

SOLECTRON CORP
Form 10-Q
July 02, 2004

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended May 28, 2004

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 1-11098

SOLECTRON CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

94-2447045

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer Identification
Number)

**847 Gibraltar Drive
Milpitas, California 95035**

(Address of principal executive offices including zip code)

(408) 957-8500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO []

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act.)

YES [X] NO []

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

At June 25, 2004, 961,668,009 shares of Common Stock of the Registrant were outstanding (including approximately 27 million shares of Solectron Global Services Canada, Inc., which are exchangeable on a one-to-one basis for the Registrant's common stock).

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| | May 31 2004 | August 31 2003 |
|---|------------------------|---------------------------|
| | <hr/> | <hr/> |
| ASSETS | | |
| Current assets: | | |
| Cash, cash equivalents and short-term investments * | \$ 1,212.1 | \$ 1,515.0 |
| Accounts receivable, net | 1,616.4 | 1,389.1 |
| Inventories | 1,577.2 | 1,327.3 |
| Prepaid expenses and other current assets | 143.2 | 270.3 |
| Current assets of discontinued operations | 138.6 | 452.1 |
| | <hr/> | <hr/> |
| Total current assets | 4,687.5 | 4,953.8 |
| Property and equipment, net | 734.6 | 781.9 |
| Goodwill | 134.6 | 134.6 |
| Other assets | 357.3 | 396.3 |
| Long-term assets of discontinued operations | 50.9 | 262.9 |
| | <hr/> | <hr/> |
| Total assets | \$ 5,964.9 | \$ 6,529.5 |
| | <hr/> | <hr/> |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Short-term debt | \$ 25.5 | \$ 973.8 |
| Accounts payable | 1,532.3 | 1,266.6 |
| Accrued employee compensation | 156.7 | 161.0 |
| Accrued expenses | 287.8 | 334.9 |
| Other current liabilities | 213.0 | 164.7 |
| Current liabilities of discontinued operations | 107.6 | 333.9 |
| | <hr/> | <hr/> |
| Total current liabilities | 2,322.9 | 3,234.9 |
| Long-term debt | 1,227.5 | 1,817.6 |
| Other long-term liabilities | 25.7 | 32.4 |
| Long-term liabilities of discontinued operations | 6.1 | 22.6 |
| | <hr/> | <hr/> |

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| | | |
|--|-------------------|-------------------|
| Total liabilities | \$ 3,582.2 | \$ 5,107.5 |
| | <u> </u> | <u> </u> |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock | 0.9 | 0.8 |
| Additional paid-in capital | 7,763.3 | 6,658.2 |
| Accumulated deficit | (5,207.1) | (5,040.6) |
| Accumulated other comprehensive loss | (174.4) | (196.4) |
| | <u> </u> | <u> </u> |
| Total stockholders' equity | 2,382.7 | 1,422.0 |
| | <u> </u> | <u> </u> |
| Total liabilities and stockholders' equity | \$ 5,964.9 | \$ 6,529.5 |
| | <u> </u> | <u> </u> |

* This caption includes \$39.2 million and \$62.0 million of restricted balances as of May 31, 2004 and August 31, 2003, respectively.

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**(in millions, except per share data)
(unaudited)

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|--|------------------------------|--------------|--------------------------|--------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$3,039.9 | \$ 2,357.3 | \$8,624.1 | \$ 7,385.0 |
| Cost of sales | 2,880.7 | 2,258.1 | 8,206.3 | 7,060.4 |
| Gross profit | 159.2 | 99.2 | 417.8 | 324.6 |
| Operating expenses: | | | | |
| Selling, general and administrative | 103.9 | 138.1 | 327.8 | 436.4 |
| Restructuring and impairment costs | 5.5 | 1,981.2 | 106.1 | 2,121.6 |
| Operating income (loss) | 49.8 | (2,020.1) | (16.1) | (2,233.4) |
| Interest income | 4.8 | 6.8 | 10.8 | 21.6 |
| Interest expense | (41.8) | (51.4) | (130.1) | (160.4) |
| Other income (expense) - net | (77.9) | (5.4) | (68.6) | 46.1 |
| Operating loss from continuing operations before income taxes | (65.1) | (2,070.1) | (204.0) | (2,326.1) |
| Income tax expense | 0.3 | 615.8 | 3.3 | 531.0 |
| Loss from continuing operations | \$ (65.4) | \$ (2,685.9) | \$ (207.3) | \$ (2,857.1) |
| Discontinued operations: | | | | |
| Income (loss) from discontinued operations | \$ 92.8 | \$ (310.3) | \$ 50.8 | \$ (312.5) |
| Income tax expense | 6.1 | 105.0 | 10.0 | 113.3 |
| Income (loss) from discontinued operations | 86.7 | (415.3) | 40.8 | (425.8) |
| Net income (loss) | \$ 21.3 | \$ (3,101.2) | \$ (166.5) | \$ (3,282.9) |
| Basic and diluted net income (loss) per share | | | | |
| Continuing operations | \$ (0.08) | \$ (3.24) | \$ (0.25) | \$ (3.45) |
| Discontinued operations | 0.10 | (0.50) | 0.05 | (0.52) |
| Basic and diluted net income (loss) per share | \$ 0.02 | \$ (3.74) | \$ (0.20) | \$ (3.97) |

| | | | | |
|---|-------|-------|-------|-------|
| Shares used to compute basic and diluted net income (loss) per share | 868.3 | 828.8 | 845.8 | 827.1 |
|---|-------|-------|-------|-------|

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS****(in millions)****(unaudited)**

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|--|----------------------------------|--------------------|---------------------------------|--------------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net income (loss) | \$ 21.3 | \$(3,101.2) | \$(166.5) | \$(3,282.9) |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | (35.7) | 115.4 | 13.4 | 157.9 |
| Unrealized gain (loss) on investments | 0.8 | (8.5) | 8.6 | (8.4) |
| Comprehensive loss | <u>\$(13.6)</u> | <u>\$(2,994.3)</u> | <u>\$(144.5)</u> | <u>\$(3,133.4)</u> |

Accumulated unrealized foreign currency translation losses were \$173.3 million at May 31, 2004 and \$186.7 million at August 31, 2003. Foreign currency translation adjustments consist of adjustments to consolidate subsidiaries that use the local currency as their functional currency and transaction gains and losses related to intercompany dollar-denominated debt that is not expected to be repaid in the foreseeable future. Accumulated unrealized loss on investments were \$1.1 million at May 31, 2004 and \$9.7 million at August 31, 2003.

See accompanying notes to condensed consolidated financial statements.

Table of Contents**SOLECTRON CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in millions)****(unaudited)**

| | Nine Months Ended May 31 | |
|--|---------------------------------|-------------|
| | 2004 | 2003 |
| Cash flows from operating activities of continuing operations: | | |
| Loss from continuing operations | \$(207.3) | \$(2,857.1) |
| Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) in operating activities of continuing operations: | | |
| Depreciation and amortization | 174.1 | 186.9 |
| Amortization of debt issuance costs and accretion of discount on notes payable | 47.7 | 67.9 |
| Loss (gain) on retirement of debt | 77.7 | (38.3) |
| Gain on termination of interest rate swap | (5.6) | |
| Inventory charge | | 76.3 |
| Deferred tax allowance | | 541.0 |
| Change in the carrying value of property and equipment, goodwill and other long-term assets | 32.3 | 1,914.7 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | (210.3) | 133.7 |
| Inventories | (246.0) | 250.0 |
| Prepaid expenses and other current assets | 23.6 | 145.6 |
| Accounts payable | 264.6 | (217.3) |
| Accrued expenses and other current liabilities | (84.0) | 49.1 |
| | <hr/> | <hr/> |
| Net cash (used in) provided by operating activities of continuing operations | (133.2) | 252.5 |
| | <hr/> | <hr/> |
| Cash flows from investing activities of continuing operations: | | |
| Change in restricted cash and cash equivalents | 22.8 | 133.7 |
| Sales and maturities of short-term investments | 28.2 | 233.3 |
| Purchases of short-term investments | | (41.0) |
| Acquisition of manufacturing assets and locations | | (45.5) |
| Acquisition of business | | (3.8) |
| Net proceeds from disposition of discontinued operations | 383.4 | |
| Capital expenditures | (101.3) | (83.9) |
| Proceeds from sale of property and equipment | 54.0 | 35.3 |
| Proceeds from sale of investments | 10.4 | |
| Advances to discontinued operations | (5.2) | 94.4 |
| Supply agreement and other | 0.2 | 48.8 |
| | <hr/> | <hr/> |
| Net cash provided by investing activities of continuing operations | 392.5 | 371.3 |
| | <hr/> | <hr/> |

See accompanying notes to condensed consolidated financial statements.

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SOLECTRON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(unaudited)

| | Nine Months Ended May 31 | |
|--|---------------------------------|-------------|
| | 2004 | 2003 |
| Cash flows from financing activities of continuing operations: | | |
| Retirement of debt | (1,013.5) | (823.1) |
| Net proceeds from issuance of convertible senior notes | 436.5 | |
| Net repayment of bank lines of credit and other debt arrangements | (52.3) | (89.3) |
| Net proceeds from termination of interest rate swap | 6.0 | |
| Net proceeds from common stock issuance | 104.9 | 7.6 |
| Other | | 20.9 |
| | | |
| Net cash used in financing activities of continuing operations | (518.4) | (883.9) |
| Effect of exchange rate changes on cash and cash equivalents - continuing operations | 10.1 | 41.8 |
| Net decrease in cash and cash equivalents - continuing operations | (249.0) | (218.3) |
| Cash and cash equivalents at beginning of period - continuing operations | 1,421.9 | 1,740.0 |
| Cash and cash equivalents at end of period - continuing operations | \$ 1,172.9 | \$1,521.7 |
| Cash and cash equivalents at beginning of period - discontinued operations | \$ 36.4 | \$ 41.9 |
| Cash used in discontinued operations | (25.0) | (8.5) |
| Cash and cash equivalents at end of period - discontinued operations | \$ 11.4 | \$ 33.4 |

See accompanying notes to condensed consolidated financial statements.

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SOLECTRON CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

NOTE 1 Basis of Presentation and Recent Accounting Pronouncements

Basis of Presentation

The accompanying financial data as of May 31, 2004 and for the three and nine months ended May 31, 2004 and 2003 has been prepared by Solectron, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The August 31, 2003 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. However, Solectron believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in Solectron's Current Report on Form 8-K dated February 9, 2004, which updated the financial statement information originally presented in our 2003 Form 10-K to reclassify three additional businesses as discontinued operations.

In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present a fair statement of financial position as of May 31, 2004, the results of operations, comprehensive loss and cash flows for the three and nine months ended May 31, 2004 and 2003 have been made. The results of operations for the three and nine months ended May 31, 2004 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

Solectron's third quarters of fiscal 2004 and 2003 ended on May 28, 2004 and May 30, 2003, respectively. Solectron's fiscal year ended on August 29, 2003. For clarity of presentation, Solectron has indicated its third quarters as having ended on May 31 and its fiscal year as having ended on August 31.

Reclassification: Beginning in the first quarter of fiscal 2004, Solectron classified research and development costs differently than in prior periods. Solectron now classifies research and development costs as selling, general and administrative expense. Previously, research and development expense was a separate line item on the condensed consolidated statements of operations. Solectron has revised prior period financial information to conform the expense classifications to the current presentation. Accordingly, selling, general and administrative expense now includes \$6.2 million and \$17.8 million of research and development expense for the three and nine months ended May 31, 2004, respectively, and \$6.2 million and \$19.5 million for the three and nine months ended May 31, 2003, respectively. This reclassification did not impact operating income (loss), net income (loss) or net income (loss) per share for the periods presented.

Table of Contents**Recent Accounting Pronouncements**

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation (FIN) No. 46, Consolidation of Variable Interest Entities (VIE), (revised December 2003 by FIN No. 46R), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN No. 46R, which was issued in December 2003, replaces FIN No. 46. Solectron will be required to apply FIN No. 46R to variable interests in VIEs created after December 31, 2003. For variable interests in VIEs created before January 1, 2004, the Interpretation will be applied beginning on January 1, 2005. For any VIEs that must be consolidated under FIN No. 46R that were created before January 1, 2004, the assets, liabilities and non-controlling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN No. 46R first applies may be used to measure the assets, liabilities and non-controlling interest of the VIE. Management believes the adoption of FIN No. 46R will not have a material impact on Solectron's financial position, results of operations or cash flows as Solectron does not have any interest in VIEs.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition. SAB 104 supercedes SAB 101, Revenue Recognition in Financial Statements. The primary purpose of SAB 104 is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of Emerging Issues Task Force (EITF) Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Additionally, SAB 104 rescinds the SEC's Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the FAQ) issued with SAB 101 that had been codified in Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 did not have a material impact on Solectron's financial position, results of operations or cash flows.

NOTE 2 Stock-Based Compensation

As it is permitted by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, Solectron accounts for its employee stock plans, which generally consist of fixed stock option plans and an employee stock purchase plan, using the intrinsic value method under APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. In general, where the exercise price of options granted under these plans is equal to the market price of the underlying common stock on the grant date, no stock-based employee compensation expense is recognized. In certain situations, under these plans, options to purchase shares of common stock may be granted at less than fair market value, which results in compensation expense equal to the difference between the market value on the date of grant and the purchase price. This expense is recognized over the vesting period of the options and included in operations. However, such expense amount has not been significant. The table below sets out the pro forma amounts of net income (loss) and net income (loss) per share that would have resulted for all fiscal periods presented, if Solectron accounted for its employee stock plans under the fair value recognition provisions of SFAS No. 123.

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| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|--|---|--------------|---|--------------|
| | 2004 | 2003 | 2004 | 2003 |
| | (in millions, except per share data) | | (in millions, except per share data) | |
| Net income (loss), as reported | \$ 21.3 | \$ (3,101.2) | \$ (166.5) | \$ (3,282.9) |
| Stock-based employee compensation expense determined under fair value method, net of related tax effects | (12.3) | (25.3) | (45.8) | (85.2) |
| Pro forma net income (loss) | \$ 9.0 | \$ (3,126.5) | \$ (212.3) | \$ (3,368.1) |
| Net income (loss) per share: | | | | |
| Basic and diluted - as reported | \$ 0.02 | \$ (3.74) | \$ (0.20) | \$ (3.97) |
| Basic and diluted - pro forma | \$ 0.01 | \$ (3.77) | \$ (0.25) | \$ (4.07) |

Stock based employee compensation expense determined under the fair value method, net of related tax effects, included \$1.2 million and \$6.2 million of expense relating to discontinued operations during the three and nine months ended May 31, 2004, respectively. Stock based employee compensation expense related to discontinued operations for the corresponding periods in fiscal 2003 was \$4.7 million and \$15.7 million, respectively.

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

| Stock Options | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|---------------------------------------|----------------------------------|----------------|---------------------------------|----------------|
| | 2004 | 2003 | 2004 | 2003 |
| Expected life of options | 3 years | 3 years | 4 years | 3 years |
| Volatility | 73% | 78% | 76% | 79% |
| Risk-free interest rate | 2.00% to 3.10% | 1.75% to 2.06% | 2.00% to 3.10% | 1.75% to 2.32% |
| Dividend yield | zero | zero | zero | zero |
| Weighted average fair value of grants | \$5.79 | \$3.50 | \$5.19 | \$3.73 |

| Employee Stock Purchase Plan | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|-------------------------------------|----------------------------------|-------------|---------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Expected life of purchase right | 6 months | 6 months | 6 months | 6 months |
| Volatility | 73% | 78% | 76% | 79% |

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| | | | | |
|---|----------------|----------------|----------------|----------------|
| Risk-free interest rate | 1.01% to 1.33% | 1.11% to 1.17% | 0.99% to 1.33% | 1.11% to 1.64% |
| Dividend yield | zero | zero | zero | zero |
| Weighted average fair value of purchase rights under ESPP | \$2.42 | \$1.21 | \$2.13 | \$1.30 |

During fiscal 2003 and 2004, Solectron provided restricted stock awards to certain eligible executives. Compensation expense related to restricted stock awards amounted to approximately \$0.6 million and \$1.8 million during the three and nine months ended May 31, 2004, respectively, and \$0.5 million and \$0.8 million in the corresponding periods of fiscal 2003.

