products, is below Spansion s expectations, if the functionality of successive generations of such products does not require increasing Flash memory density or if such products no longer require Flash memory due to alternative technologies or otherwise, Spansion would be materially adversely affected.

Spansion has lost key intellectual property arrangements because 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 through December 20, 2005, 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. As a result of the conversion of Spansion s outstanding shares of Class D common stock into shares of Spansion s Class A common stock in November 2006, Spansion ceased to be a beneficiary under most of the remainder of these license agreements. As a result, Spansion may be subject to claims that it is infringing intellectual property rights of third parties through the manufacture and sale of Spansion s products and the operation of Spansion s business. Therefore, absent negotiating its own license agreements with the third parties who own such intellectual property, Spansion will be vulnerable to claims by such parties that Spansion s products or operations infringe such parties patents or other intellectual property rights.

Spansion will continue to attempt to negotiate its own agreements and arrangements with third parties for intellectual property and technology that are important to Spansion s business, including the intellectual property that it previously had access to through its relationship with us. Spansion will also attempt to acquire new patents as Spansion s success in negotiating patent cross-license agreements with other industry participants will depend in large part upon the strength of its patent portfolio relative to that of the third party with which it is negotiating. If the third-party benefits from an existing patent cross-license agreement with us or Fujitsu, in many cases it will retain the rights that it has under that agreement, including rights to utilize the patents that we and Fujitsu transferred to Spansion in connection with Spansion s reorganization as Spansion LLC in June 2003. In many cases, any such third party will also retain such rights to utilize any patents that have been issued to Spansion or acquired by Spansion subsequent to Spansion s reorganization and prior to Spansion s IPO or, in some cases, at the time of the conversion of the Class D common stock. Spansion s negotiating position will therefore be impaired, because the other party will already be entitled to utilize a large number of Spansion s patents, while Spansion no longer has the right to utilize that party s patents. As a result, Spansion may be unable to obtain access to the other party s patent portfolio on favorable terms or at all. Similarly, with respect to licenses from third parties for technology incorporated in Spansion s products or software used to operate Spansion s business,

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Spansion may not be able to negotiate prices with these third parties on terms as favorable to Spansion as those previously available to Spansion because it is not able to take advantage of our size and purchasing power. These parties, 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 and time-consuming. Spansion cannot be sure that such litigation would be avoided or successfully concluded. The award of damages, including material royalty payments, or the entry of an injunction against the manufacture or sale of some or all of Spansion s products, would have a material adverse effect on Spansion.

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. Spansion has developed its MirrorBit ORNAND architecture to address certain portions of the integrated category of the Flash memory market served by NAND-based products, but it cannot be certain that its MirrorBit ORNAND-based products will satisfactorily address those market needs.

During 2004, industry sales of NAND-based Flash memory products grew at a higher rate than sales of NOR-based Flash memory 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. This trend continued in 2005 and 2006 when sales of NAND-based Flash memory products represented a majority of the Flash memory products sold in the overall Flash memory market. In 2005, and the first half of 2006, 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 predominantly served by floating gate NAND vendors, is expected to be a significant 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 higher density floating gate NAND-based Flash memory products over MirrorBit NOR-, ORNAND- or Quad-based Flash memory products for their applications. If this occurs and OEMs continue to prefer the attributes and characteristics of floating gate NAND-based products over those of MirrorBit NOR-, ORNAND- or Quad-based products for their applications, Spansion may be materially and adversely affected. Moreover, some floating gate NAND vendors are manufacturing on 300-millimeter wafers or may choose to utilize more advanced manufacturing process technologies than Spansion uses today to offer products competitive to Spansion s at a lower cost. If floating gate NAND vendors continue to increase their share of the Flash memory market, Spansion s market share may decrease, which would materially adversely affect Spansion.

Competitors may introduce new memory or other technologies that may make Spansion s Flash memory products uncompetitive or obsolete.

Spansion s competitors are working on a number of new technologies, including FRAM, MRAM, polymer and phase-change based memory technologies. If successfully developed and commercialized as a viable alternative to Flash memory, these or other technologies could pose a competitive threat to a number of Flash memory companies, including Spansion. In addition, Spansion and some of Spansion s competitors have licensed Flash memory intellectual property associated with NROM technology from a third party. Use of this NROM intellectual property may allow these competitors to develop Flash memory technology that may compete with MirrorBit technology.

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If Spansion fails to successfully develop products based on its new MirrorBit NOR, or MirrorBit ORNAND or MirrorBit Quad architectures, or if there is a lack of market acceptance of products based on these products, Spansion s future operating results would be materially adversely affected.

Spansion is positioning itself to address the increasing demand for higher density data optimized Flash memory by offering products based on its new MirrorBit ORNAND and MirrorBit Quad architectures. The success of these architectures requires that Spansion timely and cost effectively develop, manufacture and market products based on these architectures that are competitive with floating gate NAND-based Flash memory products. Spansion began commercial shipments of MirrorBit ORNAND-based products in the second quarter of fiscal 2006 and announced the MirrorBit Quad-based family of products in January 2007. However, if Spansion fails to develop and commercialize these products and additional products based on these architectures on a timely basis, Spansion s future operating results would be materially adversely affected. Furthermore, if market acceptance of products based on Spansion s MirrorBit technology occurs at a slower rate than Spansion anticipates, its ability to compete will be reduced, and Spansion would be materially adversely affected. If Spansion does not achieve market acceptance of these products or subsequent MirrorBit products, Spansion s future operating results would be materially adversely affected.

The loss of a significant customer or a reduction in demand for Spansion s Flash memory products from a significant customer in the mobile phone market could have a material adverse effect on Spansion.

Sales of Spansion s products are dependent to a large extent on demand for mobile phones. Historically, a small number of wireless Flash memory customers have driven a substantial portion of Spansion s net sales. If one of these customers decided to stop buying Spansion s Flash memory products, or if one of these customers were materially to reduce its operations or its demand for Spansion s products, Spansion could be materially adversely affected. For example, in the fourth quarter of fiscal 2006 Spansion was materially adversely affected by the reduced demand for mid-range wireless handsets that incorporate custom high density NOR-based Flash memory solutions.

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

Spansion currently has and will continue to have for the foreseeable future, a substantial amount of indebtedness. This substantial indebtedness may:

- require Spansion to use a substantial portion of its cash flows 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 flows 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 flows 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 flows from operations and the availability of external financing. Spansion s capital expenditures, together with ongoing operating expenses, will be a substantial drain on its cash flows and may decrease its cash balances. The timing and amount of Spansion s capital requirements cannot be precisely determined at this time and will depend on a number of factors, including demand for its products, product mix, changes in industry conditions and market competition.

Spansion may need to assess markets for external financing, including debt and equity. Such financing may not be available when needed or, if available, may not be available on satisfactory terms. Any equity financing

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would cause dilution to its stockholders. Spansion s inability to obtain needed financing or to generate sufficient cash from operations may require it to abandon projects or curtail capital expenditures. If Spansion cannot generate sufficient operating cash flows or obtain external financing, it may be delayed in achieving, or may not achieve, needed manufacturing capacity, and Spansion could be materially adversely affected.

If Spansion is unable to timely and efficiently expand its manufacturing capacity to implement 300-millimeter wafer capacity at SP1, Spansion s business, results of operations or financial condition could be materially adversely affected.

Spansion intends to expand its manufacturing capacity to produce approximately 15,000 to 20,000 300-millimeter wafers per month at SP1. Spansion s goal is to have 65- and 45-nanometer process technology on 300-millimeter wafer capacity in place in fiscal 2008. In fiscal 2006 Spansion commenced a plan to spend approximately $1.2 billion over three years to construct and equip its planned flash memory manufacturing facility in Aizu-Wakamatsu, Japan, which Spansion refers to as SP1. However, the actual cost and capacity achieved will vary depending on various factors, including available financing and future product demand. Financing for the construction of and equipment for SP1 may not be available when needed or, if available, may not be available on satisfactory terms. If Spansion does not achieve its desired capacity at the anticipated cost, or if Spansion cannot obtain suitable financing, Spansion may be delayed in achieving, or may not achieve, such capacity, and Spansion could be materially adversely affected.

The timing for implementing 300-millimeter capacity in SP1 will also depend in part on Spansion s ability to execute its plan for constructing and equipping the facility and other factors that may be beyond its control, such as delivery schedules for the required machinery and equipment and construction schedules. If Spansion is delayed in implementing this capability or is unable to obtain foundry services at competitive rates or to timely and efficiently ramp production on 300-millimeter wafers, it will not achieve anticipated cost savings associated with this technology and its gross margins could decline. Even if Spansion is successful in implementing this capacity, if the demand for its products is not sufficient to support the additional capacity when it becomes available, it could be materially and adversely affected.

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

Spansion continues to undertake a number of actions in an effort to significantly reduce its expenses. These actions include and have included streamlining operations, 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.

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

There may be situations in which Spansion s manufacturing capacity is inadequate to meet the demand for some of its products. Spansion increasingly depends on foundry, subcontractor and similar arrangements with third parties to meet demand. Spansion s arrangements with third-party suppliers do not necessarily include capacity guarantees. If a third-party manufacturer on which it relies does not have the capacity to deliver an adequate amount of product to meet actual demand, Spansion may not be able to obtain the manufacturing capacity, either in its own facilities or through other third-party arrangements, to meet such demand. During fiscal 2006, demand for certain of Spansion s products exceeded the available supply. As a result, Spansion was unable to meet the demand of some of its customers for these products. This could adversely impact Spansion s relationships with customers, cause harm to Spansion s reputation in the marketplace, cause these customers to move future business to Spansion s competitors or cause Spansion to make financial concessions to its customers. Any of these occurrences could have

a material adverse effect on Spansion. Also, in the third and fourth quarters of fiscal 2005 and the third quarter of fiscal 2006, Spansion experienced capacity constraints for

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final test and assembly of some of its products. These constraints continued into the fourth quarter of fiscal 2006. While Spansion has worked internally and with subcontractors to increase capacity to meet anticipated demand, it cannot be assured 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. If Spansion is unable to obtain sufficient manufacturing capacity to meet anticipated demand, either in its own facilities or through foundry, subcontractor or similar arrangements with third parties, or if it is unable to obtain foundry services at competitive rates, Spansion s business may be materially adversely affected.

Spansion s increased reliance on third-party manufacturers entails risks that could materially adversely affect Spansion.

Spansion currently obtains foundry services from other companies, including Taiwan Semiconductor Manufacturing Company Limited, and following the sale of its JV1 and JV2 manufacturing facilities Spansion will also obtain foundry services from Fujitsu. Spansion also uses independent contractors to perform some of the assembly, testing and packaging of its products. Third-party manufacturers are often under no obligation to provide Spansion with any specified minimum quantity of product. Spansion depends on these manufacturers to allocate to Spansion a portion of their manufacturing capacity sufficient to meet Spansion s needs, to produce products of acceptable quality and at acceptable manufacturing yields and to deliver those products to Spansion on a timely basis at acceptable prices. These manufacturers may not be able to meet Spansion s near-term or long-term manufacturing requirements. These manufacturers also make products for other companies, including certain of Spansion s competitors, and/or for themselves and could choose to prioritize capacity for themselves or other customers beyond any minimum guaranteed amounts, reduce deliveries to Spansion or, in the absence of price guarantees, increase the prices they charge Spansion on short notice, such that Spansion may not be able to pass cost increases on to Spansion s customers. Because it could take several quarters or more to establish a relationship with a new manufacturing partner, Spansion may be unable to secure an alternative supply for specific products in a short timeframe or at all at an acceptable cost to satisfy Spansion s production requirements. In addition, Spansion may be required to incur additional development, manufacturing and other costs to establish alternative sources of supply. Other risks associated with Spansion s increased dependence on third-party manufacturers include: their ability to adapt to Spansion s proprietary technology, reduced control over delivery schedules, quality assurance, manufacturing yields and cost, lack of capacity in periods of excess demand, misappropriation of Spansion s intellectual property, reduced ability to manage inventory and parts and risks associated with operating in foreign countries. If Spansion is unable to secure sufficient or reliable suppliers of wafers or obtain the necessary assembling, testing and packaging services, Spansion s ability to meet customer demand for its products may be adversely affected, which could have a material adverse effect on Spansion.

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. Spansion has experienced declining average selling prices in the past, and it has stated that it expects to continue to experience them in the future, although Spansion cannot predict when they may occur or how severe they will be. If Spansion s average selling prices continue to decline, its operating results could be materially adversely affected. In addition, average selling prices for Spansion s products may also be adversely affected by a significant decline in the price for NAND products. Such a decline may result in downward price pressure in the overall Flash memory market, which would adversely affect Spansion.

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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 Texas Instruments has asserted that a number of its products infringe some of Texas Instruments patents. Fujitsu has also provided Spansion with formal notice that they believe Spansion has a duty to defend or indemnify Fujitsu against Texas Instruments claims under the terms of its distribution agreement. Since then, Spansion and Fujitsu have been discussing the issues raised by this notice and if Fujitsu were to terminate the distribution agreement with Spansion, it could have a material adverse effect on Spansion. Defending these alleged infringement claims and similar claims could be extremely expensive and time-consuming and an 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., Renesas Technology Corp., Micron Technology, Inc. and Hynix Semiconductor Inc. In the future, Spansion s principal competitors may also include SanDisk Corporation and IM Flash Technology, LLC, the joint venture between Intel and Micron Technology, Inc. The Flash memory market is characterized by intense competition. The basis of competition is cost, selling price, performance, quality, customer relationships and ability to provide value-added solutions. 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 in the second half of fiscal 2004 and the first quarter of fiscal 2005 and adversely impacted its results of operations. Some of Spansion s competitors, including Intel, Samsung, STMicroelectronics, Toshiba, Sharp and Renesas, are more diversified than Spansion is and may be able to sustain lower operating margins in their Flash memory business based on the profitability of their other, non-Flash memory businesses. In addition, recent capital investments by competitors have resulted in substantial industry manufacturing capacity, which may further contribute to a competitive pricing environment.

Moreover, some of Spansion s competitors are able to manufacture on 300-millimeter wafers or may choose to utilize more advanced manufacturing process technologies than Spansion uses today to offer products competitive to Spansion s at a lower cost.

Spansion has stated that it expects competition in the market for Flash memory devices to intensify as existing manufacturers introduce new products, new manufacturers enter the market, industry-wide production capacity increases and competitors aggressively price their Flash memory products to increase market share. Competition also may increase if NOR memory vendors merge, if NAND memory vendors acquire NOR businesses or other NAND businesses, or if Spansion s competitors otherwise consolidate their operations. Furthermore, Spansion faces increasing competition from NAND Flash memory vendors in some portions of the integrated Flash memory market.