NOTE 3 Inventories

Inventories related to continuing operations as of May 31, 2004 and August 31, 2003, consisted of (in millions):

| | May 31 2004 | August 31 2003 |
|-----------------|------------------------|---------------------------|
| Raw materials | \$1,104.8 | \$ 906.4 |
| Work-in-process | 243.1 | 220.4 |
| Finished goods | 229.3 | 200.5 |
| | <u> </u> | <u> </u> |
| Total | <u>\$1,577.2</u> | <u>\$1,327.3</u> |

Table of Contents**NOTE 4 Commitments and Contingencies**

Lease Obligations

Solectron has synthetic lease agreements relating to four manufacturing sites related to continuing operations. The synthetic leases have expiration dates in 2007. At the end of the lease terms, Solectron has an option, subject to certain conditions, to purchase or to cause a third party to purchase the facilities subject to the synthetic leases for the

Termination Value, which approximates the lessor's original cost for each facility, or may market the property to a third party at a different price. Solectron is entitled to any proceeds from a sale of the properties to third parties in excess of the Termination Value and is liable to the lessor for any shortfall not to exceed 85% of the Termination Value. Solectron has provided loans to the lessor equaling approximately 85% of the Termination Value for each synthetic lease. These loans are repayable solely from the sale of the properties to third parties in the future, are subordinated to the amounts payable to the lessor at the end of the synthetic leases, and may be credited against the Termination Value payable if Solectron purchases the properties. The approximate aggregate Termination Values and loan amounts were \$101.3 million and \$86.1 million, respectively, as of May 31, 2004.

In addition, cash collateral of \$15.2 million is pledged for the difference between the aggregate Termination Values and the loan amounts. Each lease agreement contains various affirmative and financial covenants. A default under a lease, including violation of these covenants, may accelerate the termination date of the arrangement. Prior to the end of the second quarter of fiscal 2004, Solectron obtained waivers and amended certain terms and conditions including the minimum liquidity and the leverage covenants. Solectron was in compliance with all applicable covenants as of May 31, 2004. Monthly lease payments are generally based on the Termination Value and 30-day LIBOR index (1.1% as of May 31, 2004) plus an interest-rate margin, which may vary depending upon Solectron's Moody's Investors Services and Standard and Poor's ratings and are allocated between the lessor and Solectron based on the proportion of the loan amount to the Termination Value for each synthetic lease.

Solectron accounts for these synthetic lease arrangements as operating leases in accordance with SFAS No. 13,

Accounting for Leases, as amended. Solectron's loans to the lessor and cash collateral were included in other long-term assets and cash, cash equivalents and short-term investments, respectively, in the condensed consolidated balance sheets.

Future minimum payments for operating lease obligations related to continuing operations, including the synthetic leases discussed above, are as follows:

| | | FY05 | | | | | | | |
|-----------------|--------------|-------------|--------------|-----------|-------------|-------------|-------------|-------------|-------------------|
| | Total | Q404 | Q1-Q3 | Q4 | FY06 | FY07 | FY08 | FY09 | Thereafter |
| Operating lease | \$173.1 | \$23.0 | \$33.5 | \$8.2 | \$25.1 | \$16.9 | \$13.9 | \$11.7 | \$ 40.8 |

Purchase Commitments

Solectron has guaranteed various purchase commitments for materials, supplies and services incurred during the normal course of business. As of May 31, 2004, these commitments totaled approximately \$114.8 million.

Legal Proceedings

Solectron is from time to time involved in various litigation and legal matters, including those described below. By describing the particular matters set forth below, Solectron does not intend to imply that it or its legal advisors have concluded or believe that the outcome of any of those particular matters is or is not likely to have a material adverse impact upon Solectron's business or consolidated financial condition and results of operations.

The case entitled *Ronald Sorisho v. Solectron Corporation et al.*, Case No. CV811243, which has been previously reported, was resolved on terms not material to Solectron and the case has been dismissed.

On March 6, 2003, a putative shareholder class action lawsuit was filed against Solectron and certain of its officers in the United States District Court for the Northern District of California alleging claims under Section 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Rule 10b-5 promulgated thereunder. The case is entitled *Abrams v. Solectron Corporation et al.*, Case No. C-03-0986 CRB. The complaint alleged that the defendants issued false and misleading statements in

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certain press releases and SEC filings issued between September 17, 2001 and September 26, 2002. In particular, plaintiff alleged that the defendants failed to disclose and to properly account for excess and obsolete inventory in the former Technology Solutions business unit during the relevant time period. Additional complaints making similar allegations were subsequently filed in the same court, and pursuant to an order entered June 2, 2003, the Court appointed lead counsel and plaintiffs to represent the putative class in a single consolidated action. The Consolidated Amended Complaint, filed September 8, 2003, alleges an expanded class period of June 18, 2001 through September 26, 2002, and purports to add a claim for violation of Section 11 of the Securities Act of 1933, as amended (the Securities Act), on behalf of a putative class of former shareholders of C-MAC Industries, Inc., who acquired Solectron stock pursuant to the October 19, 2001 Registration Statement filed in connection with Solectron's acquisition of C-MAC Industries, Inc. In addition, while the initial complaints focused on alleged inventory issues at the former Technology Solutions business unit, the Consolidated Amended Complaint adds allegations of inadequate disclosure and failure to properly account for excess and obsolete inventory at Solectron's other business units. The complaint seeks an unspecified amount of damages on behalf of the putative class. On June 14, 2004 the lead plaintiffs filed a Motion for Class Certification seeking to have the court declare this matter a class action litigation. The hearing for the Motion for Class Certification is set for October 1, 2004. Solectron intends to object to the Class Certification. Solectron believes the complaint to be without merit, and that it has valid defenses to the plaintiffs' claims. There can be no assurance, however, that the outcome of the lawsuit will be favorable to Solectron or will not have a material adverse effect on Solectron's business, financial condition and results of operations. In addition, Solectron may be forced to incur substantial litigation expenses in defending this litigation.

On March 21, 2003, Solectron, all the current members of its Board of Directors, and two former officers, were named as defendants in a shareholder derivative lawsuit entitled *Lifshitz v. Cannon et al.*, Case No. CV815693, filed in the Santa Clara County, California Superior Court. The plaintiff alleged that he should be permitted to pursue litigation, purportedly for the benefit of Solectron, against the individual director and officer defendants for alleged mismanagement and waste of corporate assets during the period from May 2001 to the present, purported breaches of fiduciary duty, constructive fraud, abuse of control, and alleged violations of the California Corporations Code by certain of the individual defendants who sold some of their Solectron stockholdings during the period from September 2001 through September 2002. On May 19, 2003, Solectron and the individual defendants moved to dismiss the *Lifshitz* complaint. In the meantime, two substantively identical derivative lawsuits, entitled *Schactner v. Cannon, et al.*, Case No. CV817112, and *Nims v. Cannon, et al.*, Case No. CV817158, were filed in the same Court on May 14 and May 15, respectively. Counsel for the plaintiffs in all three suits subsequently advised the Court that they would be filing a consolidated amended complaint, and accordingly, defendants' motion to dismiss was taken off calendar pending the filing of the consolidated amended complaint combining the three lawsuits. On June 27, 2003, the plaintiffs served their consolidated amended complaint now alleging that since January of 1999 all of the current members of Solectron's Board of Directors, as well as four former officers and directors, purportedly breached their fiduciary duties and participated in or permitted constructive fraud, unjust enrichment, and alleged violations of the California Corporations Code. The consolidated complaint alleged an unspecified amount of compensatory and punitive damages, and sought the relinquishment of all profits realized by those individual defendants who sold Solectron stock during the relevant period, together with statutory penalties under California Corporations Code section 25402 which plaintiff alleged to be applicable to those sales of Solectron stock. Solectron moved to dismiss the Consolidated Amended Complaint because Solectron does not believe plaintiffs have adequately alleged a basis for plaintiffs to appropriate for themselves the duties of Solectron's Board of Directors under applicable Delaware law, and believes that the consolidated complaint contains various factual errors and legal deficiencies. On October 7, 2003, the California Superior Court granted Solectron's motion to dismiss, but granted the plaintiffs an opportunity to try to cure the deficiencies in their Consolidated Amended Complaint through a further amended complaint. The plaintiffs requested and were granted an extension of time to file a further amended complaint, which barring any further extensions, is to be filed on or before the end of August 2004. Solectron does not believe plaintiffs can show a sufficient basis to allow them to appropriate for themselves the duties of Solectron's Board of Directors under applicable Delaware law. Solectron may be forced to incur substantial litigation expenses in defending this litigation.

NOTE 5 Segment Information and Geographic Information

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

Historically, Solectron had four reportable segments: Global Operations, Technology Solutions, Global Services and MicroSystems. Following a comprehensive review of its business strategy, concluding in the fourth quarter of fiscal 2003, Solectron committed to a

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plan to divest a number of business operations (see also Note 9, *Discontinued Operations*, for a discussion of divesting activities). As a result, Solectron has divested and is in the process of divesting a majority of the assets in the former Global Services, Technology Solutions, and MicroSystems reportable segments. The assets divested and being divested are reported as discontinued operations.

Starting in the first quarter of fiscal 2004, Solectron realigned to a functional organizational structure to manage its continuing operations. Solectron is now organized into one reporting unit, Worldwide Operations, to deliver integrated solutions to its customers. Worldwide Operations consists of worldwide manufacturing and post-manufacturing services and is supported by the following functions - Worldwide Design and Engineering Services; Worldwide Sales and Account Management; Worldwide Strategy and Marketing; Finance; and Human Resources.

Solectron's chief operating decision maker is the Chief Executive Officer. As a result of Solectron's organizational realignment, the Chief Executive Officer evaluates financial information on a company-wide basis for purposes of making decisions and assessing financial performance. Accordingly, Solectron revised its presentation of operating and reportable segments from four to one to reflect how it now manages its business.

Geographic information for continuing operations as of and for the periods presented is as follows (in millions):

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|-------------------------------|----------------------------------|------------------|---------------------------------|------------------|
| | 2004 | 2003 | 2004 | 2003 |
| Geographic net sales: | | | | |
| United States | \$ 804.8 | \$ 811.3 | \$2,341.3 | \$2,487.5 |
| Other North and Latin America | 461.5 | 280.9 | 1,308.0 | 1,005.4 |
| Europe | 407.1 | 373.5 | 1,246.3 | 1,195.2 |
| Malaysia | 520.2 | 372.7 | 1,349.8 | 1,042.7 |
| China | 548.9 | 254.2 | 1,463.3 | 773.7 |
| Other Asia Pacific | 297.4 | 264.7 | 915.4 | 880.5 |
| | <u>\$3,039.9</u> | <u>\$2,357.3</u> | <u>\$8,624.1</u> | <u>\$7,385.0</u> |

| | May 31 2004 | August 31 2003 |
|-------------------------------|------------------------|---------------------------|
| Long-lived assets: | | |
| United States | \$ 329.7 | \$ 327.0 |
| Other North and Latin America | 188.9 | 224.9 |
| Europe | 173.1 | 203.9 |
| Asia Pacific | 337.9 | 346.9 |
| | <u>\$1,029.6</u> | <u>\$1,102.7</u> |

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

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|-----------------|--------------------------------------|-------------|-------------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Cisco Systems | 12.8% | 12.0% | 12.4% | 11.2% |
| Nortel Networks | *** | 12.8% | *** | 13.0% |

*** Less than 10%

Solectron has concentrations of credit risk due to sales to the customers listed above as well as Solectron's other significant customers. In particular, Nortel Networks accounted for approximately 10% and 15% of total accounts receivable related to continuing operations at May 31, 2004 and August 31, 2003, respectively.

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Liquid Yield Option Notes (LYONs)

In November 2000, Solectron issued 2.9 million LYONs at an issue price of \$524.78 per note, which resulted in gross proceeds to Solectron of approximately \$1.5 billion. These notes are unsecured and unsubordinated indebtedness of Solectron. Solectron will pay no interest prior to maturity. Each note yields 3.25% with a maturity value of \$1,000 on November 20, 2020. Each note is convertible to common shares at any time by the holder at a conversion rate of 11.7862 shares per note. Holders may require Solectron to purchase all or a portion of their notes on May 20, 2004, November 20, 2005 and November 20, 2010, at prices of \$587.46, \$616.57 and \$724.42 per note, respectively, payable in cash or common stock at the option of Solectron. Also, each holder had the right to require Solectron to repurchase all or a portion of such holder's notes if a change in control of Solectron occurred on or before May 20, 2004. On May 20, 2004, Solectron repurchased approximately 1.6 million LYONs for a total of \$950 million in cash. As of May 31, 2004, 5,000 LYONs remain outstanding at a carrying value of approximately \$3.0 million.

Adjustable Conversion-Rate Equity Securities (ACES)

During the second quarter of fiscal 2002, Solectron closed its public offering of \$1.1 billion, or 44 million units, of 7.25% ACES. Each ACES unit has a stated amount of \$25.00 and consists of (a) a contract requiring the holder to purchase, for \$25.00, a number of shares of Solectron common stock to be determined on November 15, 2004, based on the average trading price of Solectron's common stock at that time and certain specified settlement rates ranging from 2.1597 shares of Solectron's common stock per purchase contract to 2.5484 shares of Solectron's common stock per purchase contract (subject to certain anti-dilution adjustments); and (b) a \$25 principal amount of 7.25% subordinated debenture due 2006. Solectron received gross proceeds of approximately \$1.1 billion from the transaction. Solectron allocated \$46.9 million to the fair value of the purchase contracts and recorded this amount in additional paid-in capital. The debentures initially were held and pledged for Solectron's benefit to secure the holders obligation to purchase Solectron's common stock on November 15, 2004.

On April 8, 2004, Solectron commenced an early settlement offer to settle 2.5484 shares of common stock and \$1.97 in cash per unit for up to 41,800,000 units of its outstanding 7.25% ACES. The early settlement offer was finalized on May 12, 2004 and resulted in 41.4 million of the ACES units, or approximately 94% of the total outstanding, being settled. Upon finalization of the ACES early settlement offer, Solectron recorded a \$77.7 million loss in other income (expense) net.

On or about August 15, 2004, the remaining ACES debentures will be remarketed and, if the remarketing is successful, the interest rate will be reset at then current rates as described in the indenture, and the proceeds from the remarketing will be used to satisfy the holders' obligation to purchase Solectron's common stock in November 2004. If the debentures are not successfully remarketed, the interest rate will not be reset and Solectron may use the pledged debentures to satisfy the holders' obligation to purchase Solectron's common stock in November 2004. As of May 31, 2004, the remaining carrying amount of these ACES of \$62.9 million was classified as long-term debt.

9.625% Senior Notes

On February 8, 2002, Solectron issued an aggregate principal amount of \$500 million of 9.625% senior notes due 2009. Solectron is required to pay interest on the notes in cash on February 15 and August 15 of each year. The indenture governing the terms of these notes contains restrictive provisions, which limit Solectron and its subsidiaries from making distributions on their capital stock, investments, incurring debt, issuing preferred stock and engaging in assets sales, among other provisions. As of May 31, 2004, the carrying amount of the notes of \$497.9 million was classified as long-term debt.

7.375% Senior Notes

In March 1996, Solectron issued \$150 million aggregate principal amount of senior notes. These notes are in denominations and have a maturity value of \$1,000 each and are due on March 1, 2006. Interest is payable semiannually at a rate of 7.375% per annum. The notes may not be redeemed prior to maturity. As of May 31, 2004, the carrying amount of the notes of \$150.0 million was classified as long-term debt.