Spansion has also stated that it expects to face competition as it addresses new applications with the introduction of Spansion s MirrorBit ORNAND- and MirrorBit Quad-based products. These products are intended to allow Spansion to compete in the data storage portion of the integrated category and select portions of the removable category of the Flash memory market that might otherwise be served by NAND-based Flash memory products or other non-volatile storage technologies such as ROM or optical discs. As a result, Spansion may compete with a number of established NAND-based Flash memory vendors and other incumbent suppliers of alternative technology in marketing and selling these products. Moreover, Spansion s MirrorBit ORNAND- and MirrorBit Quad-based products may not have the price, performance, quality and other features necessary to compete successfully for these applications.

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To compete successfully, Spansion must decrease its manufacturing costs and develop, introduce and sell products that meet the increasing demand for greater Flash memory content in mobile phones, consumer electronics and automotive applications, among other markets, at competitive prices. If Spansion is unable to compete effectively, it could be materially adversely affected.

If essential equipment or adequate supplies of satisfactory 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. Spansion purchases equipment and materials from a number of suppliers. 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 Spansion to substitute one supplier for another or one piece of equipment for another. Some raw materials Spansion uses in the manufacture of Spansion s products are available from a limited number of suppliers. Spansion s manufacturing operations also depend upon the quality and usability of the materials Spansion uses in its products, including raw materials and wafers Spansion receives from its suppliers. For example, in the third quarter of fiscal 2006, Spansion had lower than expected yields on 12,000 raw wafers received from one of its suppliers and Spansion s revenue and gross margins were adversely affected. If the materials Spansion receives from its suppliers do not meet Spansion s manufacturing requirements or product specifications, Spansion may be materially adversely affected.

Spansion also relies on purchasing commercial memory die from third-party suppliers to incorporate these die into multi-chip package, or MCP, products. The availability of these third-party purchased commercial die is subject to market availability, and the process technology roadmaps and manufacturing capacities of Spansion s vendors. For example, Spansion s production was constrained in the first half of fiscal 2004 because of difficulties in procuring adequate supply of pseudo static RAM, or pSRAM. In addition, some of Spansion s major suppliers, including Samsung, are also Spansion s competitors. Interruption of supply from a competitor that is a supplier or otherwise or increased demand in the industry could cause shortages and price increases in various essential materials. If Spansion is unable to procure these materials, or if the materials it receives from Spansion s suppliers do not meet Spansion s production requirements or product specifications, Spansion may have to reduce its manufacturing operations or its manufacturing yields may be adversely affected. Such a reduction and yield issues have 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 1B. UNRESOLVED STAFF COMMENTS

We have not received any written comments that were issued more than 180 days before December 31, 2006, the end of the fiscal year covered by this report, from the Securities and Exchange Commission staff regarding our periodic or current reports under the Securities Exchange Act of 1934 that remain unresolved.

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ITEM 2. PROPERTIES

At December 31, 2006, we owned principal engineering, manufacturing, warehouse and administrative facilities located in the United States, Canada, China, Germany, Singapore and Malaysia. These facilities totaled approximately 2.8 million square feet. Of this amount, 2.2 million square feet were located in Dresden, Germany and were used primarily for wafer fabrication, research and development, and administrative offices.

Our main facility with respect to our graphics and chipset products and products for consumer electronics devices is located in Markham, Ontario, Canada. This facility consists of approximately 240,000 square feet of office and research and development space. We have a 50 percent interest in the joint venture company that owns this facility. We own five other facilities in Markham, Ontario that comprise over 165,000 square feet, including approximately 65,000 square-feet of manufacturing and warehouse space.

In some cases, we lease all or a portion of the land on which our facilities are located. We lease approximately 218,000 square feet of land in Singapore and 270,000 square feet of land in Suzhou, China for our microprocessor and test facility. In addition, Fab 30 and Fab 36 are located on approximately 9.7 million square feet of land. Of this amount, Fab 36 owns approximately 5.4 million square feet, and both the facility and the land are encumbered by a lien securing the obligations of AMD Fab 36 KG, the entity that owns the Fab 36 assets, under its EUR 700 Million Term Loan Facility Agreement with a consortium of banks in connection with the Fab 36 project, (Fab 36 Loan Agreements.) See Management s Discussion and Analysis of Financial Condition and Results of Operations Fab 36 Term Loan and Guarantee and Fab 36 Partnership Agreements.

As of December 31, 2006, we also leased approximately 3.0 million square feet of space for engineering, manufacturing, warehouse and administrative use, including a number of smaller regional sales offices located in commercial centers near customers, principally in the United States, Latin America, Europe and Asia. These leases expire at varying dates through 2018.

We also have approximately 220,000 square feet of building space that is currently vacant. We continue to have lease obligations with respect to this space that expire at various dates through 2011. We are actively marketing this space for sublease. Spansion leases approximately 71,000 square feet from us.

In April 2005, we announced plans for a new campus for design and administrative functions to be developed on approximately 58 acres in Austin, Texas. We expect that the campus will consist of approximately 825,000 square feet. We intend to incorporate advanced environmentally sensitive building techniques and materials during the design, development and construction process and to concentrate development to approximately 33 of the available 58 acres. The remainder of the land would remain undeveloped. Construction of the new campus is underway and we expect that we will occupy the facility in the second half of 2007 or the first half of 2008.

We currently do not anticipate difficulty in either retaining occupancy of any of our facilities through lease renewals prior to expiration or through month-to-month occupancy, or replacing them with equivalent facilities. We believe that our existing facilities are suitable and adequate for our present purposes, and that, except as discussed above, the productive capacity of such facilities is substantially being utilized or we have plans to utilize it.

ITEM 3. LEGAL PROCEEDINGS

In addition to ordinary routine litigation incidental to the business, AMD or its indirectly wholly-owned subsidiary, ATI, were party to the following material legal proceedings. The outcome of any litigation is uncertain and should any of these actions or proceedings against us be successful, we may be subject to significant damages awards which could have a material adverse effect on our financial condition.

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AMD v. Intel Corporation and Intel Kabushiki Kaisha, Civil Action No. 05-441, in the United States District Court for the District of Delaware.

On June 27, 2005, AMD filed an antitrust complaint against Intel Corporation and Intel Kabushiki Kaisha, collectively 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. The 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 in effect limit Intel s customers ability and/or incentive to deal with AMD. The complaint alleges anti-competitive business practices, including:

- Forcing major customers into Intel-exclusive deals in return for outright cash payments, discriminatory pricing or marketing subsidies conditioned on the exclusion of AMD;
- Forcing other major customers into partial exclusivity agreements by conditioning rebates, allowances and market development funds on customers agreement to severely limit or forego entirely purchases from AMD;
- Establishing a system of discriminatory and retroactive incentives triggered by purchases at such high levels as to have the intended effect of denying customers the freedom to purchase any significant volume of processors from AMD;
- Establishing and enforcing quotas among key retailers, effectively requiring them to stock overwhelmingly or exclusively computers with Intel microprocessors, and thereby artificially limiting consumer choice; and
- Forcing PC makers and technology partners to boycott AMD product launches or promotions.

AMD has requested the following findings and remedies:

- A finding that Intel is abusing its market power by forcing on the industry technical standards and products that have as their main purpose the handicapping of AMD in the marketplace;
- A finding that Intel is wrongfully maintaining its monopoly in the x86 microprocessor market in violation of Section 2 of the Sherman Act and treble damages to AMD in an amount to be proven at trial, pursuant to Section 4 of the Clayton Act, 15 U.S.C. § 15(a);
- A finding that Intel has made secret payments and allowance of rebates and discounts, and that Intel secretly and discriminatorily extended to certain purchasers special services or privileges, all in violation of California Business & Professions Code § 17045, and treble damages for AMD s resulting lost profits in an amount to be proven at trial;
- A finding that Intel has intentionally interfered with valuable business relationships of AMD to AMD s economic detriment and damages to AMD in an amount to be proven at trial for its resulting losses, as well as punitive damages, as permitted by law;
- Injunctive relief prohibiting Intel from engaging in any further conduct unlawful under Section 2 of the Sherman Act or Section 17045 of the California Business and Professions Code;

An award to AMD of such other, further and different relief as may be necessary or appropriate to restore and maintain competitive conditions in the x86 microprocessor market; and

An award of attorneys fees and costs.

Intel filed its answer on September 1, 2005. On September 26, 2006, the United States District Court for the District of Delaware granted the motion of Intel Corporation to dismiss foreign conduct claims. The effect of that decision was clarified by the Court s January 12, 2007, adoption of the Special Master s decision on our motion to compel foreign conduct discovery. As a result of these two decisions, we will be permitted to develop evidence of Intel s exclusionary practices wherever they occur, including practices foreclosing AMD from foreign customers or in foreign market segments. However, the court s ruling limits our damages to lost sales in

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the United States and lost sales abroad that would have originated from the United States. The Court also set an immovable trial date of April 27, 2009. The discovery process is ongoing.

Other Related Proceedings

On June 30, 2005, our Japanese subsidiary, AMD Japan K.K., or AMD Japan, filed an action in Japan against Intel Corporation s Japanese subsidiary, Intel Kabushiki Kaisha, or Intel K.K., in the Tokyo High Court and the Tokyo District Court for damages arising from violations of Japan s Antimonopoly Act.

Through its suit in the Tokyo High Court, AMD Japan seeks US$50 million in damages, following on the Japan Fair Trade Commission s (JFTC) findings in its March 8, 2005 Recommendation, or the JFTC Recommendation, that Intel K.K. committed violations of Japan s Antimonopoly Act. The JFTC Recommendation concluded that Intel K.K. interfered with AMD Japan s business activities by providing large amounts of funds to five Japanese PC manufacturers (NEC, Fujitsu, Toshiba, Sony, and Hitachi) on the condition that they refuse to purchase AMD s microprocessors. The suit alleges that as a result of these illegal acts, AMD Japan suffered serious damages, losing all of its sales of microprocessors to Toshiba, Sony, and Hitachi, while sales of microprocessors to NEC and Fujitsu also fell precipitously.

Through its suit in the Tokyo District Court, AMD Japan seeks US$55 million in damages for various anticompetitive acts in addition to those covered in the scope of the JFTC Recommendation. The suit alleges that these anticompetitive acts also had the effect of interfering with AMD Japan s right to engage in normal business and marketing activities.

In re ATI Technologies, Inc. Securities Litigation.

In August and September 2005, five class action lawsuits were filed in the United States District Court for the Eastern District of Pennsylvania against ATI and certain of its directors and officers on behalf of shareholders who purchased ATI common shares between October 7, 2004 and on or about June 23, 2005. The claims allege that ATI and certain of its directors and officers violated United States securities laws by failing to disclose material facts and making statements that contained misrepresentations about its business and future outlook. It is alleged that as a result of the failure to disclose material facts and the alleged misrepresentations, ATI s common stock traded at artificially inflated prices until the stock price dropped on the news of ATI s third quarter results in June 2005. The claims further allege that while in possession of material undisclosed information, certain of ATI s directors and officers sold a portion of their common shares at inflated prices. On May 23, 2006, the Court dismissed one of the five actions because the plaintiff failed to serve the summons and complaint. The four remaining lawsuits were consolidated into a single action, and on September 8, 2006, the plaintiffs filed a consolidated amended complaint. ATI filed its Motion to Dismiss the Consolidated Amended Complaint on December 4, 2006. On January 25, 2007, class plaintiffs filed their opposition to ATI s motion to dismiss.

U.S. Consumer Class Action Lawsuits

In February and March 2006, two consumer class actions were filed in the United States District Court for the Northern District of California against ATI and three of its subsidiaries. The complaints allege that ATI had misrepresented its graphics cards as being HDCP ready when they were not, and on that basis alleged violations of state consumer protection statutes, breach of express and implied warranty, negligent misrepresentation, and unjust enrichment. On April 18, 2006, the Court entered an order consolidating the two actions. On June 19, 2006,

plaintiffs filed a consolidated complaint, alleging violations of California s consumer protection laws, breach of express warranty, and unjust enrichment. On June 21, 2006, a third consumer class action that was filed in the United States District Court for the Western District of Tennessee in May 2006 alleging claims that are substantially the same was transferred to the Northern District of California, and on July 31, 2006, that case was also consolidated into the consolidated action pending in the Northern District of California. ATI filed an answer to the consolidated complaint on August 7, 2006.

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Department of Justice Subpoena

On November 29, 2006, AMD received a subpoena for documents and information in connection with the U.S. Department of Justice (DOJ) criminal investigation into potential antitrust violations related to graphics processing units and cards. AMD entered the graphics processor business following our acquisition of ATI on October 25, 2006. The DOJ has not made any specific allegations against AMD or ATI. AMD is cooperating with the investigation.

GPU Class Actions

Currently approximately thirty-six related antitrust actions have been filed against AMD, ATI and Nvidia Corporation, in the Northern District of California, the Central District of California, the District of Massachusetts, the Western District of Wisconsin, the District of South Carolina, the District of Kansas and the District of Vermont. According to the complaints, plaintiffs filed each of the actions after reading press reports that AMD and Nvidia had received subpoenas from the U.S. Department of Justice Antitrust Division in connection with the DOJ s investigation into potential antitrust violations related to graphics processing units and cards. All of the actions appear to allege that the defendants conspired to fix, raise, maintain, or stabilize the prices of graphics processing units and cards in violation of federal antitrust law and/or state antitrust law. Further, each of the complaints is styled as a putative class action and alleges a class of plaintiffs (either indirect or direct purchasers) who purportedly suffered injury as a result of the defendants alleged conduct. The majority of the complaints propose a class period from November or December 2002 to the present.

Environmental Matters

We are named as a responsible party on Superfund clean-up orders for three sites in Sunnyvale, California that are on the National Priorities List. Since 1981, we have discovered hazardous material releases to the groundwater from former underground tanks and proceeded to investigate and conduct remediation at these three sites. The chemicals released into the groundwater were commonly used in the semiconductor industry in the United States in the wafer fabrication process prior to 1979.

In 1991, we received Final Site Clean-up Requirements Orders from the California Regional Water Quality Control Board relating to the three sites. We have entered into settlement agreements with other responsible parties on two of the orders during the term of such agreements. Under these agreements other parties have assumed most of the foreseeable costs as well as the primary role in conducting remediation activities under the orders. We remain responsible for additional costs beyond the scope of the agreements as well as all remaining costs in the event that the other parties do not fulfill their obligations under the settlement agreements.

To address anticipated future remediation costs under the orders, we have computed and recorded an estimated environmental liability of approximately $4.2 million in accordance with applicable accounting rules and have not recorded any potential insurance recoveries in determining the estimated costs of the cleanup. The progress of future remediation efforts cannot be predicted with certainty, and these costs may change. We believe that the potential liability, if any, in excess of amounts already accrued, will not have a material adverse effect on our financial condition or results of operations.

Other Matters

We are a defendant or plaintiff in various other 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 our financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock (symbol AMD) is listed on the New York Stock Exchange. On February 16, 2007, there were 7480 registered holders of our common stock. The following table sets forth on a per share basis the high and low intra-day sales prices on the New York Stock Exchange for our common stock for the periods indicated:

	High	Low
Fiscal year ended December 31, 2006		
First quarter	$ 42.70	$ 30.16
Second quarter	36.08	23.46
Third quarter	27.90	16.90
Fourth quarter	25.69	19.90

	High	Low
Fiscal year ended December 25, 2005		
First quarter	$ 22.37	$ 14.63
Second quarter	18.34	14.08
Third quarter	24.03	16.63
Fourth quarter	30.65	20.22

We have never paid any cash dividends on our common stock and have no present plans to do so. Under the terms of our October 2006 Term Loan and the terms of our Indenture for the 7.75% Notes dated October 29, 2004 with Wells Fargo Bank, N.A., as Trustee, we are limited in our ability to pay cash dividends unless we obtain the written consent of the lenders and bondholders. Specifically, we are prohibited from paying cash dividends if the aggregate amount of dividends and other restricted payments made by us since entering into the respective agreement would exceed the sum of specified financial measures including fifty percent of consolidated net income as that term is defined in the respective agreement. In addition, our German subsidiary, AMD Fab 36 KG is restricted by the terms of the Fab 36 Loan Agreement from paying cash dividends to us or providing loans or advances to us in certain circumstances without the prior written consent of the lenders.

The information under the caption, Equity Compensation Plan Information, in our Proxy Statement for our Annual Meeting of Stockholders to be held on May 3, 2007 (2007 Proxy Statement) is incorporated herein by reference.

During the period covered by this report, we issued or sold the following equity securities that were not registered under the Securities Act of 1933, or the Act.

On October 25, 2006, we acquired all the outstanding shares of ATI for a combination of approximately $4.3 billion in cash, and approximately 58 million shares of our common stock. The common stock was issued pursuant Section 3(a)(10) of the Act, which provides an exemption from the registration requirements of the Act. The Superior Court of Justice (Ontario) held a hearing regarding, among other things, the fairness of the transaction and approved the transaction. This hearing satisfied the requirements of Section 3(a)(10).

We have an ongoing authorization from the Board of Directors to repurchase up to $300 million worth of our common stock over a period of time to be determined by management. These repurchases may be made in the open market or in privately negotiated transactions from time to time in compliance with applicable rules and regulations, subject to market conditions, applicable legal requirements and other factors. We are not required to repurchase any particular amount of our common stock and the program may be suspended at any time at our discretion. During the fourth quarter of 2006, we did not repurchase any of our equity securities pursuant to this Board authorized program.

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Performance Graph

Comparison of Five-Year Cumulative Total Returns

Advanced Micro Devices, S&P 500 Index and S&P 500 Semiconductor Index

The following graph shows a five-year comparison of cumulative total return on our common stock, the S&P 500 Index and the S&P 500 Semiconductor Index from December 28, 2001 through December 31, 2006. The past performance of our common stock is no indication of future performance.

Comparison of Five Year Total Return

This graph was plotted using the following data:

	Base Period	Years Ending				
Company / Index	**12/28/01**	**12/29/02**	**12/28/03**	**12/26/04**	**12/25/05**	**12/31/06**
AMD	**100**	38.77	89.74	135.04	186.20	124.24
S&P 500 Index	**100**	76.65	97.70	109.75	117.20	133.53
S&P 500 Semiconductors	**100**	49.40	91.76	73.56	86.05	75.77

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ITEM 6. SELECTED FINANCIAL DATA

Five Years Ended December 31, 2006

(In millions except per share amounts)

	2006[1][2]	2005[2]	2004[3]	2003[4]	2002
Net Revenue	$ 5,649	$ 5,848	$ 5,001	$ 3,519	$ 2,697
Cost of sales	2,856	3,456	3,033	2,327	2,105
Gross margin	2,793	2,392	1,968	1,192	592
Research and development	1,205	1,144	934	852	816
Marketing, general and administrative	1,140	1,016	812	587	670
In-process research and development	416[5]				
Amortization of acquired intangible assets and other integration charges	79[6]				
Restructuring and other special charges (recoveries), net				(14)	331[7]
Operating income (loss)	(47)	232	222	(233)	(1,225)
Interest income	116	37	18	20	35
Interest expense	(126)	(105)	(112)	(110)	(71)
Other income (expense), net	(13)	(24)	(49)[8]	1	(3)
Income (loss) before minority interest, equity in net income (loss) of Spansion Inc. and other and income taxes	(70)	140	79	(322)	(1,264)
Minority interest in consolidated subsidiaries[9]	(28)	125	18	45	
Equity in net income (loss) of Spansion Inc. and other	(45)	(107)[10]		6	6
Income (loss) before income taxes	(143)	158	97	(271)	(1,258)
Provision (benefit) for income taxes	23[12]	(7)	6	3	45[11]
Net income (loss)	$ (166)	$ 165	$ 91	$ (274)	$ (1,303)
Net income (loss) per common share					
Basic income (loss)	$ (0.34)	$ 0.41	$ 0.25	$ (0.79)	$ (3.81)
Diluted income (loss)	$ (0.34)	$ 0.40	$ 0.25	$ (0.79)	$ (3.81)
Shares used in per share calculation					
Basic	492	400	359	347	342
Diluted	492	441	371	347	342
Long-term debt, capital lease obligations and other, less current portion[13]	$ 4,189	$ 1,786	$ 2,043	$ 2,328	$ 1,892
Total assets	$ 13,147	$ 7,288	$ 7,844	$ 7,050	$ 5,694

(1) 2006 includes the operations of ATI for the period from October 25, 2006 through December 31 2006. As a result 2006 is not fully comparable to prior periods.

(2) Consolidated statement of operations data for 2005 includes the results of operations for our former Memory Products segment through December 20, 2005. From December 21, 2005, the date that Spansion closed its IPO, through December 25, 2005 and for all of 2006 we used the equity method of accounting to reflect our share of Spansion s net income (loss). We include this information under the caption, Equity in net income (loss) of Spansion Inc. and other, on our consolidated statement of operations. Therefore, 2006 is not fully comparable to prior periods.

(3) Consolidated statement of operations data for 2004 includes the results of operations for our former Memory Products segment for the entire year. Therefore, 2004 is not fully comparable to 2005 during which Spansion s results of operations were not consolidated with our results of operations for the last five days of the fiscal year.

(4) Consolidated statement of operations data for 2003 includes the results of operations of Spansion from June 30, 2003, the date of formation of Spansion LLC (formerly known as FASL LLC). Spansion s results

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of operations were reported as part of our former Memory Products segment. We formed Spansion LLC with Fujistu Limited on June 30, 2003 by expanding an existing manufacturing joint venture that was formed in 1993 and in which we had an ownership interest of slightly less than 50 percent. Upon the formation of Spansion LLC, our ownership interest increased to 60 percent, From June 30, 2003 through December 20, 2005 we maintained our 60 percent ownership interest, Prior to June 30, 2003, we accounted for our interest in the manufacturing joint venture under the equity method. Therefore, consolidated statement of operations data for 2003 is not comparable to 2004, and consolidated statement of operations data for 2003 is not comparable to 2002 data. Minority interest consists primarily of the elimination of Fujitsu Limited s share of the income (loss) of Spansion. Fujitsu held a 40 percent minority ownership interest in Spansion, prior to the IPO of Spansion Inc (Spansion Related Minority Interest).

(5) Represents a write off of in-process research and development in connection with the ATI acquisition.

(6) Represents amortization of acquisition related intangible assets acquired as part of the ATI acquisition and charges incurred to integrate the operations of ATI with our operations.

(7) In 2002, we incurred approximately $331 million of charges in connection with the 2002 Restructuring Plan.

(8) Other income (expense), net, includes a charge of approximately $32 million associated with our exchange of $201 million of our 4.50% Convertible Senior Notes due 2007 (4.5% Notes) for common stock and a charge of approximately $14 million in connection with our prepayment of amounts outstanding under a term loan agreement among our German subsidiary, AMD Fab 30 Limited Liability Company & Co. KG, and the lenders party thereto (the Fab 30 Term Loan).

(9) The 2006 minority interest amount represents the guaranteed rate of return of between 11 and 13 percent related to the limited partnership contributions that AMD Fab 36 KG received from the unaffiliated partners (Fab 36 Minority Interest); the 2005 and 2004 minority interest amount includes the Fab 36 Minority Interest and Spansion Related Minority Interest; the 2003 minority interest amount represents the Spansion Related Minority Interest.

(10) Due to the dilution in our ownership interest in Spansion from 60 percent to approximately 38 percent in connection with Spansion s IPO, we recorded a loss of $110 million which represents the difference between Spansion s book value per share before and after the IPO multiplied by the number of shares owned by us.

(11) The 2002 income tax provision was recorded primarily for taxes due on income generated in certain state and foreign tax jurisdictions. No tax benefit was recorded in 2002 on pre-tax losses due to the establishment of a valuation allowance against the remainder of our U.S. deferred tax assets, net of U.S. deferred liabilities, in the fourth quarter, due to the incurrence of continuing substantial operating losses in the U.S.

(12) The 2006 income tax provision primarily results from current foreign taxes, plus deferred U.S. tax related to indefinite-lived goodwill, and reduced by deferred foreign benefits from removing part of the valuation allowance on German net operating loss carryovers of Fab 36.

(13) Includes long-term debt and capital lease obligations, less current portion and Other long-term liabilities.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the consolidated financial statements and related notes as of December 31, 2006 and December 25, 2005 and for each of the three years in the period ended December 31, 2006, which are included in this Form 10-K.

Introduction

We are a global semiconductor company with facilities around the world. During most of 2006, within the global semiconductor industry, we offered primarily:

- x86 microprocessors, for the commercial and consumer markets, which are used for control and computing tasks; and
- Embedded microprocessors for commercial, commercial client and consumer markets.

As a result of our acquisition of ATI in October 2006, we began to supply 3D graphics, video and multimedia products and chipsets for desktop and notebook PCs, professional workstations, and servers as well as products for consumer electronic devices such as mobile phones, digital TVs and game consoles. Therefore, since the acquisition, we have actively participated in the semiconductor graphics and chipset markets as well as in the semiconductor market for consumer electronics devices.

Prior to the closing of the initial public offering, or IPO, of Spansion Inc., on December 21, 2005, which is described in more detail below, we also manufactured and sold Flash memory devices through Spansion LLC, our former majority-owned subsidiary.

In this section, we will describe the general financial condition and the results of operations for Advanced Micro Devices, Inc. and its consolidated subsidiaries, including a discussion of our results of operations for 2006 compared to 2005 and 2005 compared to 2004, an analysis of changes in our financial condition and a discussion of our contractual obligations and off balance sheet arrangements. Our results of operations include sales of graphics, video, multimedia and chipset products and products for consumer electronics devices from the closing date of the ATI acquisition on October 25, 2006 through December 31, 2006 in two new reportable segments: (i) Graphics and Chipsets and (ii) Consumer Electronics. We are not able to provide any comparative information for these two segments because prior to the ATI acquisition, we did not participate in these markets. This MD&A should be read in conjunction with the other sections of this Form 10-K, including Part I, Item 1: Business; Part II, Item 6: Selected Financial Data; and Part II, Item 8: Financial Statements and Supplementary Data.

Overview

Total net revenue in 2006 amounted to $5.6 billion, an increase of 44 percent from net revenue, excluding the Memory Products segment, of $3.9 billion in 2005. 2006 included approximately $400 million of net revenue attributable to our two new reportable segments Graphics and Chipsets, and Consumer Electronics. Overall growth, however, was primarily driven by the performance of our Computation Products segment where net revenue of $5.1 billion increased by 35 percent compared to 2005 due to increased unit sales of our desktop, mobile and server processors. We believe that our continued strategy of developing products based on our customers needs combined with our open standards

approach, which allows customers to choose the combination of technologies that best serve their needs, contributed to accelerating customer and end-user adoption of our products across all geographies.

During 2006 we also experienced the following: increasing adoption of our products among enterprises; increasing sales of our server and mobile processor products; establishment of relationships with key OEMs such as Dell Inc., Founder Technology and Tsinghua Tongfang and strengthening relationships with existing OEM customers; and a decrease in our dependence on mature markets such as North America and Europe by focusing on high growth markets, such as China. By the end of 2006, 95 percent of the top 100 and over 65 percent

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of the top 500 of the *Forbes* Global 2000 were using AMD64 technology, and existing customers continued to expand the number of AMD-based solutions targeting the commercial market. Also, compared to 2005, sales of our mobile and server processor products grew faster than sales of our desktop products.

We believe our progress in the marketplace in 2006 will allow us to continue to develop products based on platform solutions. Platforms consist of a collection of technologies that are designed to work together to provide a better product than if the technologies were used separately. With our acquisition of ATI in October 2006, which is described in more detail below, we intend to develop and offer integrated CPU and GPU platforms to our customers. However, we also intend to continue to develop and provide discrete microprocessor and graphics processor products and to maintain open interface and software standards in order to allow our customers to choose the combination of technologies that best serve their needs.

We also continued to execute our microprocessor manufacturing plans during 2006. During the first quarter, we began commercial shipments of processors manufactured on 300-millimeter wafers at Fab 36. During June 2006, we began shipments of processors manufactured at Chartered Semiconductor, and during the fourth quarter we began commercial shipments of processors manufactured using 65-nanometer technology.

We also announced developments in our future manufacturing capacity strategy. In May 2006, we announced plans to significantly expand our 300-millimeter manufacturing capacity in Dresden, Germany by converting Fab 30 from manufacturing 200-millimeter wafers to 300-millimeter wafers, expanding the capacity of Fab 36 and adding a new facility to support bump and test activities. We also announced an agreement with the New York State Urban Development Corporation d/b/a Empire State Development Corporation pursuant to which we would receive financial incentives from the State of New York to build a new 300-millimeter wafer fabrication facility on the Luther Forest Technology Campus in Saratoga County, New York if we decide to build the facility. We believe that our investment in expanding the manufacturing capacity of our Dresden operations and the option to build a new manufacturing facility in New York will provide us with maximum flexibility to intelligently scale production to meet market demand.

We also faced challenges in 2006, particularly in the second half of the year, due to competitive market conditions. Despite a richer product mix in 2006 compared to 2005, average selling prices remained relatively flat. Higher average selling prices in the first half of 2006 were offset by lower average selling prices in the second half of 2006. Average selling prices decreased significantly in the fourth quarter of 2006 as compared to the third quarter of 2006 particularly for our server processor products, which had a negative impact on fourth quarter gross margin. Similarly, gross margins in 2006 decreased compared to gross margins, excluding the Memory Products segment, in 2005. Higher gross margins in the first half of 2006 were more than offset by lower gross margins in the second half of 2006 due to declining average selling prices, higher manufacturing costs and the consolidation of the operations of ATI, which historically has had lower gross margins than AMD s business. We believe that 2007 will continue to be extremely competitive, particularly with respect to product pricing.