0.5% Convertible Senior Notes due 2034

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During the second quarter of fiscal 2004, Solectron completed the offering of \$450 million of convertible senior notes, or 450,000 notes in \$1,000 denomination, to qualified buyers in reliance on Rule 144A under the Securities Act. The notes are unsecured and unsubordinated indebtedness of Solectron and will mature on February 15, 2034. The notes are convertible into shares of common stock of Solectron at any time prior to maturity, redemption or repurchase by Solectron, if (1) the price of our common stock issuable upon conversion of a note reaches 120% of the conversion price of the notes, or \$11.60, (2) the notes have been called for redemption, (3) specified corporate transactions occur, or (4) the trading price of the notes fall below 95% of the average conversion value. The initial conversion rate is 103.4468 shares per each \$1,000 principal amount of notes, subject to adjustment in certain circumstances. This is equivalent to a conversion price of approximately \$9.67 per share.

Interest on the notes will be paid on February 15 and on August 15 of each year. The first payment will be made on August 15, 2004. On or after February 20, 2011, Solectron will have the option to redeem all or a portion of the notes that have not been previously purchased, repurchased or converted, at 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest and liquidated damages owed, if any, to, but excluding, the date of the purchase. Holders of the notes may require Solectron to purchase all or a portion of the notes for cash on each of February 15, 2011, 2014, 2019, 2024, and 2029 at a price equal to 100% of the principal amount of the notes to be repurchased plus accrued and unpaid interest, and liquidated damages owed, if any, to, but excluding, the date of repurchase. Holders will have the option, subject to certain conditions, to require Solectron to repurchase any notes held by such holder in the event of a change in control, as described in the offering circular dated February 9, 2004, at a price of 100% of the principal amount of the notes plus accrued and unpaid interest and liquidated damages owed, if any, to, but excluding, the date of repurchase.

Solectron filed a shelf registration statement in the third quarter of fiscal 2004 with respect to the resale of the notes and the common stock issuable upon conversion of the notes, pursuant to a registration rights agreement. The net proceeds of \$436.5 million were applied to repurchase Solectron's 3.25% LYONs indebtedness on May 20, 2004.

As of May 31, 2004, the carrying amount of the notes of \$450 million was classified as long-term debt.

NOTE 7 Derivative Instruments

Solectron enters into foreign exchange forward contracts intended to reduce the short-term impact of foreign currency fluctuations on foreign currency receivables, investments and payables. The gains and losses on the foreign exchange forward contracts are intended to largely offset the transaction gains and losses on the foreign currency receivables, investments, and payables recognized in earnings. Solectron does not enter into foreign exchange forward contracts for speculative purposes. Solectron's foreign exchange forward contracts related to current assets and liabilities are generally three months or less in original maturity.

As of May 31, 2004, Solectron had outstanding foreign exchange forward contracts with a total notional amount of approximately \$585.4 million related to continuing operations.

Solectron also uses interest rate swaps to hedge its mix of short-term and long-term interest rate exposures resulting from Solectron's debt obligations. During the third quarter of fiscal 2002, Solectron entered into interest rate swap transactions under which it pays variable rates and receives fixed rates. The interest rate swaps have a total notional amount of \$1 billion. \$500 million relates to the Company's \$1.1 billion ACES and expires on November 15, 2004 and \$500 million relates to the 9.625% \$500 million senior notes expiring on February 15, 2009. Under each of these swap transactions, Solectron pays an interest rate equal to the 3-month LIBOR rate plus a fixed spread. In exchange, Solectron receives fixed interest rates of 7.25% on the first \$500 million and 9.625% on the second \$500 million. These swap transactions effectively replace the fixed interest rates that the Company must pay on a portion of its ACES and all its 9.625% senior notes with variable interest rates. These swaps are designated as fair value hedges

under SFAS No. 133.

During the third quarter of fiscal 2004, Solectron settled the above mentioned \$500 million swap contract related to the \$1.1 billion ACES at the time of the early settlement of the ACES debentures. The settlement of the swap contract resulted in a gain of approximately \$5.6 million, which was recorded in other income (expense) - net.

The fair value of the outstanding derivative referred to above was not significant.

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

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by Solectron's counterparties.

NOTE 8 Intangible Assets and Goodwill

Solectron's intangible assets, which are classified in other assets in the condensed consolidated balance sheets, are categorized into three main classes: supply agreements, intellectual property agreements and other. The intellectual property agreements resulted from Solectron's acquisitions of various IBM facilities. The other intangible assets consist of miscellaneous acquisition related intangibles from Solectron's various asset purchases.

The following tables summarize the gross amounts and accumulated amortization for each main class of Solectron's intangible assets as of May 31, 2004 and August 31, 2003 (in millions):

May 31, 2004:

| | Supply Agreements | Intellectual Property Agreements | Other | Total |
|--------------------------|------------------------------|---|-------------------|-------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Gross amount | \$ 228.1 | \$ 108.5 | \$126.4 | \$ 463.0 |
| Accumulated amortization | (86.0) | (54.1) | (76.7) | (216.8) |
| Prior year impairment | (140.4) | | (31.3) | (171.7) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Carrying value | <u>\$ 1.7</u> | <u>\$ 54.4</u> | <u>\$ 18.4</u> | <u>\$ 74.5</u> |

August 31, 2003:

| | Supply Agreements | Intellectual Property Agreements | Other | Total |
|--------------------------|------------------------------|---|-------------------|-------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Gross amount | \$ 228.1 | \$ 108.5 | \$126.1 | \$ 462.7 |
| Accumulated amortization | (85.7) | (45.6) | (71.5) | (202.8) |
| Impairment | (140.4) | | (31.3) | (171.7) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Carrying value | <u>\$ 2.0</u> | <u>\$ 62.9</u> | <u>\$ 23.3</u> | <u>\$ 88.2</u> |

Solectron expects that its annual amortization expense, reportable as required by SFAS No. 142 for these intangibles, would be approximately \$18.6 million for each of the next three years and \$9.4 million for each of the two subsequent years. Amortization expense for the three and nine months ended May 31, 2004 was \$4.6 million and \$14.0 million, respectively.

During the third quarter of fiscal 2003, Solectron concluded that sufficient indicators existed to require it to perform an analysis according to the provisions of SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* to assess whether a portion of intangible assets was impaired. As a result of this analysis, Solectron recorded an impairment charge of approximately \$161.1 million primarily related to its intangible assets acquired in a transaction with a large customer. This intangible asset impairment was recorded within restructuring and impairment costs in the accompanying condensed consolidated statements of operations for the three and nine months ended May 31, 2003.

Primarily due to significant industry and economic trends that continued to negatively affect Solectron's operations and stock price, Solectron performed a goodwill impairment test according to the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* during the third quarter of fiscal 2003 in advance of the Company's annual test originally scheduled for the fourth quarter of fiscal 2003. This impairment test resulted in an impairment charge of approximately \$1.6 billion related to continuing operations and was performed using the same methodology as the annual test performed in the fourth quarter of fiscal 2002. This goodwill impairment was recorded within restructuring and impairment costs in the accompanying condensed consolidated statements of operations for the three and nine months ended May 31, 2003.

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During the fourth quarter of fiscal 2003, as a result of a full review of its portfolio of businesses, Solectron committed to a plan to divest a number of business operations that are no longer part of Solectron's strategic plan. These businesses are Dy 4 Systems Inc., Kavlico Corporation, the Solectron MicroTechnology division, SMART Modular Technologies Inc., Stream International Inc., Solectron's 63% interest in US Robotics Corporation, and Force Computers, Inc. Divesting these companies will allow Solectron to offer a more focused and integrated set of supply chain solutions for its customers.

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

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

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|--|------------------------------|-------------------|-----------------------------|-------------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$ 325.8 | \$ 458.2 | \$ 1,204.9 | \$ 1,297.2 |
| Cost of sales | 274.2 | 393.8 | 1,022.0 | 1,094.0 |
| Gross profit | 51.6 | 64.4 | 182.9 | 203.2 |
| Operating expenses (income) - net | (43.8) | 376.8 | 129.0 | 517.9 |
| Operating income (loss) | 95.4 | (312.4) | 53.9 | (314.7) |
| Interest income - net | 0.4 | 0.7 | 1.2 | 1.4 |
| Other income (expense) - net | (3.0) | 1.4 | (4.3) | 0.8 |
| Income (loss) before income taxes | 92.8 | (310.3) | 50.8 | (312.5) |
| Income tax expense | 6.1 | 105.0 | 10.0 | 113.3 |
| Income (loss) from discontinued operations, net of tax | <u>\$ 86.7</u> | <u>\$ (415.3)</u> | <u>\$ 40.8</u> | <u>\$ (425.8)</u> |

During the third quarter of fiscal 2004, Solectron completed the sale of three of its discontinued operations for net cash proceeds of \$273.4 million resulting in a pre-tax gain of \$97.2 million which is included in operating expenses (income) - net for the three and nine months ended May 31, 2004 as disclosed above. The sale agreements for these

divestitures provide for a possible adjustment to the proceeds and gain based upon final settlement of each divestiture's working capital at closing. Resolution of these possible working capital adjustments and other reconciling items pursuant to the sales agreements, if any, are expected to be included in our fiscal 2004 fourth quarter results.

As a result of the sale agreement for one of the discontinued operations during the third quarter of fiscal 2004, a synthetic lease held by the discontinued operation was not assumed by the buyer. Solectron is in the process of terminating the synthetic lease by selling the property subject to the synthetic lease and any potential loss associated with its termination will be recorded as part of discontinued operations. The approximate Termination Value and loan amounts was \$23.4 million and \$19.9 million, respectively, as of May 31, 2004. At the end of the third quarter in fiscal 2004, Solectron completed a preliminary valuation of the property under this synthetic lease and has determined a shortfall of approximately \$11.3 million between the value of the property and the loan amount. The effect of this shortfall will be recognized ratably until the termination of the lease through fiscal 2007 or upon its ultimate disposition.

During the second quarter of fiscal 2004, Solectron completed the sale of one of its discontinued operations for cash proceeds of \$110.0 million resulting in a pre-tax gain of \$67.2 million which is included in operating expenses (income) - net for the nine months ended May 31, 2004 as disclosed above. During the third quarter of fiscal 2004, Solectron reduced the gain on disposal of this discontinued operation by approximately \$8.9 million resulting from adjustments pursuant to the terms of the disposal transaction. For the three and nine months ended May 31, 2004, the adjustment to the gain on this discontinued operation is recorded in operating expenses (income) - net as disclosed above.

The sales agreements for all four divestitures contain certain indemnification provisions under which Solectron may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of breaches of covenants and certain

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breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. In aggregate, Solectron is contingently liable for up to \$61.5 million for a period of 12 to 24 months subsequent to the completion of the sale. As of May 31, 2004, there were no liabilities recorded under these indemnification obligations.

Furthermore, Solectron recorded approximately \$0.6 million and \$56.3 million of restructuring and impairment costs related to discontinued operations which is also included in operating expenses (income) - net for the three and nine months ended May 31, 2004, respectively, as disclosed above.

The current and non-current assets and liabilities of discontinued operations as of May 31, 2004 and August 31, 2003, were as follows (in millions):

| | May 31 2004 | August 31 2003 |
|--|------------------------|-------------------------------|
| Cash, cash equivalents and short-term investments | \$ 11.4 | \$ 36.4 |
| Accounts receivable, net | 61.5 | 276.2 |
| Inventories | 48.7 | 121.4 |
| Prepaid expenses and other current assets | 17.0 | 18.1 |
| | <u> </u> | <u> </u> |
| Total current assets of discontinued operations | \$138.6 | \$ 452.1 |
| | <u> </u> | <u> </u> |
| Property and equipment, net | \$ 33.1 | \$ 126.5 |
| Goodwill | | 112.2 |
| Other assets | 17.8 | 24.2 |
| | <u> </u> | <u> </u> |
| Total non-current assets of discontinued operations | \$ 50.9 | \$ 262.9 |
| | <u> </u> | <u> </u> |
| Short-term debt | \$ 6.6 | \$ 6.1 |
| Accounts payable | 41.5 | 168.1 |
| Accrued expenses and other current liabilities | 59.5 | 159.7 |
| | <u> </u> | <u> </u> |
| Total current liabilities of discontinued operations | \$107.6 | \$ 333.9 |
| | <u> </u> | <u> </u> |
| Total non-current liabilities of discontinued operations | \$ 6.1 | \$ 22.6 |
| | <u> </u> | <u> </u> |

NOTE 10 Restructuring and Impairment

Beginning in the second quarter of fiscal 2001, Solectron recorded restructuring and impairment costs as it rationalized operations in light of customer demand declines and the economic downturn. The measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, was largely intended to align Solectron's capacity and infrastructure to anticipated customer demand as well as to rationalize its footprint worldwide. The restructuring and impairment costs include employee severance and benefit costs, costs related to leased facilities abandoned and subleased, impairment of owned facilities no longer used by Solectron which will be disposed, costs related to leased equipment that has been abandoned, and impairment of owned equipment that will be disposed. For owned facilities and equipment, the impairment loss recognized was based on the fair value less costs to sell, with fair value estimated based on existing market prices for similar assets. Severance and benefit costs and other costs associated with restructuring activities initiated prior to January 1, 2003 were recorded in compliance with EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity*. Severance and benefit costs associated with restructuring activities initiated on or after January 1, 2003 are recorded in accordance with SFAS No. 112, *Employer's Accounting for Postemployment Benefits*, as Solectron concluded that it had a substantive severance plan. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the estimated lease loss accrued for leased facilities abandoned and subleased after December 31, 2002 represents the fair value of the lease liability as measured by the present value of future lease payments subsequent to abandonment less the present value of any estimated sublease income. For those facilities abandoned and subleased before January 1, 2003, as part of restructuring activities under EITF Issue No. 94-3, the estimated lease loss represents payments subsequent to abandonment less any estimated sublease income. In order to estimate future

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sublease income, Solectron works with an independent broker to estimate the length of time until it can sublease a facility and the amount of rent it can expect to receive. Estimates of expected sublease income could change based on factors that affect Solectron's ability to sublease those facilities such as general economic conditions and the real estate market, among others.

The following summarizes Solectron's restructuring charges:

Three and nine months ended May 31, 2004 and 2003

Solectron continued its restructuring activities in the third quarter of fiscal 2004 and total restructuring and impairment costs of \$5.5 million were charged against continuing operations. The following table summarizes restructuring charges included in the accompanying condensed consolidated statements of operations (in millions):

| | Three Months Ended May 31 | | Nine Months Ended May 31 | | Nature |
|--|--------------------------------------|-----------------|-------------------------------------|-----------------|---------------|
| | 2004 | 2003 | 2004 | 2003 | |
| Loss on disposal of and impairment of equipment and facilities | \$ 8.9 | \$ 104.9 | \$ 22.0 | \$ 127.1 | non-cash |
| Severance and benefit costs | 0.2 | 81.1 | 14.9 | 184.2 | cash |
| Net adjustment to equipment lease loss accrual | (3.2) | 5.9 | 0.7 | 1.7 | cash |
| Net adjustment to facility lease loss accrual | (3.1) | | 33.5 | 7.5 | cash |
| Other exit costs | 2.7 | 3.6 | 35.0 | 15.4 | cash |
| Total | \$ 5.5 | \$ 195.5 | \$ 106.1 | \$ 335.9 | |

During the three and nine months ended May 31, 2004, Solectron incurred \$8.9 million and \$22.0 million, respectively, in impairment of equipment and facilities. These costs mainly represent a loss on the sale of property and equipment.

During the three and nine months ended May 31, 2004, Solectron incurred \$0.2 million and \$14.9 million, respectively, in severance and benefit costs. These costs are related to continued reduction of employees mainly in North America and Europe.