Another challenge in the second half of 2006 related to the ability of our supply chain to keep up with the significant ramp in microprocessor units sold across a diverse set of customers and geographies and to deliver products on a timely basis. One of our key goals in 2007 is to improve the efficiency and scalability of our supply chain.

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.

ATI Acquisition

On October 25, 2006, we completed the acquisition of all of the outstanding shares of ATI, a publicly held company headquartered in Markham, Ontario, Canada for a combination of cash and our common stock.

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The aggregate consideration that we paid for all outstanding ATI common shares consisted of approximately $4.3 billion of cash and 58 million shares of our common stock. In addition, we also issued options to purchase approximately 17.1 million shares of our common stock and approximately 2.2 million comparable AMD restricted stock units in exchange for outstanding ATI stock options and restricted stock units. To finance a portion of the cash consideration paid, we borrowed $2.5 billion under the October 2006 Term Loan. The total purchase price for ATI was $5.6 billion, including acquisition related costs of $25 million, and consisted of:

	(In millions)
Acquisition of all of the outstanding shares, stock options, restricted stock units and other stock-based awards of ATI in exchange for:	
Cash	$ 4,263
58 million shares of AMD common stock	1,172
Fair value of vested options and restricted stock units issued	144
Acquisition related transaction costs	25
Total purchase price	$ 5,604

The fair value of the common stock we issued was determined under EITF 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*, which reflected the average of the closing prices of our common stock on the NYSE for the three trading days prior to October 25, 2006. The fair value of the options and restricted stock units we issued was determined under SFAS 123R, *Share-Based Payment* (SFAS 123R). The vested portion of these options and restricted stock units was valued at approximately $144 million. The unvested portion valued at approximately $69 million will be amortized over the future remaining vesting periods. The stock compensation expense for 2006 related to these stock options and restricted stock units was approximately $10 million.

Preliminary Purchase Price Allocation

We accounted for the acquisition using the purchase method of accounting in accordance with the provisions of SFAS No. 141, *Business Combinations*. We included the operations of ATI in our consolidated financial statements from October 25, 2006 through December 31, 2006. The total purchase price was preliminarily allocated to ATI s tangible and identifiable intangible assets and liabilities based on their estimated fair values as of October 24, 2006 as set forth below:

	(In millions)
Cash and marketable securities	$ 500
Accounts receivable	290
Inventories	431
Goodwill	3,217
Developed product technology	752
Game console royalty agreement	147
Customer relationships	257
Trademarks and trade names	62
Customer backlog	36
In-process research and development	416
Property, plant and equipment	143
Other assets	25
Accounts payable and other liabilities	(631)
Reserves for exit costs	(8)
Debt and capital lease obligations	(31)
Deferred revenues	(2)
Total purchase price	$ 5,604

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The primary areas of purchase price allocation that are not yet finalized relate to ATI-related exit costs, certain liabilities assumed, certain legal matters discussed in Part I, Item 3, Legal Proceedings and tax related contingencies. Resolution of ATI tax-related contingencies for amounts different than amounts recorded as of the close of the acquisition will result in adjustments to goodwill. Adjustments to amounts recorded as of the close of the acquisition related to the finalization of ATI-related exit costs and resolution of certain ATI legal contingencies will result in adjustments to goodwill or will be recorded in post-acquisition operating results, depending on the nature and timing of such adjustments.

Management performed an analysis to determine the fair value of each tangible and identifiable intangible asset, including the portion of the purchase price attributable to acquired in-process research and development projects.

In-Process Research and Development

Of the total purchase price, approximately $416 million was allocated to in-process research and development (IPR&D) and was expensed in the fourth quarter of fiscal year 2006. Projects that qualify as IPR&D represent those that have not reached technological feasibility and have no alternative future use at the time of the acquisition. The value assigned to IPR&D was determined using a discounted cash flow methodology, specifically an excess earnings approach, which estimates value based upon the discounted value of future cash flows expected to be generated by the in-process projects, net of all contributory asset returns. The approach includes consideration of the importance of each project to the overall development plan, estimating costs to develop the purchased IPR&D into commercially viable products. The revenue estimates used to value the purchased IPR&D were based on estimates of the relevant market sizes and growth factors, expected trends in technology and the nature and expected timing of new product introductions by ATI and its competitors.

The discount rates applied to individual projects were selected after consideration of the overall estimated weighted average cost of capital for ATI and the discount rates applied to the valuation of the other assets acquired. Such weighted average cost of capital was adjusted to reflect the difficulties and uncertainties in completing each project and thereby achieving technological feasibility, the percentage of completion of each project, anticipated market acceptance and penetration, market growth rates and risks related to the impact of potential changes in future target markets.

We acquired and intend to continue developing approximately $306 million and $325 million in-process projects in the Graphics and Chipsets segment, and the Consumer Electronics segment. These projects include development of next generation GPU, chipset, handheld and digital TV products. The estimated fair value of the projects for the Graphics and Chipsets segment was approximately $193 million and we expect to incur approximately $113 million to complete these projects over the next two years. The estimated fair value of the projects for the Consumer Electronics segment was approximately $223 million and we expect to incur approximately $102 million to complete these projects over the next two years. In developing the estimated fair values, we used discount rates ranging from 14 percent to 15 percent.

The development of these technologies remains a risk due to the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for new products, and significant competitive threats from our competitors. Failure to develop these technologies into commercially viable products and/or failure to bring them to market in a timely manner could result in a loss of market share and could have a material adverse impact on our business and operating results and could negatively impact the return on investment expected at the time that this acquisition was completed and may result in impairment charges.

The estimates used in valuing these IPR&D were based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable, and, as a result, actual results may differ from estimates.

There have not been any significant changes in the status of the efforts to complete these projects as of December 31, 2006.

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Other Acquisition Related Intangible Assets

Developed product technology consists of products that have reached technological feasibility and includes technology in ATI s discrete GPU products, integrated chipset products, handheld products, and digital TV products divisions. We expect this intangible asset to have a useful life of five years.

Game console royalty agreements represent agreements existing as of October 24, 2006 with video game console manufacturers for the payment of royalties to ATI for intellectual property design work performed and were estimated to have an average useful life of five years.

Customer relationship intangibles represent ATI s customer relationships existing as of October 24, 2006 and were estimated to have an average useful life of four years.

We expect trademarks and trade names to have an average useful life of seven years.

Customer backlog represents customer orders existing as of October 24, 2006 that had not been delivered and were estimated to have a useful life of 14 months.

We determined the fair value of intangible assets using income approaches based on the most current financial forecast available as of October 24, 2006. The discount rates we used to discount net cash flows to their present values ranged from 12 percent to 15 percent. We determined these discount rates after consideration of our estimated weighted average cost of capital and the estimated internal rate of return specific to the acquisition. We recorded the excess of the purchase price over the net tangible and identifiable intangible assets as goodwill.

We based estimated useful lives for the intangible assets on historical experience with technology life cycles, product roadmaps and our intended future use of the intangible assets. We are amortizing the acquisition related intangible assets using the straight-line method over their estimated useful lives.

Integration Costs

Concurrent with the acquisition, we implemented an integration plan, which included the termination of some ATI employees, the relocation or transfer to other sites of other ATI employees and the closure of duplicate facilities. We estimated the costs associated with employee severance and relocation to be $7 million. We estimated the costs associated with the closure of duplicate facilities to be $1 million. These costs were included as a component of net assets acquired. Additionally, the integration plan also included termination of some AMD employees, cancellation of some existing contractual obligations, and other costs to integrate the operations of the two companies. We estimated these costs to be $32 million for the year ended December 31, 2006, and they are included in the caption, Amortization of acquired intangible assets and integration charges on our consolidated statement of operations.

Critical Accounting Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our 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 consolidated financial statements. We evaluate our estimates on an on-going basis, including those related to our revenues, inventories, asset impairments, goodwill, business combination, 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, actual results may differ from these estimates or our estimates may be affected by different assumptions or conditions.

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We believe the following critical accounting estimates are the most significant to the presentation of our financial statements and require the most difficult, subjective and complex judgments.

Revenue Reserves. We record a provision for estimated sales returns and allowances on product sales for estimated future price reductions and other customer incentives in the same period that the related revenues are recorded. We base these estimates on actual historical sales returns, allowances, historical price reductions, market activity, and other known or anticipated trends and factors. These estimates are subject to management s judgment, and actual provisions could be different from our estimates and current provisions, resulting in future adjustments to our revenues and operating results.

Inventory Valuation. At each balance sheet date, we evaluate our ending inventories for excess quantities and obsolescence. This evaluation includes analysis of sales levels by product and projections of future demand. These projections assist us in determining the carrying value of our inventory and are also used for near-term factory production planning. Generally, inventories on hand in excess of forecasted demand for the next six months are not valued. In addition, we write off inventories that are considered obsolete. We adjust remaining specific inventory balances to approximate the lower of our standard manufacturing cost or market value. Among other factors, management considers forecasted demand in relation to the inventory on hand, competitiveness of product offerings, market conditions and product life cycles when determining obsolescence and net realizable value. If we anticipate future demand or market conditions to be less favorable than our projections as forecasted, additional inventory write-downs may be required and would be reflected in cost of sales in the period the revision is made. This would have a negative impact on our gross margin in that period. If in any period we are able to sell inventories that were not valued or that had been written off in a previous period, related revenues would be recorded without any offsetting charge to cost of sales, resulting in a net benefit to our gross margin in that period.

Impairment of Long-Lived Assets. We consider no less frequently than quarterly whether indicators of impairment of long-lived assets are present. These indicators may include, but are not limited to, significant decreases in the market value of an asset and significant changes in the extent or manner in which an asset is used. If these or other indicators are present, we determine whether the estimated undiscounted cash flows attributable to the assets in question are less than their carrying value. If less, we recognize an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value is determined by discounted future cash flows, appraisals or other methods. If the asset determined to be impaired is to be held and used, we recognize an impairment loss through a charge to our operating results which also reduces the carrying basis of the related asset(s). The new carrying value of the related asset(s) is depreciated over the remaining estimated useful life of the asset(s). We may incur additional impairment losses in future periods if factors influencing our estimates of the undiscounted cash flows change.

Goodwill. As a result of the ATI acquisition, we recorded approximately $3.2 billion of goodwill on our books. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets, w*e are required to review goodwill for impairment at least annually or more often if there are indicators of impairment present. We will perform our annual impairment analysis during the fourth quarter of each year, with the first impairment test related to ATI goodwill to be performed during the fourth quarter of 2007. The provisions of SFAS 142 require that a two-step impairment test be performed on goodwill. In the first step, we will compare the fair value of each reporting unit to which goodwill has been allocated to its carrying value. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is considered not impaired and we are not required to perform further testing. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then we must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, then we would record an impairment loss equal to the difference.

Determining the number of reporting units and the fair value of a reporting unit requires us to make judgments and involves the use of significant estimates and assumptions. These estimates and assumptions include revenue growth rates and operating margins used to calculate projected future cash flows, risk-adjusted

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discount rates, future economic and market conditions and determining of appropriate market comparables. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates. In addition, we make judgments and assumptions in allocating assets and liabilities to each of our reporting units.

Business Combinations. In accordance with business combination accounting, we have allocated the purchase price of ATI to tangible and acquisition related intangible assets acquired and liabilities assumed as well as to in-process research and development based on their estimated fair values. These valuations require us to make significant estimates and assumptions, especially with respect to acquisition related intangible assets.

We will review the acquisition related intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recovered.

We make estimates of fair value using reasonable assumptions based on historical experience and information obtained from the management of the acquired company. Critical estimates in valuing certain of the acquisition related intangible assets include but are not limited to: future expected cash flows from sale of products, expected costs to develop in-process research and development projects into commercially viable products and estimated cash flows from the projects when completed; the market s awareness of the acquired company s brand and the acquired company s market position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company s product portfolio; and discount rates. Unanticipated events may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

Income Taxes. In determining taxable income for financial statement reporting purposes, we must make certain estimates and judgments. These estimates and judgments are applied in the calculation of certain tax liabilities and in the determination of the recoverability of deferred tax assets, which arise from temporary differences between the recognition of assets and liabilities for tax and financial statement reporting purposes.

We must assess the likelihood that we will be able to recover our deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a charge to income tax expense, in the form of a valuation allowance, for the deferred tax assets that we estimate will not ultimately be recoverable. We consider past performance, future expected taxable income and prudent and feasible tax planning strategies in determining the need for a valuation allowance.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax rules and the potential for future adjustment of our uncertain tax positions by the Internal Revenue Service or other taxing jurisdiction. If our estimates of these taxes are greater or less than actual results, an additional tax benefit or charge will result.

Results of Operations

We review and assess operating performance using segment revenues and operating income (loss) before interest, taxes, equity in net loss of Spansion Inc. and other, 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 AMD chipset products;
- the Memory Products segment, which included Spansion Flash memory products; and
- the Personal Connectivity Solutions segment, which consisted of embedded processors for global commercial and consumer markets.

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On December 21, 2005, Spansion Inc., our former majority-owned subsidiary, completed its initial public offering, or IPO. Following the IPO, our ownership interest in Spansion was reduced from 60 percent to approximately 38 percent of Spansion s outstanding common stock. In November 2006, we sold 21 million shares of Spansion s Class A common stock in an underwritten public offering. As a result of this sale, as of December 31, 2006 we owned approximately 21 percent of Spansion s outstanding common stock.

As a result of Spansion s IPO, our financial results of operations include Spansion s financial results of operations as a consolidated subsidiary only 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 share of Spansion s net income (loss) from December 21, 2005 through December 31, 2006. Accordingly, our operating results, including the segment operating results for the Memory Products segment, for the year ended December 25, 2005 are not fully comparable with our results for 2004 or 2006. Because we currently report our interest in Spansion s results of operations using the equity method of accounting, our share of Spansion s net income (loss) will impact our net income (loss).

Following Spansion s IPO, from December 21, 2005 through October 24, 2006, we had two reportable segments: the Computation Products segment and the Embedded Products segment, which prior to the first quarter of 2006, we referred to as the Personal Connectivity Solutions segment. In addition we also had an All Other category, which was not a reportable segment. This category included sales of Personal Internet Communicator (PIC) products, which the Company s Chief Operating Decision Maker (CODM), who is also our Chief Executive Officer, began to review separately starting in the third quarter of 2005, and certain operating expenses and credits that were not allocated to any of our reportable segments because the CODM did not consider these operating expenses and credits in evaluating the operating performance of our reportable segments. Effective as of the third quarter of 2006, PIC products have not been manufactured.

As a result of the acquisition of ATI, effective October 25, 2006, we now have the following four reportable segments:

- the Computation Products segment, which includes microprocessors, chipset products that we manufactured prior to the ATI acquisition and related revenue;
- the Embedded Products segment, which includes embedded processors and related revenue;
- the Graphics and Chipsets segment, which includes 3D graphics, video and multimedia products and chipsets sold by ATI prior to the acquisition for use in desktop and notebook PCs, including home media PCs, professional workstations and servers, and related revenue; and
- the Consumer Electronics segment, which includes products used in handheld devices, such as mobile phones and PDAs, digital televisions and other consumer electronics products as well as related revenue and revenue for royalties received in connection with sales of game console systems that incorporate our products.

In addition to the reportable segments, we have an All Other category, which is not a reportable segment. The All Other category includes certain operating expenses and credits that are not allocated to any of the operating segments because the CODM does not consider these operating expenses and credits in evaluating the operating performance of the operating segments. Also, following the acquisition of ATI, we began including employee stock-based compensation expense, profit sharing expense, and ATI acquisition-related and integration charges in the All Other category. We reclassified prior period segment information 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 year ended December 31, 2006 consisted of 53 weeks, and the years ended December 25, 2005, and December 26, 2004 each included 52 weeks. References in this report to 2006, 2005 and 2004 shall refer to the fiscal year unless explicitly stated otherwise. Commencing in 2007, we will use a 52- to 53-week fiscal year ending on the last Saturday in December.

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The following is a summary of our net revenue and operating income (loss) by segment for 2006, 2005 and 2004.

	2006	2005	2004
		(In millions)	
Net revenue:			
Computation Products	$ 5,104	$ 3,793	$ 2,528
Embedded Products	149	136	130
Graphics and Chipsets	278		
Consumer Electronics	120		
All Other	(2)	6	
Memory Products		1,913	2,343
Total Net Revenue	$ 5,649	$ 5,848	$ 5,001
Operating income (loss):			
Computation Products	$ 706	$ 641	$ 280
Embedded Products	(18)	(55)	(54)
Graphics and Chipsets	(33)		
Consumer Electronics	20		
All Other	(722)	(43)	(39)
Memory Products		(311)	35
Total Operating Income (Loss)	$ (47)	$ 232	$ 222

Computation Products

Computation Products net revenue of $5.1 billion in 2006 increased 35 percent compared to net revenue of $3.8 billion in 2005 primarily as a result of a 35 percent increase in unit shipments. Unit shipments increased in 2006 compared to 2005 due to increased demand for processors in each of the desktop, server and mobile products. However, we believe that the challenge we experienced with the ability of our supply chain to keep up with the increased demand across a diverse set of customers and geographies and to deliver products on a timely basis had an adverse impact on unit shipments. Despite a richer product mix in 2006, average selling prices remained relatively flat in 2006 as compared to 2005. Higher average selling prices in the first half of 2006 were offset by lower average selling prices in the second half of 2006 due to competitive market conditions. Specifically, in the second half of 2006 aggressive pricing by our principal competitor in an attempt to regain market share adversely impacted our average selling prices. Our competitor also launched its quad-core multi-chip module processors during the fourth quarter of 2006, and since we did not offer quad-core products during this period, we discounted the selling price of certain of our competing products which adversely impacted our average selling prices, margins and profitability. We do not anticipate shipping our first quad-core products until mid-2007. We anticipate that 2007 will continue to remain extremely competitive, particularly with respect to product pricing.

Computation Products net revenue of $3.8 billion in 2005 increased 50 percent compared to net revenue of $2.5 billion for 2004 primarily due to an increase of 37 percent in unit shipments and an increase of nine percent in average selling prices. Unit shipments increased due to greater demand for our desktop, mobile and server products across all geographic regions, particularly in North America and Greater China. In addition, 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. The increase in average selling prices was primarily due to increased sales of our higher priced, high-performance AMD64-based processors which contributed to a richer product mix.

Computation Products operating income of $706 million in 2006 increased by $65 million, or 10 percent, compared to operating income of $641 million in 2005. This increase was primarily due the 35 percent increase

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in net revenue partially offset by an increase in marketing, general and administrative expenses of $258 million and an increase in research and development expenses of $222 million.

Computation Products operating income of $641 million in 2005 increased by $361 million, or 129 percent, compared to operating income of $280 million in 2004. This increase was primarily due to a 50 percent increase in net revenue whereas cost of sales increased by only 45 percent. Partially offsetting this increase was an increase in marketing, general and administrative expense of $199 million and an increase in research and development expenses of $203 million.

Embedded Products

Embedded Products net revenue of $149 million in 2006 increased by $13 million, or 10 percent, compared to net revenue of $136 million in 2005. The increase was primarily due to a $16 million increase in sales of AMD Geode products, offset by $4 million decrease in legacy networking products.

Embedded Products net revenue of $136 million in 2005 increased by $6 million, or four percent, compared to net revenue of $130 million in 2004. The increase was primarily due to a $13 million increase in sales of AMD Geode products and an $8 million increase in sales of other embedded processors, partially offset by a $15 million decrease in sales of legacy networking products and MIPS-architecture based products.

Embedded Products operating loss of $18 million in 2006 decreased $37 million as compared to an operating loss of $55 million in 2005. The decrease in operating loss was primarily due to a $20 million decrease in research and development expenses and $12 million in sales of products that we had previously written off.

Embedded Products operating loss of $55 million in 2005 was flat compared to an operating loss of $54 million in 2004. The increase in net revenue of $6 million from 2004 to 2005 was offset by an increase in operating expenses of $6 million.

Graphics and Chipsets

Net revenue and operating loss represents the operating results of this segment for the period of October 25, 2006 through December 31, 2006. We are not able to provide any comparative information for this segment because prior to the ATI acquisition we did not sell comparable products. Sales of AMD chipsets are included in the Computation Products segment.

Consumer Electronics

The revenue and operating income represents the operating results of this segment for the period of October 25, 2006 through December 31, 2006. We are not able to provide any comparative information for this segment because prior to the ATI acquisition we did not sell comparable

products.

Memory Products

As a result of Spansion s IPO in December 2005, we stopped manufacturing and selling memory products. Therefore, we did not have a Memory Products segment in 2006.

Memory Products net revenue of $1.9 billion in 2005 decreased 18 percent compared to net revenue of $2.3 billion in 2004. In 2005, we consolidated Spansion s net revenue into our Memory Product segment only through December 20, 2005. Therefore, approximately $104 million of Spansion s net revenue from December 21, 2005 through December 25, 2005 was excluded from Memory Products net revenue in 2005. In addition, Memory Products net revenue was adversely impacted due to a decrease of 28 percent in average selling prices in 2005 compared to 2004, partially offset by an increase of 14 percent in unit shipments in 2005 compared to 2004. Net

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revenue for the Memory Products segment for 2005 is not fully comparable with net revenue for 2004 because Spansion s net revenue was not consolidated with our net revenue from December 21, 2005 through December 25, 2005.

We experienced an operating loss of $311 million in 2005 in the Memory Products segment compared to operating income of $35 million in 2004. The decline in operating results was primarily due to a decrease in net revenue of $430 million while the cost of sales only decreased $109 million. Net revenue decreased as a result of a decrease of 28 percent in average selling prices in 2005 compared to 2004. Net revenue for the Memory Products segment for 2005 is not fully comparable with net revenue for 2004 because Spansion s net revenue was not consolidated with our net revenue from December 21, 2005 through December 25, 2005. In addition, we recorded a goodwill impairment charge of approximately $16 million during the fourth quarter of 2005. Goodwill in the amount of $16 million was generated on June 30, 2003 as a result of the formation of Spansion LLC, which we accounted for as a partial step acquisition and purchase business combination. In the fourth quarter of 2005, after considering the fact that the estimated fair value of Spansion was less than our carrying net book value and after comparing the estimated fair value of Spansion s assets (other than goodwill) to our carrying net book value for such assets, we concluded that the implied fair value of goodwill is zero. Therefore, we wrote off the entire $16 million of recorded goodwill.

All Other Category

All Other net revenue in 2006 decreased by $8 million from 2005, primarily because, we had minimal revenue from sales of PIC products and customers returned previously sold PIC products. Effective as of the third quarter of 2006, PIC products have not been manufactured.

All Other net revenue in 2005 was $6 million because of sales of PIC products. We launched the PIC in October 2004, and we did not generate any material sales from PIC products in 2004.

All Other operating loss of $722 million in 2006 increased by $679 million compared to an operating loss of $43 million in 2005. The increase in operating loss was primarily attributable to ATI acquisition-related charges of $557 million and an increase in employee stock-based compensation expense and profit sharing expense of $104 million. The ATI acquisition-related charges include the in-process research and development write-off of $416 million, amortization of acquired intangible assets of $47 million, cost of fair value adjustments to acquired inventory of $62 million and a $32 million charge associated with the integration plan which included termination of some AMD employees, cancellation of some existing contractual obligations and other costs that we incurred to integrate the operations of the two companies.

All Other operating loss of $43 million in 2005 increased from $39 million in 2004, primarily due a $10 million increase in employee stock-based compensation expense and profit sharing expense, partially offset by the fact that in 2004 we incurred restructuring and other special charges of $5 million, whereas there were no comparable charges in 2005.

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

The following is a summary of certain consolidated statement of operations data for the years ended December 31, 2006, December 25, 2005 and December 26, 2004:

	2006	2005	2004
		(In millions except for percentages)	
Cost of sales	$ 2,856	$ 3,456	$ 3,033
Gross margin	2,793	2,392	1,968
Gross margin percentage	49%	41%	39%
Gross margin percentage excluding Memory Products	49%	56%	55%
Research and development	$ 1,205	$ 1,144	$ 934
Marketing, general and administrative	1,140	1,016	812
In-process research and development	416		
Amortization of acquired intangible assets and integration charges	79		
Interest income	(116)	(37)	(18)
Interest expense	126	105	112
Other income (expense), net	(13)	(24)	(49)
Equity in net loss of Spansion Inc. and other	(45)	(107)	
Income tax provision (benefit)	23	(7)	6

Gross Margin

Gross margin increased to 49 percent in 2006 compared to 41 percent in 2005 because we did not consolidate Spansion s results of operations with ours in 2006. Gross margin decreased to 49 percent in 2006 compared to gross margin, excluding the Memory Products segment, of 56 percent in 2005. Higher gross margin in the first half of 2006 was more than offset by lower gross margin in the second half of 2006. The decrease in gross margin in 2006 compared to 2005 was primarily due to increased manufacturing costs and flat average selling prices. The increase in manufacturing costs was primarily due to a shift in our product mix to higher-end microprocessor products. In addition, consolidated gross margin was adversely impacted by approximately two percent due to the consolidation of ATI s operations into ours from October 25, 2006 through December 31, 2006. Historically, the ATI business had lower gross margins as compared to AMD. Gross margin was also adversely impacted by approximately one percent due to the costs of fair value adjustments related to the inventory we acquired through the ATI acquisition. To the extent that average selling prices decrease without a corresponding decrease in manufacturing costs, our gross margins will be adversely impacted.

Gross margin increased to 41 percent in 2005 compared to 39 percent in 2004. The improvement in gross margin was primarily due to increased sales of our microprocessor products, which comprised a greater percentage of total net revenue in 2005 as compared to 2004. Computation Products net revenue carried a higher gross margin than Memory Products net revenue. In addition, the improvement in gross margin was due to a 1.5 percent increase in gross margin for Computation Products. Computation Products gross margin improved as a result of a nine percent increase in average selling prices discussed above, partially offset by increased manufacturing costs caused by the shift in our product mix to higher-end microprocessor products. Gross margin also improved because we were better able to absorb our fixed manufacturing costs due in part to improving yields at Fab 30. The improvement in gross margin was partially offset by a 12 percent decrease in gross margin for Memory Products due primarily to a decrease of 28 percent in average selling prices in 2005 compared to 2004, partially offset by an increase of 14 percent in unit shipments in 2005 compared to 2004.

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 consolidated financial statements. We amortize these amounts as they are earned as a reduction to operating expenses. We record the amortization of the

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production related grants and allowances as a credit to cost of sales. The credit to cost of sales totaled $116 million in 2006, $72 million in 2005, and $67 million in 2004. The fluctuations in the recognition of these credits have not significantly impacted our gross margins.

Expenses

Research and Development Expenses

Research and development expenses increased $61 million, or 5 percent, from $1,144 million in 2005 to $1,205 million in 2006. This increase was primarily attributable to: a $222 million increase in research and development expenses attributable to our Computation Products segment primarily due to an increase in silicon design, platform and product development costs for our microprocessor products, a $90 million increase due to the consolidation of ATI s research and development expenses from October 25, 2006, and a $39 million increase in stock-based compensation, corporate bonus and profit sharing expenses. Research and development expenses were partially offset by the absence of Spansion research and development expenses because we did not consolidate Spansion s results of operations into ours in 2006. In 2005, research and development expenses attributable to our Memory Products segment were $290 million.

Research and development expenses increased $210 million, or 22 percent, from $934 million in 2004 to $1,144 million in 2005 primarily due to an increase of $103 million in product design and process improvement costs for new generations of our microprocessors and an increase in start-up costs associated with the Fab 36 project of $96 million.

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. 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 $27 million in 2006, $44 million in 2005, and $21 million in 2004.

Marketing, General and Administrative Expenses

Marketing, general and administrative expenses of $1,140 million in 2006 increased $124 million, or 12 percent, from $1,016 million in 2005. This increase was primarily attributable to a $258 million increase in marketing, general and administrative expenses attributable to our Computation Products segment primarily due to: a $215 million increase in marketing, branding and cooperative advertising costs, a $36 million increase due to the consolidation of ATI s marketing, general and administrative expenses from October 25, 2006, and a $27 million increase in stock-based compensation, corporate bonus and profit sharing expenses. Marketing, general and administrative expenses were partially offset by the absence of Spansion market, general and administrative expenses because we did not consolidate Spansion s results of operations into ours in 2006. In 2005, marketing, general and administrative expenses attributable to our Memory Products segment were $208 million.

Marketing, general and administrative expenses of $1,016 million in 2005 increased $204 million, or 25 percent, compared to $812 million in 2004, primarily due to an increase of $110 million in marketing and cooperative advertising costs and other expenses related to the 17 percent increase in revenue in 2005 compared to 2004. In addition, in 2005 we wrote off goodwill of $16 million, which was originally recorded in 2003 as a result of the formation of Spansion LLC.

In-process research and development, and amortization of acquired intangible assets and integration charges

In-process research and development of $416 million in 2006 relates to projects acquired in connection with the acquisition of ATI. Amortization of acquired intangible assets and integration charges in 2006 includes amortization of $47 million and integration charges of $32 million. See Part II, Item 7, MD&A ATI

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Acquisition In-Process Research and Development, Other Acquisition Related Intangible Assets and Integration Costs, for additional information.

Effects of 2002 Restructuring Plan

In December 2002, we began implementing a restructuring plan (the 2002 Restructuring Plan) to further align our cost structure to industry conditions resulting from weak customer demand and industry-wide excess inventory.