During the three and nine months ended May 31, 2004, Solectron continued to perform a review of its operating leases for restructured facilities and equipment in order to ensure all assumptions and estimates made to record these liabilities were still accurate. Upon review, Solectron has adjusted the accrual for restructured facilities and equipment based on the unforeseen reutilization of certain facilities and equipment in operations as well as for any changes to the current and projected market conditions for applicable rental markets. As of May 31, 2004, Solectron has approximately 1.7 million square feet of vacant facility space in continuing operations. If projected sublease income does not meet expectation, Solectron could potentially incur up to approximately \$25.0 million in additional facility lease expenses.

During the three and nine months ended May 31, 2004, Solectron also incurred \$2.7 million and \$35.0 million, respectively, in other exit costs. These costs mainly represent program transfer activity between global operation sites, which are recorded as the charges are incurred.

Fiscal 2003 and 2002

The following table summarizes restructuring charges relating to continuing operations recorded in fiscal 2003 and 2002 (in millions):

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| | Years Ended August 31 | | Nature |
|--|----------------------------------|-------------|---------------|
| | 2003 | 2002 | |
| Impairment of equipment | \$ 47.7 | \$ 120.0 | non-cash |
| Impairment of facilities | 77.8 | 81.0 | non-cash |
| Impairment of other long-lived assets | 26.9 | 162.5 | non-cash |
| | <hr/> | <hr/> | |
| Impairment of equipment, facilities and other | \$ 152.4 | \$ 363.5 | |
| Severance and benefit costs | \$ 220.7 | \$ 115.0 | cash |
| Net adjustment to equipment lease loss accrual | 2.2 | 23.8 | cash |
| Net adjustment to facility lease loss accrual | 23.6 | 79.3 | cash |
| Other exit costs | 32.6 | 20.7 | cash |
| | <hr/> | <hr/> | |
| Total | \$ 431.5 | \$ 602.3 | |
| | <hr/> | <hr/> | |

The employee severance and benefit costs included in the restructuring charges recorded in fiscal 2003 relate to the elimination of approximately 9,500 full-time positions worldwide and all such positions have now been eliminated under this plan. Approximately 57% of the positions eliminated were in the Americas region, 31% were in Europe and 12% were in Asia/Pacific. Facilities and equipment subject to restructuring were primarily located in the Americas and Europe. For leased facilities that are abandoned and subleased, the lease costs represent future lease payments subsequent to abandonment less estimated sublease income. For owned facilities and equipment, the impairment loss recognized was based on the fair value less costs to sell, with fair value based on estimates of existing market prices for similar assets.

The employee severance and benefit costs included in the restructuring charges recorded in fiscal 2002 related to approximately 15,000 full-time positions worldwide, all of which have been eliminated. Approximately 69% of the positions were in the Americas region, 20% were in Europe and 11% were in Asia/Pacific. The employment reductions primarily affected employees in manufacturing and back office support functions. Facilities and equipment subject to restructuring were primarily located in the Americas and Europe.

The following table summarizes the restructuring accrual balance for continuing operations as of May 31, 2004 (in millions):

| | Severance and Benefits | Facility Lease Loss | Equipment Lease Loss | Other Exit Costs | Total |
|--|---------------------------------------|------------------------------------|-------------------------------------|---------------------------------|--------------|
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Balance of accrual at August 31, 2003 | \$ 73.1 | \$ 32.5 | \$ 29.3 | \$ 10.5 | \$ 145.4 |
| Q1-FY04 Provison | 10.1 | 4.5 | 0.3 | 14.6 | 29.5 |

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| | | | | | |
|---|----------------|----------------|----------------|----------------|----------------|
| Q1-FY04 Cash payments | <u>(23.5)</u> | <u>(1.3)</u> | <u>(8.8)</u> | <u>(16.9)</u> | <u>(50.5)</u> |
| Balance of accrual at November 30, 2003 | \$ 59.7 | \$ 35.7 | \$ 20.8 | \$ 8.2 | \$124.4 |
| Q2-FY04 Provision | 4.6 | 32.1 | 3.6 | 17.7 | 58.0 |
| Q2-FY04 Cash payments | <u>(36.7)</u> | <u>(4.5)</u> | <u>(5.4)</u> | <u>(0.7)</u> | <u>(47.3)</u> |
| Balance of accrual at February 28, 2004 | \$ 27.6 | \$ 63.3 | \$ 19.0 | \$ 25.2 | \$135.1 |
| Q3-FY04 Provision | 0.2 | (3.1) | (3.2) | 2.7 | (3.4) |
| Q3-FY04 Cash payments | <u>(5.7)</u> | <u>(3.9)</u> | <u>(5.0)</u> | <u>(10.4)</u> | <u>(25.0)</u> |
| Balance of accrual at May 31, 2004 | <u>\$ 22.1</u> | <u>\$ 56.3</u> | <u>\$ 10.8</u> | <u>\$ 17.5</u> | <u>\$106.7</u> |

Accruals related to restructuring activities were recorded in accrued expenses in the accompanying condensed consolidated balance sheets.

NOTE 11 Loss Per Share Calculation

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

Due to Solectron's loss from continuing operations, dilutive potential common shares were excluded from the computation of diluted loss per share, as inclusion would be anti-dilutive for the periods presented. Diluted net loss per common share is computed using the weighted average number of common and dilutive potential common shares outstanding during the period; dilutive potential common shares consist of options to purchase common stock and shares issuable upon conversion of Solectron's LYONs and ACES. Dilutive

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potential common shares would also include shares issuable upon conversion of Solectron's 0.5% senior notes only if certain conversion events occur.

The following table summarizes the dilutive potential common shares that were excluded from the computation of diluted loss per share (in millions):

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|--|------------------------------|-------|-----------------------------|-------|
| | 2004 | 2003 | 2004 | 2003 |
| Dilutive potential common shares: | | | | |
| Employee stock options | 6.0 | 2.1 | 8.0 | 1.3 |
| Shares issuable upon conversion of LYONs | 17.7 | 30.9 | 18.8 | 35.0 |
| Shares issuable upon conversion of ACES | 1.7 | 112.1 | 0.6 | 112.1 |
| | 25.4 | 145.1 | 27.4 | 148.4 |
| Total dilutive potential common shares | 25.4 | 145.1 | 27.4 | 148.4 |
| Contingent dilutive potential common shares: | | | | |
| Shares issuable upon conversion of 0.5% senior notes, only if certain conversion events occur | 46.6 | | 17.2 | |
| | 46.6 | | 17.2 | |

NOTE 12 Income Taxes

SFAS No. 109, Accounting for Income Taxes, requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence needs to be considered, including the company's performance, the market environment in which the company operates, the utilization of past tax credits, length of carryback and carryforward periods, and existing contracts or sales backlog that will result in future profits, among other factors. It further states that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years in the jurisdictions to which the deferred tax assets relate. Therefore, cumulative losses weigh heavily in the overall assessment. As a result of the review undertaken after the end of the third quarter of the preceding fiscal year, Solectron concluded that it was appropriate to establish a full valuation allowance for most of the net deferred tax assets arising from its operations in the jurisdictions to which the deferred tax assets relate. The total valuation allowance is approximately \$1.5 billion as of May 31, 2004. In addition, Solectron expects to continue to provide a full valuation allowance on future tax benefits until it can demonstrate a sustained level of profitability that establishes its ability to utilize the assets in the jurisdictions to which the assets relate. Solectron incurred net tax expenses in certain countries in which it has profitable operations during the three and nine months ended May 31, 2004.

Certain of Solectron's offshore operations are beginning to report taxable profits, mostly arising in low-cost locations. Accordingly, Solectron anticipates some tax expense in future quarters related to those operations. Solectron will not be able to offset this tax expense with unrecognized deferred tax assets described above, because, for the most part,

those assets did not arise in the jurisdictions where Solectron is realizing taxable profits.

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

NOTE 13 Common Stock

During the third quarter of fiscal 2004, Solectron issued 17.1 million shares of common stock at a price of \$4.775 per share for total net proceeds of \$81.7 million. These net proceeds of \$81.7 million in part, along with an additional common stock issuance of 105.6 million shares, were used to early settle approximately 94% of the 7.25% ACES debentures. See Note 6, Long-Term Debt, for further discussion of the early settlement of the 7.25% ACES debentures.

NOTE 14 Subsequent Events

On June 16, 2004, Solectron signed a definitive agreement to sell its Force Computers, Inc. embedded computing business to Motorola,

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Inc. On June 29, 2004, Solectron sold its 63% interest in US Robotics Corporation to the management of US Robotics.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement Regarding Forward-Looking Statements

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

future sales and operating results;

future prospects and growth;

our ability to improve our gross profit margins;

the capabilities and capacities of our business operations;

any financial or other guidance, including interest expense savings;

our business strategy and our ability to execute on such strategy;

our ability to successfully divest certain operations;

the anticipated financial impact of recent and future acquisitions and divestitures;

the timing and amount of our planned restructuring activities and related estimated cost savings;

the expansion of our low-cost manufacturing capacity and redirection of our manufacturing operations to lower-cost facilities;

our ability to maintain a long-term cost structure to support improved operating efficiency and margins;

the anticipated production levels and revenues of manufacturing and supply agreements with customers;

the potential impact of, and our strategies for addressing, our current litigation and environmental liability exposure; and

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

We intend that our forward-looking statements be subject to the safe harbors created by the Exchange Act. The forward-looking statements are generally accompanied by words such as intend, anticipate, believe, estimate, expect, and other similar words and statements. Our forward-looking statements are based on current expectations, forecasts and assumptions and are subject to risks, uncertainties and changes in condition, significance, value and effect, including those discussed under the heading Risk Factors in this report and in our reports filed with the Securities and Exchange Commission on Forms 10-K, 8-K, 10-Q and S-3. Such risks, uncertainties and changes in condition, significance, value and effect could cause our actual results to differ materially from our anticipated outcomes.

Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate. Therefore, we can give no assurance that the results implied by these forward-looking statements will be realized. The inclusion of forward-looking information should not be regarded as a representation by our company or any other person that the future events, plans or expectations contemplated by Solectron will be achieved. Furthermore, past performance in operations and share price is not necessarily indicative of future performance. We disclaim any intention or obligation to update or revise any forward-looking statements contained in the documents incorporated by reference herein, whether as a result of new information, future events or otherwise.

Table of Contents**Overview**

We provide a range of global manufacturing and integrated supply chain services to companies who design and market electronic products. Our revenue is generated from sales of our services primarily to customers in the Computing & Storage, Networking, Communications, Consumer, Industrial, and Automotive markets.

Sales to a relatively small number of customers historically have been making up a significant portion of our net sales and we expect that trend to continue in the future. Sales to our ten largest customers accounted for 60.7% and 60.0% for the three and nine months ended May 31, 2004, respectively. Currently, our largest customer, Cisco Systems, accounted for 10% or more of our net sales in the three and nine months ended May 31, 2004.

The EMS industry experienced rapid change and growth over the past decade as an increasing number of OEMs outsourced an increasing portion of their manufacturing requirements. In 2001, the industry's revenue declined as a result of significant reduction in end-market demand, which was consistent with the overall global economic downturn. Beginning in the second quarter of fiscal 2001, we initiated the restructuring of our operations in light of the global economic downturn. The measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, were intended to align our capacity and infrastructure to anticipated customer demand, transition our operations to lower cost regions and rationalize our footprint worldwide. Additionally, we decided to divest selected assets that are not central to our strategy. These assets have been accounted for as discontinued operations. Our revenues have increased over the last year as customer production requirements have risen during this economic recovery, and we are winning business with new and existing customers.

The electronics industry is subject to rapid technological change, product obsolescence and price competition. These and other factors affecting the electronics industry, or any of Solectron's major customers in particular could materially harm Solectron's results of operations. See **Risk Factors** for additional factors relating to possible fluctuations of our operating results.

Summary of Results

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

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|---|--------------------------------------|-------------|---------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$3,039.9 | \$2,357.3 | \$8,624.1 | \$7,385.0 |
| Gross profit | 159.2 | 99.2 | 417.8 | 324.6 |
| Selling, general and administrative expense | 103.9 | 138.1 | 327.8 | 436.4 |
| Income (loss) from discontinued operations | 86.7 | (415.3) | 40.8 | (425.8) |

Sales for the third quarter of fiscal 2004 increased 29.0% to \$3.0 billion compared to \$2.4 billion for the same period of fiscal 2003. Our sales levels during the third quarter of fiscal year 2004 were stronger across all markets. The increase in revenue base represents stronger demand from existing programs, as well as growth from new and existing customers.

Gross margin improved to 5.2% for the third quarter of fiscal 2004 compared to 4.2% for the same period of fiscal 2003. The improvement in gross margin is a result of the execution of our Lean Six Sigma manufacturing initiative (Lean Initiative), increased discipline in the implementation of our quote process, and improved capacity utilization. The Lean Initiative has begun to give us greater flexibility, improved our productivity and reduced costs. The Lean Initiative encompasses specifying value, lining-up value-creating actions in the best sequence, conducting these activities without interruption whenever a customer requests them, and performing them more effectively. In general, the Lean Initiative in our manufacturing environment attempts to provide customers with what they require using less human effort, equipment, time and space. The increased discipline in the implementation of our quote process has involved centralizing the process, standardizing the cost models used to evaluate programs, raising decision making authority to more senior levels within the company, emphasizing the expected returns to Solectron in deciding what pricing to offer and accept, and implementing profitability-based sales force compensation.

Selling, general and administrative (SG&A) expense continued to decline in the third quarter of fiscal 2004. SG&A expense was \$103.9 million during the third quarter of fiscal 2004 compared to \$138.1 million for the same period of fiscal 2003. The reduction in

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SG&A expense, which was required for us to be competitive within our industry, is a result of our restructuring activities.

During the three months ended May 31, 2004, we completed the sale of three discontinued operations: Kavlico Corporation, Stream International Inc., and SMART Modular Technologies, Inc. Additionally in June 2004, we announced that we entered into a definitive agreement to sell Force Computers, Inc. and we sold our 63% interest in US Robotics Corporation. We continue to anticipate total proceeds from the sale of all discontinued operations to range from \$500-\$600 million.

We have made significant progress in reducing our outstanding debt. During the third quarter of fiscal 2004, we completed the early settlement of approximately 94% of our outstanding 7.25% ACES debentures and the cash settlement of \$950 million of our outstanding LYONs. These two actions decreased our outstanding debt by approximately \$2.0 billion, increased equity by approximately \$1.0 billion, and will reduce quarterly interest expense by approximately \$23.0 million in the fourth quarter of fiscal year 2004 from the third quarter of fiscal 2004. The net effect of reducing debt and increasing equity improved our debt-to-capital ratio from 71.3% to 34.5%. Our short-term debt is now \$25.5 million and our remaining long-term debt of \$1.2 billion has an average maturity of 5 years.

Key Performance Indicators

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

| | Three Months Ended | | | |
|------------------------------------|---------------------------|------------------------------|------------------------------|----------------------------|
| | May 31, 2004 | February 28, 2004 | November 30, 2003 | August 31, 2003 |
| Inventory turns | 7.5 turns | 7.4 turns | 7.4 turns | 6.6 turns |
| Days sales outstanding (DSO) | 47 days | 49 days | 50 days | 53 days |
| Days payable outstanding (DPO) | 46 days | 48 days | 48 days | 46 days |
| Cash-to-cash cycle (C2C) | 49 days | 50 days | 50 days | 59 days |
| Capital expenditures (in millions) | \$ 32.8 | \$ 31.5 | \$ 37.0 | \$ 40.7 |

Inventory turns is calculated as the ratio of cost of sales compared to the average inventory for the quarter. The improvement in inventory turns was primarily the result of: (1) our disciplined and focused effort on material and production planning and, (2) continued implementation of the Lean Initiative in our manufacturing sites around the world. DSO is calculated as the ratio of average accounts receivable for the quarter compared to daily revenue for the quarter. DSO has declined from the prior quarter due to an increased focus on collection activity and ensuring compliance with the terms and conditions of our contracts. DPO is calculated as the ratio of average accounts payable during the quarter compared to daily cost of sales for the quarter. The C2C cycle is determined by taking the ratio of 360 days compared to inventory turns plus DSO minus DPO. The C2C cycle has declined from the prior quarter primarily as a result of improvements in both inventory turns and DSO, partially offset by lower DPO. Capital expenditures are primarily related to equipment purchases supporting increased demand and new programs.