The 2002 Restructuring Plan resulted in the consolidation of facilities, primarily at our Sunnyvale, California site and at sales offices worldwide. We vacated and are attempting to sublease certain facilities that we currently occupy under long-term operating leases through 2011. We also terminated the implementation of certain partially completed enterprise resource planning software and other information technology implementation activities, resulting in the abandonment of certain software, hardware and capitalized development costs.

With the exception of exit costs consisting primarily of remaining lease payments on abandoned facilities net of estimated sublease income that are payable through 2011, we have completed the activities associated with the 2002 Restructuring Plan.

The following table summarizes activities under the 2002 Restructuring Plan for the three years ended December 31, 2006 (in millions):

	Severance and Employee Benefits	Exit and Equipment Decommission Costs	Total
Accruals at December 28, 2003	$ 7	$ 121	$ 128
Cash payments	(7)	(20)	(27)
Non-cash adjustments		5	5
Accruals at December 26, 2004		106	106
Cash payments		(21)	(21)
Accruals at December 25, 2005		85	85
Cash payments		(18)	(18)
Accruals at December 31, 2006	$	$ 67	$ 67

Interest Income

Interest income of $116 million in 2006 increased from $37 million in 2005, primarily due to a combination of an increase in average cash and marketable securities during 2006 compared to 2005 and a 54 percent increase in weighted-average interest rates.

Interest income of $37 million in 2005 increased from $18 million 2004, primarily due to a 135 percent increase in weighted-average interest rates and an increase in average cash and marketable securities in 2005 compared to 2004.

We expect interest income will be significantly lower in 2007 due to lower average cash and marketable securities balances.

Interest Expense

	2006	2005	2004
		(In millions)	
Total interest charges	$ 136	$ 140	$ 121
Less: interest capitalized	(10)	(35)	(9)
Interest expense	$ 126	$ 105	$ 112

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Interest expense of $126 million in 2006 increased from $105 million in 2005 primarily for the following reasons:

- Interest expense incurred on the October 2006 Term Loan and the Fab 36 Term Loan was $38 and $10 million, and these loans were not outstanding in 2005;
- Interest expense incurred on capital lease payments was approximately $11 million higher in 2006 due to increased assets acquired under capital leases; and
- Capitalized interest expense which was primarily related to Fab 36 was $25 million lower in 2006 compared to 2005.

These factors were offset by the following factors:

- During 2006 we did not consolidate Spansion s results of operations, and, therefore interest expense on Spansion s third-party debt, which was $24 million for 2005, was not included in 2006;
- Interest expense incurred on our 4.75% Debentures decreased by $21 million in 2006 compared to 2005 because holders of the 4.75% Debentures converted their debentures into shares of our common stock during the first quarter of 2006 whereas during 2005, $500 million of the aggregate principal amount of our 4.75% Debentures was outstanding; and
- Interest expense incurred on our 7.75% Notes decreased by $13 million because we redeemed $210 million of the aggregate principal amount outstanding during the first quarter of 2006.

We expect that interest expense will be significantly higher in 2007 due to additional interest incurred pursuant to the October 2006 Term Loan and the Fab 36 Term Loan.

Interest expense of $105 million in 2005 decreased $7 million compared to $112 million in 2004 primarily for the following reasons:

- In 2004, interest expense included approximately $26 million of interest under the Fab 30 Term Loan. Because we prepaid this loan on November 2, 2004, we did not incur any interest in connection with this loan in 2005;
- Interest expense incurred on our 4.50% Convertible Senior Notes due 2007 was $9 million in 2005 compared with $19 million in 2004 because the holders of an aggregate principal amount of $201.5 million of these notes converted their notes into our common stock during the fourth quarter of 2005, and we exchanged an aggregate principal amount of $200 million of these notes in a series of transactions during the fourth quarter of 2004 for shares of our common stock, and
- During 2005, we capitalized interest of $35 million in connection with Fab 36 construction activities in Dresden, Germany compared with $9 million in 2004.

These factors were offset by the following:

During 2005 we incurred higher interest expense of $48 million in connection with our 7.75% Notes, which we sold on October 29, 2004, compared with $8 million in 2004; and

Interest expense incurred pursuant to capital leases increased by approximately $10 million in 2005 compared with 2004.

Other Income (Expense), Net

Other income (expense), net of $13 million expense in the 2006 consisted primarily of a charge of $16 million related to a redemption premium and a charge of $4 million related to 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, and $12 million of finance charges related to the Fab 36 Term Loan, partially offset by a gain of $10 million associated with Spansion LLC s repurchase of its 12.75% Senior Subordinated Notes due 2016 and other miscellaneous items of income, net totaling $9 million.

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Other income (expense), net of $24 million expense in 2005 consisted primarily of a loss of approximately $10 million during the fourth quarter of 2005 resulting from the mark-to-market to earnings of certain foreign currency forward contracts which became ineffective in hedging against certain forecasted foreign currency transactions and approximately $14 million of commitment and guarantee fees incurred in connection with the Fab 36 Term Loan. We don t expect these foreign currency transactions to occur in the future due to the change of functional currency for AMD Fab 36 KG from the euro to the U.S. dollar.

Other income (expense), net of $49 million in 2004 was due primarily to a charge of approximately $32 million related to a series of transactions pursuant to which we exchanged $201 million of our 4.50% Convertible Senior Notes due 2007 for our common stock. The charge represented the difference between the fair value of the common stock issued in the transactions and the fair value of common stock issuable pursuant to the original conversion terms of these notes. In addition, interest income and other income (expense), net, in 2004 included a charge of approximately $14 million in connection with our prepayment of the term loan agreement between our German subsidiary, AMD Saxony Limited Liability Company & Co. KG and a consortium of banks in order to finance Fab 30, and a loss of approximately $6 million during the second quarter of 2004 resulting from the mark-to-market to earnings of certain foreign currency forward contracts that we used as economic hedges of forecasted capital contributions to AMD Fab 36 KG, which did not qualify as accounting hedges.

Equity in net loss of Spansion Inc. and other

Prior to the Spansion IPO, we held a 60 percent controlling ownership interest in Spansion, and Spansion s financial position, results of operations and cash flows were consolidated with ours. Consequently, Spansion s results of operations through December 20, 2005 were included in our consolidated statements of operations and cash flows in 2005. Following Spansion s IPO, our ownership interest was diluted from 60 percent to approximately 38 percent and we no longer exercised control over Spansion. As a result, from December 21, 2005, the closing date of the IPO, through December 25, 2005 and during 2006 we used the equity method of accounting to reflect our share of Spansion s net income (loss), and we no longer consolidated Spansion s financial position, operating results or cash flows with ours. In connection with the reduction of our ownership interest in Spansion, we recorded a loss of $110 million in 2005 which represents the difference between Spansion s book value per share before and after the IPO multiplied by the number of shares of Spansion s common stock owned by us.

In November 2006, we sold 21,000,000 shares of Spansion s Class A common stock in an underwritten public offering. We received $278 million in net proceeds from the offering and realized a gain of $6 million from the sale, which was included in the caption, Equity in net loss of Spansion, Inc. and other in our consolidated statements of operations. As a result of the offering, as of December 31, 2006 we own a total of 27,529,403 shares or approximately 21 percent of Spansion s outstanding common stock. During 2006, our equity in net loss of Spansion Inc. was $51 million. As of December 31, 2006, the carrying net book value of our net equity investment in Spansion, which includes our proportionate share of Spansion s accumulated other comprehensive income, amounted to approximately $361 million. The fair value of this investment was approximately $409 million based on Spansion s common stock closing market price on December 29, 2006, the last trading day of the fiscal year.

To the extent that our ownership in Spansion decreases in the future whether it is caused by disposal of our ownership interest or by Spansion s issuance of additional common stock, we would record either a gain or a loss on such further dilution depending on Spansion s book value and fair value at that time, which could have a material effect on our results of operations in the period in which this ownership dilution occurs.

Income Taxes

We recorded an income tax provision of $23 million in 2006, a tax provision benefit of $7 million in 2005, and an income tax provision of $6 million in 2004. The income tax provision in 2006 primarily results from

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current foreign taxes, plus deferred U.S. taxes related to indefinite-lived goodwill, and reduced by deferred foreign benefits from removing part of the valuation allowance on German net operating loss carryovers of Fab 36. The income tax benefit in 2005 primarily reflects U.S. tax benefits realized from the utilization of net operating losses and tax credits and foreign tax benefits generated by Spansion in certain foreign jurisdictions. Spansion s IPO did not have a material impact on our tax provision. The income tax provision in 2004 primarily reflects U.S. income taxes, including taxes on the dividends repatriated from controlled foreign corporations, partially offset by foreign tax benefits because of losses in various foreign jurisdictions.

As of December 31, 2006, we had U.S. federal and state net operating loss carry-forwards of approximately $38 million and $99 million. We also had U.S. federal and state tax credit carry-forwards of approximately $310 million and $112 million. The U.S. net operating loss and tax credit carry-forwards subject to expiration will expire at various dates beginning in 2007 through 2026, if not utilized. Approximately $28 million of our U.S. federal net operating loss carry-forwards are subject to annual limitations as a result of the ATI acquisition and prior purchase transactions. Less than $6 million of U.S. federal tax credit carry-forwards will expire unused by the end of 2009 should U.S. federal income tax liabilities not be large enough to utilize them in these future years.

We had German federal income and state trade tax operating loss carry-forwards of approximately $469 million and $414 million. German federal income and trade tax net operating losses are not subject to expiration. However, German losses are limited to 60 percent of taxable income in any one year.

We had Canadian federal and provincial tax operating loss carry-forwards of approximately $31 million. These losses expire in 2026. We also had Canadian investment tax credits of approximately $139 million. $72 million of these investment tax credits expires in 2012 and 2013 with the remainder expiring by 2026. We also had Canadian federal and provincial research and development pools of $523 million and $275 million, respectively, which are not subject to expiration.

We had net operating losses of $154 million in Barbados which expire beginning in 2012 through 2015.

We also had foreign loss carry-forwards totaling approximately $34 million in other countries with various expiration dates.

We maintain a full valuation allowance against all our net U.S. federal, state and Canadian deferred tax assets and certain of our other foreign deferred tax assets ($1.046 billion at December 31, 2006) because of our prior history of losses.

In 2006 the net valuation allowance increased by $305 million primarily to provide valuation allowance for tax assets in Canada and for losses in the U.S. as a result of our purchase accounting related to the ATI acquisition. If we in the future determine that it is more likely than not that some or all of the net deferred tax assets will be realized, an appropriate amount of the previously provided valuation allowance will be reversed, resulting in a benefit to our operating results or a reduction of goodwill if the valuation allowance is related to acquired deferred tax assets. Such benefits would be recorded on the income tax (benefit) provision line of our statement of operations in the quarter such determination is made.

We have placed a full valuation allowance on our Canadian net deferred tax assets acquired from the acquisition of ATI. These new Canadian operations are subject to immediate taxation in the U.S. as a branch. Future profits will be taxed at U.S. corporate tax rates net of any Canadian income taxes allowable as U.S. foreign income tax credits.

We have a deferred tax liability associated with a portion of the indefinite-lived goodwill resulting from the acquisition of ATI, as this portion of the purchase price is tax deductible. Because we also have a full valuation allowance against our net deferred tax assets without this item, future increases to this deferred tax liability will increase our provision for income taxes independent of the changes in deferred tax assets, liabilities, and

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valuation allowance related to other temporary differences. This deferred tax liability cannot be used as a source of realization for deferred tax assets because the underlying tax deductible goodwill is indefinite lived. Once the valuation allowance on U.S. deferred tax assets, net of deferred tax liabilities, is removed continued increases to this deferred tax liability may not directly increase the tax provision as this increase will be aggregated with other deferred tax changes. While the valuation allowance is present our tax expenses will not decline proportionately with declines in our consolidated income.

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. Prior to the adoption of SFAS 123R, we recognized stock-based compensation expense in accordance with Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees.* Upon adoption of SFAS 123R, we changed our 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. Also, upon adoption of SFAS 123R, we changed the method of valuing stock option awards from the Black-Scholes option pricing model, which was previously used for our pro forma information disclosures of stock-based compensation expense as required under SFAS No. 123, *Stock Based Compensation* (SFAS 123) to a lattice-binomial option-pricing model. The following table summarizes our stock-based compensation expense related to employee stock options, restricted stock, restricted stock units and employee stock purchases pursuant to our Employee Stock Purchase Plan under SFAS 123R for the year ended December 31, 2006, which we recorded in our consolidated results of operations as follows:

Stock-based compensation included as a component of:

	Year Ended December 31, 2006 (In millions)
Cost of sales	$ 8
Research and development	30
Marketing, general, and administrative	39
Total stock-based compensation expense related to employee stock options, restricted stock, restricted stock units, and employee stock purchases	77
Tax benefit	
Stock-based compensation expense related to employee stock options, restricted stock, restricted stock units, and employee stock purchases, net of tax	$ 77

We recognized minimal stock-based compensation expense for the years ended December 25, 2005, and December 26, 2004.

In anticipation of the adoption of SFAS 123R, beginning in the first quarter of 2006 we changed the quantity and type of instrument we primarily use in stock-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 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. Beginning in the first quarter of 2006, all employees below the level of vice president receive restricted stock units and employees at the vice president level and above receive grants of restricted stock units and stock options. As of December 31, 2006, we had $56 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock options that will be recognized over the weighted average

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period of 1.05 years. Also, as of December 31, 2006, we had $110 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock and restricted stock units that will be recognized over the weighted average period of 1.64 years. For additional information on stock-based compensation expense, see Note 2 to our consolidated financial statements.

On April 27, 2005, we accelerated the vesting of all stock options outstanding under the 2004 Equity Incentive Plan and our prior equity compensation plans that had exercise prices per share higher than the closing price of our stock on April 27, 2005, which was $14.51. Options to purchase approximately 12 million shares of our common stock became exercisable immediately. Options held by non-employee directors were not included in the vesting acceleration.

The primary purpose for accelerating the vesting was to eliminate future compensation expense we would otherwise recognize in our statement of operations with respect to these accelerated options upon the adoption of SFAS 123R. The acceleration of the vesting of these options did not result in a charge based on U.S. generally accepted accounting principles.

On December 15, 2005, we accelerated the vesting of all outstanding AMD stock options and restricted stock units held by Spansion employees that would otherwise have vested from December 16, 2005 to December 31, 2006. In connection with the modification of the terms of these options to accelerate their vesting, $1.2 million was recorded as non-cash compensation expense on a pro forma basis in accordance with SFAS 123, and this amount was included in the pro forma stock compensation expense for the year ended December 25, 2005.

The primary purpose for accelerating the vesting of these awards was to minimize future compensation expense that we and Spansion would otherwise have been required to recognize in Spansion s and our respective statements of operations with respect to these awards. If we had not accelerated the vesting of these awards, they would have been subject to variable accounting in accordance with the guidance provided in EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Service* and EITF Issue No. 00-12, *Accounting by an Investor for Stock-Based Compensation Granted to Employees of an Equity Method Investee*. This accounting treatment would have applied because following Spansion s IPO, we no longer consolidate Spansion s results of operations in our financial statements. Accordingly, Spansion employees are no longer considered our employees. Under variable fair value accounting, we would have been required to re-measure the fair value of unvested stock-based awards of our common stock held by Spansion employees after Spansion s IPO at the end of each accounting period until such awards were fully vested.

In connection with the acceleration of the vesting of these awards, we recorded a compensation charge in the fourth quarter of 2005 of $1.5 million, which was based on the estimated forfeiture rate of 7.94 percent. The actual forfeitures for 2006 were not materially different from the estimate used.

International Sales

International sales as a percent of net revenue were 75 percent in 2006, 79 percent in 2005 and 79 percent in 2004. In 2006, all of our net revenue was denominated in U.S. dollars. During 2005 and 2004, approximately 14 and 22 percent of our net revenue was denominated in currencies other than the U.S. dollar, primarily the Japanese yen. However, as a result of the closing of Spansion s IPO on December 21, 2005, we do not expect to have significant sales denominated in the Japanese yen in the future.

FINANCIAL CONDITION

Our cash, cash equivalents and marketable securities at December 31, 2006 totaled $1.5 billion and our debt and capital lease obligations totaled $3.8 billion.

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Net Cash Provided by Operating Activities

Net cash provided by operating activities was approximately $1.3 billion in 2006. Net loss of $166 million was adjusted for non-cash charges consisting primarily of $837 million of depreciation and amortization expense, $416 million for the write-off of in-process research and development expenses related to the ATI acquisition, stock-based compensation expense of $77 million, and $45 million related to an equity interest in the net loss of Spansion. These charges were offset by amortization of foreign grants and subsidies of $151 million. The net changes in operating assets at December 31, 2006 compared to December 25, 2005 included a decrease in payables to related parties of $229 million because we no longer ship products and invoice customers on behalf of Spansion. Prior to the second quarter of 2006, we shipped products to and invoiced Spansion s customers in our name on behalf of Spansion and remitted the receipts to Spansion. The increase in other assets was primarily due to purchases of new technology licenses. The increase in accounts payable and accrued liabilities of $530 million was primarily related to higher purchases of raw materials, future payment of technology licenses, and marketing accruals due to increased operations in the Computation Products segment.

Net cash provided by operating activities was approximately $1.5 billion in 2005. Net income of $165 million was adjusted for non-cash charges consisting primarily of $1.2 billion of depreciation and amortization expense, a non-cash charge of approximately $110 million that we incurred as a result of the dilution of our ownership in Spansion from 60 percent to approximately 38 percent as a result of Spansion s IPO, and a non-cash charge of $16 million in connection with our write-off of goodwill that was generated as of June 30, 2003 as a result of the formation of Spansion LLC, contributed to the positive cash flows from operations. The net changes in operating assets in 2005 compared to 2004 included an increase in accounts receivable due to higher net revenue and decreased inventories due primarily to the deconsolidation of Spansion s results of operations from ours as a result of Spansion s IPO.

Net cash provided by operating activities was approximately $1.1 billion in 2004. Net income of $91 million was adjusted for non-cash charges consisting primarily of $1.2 billion of depreciation and amortization expense and $32 million associated with our exchange of $201 million of our 4.50% Notes for common stock in the fourth quarter of 2004, contributed to the positive cash flows from operations. The net changes in operating assets in 2004 as compared to 2003 included an increase in accounts receivable due to higher net revenue, and increased inventories due primarily to an increase in microprocessor inventories resulting from a higher percentage of AMD64-based processors and improved market conditions.

Net Cash Used in Investing Activities

Net cash used in investing activities was $4.3 billion in 2006. We used $3.9 billion, net of cash and cash equivalents acquired, to acquire ATI, and $1.9 billion to purchase property, plant and equipment, including approximately $987 million to purchase equipment for Fab 36. This was partially offset by a net cash inflow of $947 million from sales and maturities of available for sale securities, $278 million from the sale of part of our investment in Spansion, Inc., and $175 million of proceeds from Spansion LLC s repurchase of its 12.75% Senior Subordinated Notes due 2016.

Net cash used in investing activities was $2.3 billion in 2005. We used $1.5 billion to purchase property, plant and equipment, including approximately $726 million for Fab 36, and a net cash outflow of $726 million from purchases of available-for-sale securities, including a purchase of $175 million aggregate principal amount of Spansion s 12.75% Senior Subordinated Notes for approximately $158.9 million, partially offset by $261 million in proceeds from Spansion s repayment of amounts outstanding under promissory notes to us and $133 million cash decrease due to the deconsolidation of Spansion s results of operations from ours.

Net cash used in investing activities was $1.6 billion in 2004. We used $1.4 billion to purchase property, plant and equipment, including approximately $569 million to construct Fab 36, and a net cash outflow of $150 million from purchases of available-for-sale securities, offset by $34 million in proceeds from sales of property, plant and equipment.

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Net Cash Provided by Financing Activities

Net cash provided by financing activities was $3.8 billion in 2006, and consisted primarily of proceeds from: borrowings of $3.4 billion pursuant to the October 2006 Term Loan and the Fab 36 Term Loan; proceeds of $495 million from the sale of our common stock in an equity offering, issuance of stock under our Employee Stock Purchase Plan and the exercise of employee stock options of $231 million; and capital investment grants and allowances from the Federal Republic of Germany and the State of Saxony for the Fab 36 project of $210 million. These amounts were offset by $539 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, and $284 million to repay a portion of the amount outstanding under the October 2006 Term Loan. During 2006, we did not realize any excess tax benefits related to stock-based compensation. Therefore, we did not record any related financing cash flow.

Net cash provided by financing activities was $494 million in 2005. This amount included $186 million in proceeds from borrowings by Spansion and $60 million of silent partnership contributions from the unaffiliated partners of AMD Fab 36 KG which we classify as debt, approximately $90 million in investments from the these unaffiliated partners, $189 million in proceeds from the issuance of stock under our Employee Stock Purchase Plan and the exercise of stock options, $163 million of capital investment grants and allowances from the Federal Republic of Germany and the Free State of Saxony for the Fab 36 project and $129 million of proceeds from equipment sale and leaseback transactions completed by Spansion. These amounts were offset by $316 million in payments on debt and capital lease obligations.

Net cash provided by financing activities was $413 million in 2004. This amount included $745 million of proceeds from financing activities, including $588 million in proceeds, net of $13 million in debt issuance costs, from the issuance of our 7.75% Notes, approximately $250 million in investments from the un-affiliated partners of AMD Fab 36 KG, $60 million of proceeds from equipment sale and leaseback transactions, $30 million of capital investment grants and allowances from the Federal Republic of Germany and the Free State of Saxony for the Fab 36 project, $124 million in proceeds from the issuance of stock under our Employee Stock Purchase Plan and the exercise of stock options and the elimination of our $224 million compensating cash balance due to the prepayment of our Fab 30 Term Loan. These amounts were offset by $898 million in payments on debt and capital lease obligations, including approximately $647 million used to prepay amounts outstanding under the Fab 30 Term Loan, including accrued and unpaid interest.

Liquidity

We believe that cash flows from operations and current cash, cash equivalents and marketable securities 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 $2.5 billion in capital expenditures in 2007. 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.

Additionally, under the terms of the October 2006 Term Loan, we must prepay the October 2006 Term Loan with: (i) 100 percent of the net cash proceeds from any debt incurred by us or a restricted subsidiary; (ii) 50 percent of net cash proceeds from the issuance of any capital stock by us (subject to specified exceptions); (iii) 100 percent of extraordinary receipts (as defined in the October 2006 Term Loan) in excess of $30 million; (iv) 100 percent of net cash proceeds from asset sales outside of the ordinary course of business in excess of $30 million, subject to a reinvestment allowance; (v) commencing with the fiscal year ending December 30, 2007, 50 percent of excess cash flow; and (vi) 100 percent of net cash proceeds from sale of capital stock of Spansion Inc. Prepayment of the October 2006 Term Loan from 50 percent of excess cash flow as used in the preceding clause (v), is intended to reach our cash income that is not actually applied to certain limited uses that merit priority over prepayment of the amount outstanding under the October 2006 Term Loan. Excess cash flow is

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defined as consolidated net income adjusted for non-cash items and changes in working capital, but subtracting actual capital expenditures and mandatory and optional repayment of any funded debt (other than revolving loans, except to the extent the revolving loan commitment is permanently reduced). See Part II, Item 7, MD& A- October 2006 Term Loan, below for more information regarding the terms of this loan.

Despite these mandatory prepayment obligations, we believe that, in the event additional funding is required, 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.

We have an ongoing authorization from the Board of Directors to repurchase up to $300 million worth of our common stock over a period of time to be determined by management. These repurchases may be made in the open market or in privately negotiated transactions from time to time in compliance with applicable rules and regulations, subject to market conditions, applicable legal requirements and other factors. We are not required to repurchase any particular amount of our common stock and the program may be suspended at any time at our discretion. During the fourth quarter of 2006, we did not repurchase any of our equity securities pursuant to this Board authorized program.

Contractual Obligations

The following table summarizes our principal contractual cash obligations at December 31, 2006, and is supplemented by the discussion following the table.

Contractual obligations at December 31, 2006 were:

		Payment due by period					
Contractual Obligations	**Total**	**Fiscal 2007**	**Fiscal 2008**	**Fiscal 2009**	**Fiscal 2010**	**Fiscal 2011**	**Fiscal 2012 and beyond**
				(In millions)			
October 2006 Term Loan	$ 2,216	$ 18	$ 23	$ 22	$ 22	$ 22	$ 2,109
Fab 36 Term Loan	893	53	179	268	304	89	
Repurchase obligations to Fab 36 Partners[1]	126	42	42	42			
7.75% Senior Notes Due 2012	390						390
Other debt	12	3	1	1	1	1	5
Other long-term liabilities	87	6	51	20			10
Aggregate interest obligation[2]	1,522	299	274	247	216	195	291
Obligations under capital leases[3]	315	25	25	26	26	26	187
Operating leases	381	69	64	54	49	26	119
Unconditional purchase commitments[4]	3,035	1,240	624	364	105	102	600
Total contractual obligations	$ 8,977	$ 1,755	$ 1,283	$ 1,044	$ 723	$ 461	$ 3,711

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

(2) Represents estimated aggregate interest obligations for our debt obligations (excluding capital lease obligations), including the guaranteed rate of return on our repurchase of the unaffiliated partners silent partnership contributions, based on our assumptions regarding wafer output.

(3) Includes principal and interest.

(4) 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 commitments in the table above. Also, purchase orders for goods and services that are cancelable upon notice and without significant penalties are not included in the amounts above.

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October 2006 Term Loan

On October 24, 2006, we entered into a credit agreement with Morgan Stanley Senior Funding, Inc., as Syndication Agent and Administrative Agent, Wells Fargo Bank, N.A., as Collateral Agent, and other lenders that may become party thereto from time to time (October 2006 Term Loan), pursuant to which we borrowed an aggregate amount of $2.5 billion to finance a portion of the acquisition of ATI and related fees and expenses.

Amounts borrowed under the October 2006 Term Loan bear interest, in the case of base rate loans, at a rate equal to the base rate, which is the higher of (i) the prime rate published by the Wall Street Journal and (ii) 0.5 percent per annum above the Federal Funds Effective Rate (as defined in the October 2006 Term Loan) plus a 1.25 percent margin, or in the case of Eurodollar loans, at a rate equal to the Eurodollar Rate (as defined in the October 2006 Term Loan) plus a 2.25 percent margin. Such margins will reduce by 0.25 percent when the outstanding aggregate principal amount of the October 2006 Term Loan is less than $1.75 billion. As of October 24, 2006, the base rate was 8.25 percent, without the margin, and the Eurodollar Rate was 5.32 percent, without the margin. Pursuant to the October 2006 Term Loan, we may select an interest period of one, two, three, six, or if available to all the lenders, nine or twelve months for each loan. The rate of interest is reset at the beginning of each new interest period. The October 2006 Term Loan is repayable in quarterly installments commencing in December 2006 and terminating in December 2013. The initial twenty-five quarterly payments are in the principal amount of approximately $6 million. The final four quarterly repayments are in the principal amount of approximately $521 million. As of December 31, 2006, the interest rate, which was based on the Eurodollar Rate, was 7.62 percent.

We may prepay the October 2006 Term Loan at any time without premium or penalty. In addition, we are required to prepay the October 2006 Term Loan with: (i) 100 percent of the net cash proceeds from any debt incurred by us or a restricted subsidiary; (ii) 50 percent of net cash proceeds from the issuance of any capital stock by us (subject to specified exceptions); (iii) 100 percent of extraordinary receipts (as defined in the October 2006 Term Loan) in excess of $30 million; (iv) 100 percent of net cash proceeds from asset sales outside of the ordinary course of business in excess of $30 million, subject to a reinvestment allowance; (v) commencing with the fiscal year ending December 29, 2007, 50 percent of excess cash flow; and (vi) 100 percent of net cash proceeds from sale of capital stock of Spansion Inc. See Part II, Item 7, MD&A Liquidity, for additional information on the definition of excess cash flow.

The October 2006 Term Loan contains certain covenants that limit, among other things, our ability and the ability of our restricted subsidiaries (which at this time are all of our subsidiaries) from:

- incurring additional indebtedness, except specified permitted debt;
- creating or permitting certain liens;
- consolidating, merging or selling assets as an entirety or substantially as an entirety unless specified conditions are met;
- paying dividends and making other restricted payments if a default or an event of default exists, or if specified financial conditions are not satisfied;
- making or committing to make any capital expenditures in the ordinary course of business exceeding a specified amount;

issuing or selling any shares of capital stock of our restricted subsidiaries;

entering into certain types of transactions with affiliates;

creating restrictions on the making of certain distributions by our restricted subsidiaries, such as dividends, loans or transfer of properties to us;

permitting domestic wholly-owned restricted subsidiaries to guarantee our indebtedness unless they also guarantee the October 2006 Term Loan; and

permitting our Consolidated Net Senior Secured Leverage Ratio (as defined in the October 2006 Term Loan) to exceed 2.25 to 1.00.

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Amounts outstanding under the October 2006 Term Loan may become due and payable upon the occurrence of specified events, including, among other things: failure to pay any obligations under the October 2006 Term Loan that have become due; breach of any representation or warranty, or specific covenants; any default in making any payment of principal or interest of any debt the outstanding amount of which exceeds $50 million or any default in the observance or performance of any other obligations under such debt; any default in the related security documents executed in connection with the October 2006 Term Loan, or the security documents or any lien created by the security documents ceasing to be in full force or effect; filings or proceedings in bankruptcy; judgment or awards entered against us or any significant subsidiary involving aggregate liability of $50 million or more; or a change of control (as defined in the October 2006 Term Loan).