Critical Accounting Policies

Management is required to make judgments, assumptions and estimates that affect the amounts reported when we prepare financial statements and related disclosures in conformity with generally accepted accounting principles in the United States. Note 1, Summary of Significant Accounting Policies, to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended August 31, 2003 describes the significant accounting policies and methods used in the preparation of our consolidated financial statements. Estimates are used for, but not limited to, our accounting for contingencies, allowance for doubtful accounts, inventory valuation, goodwill and other intangible asset impairments, restructuring costs, and income taxes. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of our consolidated financial statements.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood and our ability to reasonably estimate the amount of loss in determining the necessity for, and amount of, any loss contingencies. Estimated loss contingencies are accrued when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate information available to us to determine whether any such accruals should be adjusted.

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Such revisions in the estimates of the potential loss contingencies could have a material impact in our results of operations and financial position.

Inventory Valuation

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

Allowance for Doubtful Accounts

We evaluate the collectability of our accounts receivable based on a combination of factors. Where we are aware of circumstances that may impair a specific customer's ability to meet its financial obligations to us, we record a specific allowance against amounts due to us and thereby reduce the net receivable to the amount we reasonably believe is likely to be collected. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are outstanding, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, additional allowances may be required.

Goodwill

We perform a goodwill impairment test annually during the fourth quarter of our fiscal year and more frequently if an event or circumstance indicates that an impairment loss has occurred. Such events or circumstances may include significant adverse changes in the general business climate or a prolonged depressed market capitalization, among others. The tests are performed by determining the fair values of our reporting units using a discounted future cash flow model and comparing those fair values to the carrying values of the reporting units, including goodwill. If the fair value of a reporting unit is less than its carrying value, we then allocate the fair value of the unit to all the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit's fair value was the purchase price to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of the goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that excess. The process of evaluating the potential impairment of goodwill is subjective and requires judgment at many points during the test including future revenue forecasts, discount rates and various reporting unit allocations.

Intangible Assets

Our intangible assets consist primarily of intellectual property agreements and other intangible assets obtained from asset acquisitions. Intangible assets are evaluated for impairment whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. Such an asset is considered impaired if the carrying amount of the asset grouping including the intangible asset exceeds the sum of the undiscounted cash flows expected to result from the use and ultimate disposition of the assets. If such assets are considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the assets exceeds fair value determined using a discounted cash flow model. While our cash flow assumptions and estimated useful lives are consistent with

our business plans, there is significant judgment involved in determining these cash flows.

Restructuring and Related Impairment Costs

Over the past few years, we have recorded restructuring and impairment costs as we rationalized our operations in light of customer demand declines and the economic downturn. These restructuring and impairment charges include employee severance and benefit costs, costs related to leased facilities that have been abandoned and subleased, owned facilities no longer used by us which will be disposed of, costs related to leased equipment that has been abandoned, and impairment of owned equipment that will be disposed of. For owned facilities and equipment, the impairment loss recognized was based on the fair value less costs to sell, with fair value estimated based on existing market prices for similar assets. Severance and benefit costs and other costs associated with restructuring activities initiated prior to January 1, 2003 were recorded in compliance with EITF Issue No. 94-3, Liability Recognition for Certain

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Employee Termination Benefits and Other Costs to Exit an Activity. Severance and benefit costs associated with restructuring activities initiated on or after January 1, 2003 are recorded in accordance with SFAS No. 112, *Employer's Accounting for Postemployment Benefits*, as we concluded that we had a substantive severance plan. In accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, the estimated lease loss accrued for leased facilities that have been abandoned and subleased after December 31, 2002 represents the fair value of the lease liability as measured by the present value of future lease payments subsequent to abandonment less the present value of any estimated sublease income. For those facilities abandoned and subleased as part of restructuring activities under EITF Issue No. 94-3, the estimated lease loss represents payments subsequent to abandonment less any estimated sublease income. In order to estimate future sublease income, we work with an independent broker to estimate the length of time until we can sublease a facility and the amount of rent we can expect to receive. Our estimates of expected sublease income could change based on factors that affect our ability to sublease those facilities such as general economic conditions and the real estate market, among others.

Income Taxes

We currently have significant deferred tax assets in certain jurisdictions resulting from tax credit carryforwards, net operating losses and other deductible temporary differences, which will reduce taxable income in such jurisdictions in future periods. We have provided valuation allowances for future tax benefits resulting from foreign net operating loss carryforwards and for certain other U.S. and foreign deductible temporary differences where we believe future realizability is in doubt. SFAS No. 109 requires a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized, and further provides that it is difficult to conclude that a valuation allowance is not needed when there is negative evidence in the form of cumulative losses in recent years. Therefore, cumulative losses weigh heavily in the overall assessment. We established a valuation allowance in the third quarter of fiscal 2003 for most of our deferred tax assets because prior losses and an uncertain future outlook did not support projections of profitability sufficient to establish our ability to use those deferred tax assets in future periods. We have not yet established sufficient sustained profitability since that time which would support projections of future profitability consistent with the recognition of deferred tax assets generated in prior and current periods. As a result of our assessment, we increased our total valuation allowance on deferred tax assets arising from continuing operations to approximately \$1.5 billion at May 31, 2004. We expect to record a full valuation allowance on future tax benefits until we reach a sustained level of profitability in the countries in which deferred tax assets arise.

Results of Operations

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

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| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|---|--------------------------------------|-------------|-------------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of sales | 94.8 | 95.8 | 95.2 | 95.6 |
| Gross profit | 5.2 | 4.2 | 4.8 | 4.4 |
| Operating expenses: | | | | |
| Selling, general and administrative | 3.4 | 5.9 | 3.8 | 5.9 |
| Restructuring and impairment costs | 0.2 | 84.0 | 1.2 | 28.7 |
| Operating income (loss) | 1.6 | (85.7) | (0.2) | (30.2) |
| Interest income | 0.2 | 0.3 | 0.1 | 0.3 |
| Interest expense | (1.4) | (2.2) | (1.5) | (2.2) |
| Other income (expense) - net | (2.6) | (0.2) | (0.8) | 0.6 |
| Operating loss from continuing operations before income taxes | (2.2) | (87.8) | (2.4) | (31.5) |
| Income tax expense | | 26.1 | | 7.2 |
| Loss from continuing operations | (2.2)% | (113.9)% | (2.4)% | (38.7)% |
| Discontinued operations: | | | | |
| Income (loss) from discontinued operations | 3.1 | (13.2) | 0.6 | (4.2) |
| Income tax expense | 0.2 | 4.5 | 0.1 | 1.5 |
| Net income (loss) | 0.7% | (131.6)% | (1.9)% | (44.4)% |

Net Sales Continuing Operations

For the third quarter of fiscal 2004, net sales increased 29.0% to \$3.0 billion from \$2.4 billion in the same period of fiscal 2003. The increase for the three months ended May 31, 2004 from the same period of the previous fiscal year was due to increased sales levels across all markets. Specific increases include an 8.6% increase in the sale of computing and storage products; a 14.9% increase in the sale of networking products; a 27.0% increase in the sale of communication products; an 81.3% increase in sales of consumer products; a 135.4% increase in the sale of industrial

products; and a 20.1% increase in the sales of automotive products. The increased sales levels were due to the addition of new customers and growth in these markets.

For the nine months ended May 31, 2004, net sales increased 16.8% to \$8.6 billion from \$7.4 billion in the same period of fiscal 2003. The increase for the nine months ended May 31, 2004 from the same period of the previous fiscal year was due to increased sales levels across most markets. Specific increases include a 18.0% increase in the sale of computing and storage products; a 7.3% increase in the sale of networking products; a 62.1% increase in sales of consumer products; a 50.8% increase in the sale of industrial products; and a 26.6% increase in the sales of automotive products. The increased sales levels were due to the addition of new customers and growth in these markets.

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

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| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|---------------------|--------------------------------------|-------------|-------------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Computing & Storage | 29% | 34% | 32% | 31% |
| Consumer | 20% | 14% | 19% | 14% |
| Communications | 19% | 20% | 18% | 22% |
| Networking | 21% | 24% | 21% | 23% |
| Industrial | 6% | 3% | 5% | 4% |
| Automotive | 3% | 3% | 3% | 3% |
| Other | 2% | 2% | 2% | 3% |
| Total | 100% | 100% | 100% | 100% |

International Sales Continuing Operations

In the three and nine months ended May 31, 2004, our international locations contributed approximately 73.5% and 72.9%, respectively, of net sales compared to approximately 65.6% and 66.3% for the corresponding periods of fiscal 2003, respectively. Net sales from our international sites, as a percentage of consolidated net sales, have grown primarily in the Asia/Pacific region where we have invested to take advantage of the lower cost of operations.

Major Customers Continuing Operations

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

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|-----------------|----------------------------------|-------------|---------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Cisco Systems | 12.8% | 12.0% | 12.4% | 11.2% |
| Nortel Networks | *** | 12.8% | *** | 13.0% |

*** Less than 10%

Our top ten customers accounted for approximately 60.7% and 60.0% of net sales for the three and nine months ended May 31, 2004, respectively, compared to approximately 61.7% and 60.1% in the corresponding periods of fiscal 2003, respectively.

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

may be materially adversely affected.

Gross profit Continuing Operations

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

Our gross profit percentage increased to 5.2% and 4.8% for the three and nine months ended May 31, 2004, respectively, compared to 4.2% and 4.4% for the corresponding periods in fiscal 2003, respectively. The gross profit improvement was the result of effectively implementing the Lean Initiative in our manufacturing sites around the world and increasing discipline in the implementation of our quote process. Furthermore, during the second quarter of fiscal 2003, our margin was negatively affected by inefficiencies associated with reduced demand and a \$76.3 million inventory charge related to excess and obsolete inventory which was taken due to the continued depressed condition of the telecommunications market.

We continue to implement a number of initiatives to improve our gross profits: (1) Lean Initiative to improve operational effectiveness and efficiency; (2) further improving capacity utilization; (3) ensuring contractual relationships reflect value added by

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our operations; (4) a disciplined pricing model; (5) engaging with our customers in collaborative design; and (6) profitability-based sales force compensation.

Sales of inventory previously written down or written off have not been significant and have not had any material impact on our gross profits for the three and nine months ended May 31, 2004.

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

SG&A expenses decreased \$34.2 million, or 24.8%, for the three months ended May 31, 2004 compared to the corresponding period in fiscal 2003. SG&A expenses decreased \$108.6 million, or 24.9%, for the nine months ended May 31, 2004 compared to the corresponding period in fiscal 2003. As a percentage of net sales, SG&A expenses decreased to 3.4% and 3.8% for the three and nine months ended May 31, 2004, respectively, compared to 5.9% in the corresponding periods in fiscal 2003. The decrease was primarily due to headcount and other SG&A expense reductions resulting from our restructuring initiatives.

Restructuring and Impairment Continuing Operations

During the third quarter of fiscal 2004, we continued our restructuring activities and total restructuring and impairment costs of \$5.5 million were charged against operations which mainly related to the loss on disposal of property and equipment and continued review of our operating lease liabilities associated with vacant facilities and unused equipment.

As of May 31, 2004, liabilities related to our restructuring activities total approximately \$106.7 million. Approximately \$67.0 million of this total is expected to be paid out within the next twelve months for severance and benefit payments related to the remaining restructuring activities, lease commitment costs and other exit costs. The remaining balance, consisting of lease commitment costs, is expected to be paid out through 2012. As of May 31, 2004, Solectron has approximately 1.7 million square feet of vacant facility space in continuing operations. If projected sublease income does not meet expectation, Solectron could potentially incur up to approximately \$25 million in additional facility lease expenses.

Ongoing Restructuring Activities

We continue to evaluate our cost structure relative to current anticipated revenue levels and to adjust our manufacturing footprint between high cost and low cost areas and may take additional restructuring charges in the future. If our estimates about future restructuring charges prove to be inadequate, our financial condition and results of operations may suffer. We expect to incur nominal restructuring charges which will consist of both cash and non-cash charges during the remainder of the fiscal year as we continue to sell assets and revise previous estimates.

See Note 10, Restructuring and Impairment, for further discussion of our restructuring activities.

Interest Income Continuing Operations

Interest income decreased \$2.0 million to \$4.8 million for the three months ended May 31, 2004 from \$6.8 million in the corresponding period in fiscal 2003. Interest income decreased \$10.8 million to \$10.8 million for the nine months ended May 31, 2004 from \$21.6 million in the corresponding period in fiscal 2003. The decreases were due to reduced average cash, cash equivalent and short-term investment balances and lower average interest rates in fiscal 2004 as compared to fiscal 2003.

Interest Expense Continuing Operations

Interest expense decreased \$9.6 million to \$41.8 million for the three months ended May 31, 2004 from \$51.4 million in the corresponding period in fiscal 2003. Interest expense decreased \$30.3 million to \$130.1 million for the nine months ended May 31, 2004 from \$160.4 million in the corresponding period in fiscal 2003. The decreases were primarily due to the retirement of approximately \$1.8 billion aggregate principal amount at maturity of our LYONs during fiscal 2003 and approximately \$1.6 billion aggregate principal amount at maturity of our LYONs during the third quarter of fiscal 2004. In addition, we completed the early settlement of approximately 94% of our outstanding 7.25% ACES debentures during the third quarter of fiscal 2004. The LYONs retirement and early settlement of our 7.25% ACES debentures will provide an interest expense reduction of approximately \$23 million in future fiscal quarters.

Table of Contents**Other Income (Expense) - net Continuing Operations**

Other income (expense) - net increased \$72.5 million to a \$77.9 million expense for the three months ended May 31, 2004 from a \$5.4 million expense in the corresponding period in fiscal 2003. Other income (expense) net decreased \$114.7 million to a \$68.6 million expense for the nine months ended May 31, 2004 from a \$46.1 million income in the corresponding period in fiscal 2003. For the three and nine months ended May 31, 2004, other income (expense) net primarily consisted of a loss resulting from the early settlement of approximately 94% of our 7.25% ACES debentures of \$77.7 million. For the nine months ended May 31, 2003, other income (expense) - net primarily consisted of gains on retirement of our LYONs. The following tables provide the details of the early settlement of our 7.25% ACES debentures, the retirement of our 4.0% LYONs due 2019, the retirement of our 2.75% LYONs due 2020 and the retirement of our 3.25% LYONs due 2020 in each period presented recorded in the accompanying condensed consolidated financial statements (in millions):

| 7.25% ACES Early Settlement | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|---|--------------------------------------|-------------|-------------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Principal amount at maturity | \$ 1,012.5 | \$ - | \$ 1,012.5 | \$ - |
| Carrying value | \$ 1,007.5 | \$ - | \$ 1,007.5 | \$ - |
| Common stock issued | 1,006.4 | - | 1,006.4 | - |
| Cash paid | 63.3 | - | 63.3 | - |
| Debt issuance cost write-off | 15.5 | - | 15.5 | - |
| Loss included in other income (expense) - net | \$ (77.7) | \$ - | \$ (77.7) | \$ - |

| LYONs Retirement | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|---|--------------------------------------|-------------|-------------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Principal amount at maturity | \$ 1,617.5 | \$ 818.1 | \$ 1,617.5 | \$ 1,443.1 |
| Carrying value | \$ 950.2 | \$ 514.2 | \$ 950.2 | \$ 861.4 |
| Cash paid | 950.2 | 514.2 | 950.2 | 823.1 |
| Gain included in other income (expense) - net | \$ - | \$ - | \$ - | \$ 38.3 |

The remaining components of other income (expense) - net fluctuated primarily due to foreign currency gains and losses.

Income Taxes Continuing Operations

Our income tax expense was \$0.3 million and \$3.3 million, respectively, for the three and nine months ended May 31, 2004 as compared to an income tax expense of \$615.8 million and \$531.0 million, respectively, for the three and nine months ended May 31, 2003. Management's decision to provide a valuation allowance on certain deferred tax assets resulted in the tax expense incurred in the third quarter of fiscal 2003. Subsequent to the third quarter of fiscal 2003, we established a full valuation allowance for most of the net deferred tax assets arising from operations. Income tax expense that would otherwise be incurred over the next several quarters will be reduced to the extent of offsetting valuation allowance reductions. We incurred net tax expense in certain countries in which we have profitable operations during the three and nine months ended May 31, 2004.

In prior quarters, the effective income tax rate had been largely a function of the balance between income and losses from domestic and international operations. Our international operations, taken as a whole, have been subject to tax at a lower rate than operations in the United States, primarily due to tax holidays granted to several of our overseas sites in Malaysia, Singapore and China. The Malaysian tax holiday is effective through July 2011, subject to some conditions, including maintaining certain levels of research and development expenditures. The Singapore tax holiday is effective through March 2011, subject to some conditions. Seven of our China sites have separate tax holiday agreements. Each agreement expires five years from the first profitable year for each site.

Certain of our offshore operations are beginning to report taxable profits, mostly arising in low-cost locations. Accordingly, we anticipate some tax expense in future quarters related to those operations. We will not be able to offset this tax expense with

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unrecognized deferred tax assets described above, because, for the most part, those assets did not arise in the jurisdictions where we are realizing taxable profits.

Liquidity and Capital Resources Continuing Operations

Cash, cash equivalents, and short-term investments decreased to approximately \$1.2 billion at May 31, 2004 from approximately \$1.5 billion at August 31, 2003. The table below, for the periods indicated, provides selected condensed consolidated cash flow information (in millions):

| | Nine Months Ended May 31 | |
|--|-------------------------------------|-------------|
| | 2004 | 2003 |
| Net cash (used in) provided by operating activities of continuing operations | \$ (133.2) | \$ 252.5 |
| Net cash provided by investing activities of continuing operations | \$ 392.5 | \$ 371.3 |
| Net cash used in financing activities of continuing operations | \$ (518.4) | \$ (883.9) |

We used cash from operating activities of \$133.2 million during the nine months ended May 31, 2004. This use of cash was generated from a \$207.3 million loss from continuing operations, a \$210.3 million increase in accounts receivable, net, a \$246.0 million increase in inventories offset by a \$264.6 million increase in accounts payable, non-cash depreciation and amortization charges of \$174.1 million and loss on the retirement of debt of \$77.7 million. The rise in inventory levels and accounts payable is due to an increase in forecasted demand from our customers. Accounts receivable, net has increased in conjunction with higher revenues.

We generated cash from investing activities of \$392.5 million during the nine months ended May 31, 2004 primarily due to net proceeds of \$383.4 million received from the disposition of four of our discontinued operations.

Net cash used in financing activities of \$518.4 million during the nine months ended May 31, 2004 primarily consisted of the retirement of LYONs for \$950 million offset by \$436.5 million of net proceeds generated from the issuance of 0.5% convertible senior notes.

As of May 31, 2004, we had available a \$250 million revolving credit facility that expires on February 14, 2005. Our revolving credit facility is guaranteed by certain of our domestic subsidiaries and secured by the pledge of domestic accounts receivable, inventory and equipment, the pledge of equity interests in certain of our subsidiaries and notes evidencing intercompany debt. Borrowings under the credit facility bear interest, at our option, at the London Interbank offering rate (LIBOR) plus a margin of 2.125% based on our current senior unsecured debt ratings, or the higher of the Federal Funds Rate plus 1/2 of 1% or Bank of America N.A.'s publicly announced prime rate. As of May 31, 2004, there were no borrowings outstanding under this facility. We are subject to compliance with certain financial covenants set forth in these facilities including, but not limited to, capital expenditures, consolidated tangible net worth, cash interest coverage, leverage, liquidity, and minimum cash. Prior to the end of the second quarter of fiscal 2004, we amended certain terms and conditions including the minimum liquidity and the leverage covenants. We were in compliance with all applicable covenants as of May 31, 2004.

On October 28, 2003 Standard and Poor's downgraded our senior unsecured debt rating to B+ with a stable outlook. On October 31, 2003 Moody's downgraded our senior unsecured debt rating to B1 with a stable outlook. These rating downgrades increase our cost of capital should we borrow under our revolving lines of credit, and may make it more expensive for us to raise additional capital in the future. Such capital raising activities may be on terms that may not

be acceptable to us or otherwise not available. On June 22, 2004, Standard and Poor's affirmed our senior unsecured rating and revised our outlook to positive from stable.

In addition, we had \$31.6 million in committed and \$198.0 million in uncommitted foreign lines of credit and other bank facilities as of May 31, 2004 relating to continuing operations. A committed line of credit obligates a lender to loan us amounts under the credit facility as long as we adhere to the terms of the credit agreement. An uncommitted line of credit is extended to us at the sole discretion of a lender. The interest rates range from the bank's prime lending rate to the bank's prime rate plus 2.0%. As of May 31, 2004, borrowings and guaranteed amounts were \$8.4 million under committed and \$11.6 million under uncommitted foreign lines of credit. Borrowings are payable on demand. The weighted-average interest rate was 1.92% for committed and 5.46% for uncommitted foreign lines of credit as of May 31, 2004.

During the third quarter of fiscal 2004, we issued 17.1 million shares of common stock for total net proceeds of \$81.7 million. These

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net proceeds of \$81.7 million in part, along with an additional common stock issuance of 105.6 million shares were used to early settle approximately 94% of our 7.25% ACES.

Holders of our 3.25% LYONs due November 2020 had the option to require us to repurchase their notes on May 20, 2004 in an amount of \$587.46 per \$1,000 principal amount for a total of approximately \$953 million. Solectron repurchased approximately \$950 million of these LYONS with cash during the third quarter of fiscal 2004. The early settlement of approximately 94% of our ACES debentures results in approximately \$63 million of the 7.25% subordinated ACES debentures to be due on November 15, 2006. On or about August 15, 2004, the remaining ACES debentures of \$63 million are scheduled to be remarketed and if the remarketing is successful, the interest rate will be reset at the then current rates as described in the indenture and the proceeds from the remarketing will be used to satisfy the holders' obligation to purchase our common stock in November 2004. If the debentures are not successfully remarketed, the interest rate will not be reset and we expect to use the pledged debentures to satisfy the holders' obligation to purchase our common stock in November 2004. In addition, our \$150 million aggregate principal amount of 7.375% senior notes is due on March 1, 2006, our \$500 million aggregate principal amount of 9.625% senior notes is due on February 15, 2009, and our \$450 million aggregate principal amount of 0.5% convertible senior notes is due on February 15, 2034.

We have synthetic lease agreements relating to four manufacturing sites for continuing operations. The synthetic leases have expiration dates in 2007. At the end of the lease term, we have an option, subject to certain conditions, to purchase or to cause a third party to purchase the facilities subject to the synthetic leases for the Termination Value, which approximates the lessor's original cost for each facility, or we may market the property to a third party at a different price. We are entitled to any proceeds from a sale of the properties to third parties in excess of the Termination Value and liable to the lessor for any shortfall. We provided loans to the lessor equaling approximately 85% of the Termination Value for each synthetic lease. These loans are repayable solely from the sale of the properties to third parties in the future, are subordinated to the amounts payable to the lessor at the end of the synthetic leases, and may be credited against the Termination Value payable if we purchase the properties. The approximate aggregate Termination Values and loan amounts are \$101.3 million and \$86.1 million, respectively, as of May 31, 2004.

In addition, cash collateral of \$15.2 million is pledged for the difference between the aggregate Termination Values and the loan amounts. Each synthetic lease agreement contains various affirmative and financial covenants. A default under a lease, including violation of these covenants, may accelerate the termination date of the arrangement. Prior to the end of the second quarter of fiscal 2004, we amended certain terms and conditions including the minimum liquidity and the leverage covenants. We were in compliance with all applicable covenants as of May 31, 2004. Monthly lease payments are generally based on the Termination Value and 30-day LIBOR index (1.1% as of May 31, 2004) plus an interest-rate margin, which may vary depending upon our Moody's Investors' Services and Standard and Poor's ratings, and are allocated between the lessor and us based on the proportion of the loan amount to the Termination Value for each synthetic lease.

We account for these synthetic lease arrangements as operating leases in accordance with SFAS No. 13, *Accounting for Leases*, as amended. Our loans to the lessor and cash collateral were included in other long-term assets and cash, cash equivalents and short-term investments, respectively, in the condensed consolidated balance sheets.

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

The following is a summary of certain obligations and commitments as of May 31, 2004 for continuing operations:

Payments Due by Period
(in millions)

| | FY05 | | | | | | | | |
|-----------------|------------------|----------------|---------------|--------------|----------------|---------------|---------------|---------------|-------------------|
| | Total | Q404 | Q1-Q3 | Q4 | FY06 | FY07 | FY08 | FY09 | Thereafter |
| Long term debt | \$1,213.3 | \$ | \$ | \$1.5 | \$171.7 | \$72.5 | \$ 0.2 | \$ 0.1 | \$ 967.3 |
| Operating lease | 173.1 | 23.0 | 33.5 | 8.2 | 25.1 | 16.9 | 13.9 | 11.7 | 40.8 |
| Other (1) | 114.8 | 114.8 | — | — | — | — | — | — | — |
| | \$1,501.2 | \$137.8 | \$33.5 | \$9.7 | \$196.8 | \$89.4 | \$14.1 | \$11.8 | \$1,008.1 |

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

In addition, we guarantee committed and uncommitted lines of credit and debt for our continuing operations subsidiaries totaling \$229.6 million as of May 31, 2004. We also guarantee performance of certain of our continuing operations subsidiaries in various transactions such as leases, totaling \$261.6 million as of May 31, 2004.

Off-Balance Sheet Arrangements and Contractual Obligations

Our off-balance sheet arrangements consist of our synthetic and operating leases, subsidiary guarantees (leases and subsidiary guarantees are both described in the Liquidity and Capital Resources portion of Management's Discussion and Analysis of Financial Condition and Results of Operations), our interest rate swap instrument related to our long-term debt (described in the We are exposed to interest rate fluctuations Risk Factor), and our foreign exchange contracts (described in the We are exposed to fluctuations in foreign currency exchange rates Risk Factor).

A tabular presentation of our contractual obligations is provided in the Liquidity and Capital Resources portion of Management's Discussion and Analysis of Financial Condition and Results of Operations.

Discontinued Operations

During the fourth quarter of fiscal 2003, as a result of a full review of our portfolio of businesses, we committed to a plan to divest a number of business operations that are no longer part of our strategic plan for the future. In accordance with SFAS No. 144, we have reported the results of operations and financial position of these businesses in discontinued operations within the condensed consolidated statements of operations and balance sheets for all periods presented. As a result of further divestment activity during the first quarter of fiscal 2004, we identified certain additional operations, which were included in continuing operations in fiscal 2003 that now qualify for classification as discontinued operations. The companies that we have divested and are in the process of divesting and that are included in discontinued operations are: Dy 4 Systems Inc., Kavlico Corporation, Solectron's MicroTechnology division, SMART Modular Technologies Inc., Stream International Inc., our 63% interest in US Robotics Corporation, and Force Computers, Inc.

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

| | Three Months Ended May 31 | | Nine Months Ended May 31 | |
|-----------------------------------|--------------------------------------|-------------|-------------------------------------|-------------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$ 325.8 | \$ 458.2 | \$ 1,204.9 | \$ 1,297.2 |
| Cost of sales | 274.2 | 393.8 | 1,022.0 | 1,094.0 |
| Gross profit | 51.6 | 64.4 | 182.9 | 203.2 |
| Operating expenses (income) - net | (43.8) | 376.8 | 129.0 | 517.9 |
| Operating income (loss) | 95.4 | (312.4) | 53.9 | (314.7) |
| Interest income - net | 0.4 | 0.7 | 1.2 | 1.4 |
| Other income (expense) - net | (3.0) | 1.4 | (4.3) | 0.8 |

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| | | | | |
|--|---------|------------|---------|------------|
| | _____ | _____ | _____ | _____ |
| Income (loss) before income taxes | 92.8 | (310.3) | 50.8 | (312.5) |
| Income tax expense | 6.1 | 105.0 | 10.0 | 113.3 |
| | _____ | _____ | _____ | _____ |
| Income (loss) from discontinued operations, net of tax | \$ 86.7 | \$ (415.3) | \$ 40.8 | \$ (425.8) |
| | _____ | _____ | _____ | _____ |

Net sales, gross profit, operating expenses (income) net, and interest income - net from discontinued operations decreased for the three and nine months ended May 31, 2004 as compared to the same periods in fiscal 2003 primarily due to the sale of four discontinued operations during the nine months ended May 31, 2004. In addition, the aggregate pre-tax gain from the sales of all four discontinued operations of \$88.3 million and \$155.5 million was recorded in operating expenses (income) - net for the three and nine month periods ended May 31, 2004, respectively. We continue to anticipate total proceeds from the sale of all discontinued operations to range from \$500-\$600 million.

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As a result of the sales agreement for one of the discontinued operations during the third quarter of fiscal 2004, a synthetic lease held by the discontinued operations was not assumed by the buyer. We are in the process of terminating the synthetic lease by selling the property subject to the synthetic lease and any potential loss associated with its termination will be recorded as part of discontinued operations. The approximate Termination Value and loan amounts was \$23.4 million and \$19.9 million, respectively, as of May 31, 2004. At the end of the third quarter in fiscal 2004, we completed a preliminary valuation of the property under this synthetic lease and has determined a shortfall of approximately \$11.3 million between the value of the property and the loan amount. The effect of this shortfall will be realized ratably until the termination of the lease through fiscal 2007 or upon its ultimate disposition.

The sales agreements for all four divestitures contain certain indemnification provisions under which Solectron may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of breaches of covenants and certain breaches of representations and warranties relating to the condition of the business prior to and at the time of sale. In aggregate, Solectron is contingently liable for up to \$61.5 million for a period of 12 to 24 months subsequent to the completion of the sale. As of May 31, 2004, there were no liabilities recorded under these indemnification obligations.

The sales agreements of the discontinued operations generally include terms which may result in adjustments to the gain or loss in fiscal quarters subsequent to the closing of the sale.

On June 16, 2004, we signed a definitive agreement to sell Force Computers, Inc. embedded computing business to Motorola, Inc. On June 29, 2004, we sold our 63% interest in US Robotics Corporation to the management of US Robotics.

RISK FACTORS

MOST OF OUR NET SALES COME FROM A SMALL NUMBER OF CUSTOMERS; IF WE LOSE ANY OF THESE CUSTOMERS, OUR NET SALES COULD DECLINE SIGNIFICANTLY.

Most of our annual net sales come from a small number of our customers. Our ten largest customers accounted for approximately 60.7% and 61.7% of net sales from continuing operations in the third quarters of fiscal 2004 and 2003, respectively. Some of these customers individually account for more than ten percent of our annual net sales. Any material delay, cancellation or reduction of orders from these or other major customers could cause our net sales to decline significantly, and we may not be able to reduce the accompanying expenses at the same time. We cannot guarantee that we will be able to retain any of our largest customers or any other accounts, or that we will be able to realize the expected revenues under existing or anticipated supply agreements with these customers. Our business, market share, financial condition and results of operations will continue to depend significantly on our ability to obtain orders from new customers, retain existing customers, realize expected revenues under existing and anticipated supply agreements, as well as on the financial condition and success of our customers and their customers.