In connection with the October 2006 Term Loan we and our subsidiaries, AMD International Sales & Service, Ltd., AMD (U.S.) Holdings, Inc., AMD US Finance, Inc., ATI Research Silicon Valley Inc., ATI Research, Inc., and ATI Technologies Systems Corp. (collectively referred to as the Grantors) entered into a collateral agreement in favor of Wells Fargo, as Collateral Agent. Under the Collateral Agreement, each Grantor granted Wells Fargo a security interest in, among other things, and subject to certain exceptions, now owned and hereafter acquired: (i) accounts receivable; (ii) proceeds and products from the sale of capital stock of Spansion Inc.; (iii) the Spansion Collateral Account (as defined in the October 2006 Term Loan), if and when it is created; (iv) certain of the Grantors respective equity interests in certain affiliates; and (v) all indebtedness for borrowed money owed to any Grantor by an affiliate.

In connection with the October 2006 Term Loan and the Collateral Agreement, the Grantors and Wells Fargo, as Collateral Agent, entered into a collateral trust agreement (Collateral Trust Agreement) whereby Wells Fargo holds in trust the pledged collateral under the Collateral Agreement. The Collateral Trust Agreement is the principal document by which the holders of our 7.75% Notes are secured equally and ratably with the lenders under the October 2006 Term Loan, as is required by the Indenture, dated as of October 29, 2004, between us and Wells Fargo, as trustee.

In November 2006, we repaid $278 million of the October 2006 Term Loan out of the net cash proceeds from the sale of Spansion common stock. In addition, in December 2006, we repaid the first quarterly installment of $6 million. As of December 31, 2006, $2.2 billion was outstanding under this loan.

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 Limited Liability Company & Co. KG (or 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.

To date, we have provided a significant portion of financing for the Fab 36. In addition to our financing, 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 have provided financing for the project. Leipziger Messe and Fab 36 Beteiligungs are limited partners in AMD Fab 36 KG. We also anticipate receiving grants and allowances from federal and state German authorities for the Fab 36 project. We expect that our capital expenditures for Fab 36 from 2007 through 2008 will be approximately $1.0 billion in the aggregate.

The funding to construct and facilitize Fab 36 consists of:

equity contributions from us of $772 million under the partnership agreements, revolving loans from us of up to approximately $990 million, and guarantees from us for amounts owed by AMD Fab 36 KG and its affiliates to the lenders and unaffiliated partners;

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investments of approximately $422 million from Leipziger Messe and Fab 36 Beteiligungs;

loans of approximately $893 million from a consortium of banks, which was fully drawn as of December 31, 2006;

up to approximately $716 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 $364 million of cash has been received as of December 31, 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 December 31, 2006, we had contributed to AMD Fab 36 KG the full amount of equity required under the partnership agreements and no loans from us were outstanding. These equity amounts have been eliminated in our consolidated financial statements.

On April 21, 2004, AMD Fab 36 KG entered into a EUR 700 million Term Loan Facility Agreement among AMD Fab 36 KG, as borrower, and a consortium of banks led by Dresdner Bank AG, as lenders, dated April 21, 2004 (Fab 36 Term Loan) and other related agreements (collectively, the Fab 36 Loan Agreements) to finance the purchase of equipment and tools required to operate Fab 36. The consortium of banks agreed to make available up to $893 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 $1.3 billion.

On October 13, 2006, we executed an Amendment Agreement dated as of October 10, 2006, which amended the terms of the Fab 36 Term Loan. Under the amended and restated Fab 36 Term Loan, AMD Fab 36 KG has the option to borrow in U.S. dollars as long as our group consolidated cash (which is defined as the sum of our unsecured cash, cash equivalents and short-term investments less the aggregate amount outstanding under any revolving credit facility) is at least $500 million. Moreover, to protect the lenders from currency risks, if our consolidated cash is below $1 billion or our credit rating drops below B3 by Moody s and B- by Standard & Poor s, AMD Fab 36 KG will be required to maintain a cash reserve account with deposits equal to 5 percent of the amount of U.S. dollar loans outstanding under the Fab 36 Term Loan and to make balancing payments into this account equal to the difference between (x) the total amount of U.S. dollar loans outstanding under the Fab 36 Term Loan and (y) the U.S dollar equivalent of 700 million euros (as reduced by repayments, prepayments, cancellations, and any outstanding loans denominated in euros.

In October 2006, AMD Fab 36 KG borrowed $645 million in U.S. dollars under the Fab 36 Term Loan (the First Installment). In December 2006, AMD Fab 36 KG borrowed $248 million in U.S. dollars under the Fab 36 Term Loan (the Second Installment). As of December 31, 2006, AMD Fab 36 KG had borrowed the full amount available under the Fab 36 Term Loan and the total amount outstanding under the Fab 36 Term Loan was $893 million. AMD Fab 36 KG may select an interest period of one, two, or three months or any other period agreed between AMD Fab 36 KG and the lenders. The rate of interest on each installment for the interest period selected is the percentage rate per annum which is the aggregate of the applicable margin, plus LIBOR plus minimum reserve cost if any. As of December 31, 2006, the rate of interest for the initial interest period was 7.1259 percent for the First Installment and 7.11563 percent for the Second Installment. This loan is repayable in quarterly installments commencing in September 2007 and terminating in March 2011.

The amended and restated Fab 36 Term Loan also amends certain covenants applicable to AMD Fab 36 KG. For example, for as long as group consolidated cash is at least $1 billion, our credit rating is at least B3 by Moody s and B- by Standard & Poor s, and no event of default has occurred, the only financial covenant that AMD Fab 36 KG is required to comply with is a loan to fixed asset value covenant. Specifically, the

loan to fixed

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asset value (as defined in the agreement) as at the end of any relevant period specified in Column A below cannot exceed the percentage set out opposite such relevant period in Column B below:

Column A (Relevant Period)	Column B (Maximum Percentage of Loan to Fixed Asset Value)
up to and including 31 December 2008	50 percent
up to and including 31 December 2009	45 percent
thereafter	40 percent

As of December 31, 2006, AMD Fab 36 KG was in compliance with this covenant.

If group consolidated cash is less than $1 billion or our credit rating is below B3 by Moody s and B- by Standard & Poor s, AMD Fab 36 KG will also be required to maintain minimum cash balances equal to the lesser of 100 million euros and 50 percent of the total outstanding amount under the Fab 36 Term Loan. AMD Fab 36 KG may elect to maintain the minimum cash balances in an equivalent amount of U.S. dollars if group consolidated cash is at least $500 million. If on any scheduled repayment date, our credit rating is Caa2 or lower by Moody s or CCC or lower by Standard & Poor s, AMD Fab 36 must increase the minimum cash balances by five percent of the total outstanding amount, and at each subsequent request of Dresdner Bank, by a further five percent of the total outstanding amount until such time as either the credit rating increases to at least Ba3 by Moody s and BB- by Standard & Poor s or the minimum cash balances are equal to the total outstanding amounts.

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 Agreement among us, as guarantor, AMD Fab 36 KG, Dresdner Bank AG and Dresdner Bank AG, Niederlassung Luxemburg, we have to comply with specified adjusted tangible net worth and EBITDA financial covenants if the sum of our group consolidated cash declines below the following amounts:

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

As of December 31, 2006, group consolidated cash was greater than $500 million and therefore, the preceding financial covenants were not applicable.

If our group consolidated cash declines below the amounts set forth above, we would be required to maintain adjusted tangible net worth, determined as of the last day of each preceding fiscal quarter, of not less than the amounts set forth below:

	Amount
Measurement Date on fiscal quarter ending	**(In millions)**
December 2005	$ 1,500
March 2006 and on the last day of each fiscal quarter thereafter	$ 1,750

In addition, if our group consolidated cash declines below the amounts set forth above, we would be required to maintain EBITDA (as defined in the agreement) as of the last day of each preceding fiscal period set

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forth below in an amount not less than the amount set forth below opposite the date of such preceding fiscal period:

Period	Amount (In millions)
for the four consecutive fiscal quarters ending December 2005 and for the four fiscal quarters ending on each fiscal quarter thereafter	$850 and $750 on an annualized basis for the two most recent fiscal quarters ending prior to December 31, 2006

Also 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 was 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.

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 $772 million, Leipziger Messe agreed to provide an aggregate of $264 million and Fab 36 Beteiligungs agreed to provide an aggregate of $158 million. The capital contributions of Leipziger Messe and Fab 36 Beteiligungs are comprised of limited partnership contributions and silent partnership contributions. These contributions were due at various dates upon the achievement of milestones relating to the construction and operation of Fab 36. As of December 31, 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 $66 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

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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 $4.6 million to Leipziger Messe and a premium of $2.8 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 were required to repurchase Leipziger Messe s silent partnership interest of $106 million in annual 25 percent installments commencing in December 2006, and Fab 36 Beteiligungs silent partnership interest of $79 million in annual 20 percent installments commencing in October 2005. As of December 31, 2006, AMD Fab 36 Holding and AMD Fab 36 Admin repurchased $32 million of Fab 36 Beteiligungs silent partnership contributions and $26 million of Leipziger Messe s silent partnership contribution.

Under U.S. generally accepted accounting principles, we initially classified the portion of the silent partnership contribution that is mandatorily redeemable as debt on the consolidated balance sheets at its fair value at the time of issuance because of the mandatory redemption features described in the preceding paragraph. Each accounting period, we increase the carrying value of this debt towards its 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 Portion 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. In 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 its 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 No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

As of December 31, 2006, AMD Fab 36 KG had received $185 million of silent partnership contributions and $238 million of limited partnership contributions, which includes a New Silent Partnership Amount of $66 million, from the unaffiliated partners. These contributions were recorded as debt and minority interest, respectively, in the accompanying 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 $716 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 consolidated

balance sheet and amortize them to operations ratably starting from December 2004 through December 2012. Initially, we amortized the grant amounts as a reduction to research and development expenses. Beginning in the first quarter of 2006 when Fab 36 began producing revenue generating products, we started amortizing these amounts as a reduction to cost of sales. For allowances, starting from the first quarter of 2006, we amortize the amounts as a reduction of depreciation expense ratably

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over the life of the equipment because these allowances are intended to subsidize the capital investments in equipment. 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 December 31, 2006, AMD Fab 36 KG received cash allowances of $157 million for capital investments made in 2003 through 2005 as well as cash grants of $207 million for capital investments made in 2003 through 2006 and a prepayment for capital investments planned in 2007 and the first half of 2008.

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;
- 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 loan to fixed asset value ratio and, in certain circumstances, 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 Term Loan. In addition, the occurrence of a default under this agreement could result in a cross-default under the indenture governing our 7.75% Notes and the October 2006 Term Loan. 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.

7.75% Senior Notes Due 2012

On October 29, 2004, we issued $600 million of 7.75% 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

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publicly registered 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 percent
Beginning on November 1, 2009 through October 31, 2010	101.938 percent
Beginning on November 1, 2010 through October 31, 2011	100.000 percent
On November 1, 2011	100.000 percent

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.

In February 2006, we redeemed 35 percent (or $210 million) of the aggregate principal amount outstanding of the 7.75 % Notes. The holders of the 7.75 % Notes received 107.75 percent of the principal amount of the 7.75 % Notes plus accrued interest. In connection with the redemption, we recorded an expense of approximately $16 million, which represents the 7.75 % redemption premium that we paid, 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. We included these charges in other income (expense), net in the consolidated statement of operations for the year ended December 31, 2006.

Issuance costs incurred in connection with this transaction in the amount of approximately $13 million will be amortized ratably over the term of the 7.75% Notes as interest expense, approximating the effective interest method. Of this amount, approximately $4 million was charged to other income (expense), net as a result of redemption described above.

In October 2006, the holders of the 7.75% Notes received a security interest that is equal and ratable to that held by the lenders under the October 2006 Term Loan, See the section entitled October 2006 Term Loan, above for more information.

We may elect to purchase or otherwise retire the remaining principal outstanding under 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.

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Other Long-Term Liabilities

Other Long-Term Liabilities included $66 million related to certain technology licenses that will be paid through 2008. Other Long-Term Liabilities excluded amounts recorded on our consolidated balance sheet that do not require us to make cash payments, which, as of December 31, 2006, primarily consisted of $364 million of deferred grants and subsidies related to the Fab 30 and Fab 36 projects and a $18 million deferred gain as a result of the sale and leaseback of our corporate marketing, general and administrative facility in Sunnyvale, California in 1998.

Capital Lease Obligations

As of December 31, 2006, we had aggregate outstanding capital lease obligations of $160 million. Included in this amount is $141 million in 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 requirements. We accounted for certain fixed payments due under these energy supply arrangements as capital leases pursuant to EITF 01-8, *Determining Whether an Arrangement Contains a Lease* and SFAS 13, *Accounting for Leases.* The capital lease obligations under the energy supply arrangements 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 December 31, 2006, were $381 million, of which $67 million is accrued as a liability for certain facilities that were included in our 2002 Restructuring Plan. We will make these payments through 2011.

Unconditional Purchase Commitments

Total non-cancelable purchase commitments as of December 31, 2006, were $3.0 billion for periods through 2020. These purchase commitments include $1 billion related to contractual obligations of Fab 30 and Fab 36 to purchase silicon-on-insulator wafers and energy and gas and up to $169 million representing payments to IBM for 2007 and 2008 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 above only reflects our obligations through December 31, 2008. If such approval is received from IBM, the additional obligations from January 2009 through December 2011 would be between $304 million and $334 million. In addition, unconditional purchase commitments also include $206 million for technology license agreements that require periodic payments through 2009 as well as 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.

In connection with the acquisition of ATI, we made several commitments to the Minister of Industry under the Investment Canada Act including that we will: increase spending on research and development in Canada to a specified amount over the course of a three-year period when compared to ATI s expenditures in this area in prior years; maintain Canadian employee headcount at specified levels by the end of the three-year anniversary of the acquisition; increase by a specified amount the number of our Canadian employees focusing on research and development; attain specified Canadian capital expenditures over a three-year period; maintain a presence in Canada via a variety of commercial activities for a period of five years; and nominate a Canadian for election to

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our Board of Directors over the next five years. Our Canadian capital expenditures and research and development commitments are included in our aggregate unconditional purchase commitments.

Off-Balance Sheet Arrangements

Guarantees of Indebtedness Recorded on Our Consolidated Balance Sheet

The following table summarizes the principal guarantees issued as of December 31, 2006 related to underlying liabilities that are already recorded on our consolidated balance sheet as of December 31, 2006 and their expected expiration dates by year. No incremental liabilities are recorded on our consolidated balance sheet for these guarantees. For more information on these guarantees, see Contractual Obligations above.

	Amounts Guaranteed	2007	2008	2009
		(In millions)		
Repurchase obligations to Fab 36 partners[1]	$ 126	$ 42	$ 42	$ 42
Payment guarantees on behalf of consolidated subsidiaries[2]	142	142		
Total guarantees	$ 268	$ 184	$ 42	$ 42

(1)