Net sales may not improve, and could decline, in future periods if there is continued or resumed weakness in customer demand, particularly in the telecommunications and computing sectors, resulting from worldwide economic conditions. In addition, in connection with our efforts to improve our gross margins, we are engaged in pricing discussions with certain current customers on specific programs where we feel we are presently under-compensated for the services and value that we provide. Where we are not able to reach mutual agreement with a customer on price adjustments, we have mutually agreed with the customer to transition the business in question to a new supplier. While we believe our disengagement from specific programs with certain customers will ultimately advance our efforts to return to sustained profitability, there can be no assurance that such disengagements will not result in a loss of significant revenue, a lowering of our capacity utilization at affected sites, and other adverse financial effects.

OUR CUSTOMERS MAY CANCEL THEIR ORDERS, CHANGE PRODUCTION QUANTITIES OR LOCATIONS, OR DELAY PRODUCTION.

To remain competitive, EMS companies must provide increasingly rapid product turnaround, at increasingly competitive prices, for their customers. We generally do not have long-term contractual commitments from our top customers. As a result, we cannot guarantee that we will continue to receive any net sales from our customers. Customers may cancel their orders, change production quantities or delay production for a number of reasons outside of our control. Many of our customers' industries have recently experienced a significant decrease in demand for their products and services, as well as substantial price competition. The generally uncertain economic condition of several of our customers' industries has resulted, and may continue to result, in some of our customers delaying purchases on some of the products we manufacture for them, and placing purchase orders for lower volumes of

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products than previously anticipated. Cancellations, reductions or delays by a significant customer or by a group of customers would seriously harm our results of operations by reducing the volumes of products manufactured by us for the customers and delivered in that period. Furthermore, delays in the repayment of our expenditures for inventory in preparation for customer orders and lower asset utilization in those periods would result in lower gross margins. In addition, customers may require that manufacturing of their products be transitioned from one facility to another to achieve cost and other objectives. Such transfers, if unanticipated or not properly executed, could result in various inefficiencies and costs, including excess capacity and overhead at one facility and capacity constraints and related strains on our resources at the other, disruption and delays in product deliveries and sales, deterioration in product quality and customer satisfaction, and increased manufacturing and scrap costs.

WE MAY NOT BE ABLE TO SELL EXCESS OR OBSOLETE INVENTORY TO CUSTOMERS OR THIRD PARTIES, WHICH COULD HAVE A MATERIAL ADVERSE IMPACT ON OUR FINANCIAL CONDITION.

The majority of our inventory purchases and commitments are based upon demand forecasts that our customers provide to us. The customers' forecasts, and any changes to the forecasts, including cancellations, may lead to on-hand inventory quantities and on-order purchase commitments that are in excess of the customers' revised needs, or that become obsolete.

We generally enter into supply agreements with our significant customers. Under these supply agreements, the extent of our customer's responsibility for excess or obsolete inventory related to raw materials that were previously purchased or ordered to meet that customer's demand forecast is defined. If our customers do not comply with their contractual obligations to purchase excess or obsolete inventory back from us and we are unable to use or sell such inventory, our financial condition could be materially harmed. Some of our customers are in the telecommunications industry, an industry that in recent years has experienced declining revenue, large losses, negative cash flows, and several bankruptcies or defaults on borrowing arrangements. In the past, some of our customers have defaulted on their obligations to purchase inventory back from us. There is a risk that, in the future, these or other customers may not purchase inventory back from us despite contractual obligations, which could harm our financial condition if we are unable to sell the inventory at carrying value. In addition, enforcement of these supply agreements may result in material expenses, delays in payment for inventory and/or disruptions in our customer relationships.

We are responsible for excess and obsolete inventory resulting from inventory purchases in excess of inventory needed to meet customer demand forecasts at the time the purchase commitments were made, as well as any inventory purchases not made pursuant to the customer's responsibility under our supply agreements. For inventory which is not the customer's responsibility, provisions are made when required to reduce any such excess or obsolete inventory to its estimated net realizable value, based on the quantity of such inventory on hand, our customers' latest forecasts of production requirements, and our assessment of available disposition alternatives such as use of components on other programs, the ability and cost to return components to the vendor, and our estimates of resale values and opportunities. These assessments are necessarily based upon various assumptions and market conditions which are subject to rapid change, and/or which may ultimately prove to be inaccurate. Any material changes in our assumptions or market conditions could have a significant effect on our estimates of net realizable value, could necessitate material changes in our allowances for excess and obsolete inventory, and could have a material adverse impact on our financial condition. In addition, in the normal course of business, bona fide disagreements may arise over the amount and/or timing of such claims, and in order to avoid litigation expenses, collection risks, or disruption of customer relationships, we may elect to settle such disputes for lesser amounts than we believe we should be entitled to recover. In these instances, we must bear the economic loss of any such excess or obsolete inventory, which could have a material adverse impact on our financial condition. For example, we recorded a charge of \$76 million related to excess and obsolete inventory during the second quarter of fiscal 2003, and there can be no assurance that similar charges at lesser or greater levels will not be necessary in future periods.

OUR NON-U.S. LOCATIONS REPRESENT A SIGNIFICANT PORTION OF OUR NET SALES; WE ARE EXPOSED TO RISKS ASSOCIATED WITH OPERATING INTERNATIONALLY.

Approximately 73.5% and 65.6% of our net sales from continuing operations came from sites outside the United States during the third quarters of fiscal 2004 and 2003, respectively. As a result of our foreign sales and facilities, our operations are subject to a variety of risks and costs that are unique to international operations, including the following:

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

import and export duties, and value added taxes;

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

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potential restrictions on the transfer of funds;

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

disruption of local labor supply and/or transportation services;

inflexible employee contracts in the event of business downturns;

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

economic and political risks in emerging or developing economies; and

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

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

WE ARE EXPOSED TO GENERAL ECONOMIC CONDITIONS, WHICH COULD HAVE A MATERIAL ADVERSE IMPACT ON OUR BUSINESS, OPERATING RESULTS AND FINANCIAL CONDITION.

As a result of the recent economic downturn in the U.S. and internationally, and reduced capital spending as well as end-market demand, our customers' and therefore our sales have declined significantly from prior years. In particular, we depend on the telecommunications and computing industries, where the decline began in the second quarter of fiscal 2001. If there were to be continued or resumed weakness in these industries or any further deterioration in the business or financial condition of our customers, it could have a material adverse impact on our business, operating results and financial condition. In addition, if the economic conditions in the United States and the other markets we serve worsen, we may experience a material adverse impact on our business, operating results and financial condition.

POSSIBLE FLUCTUATION OF OPERATING RESULTS FROM QUARTER TO QUARTER AND FACTORS OUT OF OUR CONTROL COULD AFFECT THE MARKET PRICE OF OUR SECURITIES.

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

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

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

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

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

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

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

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fluctuations in the availability and pricing of components;

timing of expenditures in anticipation of increased sales;

cyclicality in our target markets;

fluctuations in our market share;

expenses and disruptions associated with acquisitions and divestitures;

announcements of operating results and business conditions by our customers;

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

economic developments in the electronics industry as a whole;

credit rating and stock analyst downgrades;

political and economic developments in countries in which we have operations; and

general market conditions.

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

WE MAY NOT BE ABLE TO MEET OUR CASH REQUIREMENTS BECAUSE OF A NUMBER OF FACTORS, MANY OF WHICH ARE BEYOND OUR CONTROL.

Our ability to meet our cash requirements (including our debt service obligations) is dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. If we are unable to meet our cash requirements from operations, we would be required to fund these cash requirements by alternative financings. The degree to which we may be leveraged could materially and adversely affect our ability to obtain financing for working capital, acquisitions or other purposes, could make us more vulnerable to industry downturns and competitive pressures, or could limit our flexibility in planning for, or reacting to, changes and opportunities in the electronics manufacturing industry, which may place us at a competitive disadvantage. There can be no assurance that we will be able to obtain alternative financing, that any such financing would be on acceptable terms, or that we would be permitted to do so under the terms of our existing financing arrangements. In the absence of such financing, our ability to respond to changing business and economic conditions, make future acquisitions, react to adverse operating results, meet our debt service obligations or fund required capital expenditures or increased working capital requirements may be adversely affected.

IF WE INCUR MORE RESTRUCTURING-RELATED CHARGES THAN CURRENTLY ANTICIPATED, OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS MAY SUFFER.

In furtherance of the continued implementation of the series of restructuring plans which we commenced in fiscal 2001, we expect to continue to incur restructuring-related charges in fiscal 2004, primarily to consolidate facilities and reduce our workforce in North America and Europe, although no certainty can be attributed to an amount or the timing of its recognition. We will continue to evaluate our cost structure relative to our revenue levels and may take additional restructuring charges in the future. If our estimates about future restructuring charges prove to be inadequate, our financial condition and results of operations may suffer. In addition, if we are unable to successfully

move production from higher cost to lower cost facilities without experiencing degradation of quality or timeliness of our service to our customers, our business could be harmed.

WE DEPEND ON LIMITED OR SOLE SOURCE SUPPLIERS FOR CRITICAL COMPONENTS. THE INABILITY TO OBTAIN SUFFICIENT COMPONENTS AS REQUIRED, AND UNDER FAVORABLE PURCHASE TERMS, WOULD CAUSE HARM TO OUR BUSINESS.

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

WE POTENTIALLY BEAR THE RISK OF PRICE INCREASES ASSOCIATED WITH SHORTAGES IN ELECTRONICS COMPONENTS.

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

OUR NET SALES COULD DECLINE IF OUR COMPETITORS PROVIDE COMPARABLE MANUFACTURING SERVICES AND IMPROVED PRODUCTS AT A LOWER COST.

We compete with different contract manufacturers, depending on the type of service we provide or the geographic locale of our operations, in an industry which is intensely competitive. These competitors may have greater manufacturing, financial, R&D and/or marketing resources than we have. In addition, we may not be able to offer prices as low as some of our competitors because those competitors may have lower cost structures as a result of their geographic location or the services they provide, or because such competitors are willing to accept business at lower margins in order to utilize more of their excess capacity. In that event, our net sales could decline. We also expect our competitors to continue to improve the performance of their current products or services, to reduce their current products or service sales prices and to introduce new products or services that may offer greater value-added performance and improved pricing. Any of these could cause a decline in sales, loss of market acceptance of our products or services and corresponding loss of market share, or profit margin compression.

WE DEPEND ON THE CONTINUING TREND OF OEMS TO OUTSOURCE.

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

THE AGREEMENTS GOVERNING OUR EXISTING AND FUTURE DEBT CONTAIN AND WILL CONTAIN VARIOUS COVENANTS THAT LIMIT OUR DISCRETION IN THE OPERATION OF OUR BUSINESS.

The agreements and instruments governing our existing and future debt and our secured credit facility contain and will contain various restrictive covenants that, among other things, require us to comply with or maintain certain financial

tests and ratios and restrict our ability to:

incur debt;

incur or maintain liens;

redeem and/or prepay debt;

make acquisitions of businesses or entities;

make investments, including loans, guarantees and advances;

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- make capital expenditures;
- engage in mergers, consolidations or certain sales of assets;
- engage in transactions with affiliates;
- pay dividends or engage in stock redemptions; and
- enter into certain restrictive agreements.

Our secured credit facility is secured by a pledge of all of the capital stock of our material domestic subsidiaries, 65% of the capital stock of certain of our material foreign subsidiaries, certain of our intercompany loans and certain additional assets, including inventory, accounts receivable and equipment of us and our domestic subsidiaries. The covenants governing our secured credit facility also restrict the operations of certain of our subsidiaries, including, in some cases, limiting the ability of our subsidiaries to make distributions to us.

Our ability to comply with covenants contained in our secured credit facility and other indebtedness to which we are or may become a party may be affected by events beyond our control, including prevailing economic, financial and industry conditions. Our failure to comply with our debt-related obligations could result in an event of default which, if not cured or waived, could result in an acceleration of our indebtedness and cross-defaults under our other indebtedness, which could have a material adverse effect on our financial condition. We obtained amendments related to the minimum cash interest coverage ratio covenants applicable to various debt and lease agreements as described in *Liquidity and Capital Resources* , and as a result of such waivers, we were in compliance with all applicable covenants as of May 31, 2004.

Even if we are able to comply with all applicable covenants, the restrictions on our ability to operate our business in our sole discretion could harm our business by, among other things, limiting our ability to take advantage of financings, mergers, acquisitions and other corporate opportunities.

OUR STRATEGIC RELATIONSHIPS WITH MAJOR CUSTOMERS CREATE RISKS.

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

- we may pay a purchase price to the divesting OEMs that exceeds the value we are ultimately able to realize from the future business of the OEM;
- the integration into our business of the acquired assets and facilities may be time-consuming and costly;

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

we may not achieve anticipated cost reductions and efficiencies;

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

if demand for the OEM's products declines, the OEM may reduce its volume of purchases, and we may not be able to sufficiently reduce the expenses of operating the facility or use the facility to provide services to other OEMs, and we might find it appropriate to close, rather than continue to operate, the facility, and any such actions would require us to incur

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significant restructuring and/or impairment charges.

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

IF WE ARE UNABLE TO MANAGE OUR DIVESTITURES AND ANY FUTURE ACQUISITIONS, AND COST-EFFECTIVELY RUN OUR OPERATIONS AND DISPOSE OF NON-STRATEGIC ASSETS, OUR PROFITABILITY COULD BE ADVERSELY AFFECTED.

While we may consider future acquisitions of companies and strategic assets on a selective basis, subject to compliance with any restrictions that may exist under certain of our financing instruments, we are presently focused on divestiture activity. We are in the process of divesting certain parts of our current operations that we do not believe to be strategic or synergistic to our primary business focus, and we believe such divestitures, if successfully and timely completed at the presently anticipated valuations and without undue disruption of operations, present us with the opportunity to improve our liquidity and reduce our interest and operating expenses.

In order to achieve anticipated revenue and other financial performance targets, we must continue to manage our assets and operations efficiently while simultaneously preparing parts of our operations for divestiture. Our divestiture activities are expected to place a heavy strain on various personnel and management resources, and must be carefully managed in order to avoid or minimize disruptions in the business operations of the affected businesses, customer relations and cash flows, and to enable us to maximize the value which we may be able to realize from the divestitures. There can be no assurance that such divestiture activities will be able to be consummated without an adverse impact on the near-term operations of the affected businesses or on Solectron as a whole. Any failure to successfully manage and consummate the divestitures in a timely manner could harm our financial condition and results of operations, as well as adversely impact the realizable value of the divested operations. In addition, there can be no assurance that we will be successful in realizing the presently anticipated benefits from our divestiture activities, as such transactions involve significant risks and uncertainties with respect to valuation of the entities to be divested, particularly given the potential disruption of operations inherent in the divestiture process, and may result in significant costs, expenses and charges that may significantly reduce the value which we may realize in connection with the anticipated divestiture transactions. In the event we fail to consummate a divestiture, we may need to incur restructuring charges.

Our ability to manage and integrate any future acquisitions will require successful integration of such acquisitions into our manufacturing and logistics infrastructure, and may require enhancements or upgrades of accounting and other internal management systems and the implementation of a variety of procedures and controls. We cannot guarantee that significant problems in these areas will not occur. Any failure to enhance or expand these systems and implement such procedures and controls in an efficient manner and at a pace consistent with our business activities could harm our financial condition and results of operations. In addition, we may experience inefficiencies from the management of geographically dispersed facilities and incur substantial infrastructure and working capital costs. We incurred approximately \$5.5 million of restructuring and impairment costs relating to continuing operations in the third quarter of fiscal 2004. See also the Risk Factor entitled *If We Incur More Restructuring-Related Charges Than Currently Anticipated, Our Financial Condition and Results of Operations May Suffer*.

NOTWITHSTANDING OUR DIVESTITURE OF CERTAIN BUSINESSES, WE WILL REMAIN SUBJECT TO CERTAIN INDEMNIFICATION OBLIGATIONS FOR A PERIOD OF TIME AFTER COMPLETION OF THE DIVESTITURES

The sale agreement for each of our divested businesses contains indemnification provisions under which we may be required to indemnify the buyer of the divested business for liabilities, losses, or expenses arising out of breaches of

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

WE ARE EXPOSED TO FLUCTUATIONS IN FOREIGN CURRENCY EXCHANGE RATES.

We have currency exposure arising from both sales and purchases denominated in currencies other than the functional currency of our sites. Fluctuations in the rate of exchange between the currency of the exposure and the functional currency of our sites could seriously harm our business, operating results and financial condition. For example, if there is an increase in the rate at which a

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foreign currency is exchanged for U.S. dollars, it will require more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. In such cases, and if we price our products and services in the foreign currency, we will receive less in U.S. dollars than we did before the rate increase went into effect. If we price our products and services in U.S. dollars and competitors price their products in local currency, an increase in the relative strength of the U.S. dollar could result in our prices being uncompetitive in markets where business is transacted in the local currency.

We enter into foreign exchange forward contracts intended to reduce the short-term impact of foreign currency fluctuations on foreign currency cash, receivables, investments and payables. The gains and losses on the foreign exchange forward contracts are intended to offset the transaction gains and losses on the foreign currency cash, receivables, investments, and payables recognized in earnings. We do not enter into foreign exchange forward contracts for speculative purposes. Our foreign exchange forward contracts related to current assets and liabilities are generally three months or less in original maturity.

As of May 31, 2004, we had outstanding foreign exchange forward contracts with a total notional amount of approximately \$585.4 million related to continuing operations. The change in value of the foreign exchange forward contracts resulting from a hypothetical 10% change in foreign exchange rates would be offset by the remeasurement of the related balance sheet items, the result of which would not be significant.

As of May 31, 2004, the majority of our foreign currency hedging contracts were scheduled to mature in approximately three months and there were no material deferred gains or losses. In addition, our international operations in some instances act as a natural hedge because both operating expenses and a portion of sales are denominated in local currency. In these instances, although an unfavorable change in the exchange rate of a foreign currency against the U.S. dollar will result in lower sales when translated to U.S. dollars, operating expenses will also be lower in these circumstances. Although approximately 29.1% of our net sales from continuing operations in the third quarter of fiscal 2004 were denominated in currencies other than the U.S. dollar, we do not believe our total exposure to be significant because of natural hedges.

WE ARE EXPOSED TO INTEREST RATE FLUCTUATIONS.

The primary objective of our investment activities is to preserve principal, while at the same time maximize yields without significantly increasing risk. To achieve this objective, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including government and corporate obligations, certificates of deposit and money market funds. As of May 31, 2004, substantially our entire total portfolio was scheduled to mature in less than three months. A hypothetical 10% change in interest rates would not have a material effect on the fair value of our investment portfolios.

As of May 31, 2004, we had no cash equivalents and short-term investments that were subject to interest rate risk (defined as risk of loss of investment fair value due to interest rate movements). The fair value of our cash equivalents and short-term investments approximated the carrying value as of May 31, 2004.

Interest on long-term debt instruments is payable at fixed rates. In addition, the amount of principal to be repaid at maturity is also fixed. During the third quarter of fiscal 2002, we entered into an interest rate swap transaction under which we pay variable rates and we receive fixed rates. The interest swap effectively converted \$500 million of our long-term debt with fixed interest rates into debt with variable rates of interest. Our interest rate swap, which expires on February 15, 2009, has a total notional amount of \$500 million and relates to our 9.625% \$500 million senior notes. Under this swap transaction we pay an interest rate equal to the 3-month LIBOR rate plus a fixed spread. In exchange, we receive fixed interest rates of 9.625%. On November 15, 2002, the original swaps related to the senior notes were settled. This settlement resulted in cash received and a gain of approximately \$26 million, which is being

amortized over the remaining life of the senior notes. Also on November 15, 2002, Solectron entered into swaps with terms similar to the original swap transactions used to hedge the interest paid on the senior notes and designated the swaps as fair value hedges under SFAS No. 133.

FAILURE TO ATTRACT AND RETAIN KEY PERSONNEL AND SKILLED ASSOCIATES COULD HURT OUR OPERATIONS.

Our continued success depends to a large extent upon the efforts and abilities of key managerial and technical associates. Losing the services of key personnel could harm us. Our business also depends upon our ability to continue to attract key executives and retain senior managers and skilled associates. Failure to do so could harm our business.

FAILURE TO COMPLY WITH ENVIRONMENTAL REGULATIONS COULD HARM OUR BUSINESS.

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

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

WE MAY NOT BE ABLE TO ADEQUATELY PROTECT OR ENFORCE OUR INTELLECTUAL PROPERTY RIGHTS AND COULD BECOME INVOLVED IN INTELLECTUAL PROPERTY DISPUTES

Our ability to effectively compete may be affected by our ability to protect our proprietary information. We (including companies included in discontinued operations) hold a number of patents and possess various other trade secrets and license rights. These patents, trade secrets, and license rights may not provide meaningful protection for our manufacturing processes and equipment innovations, which could result in litigation. Any resulting litigation could be lengthy and costly and could harm our financial condition.

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

OUR RATING DOWNGRADES MAKE IT MORE EXPENSIVE FOR US TO BORROW MONEY.

On October 28, 2003 Standard and Poor's downgraded our senior unsecured debt rating to B+ with a stable outlook. On October 31, 2003 Moody's downgraded our senior unsecured debt rating to B1 with a stable outlook. Rating downgrades increase our cost of capital should we borrow under our revolving line of credit, and may make it more expensive for us to raise additional capital in the future. Such capital raising activities may be on terms that may not be acceptable to us or may otherwise not be available.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

See Risk Factors - We Are Exposed to Fluctuations in Foreign Currency Exchange Rates, and We Are Exposed to Interest Rate Fluctuations, for factors related to fluctuations in the exchange rates of foreign currency and fluctuations in interest rates.

Item 4. Controls and Procedures

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

Changes in Internal Controls. There were no changes in Solectron's internal controls over financial reporting during the third quarter of fiscal 2004 or in other factors that could have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Solectron is from time to time involved in various litigation and legal matters, including those described below. By describing the particular matters set forth below, Solectron does not intend to imply that it or its legal advisors have concluded or believe that the outcome of any of those particular matters is or is not likely to have a material adverse impact upon Solectron's business or consolidated financial condition and results of operations.

The case entitled *Ronald Sorisho v. Solectron Corporation et al.*, Case No. CV811243, which has been previously reported, was resolved on terms not material to Solectron and the case has been dismissed.

On March 6, 2003, a putative shareholder class action lawsuit was filed against Solectron and certain of its officers in the United States District Court for the Northern District of California alleging claims under Section 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Rule 10b-5 promulgated thereunder. The case is entitled *Abrams v. Solectron Corporation et al.*, Case No. C-03-0986 CRB. The complaint alleged that the defendants issued false and misleading statements in certain press releases and SEC filings issued between September 17, 2001 and September 26, 2002. In particular, plaintiff alleged that the defendants failed to disclose and to properly account for excess and obsolete inventory in the former Technology Solutions business unit during the relevant time period. Additional complaints making similar allegations were subsequently filed in the same court, and pursuant to an order entered June 2, 2003, the Court appointed lead counsel and plaintiffs to represent the putative class in a single consolidated action. The Consolidated Amended Complaint, filed September 8, 2003, alleges an expanded class period of June 18, 2001 through September 26, 2002, and purports to add a claim for violation of Section 11 of the Securities Act of 1933, as amended (the Securities Act), on behalf of a putative class of former shareholders of C-MAC Industries, Inc., who acquired Solectron stock pursuant to the October 19, 2001 Registration Statement filed in connection with Solectron's acquisition of C-MAC Industries, Inc. In addition, while the initial complaints focused on alleged inventory issues at the former Technology Solutions business unit, the Consolidated Amended Complaint adds allegations of inadequate disclosure and failure to properly account for excess and obsolete inventory at Solectron's other business units. The complaint seeks an unspecified amount of damages on behalf of the putative class. On June 14, 2004 the lead plaintiffs filed a Motion for Class Certification seeking to have the court declare this matter a class action litigation. The hearing for the Motion for Class Certification is set for October 1, 2004. Solectron intends to object to the Class Certification. Solectron believes the complaint to be without merit, and that it has valid defenses to the plaintiffs' claims. There can be no assurance, however, that the outcome of the lawsuit will be favorable to Solectron or will not have a material adverse effect on Solectron's business, financial condition and results of operations. In addition, Solectron may be forced to incur substantial litigation expenses in defending this litigation.

On March 21, 2003, Solectron, all the current members of its Board of Directors, and two former officers, were named as defendants in a shareholder derivative lawsuit entitled *Lifshitz v. Cannon et al.*, Case No. CV815693, filed in the Santa Clara County, California Superior Court. The plaintiff alleged that he should be permitted to pursue litigation, purportedly for the benefit of Solectron, against the individual director and officer defendants for alleged mismanagement and waste of corporate assets during the period from May 2001 to the present, purported breaches of fiduciary duty, constructive fraud, abuse of control, and alleged violations of the California Corporations Code by certain of the individual defendants who sold some of their Solectron stockholdings during the period from September 2001 through September 2002. On May 19, 2003, Solectron and the individual defendants moved to dismiss the *Lifshitz* complaint. In the meantime, two substantively identical derivative lawsuits, entitled *Schactner v. Cannon, et al.*, Case No. CV817112, and *Nims v. Cannon, et al.*, Case No. CV817158, were filed in the same Court on May 14 and May 15, respectively. Counsel for the plaintiffs in all three suits subsequently advised the Court that they would be filing a consolidated amended complaint, and accordingly, defendants' motion to dismiss was taken off

calendar pending the filing of the consolidated amended complaint combining the three lawsuits. On June 27, 2003, the plaintiffs served their consolidated amended complaint now alleging that since January of 1999 all of the current members of Solectron's Board of Directors, as well as four former officers and directors, purportedly breached their fiduciary duties and participated in or permitted constructive fraud, unjust enrichment, and alleged violations of the California Corporations Code. The consolidated complaint alleged an unspecified amount of compensatory and punitive damages, and sought the relinquishment of all profits realized by those individual defendants who sold Solectron stock during the relevant period, together with statutory penalties under California Corporations Code section 25402 which plaintiff alleged to be applicable to those sales of Solectron stock. Solectron moved to dismiss the Consolidated Amended Complaint because Solectron does not believe plaintiffs have adequately alleged a basis for plaintiffs to appropriate for themselves the duties of Solectron's Board of Directors under applicable Delaware law, and believes that the consolidated complaint contains various factual errors and legal deficiencies. On October 7, 2003, the California Superior Court granted Solectron's motion to dismiss, but granted the plaintiffs an

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opportunity to try to cure the deficiencies in their Consolidated Amended Complaint through a further amended complaint. The plaintiffs requested and were granted an extension of time to file a further amended complaint, which barring any further extensions, is to be filed on or before the end of August 2004. Solectron does not believe plaintiffs can show a sufficient basis to allow them to appropriate for themselves the duties of Solectron's Board of Directors under applicable Delaware law. Solectron may be forced to incur substantial litigation expenses in defending this litigation.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

| Exhibit No. | Exhibit Description |
|--------------------|--|
| 3.1* | Certificate of Incorporation of Solectron, as amended |
| 3.2** | Amended and Restated Bylaws of Solectron |
| 3.3*** | Certificate of Designation Rights, Preferences and Privileges of Series A Participating Preferred Stock of Solectron |
| 10.1 | Eighth Amendment and Waiver to Credit Agreement, dated as of April 6, 2004, among Solectron, Goldman Sachs Credit Partners L.P., JPMorgan Chase Bank, The Bank of Nova Scotia, Bank of America, N.A. and certain other lenders |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| * | Incorporated by reference from Exhibit 3.1 filed with Solectron's Form 10-Q for the quarter ended February 28, 2001, Exhibit 3.1 filed with Solectron's Form 10-Q for the quarter ended February 25, 2000, and Exhibit 3.1 filed with Solectron's Form 10-Q for the quarter ended February 26, 1999. |
| ** | Incorporated by reference from Exhibit 3.2 filed with Solectron's Form 10-Q for the quarter ended November 30, 2003. |
| *** | Incorporated by reference from Exhibit 3.3 filed with Solectron's Annual Report on Form 10-K for the fiscal year ended August 31, 2001. |

(b) Reports on Form 8-K

On May 7, 2004, Solectron filed a report on Form 8-K with the SEC which incorporated, pursuant to Item 5, an Underwriting Agreement with Goldman, Sachs & Co. and certain other exhibits relating to the offering and sale by Solectron of up to 17,109,948 shares of common stock under its Registration Statement on Form S-3 (Registration No. 333-64454-01).

On May 25, 2004, Solectron filed a report on Form 8-K with the SEC which incorporated, pursuant to Item 5, (i) a Prospectus Supplement, dated May 6, 2004, to and with the Prospectus dated August 29, 2001, included as part of Solectron's Registration Statement on Form S-3 (Registration No. 333-64454-01), relating to the offering of 17,109,948 shares of the Solectron's common stock (ii) a press release issued by Solectron regarding final results of the early settlement offer, dated May 12, 2004, relating to its offer to exchange up to a maximum of 41,800,000 of its outstanding 7.25% Adjustable Conversion-Rate Equity Security Units, issued in December 2001, for shares of Solectron common stock and cash, and (iii) a press release issued by Solectron regarding Solectron's repurchase of approximately \$950 million of its zero-coupon senior convertible notes due in November 2020, dated May 21, 2004.

On June 17, 2004, Solectron filed a report on Form 8-K with the SEC in which it furnished, pursuant to Item 12, a press release announcing Solectron's results of operations for its fiscal quarter ended May 31, 2004.

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SOLECTRON CORPORATION

SIGNATURES

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

SOLECTRON CORPORATION
(Registrant)

Date: July 2, 2004

By /s/ Kiran Patel

Kiran Patel
*Executive Vice President, Chief Financial
Officer
(Principal Financial Officer)*

By /s/ Warren Ligan

Warren Ligan
*Senior Vice President, Corporate Controller
(Principal Accounting Officer)*

Table of Contents**INDEX TO EXHIBITS**

| Exhibit No. | Exhibit Description |
|--------------------|--|
| 3.1* | Certificate of Incorporation of Solectron, as amended |
| 3.2 ** | Amended and Restated Bylaws of Solectron |
| 3.3*** | Certificate of Designation Rights, Preferences and Privileges of Series A Participating Preferred Stock of Solectron |
| 10.1 | Eighth Amendment and Waiver to Credit Agreement, dated as of April 6, 2004, among Solectron, Goldman Sachs Credit Partners L.P., JPMorgan Chase Bank, The Bank of Nova Scotia, Bank of America, N.A. and certain other lenders |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| * | Incorporated by reference from Exhibit 3.1 filed with Solectron's Form 10-Q for the quarter ended February 28, 2001, Exhibit 3.1 filed with Solectron's Form 10-Q for the quarter ended February 25, 2000, and Exhibit 3.1 filed with Solectron's Form 10-Q for the quarter ended February 26, 1999. |
| ** | Incorporated by reference from Exhibit 3.2 filed with Solectron's Form 10-Q for the quarter ended November 30, 2003. |
| *** | Incorporated by reference from Exhibit 3.3 filed with Solectron's Annual Report on Form 10-K for fiscal year ended August 31, 2001. |