SUNPOWER CORP
Form 10-Q
November 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended September 30, 2007
	OR
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 000-51593

SunPower Corporation

(Exact name of registrant as specified in its charter)

Delaware	**94-3008969**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3939 North First Street, San Jose, California 95134

(Address of principal executive offices and zip code)

(408) 240-5500

(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 such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The total number of outstanding shares of the registrant s class A common stock as of November 2, 2007 was 39,278,279.

The total number of outstanding shares of the registrant s class B common stock as of November 2, 2007 was 44,533,287.

SunPower Corporation

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PART I. FINANCIAL INFORMATION

Item 1. **Financial Statements**

SunPower Corporation

Condensed Consolidated Balance Sheets

(in thousands, except share data)

(unaudited)

	September 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 407,177	$ 165,596
Short-term investments	58,570	16,496
Accounts receivable, net	82,794	51,680
Costs and estimated earnings in excess of billings	79,410	
Inventories	99,940	22,780
Deferred project costs	11,474	
Prepaid expenses and other current assets	35,667	16,655
Current portion of advances to suppliers	16,637	15,394
Total current assets	791,669	288,601
Restricted cash	29,203	
Property, plant and equipment, net	348,189	202,428
Goodwill	179,843	2,883
Intangible assets, net	58,078	14,049
Advances to suppliers, net of current portion	94,559	62,242
Other long-term assets	35,221	6,633
Total assets	$ 1,536,762	$ 576,836
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 102,841	$ 26,534
Accounts payable to Cypress	1,881	2,909
Accrued liabilities	56,542	18,585
Billings in excess of costs and estimated earnings	19,997	
Current portion of customer advances	8,742	12,304
Total current liabilities	190,003	60,332
Convertible debt	425,000	
Deferred tax liability	10,393	46
Customer advances, net of current portion	61,052	27,687
Other long-term liabilities	8,717	
Total liabilities	695,165	88,065
Commitments and contingencies (Note 13)		
Stockholders equity:		

Preferred stock, $0.001 par value per share; 10,042,490 shares authorized; none issued and outstanding				
Common stock, $0.001 par value; 375,000,000 shares authorized; 84,299,860 and 69,849,369 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively		84		70
Additional paid-in capital		866,968		522,819
Accumulated other comprehensive income (loss)		2,236		(2,101)
Accumulated deficit		(27,691)		(32,017)
Total stockholders equity		841,597		488,771
Total liabilities and stockholders equity	$	1,536,762	$	576,836

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

SunPower Corporation

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2007	Three Months Ended October 1, 2006	Nine Months Ended September 30, 2007	Nine Months Ended October 1, 2006
Revenue:				
Systems	$ 157,734	$	$ 340,266	$
Components	76,600	65,348	210,181	162,001
	234,334	65,348	550,447	162,001
Costs and expenses:				
Cost of systems revenue	135,111		289,095	
Cost of components revenue	60,818	50,164	160,730	129,678
Research and development	3,902	2,536	9,659	7,120
Sales, general and administrative	27,708	6,206	76,188	15,572
Purchased in-process research and development			9,575	
Impairment of acquisition-related intangibles			14,068	
Total costs and expenses	227,539	58,906	559,315	152,370
Operating income (loss)	6,795	6,442	(8,868)	9,631
Interest income	4,609	3,874	8,789	7,125
Interest expense	(1,372)	(434)	(3,576)	(1,282)
Other income (expense), net	(205)	518	(448)	1,008
Income (loss) before income taxes	9,827	10,400	(4,103)	16,482
Income tax provision (benefit)	1,396	832	(8,429)	1,275
Net income	$ 8,431	$ 9,568	$ 4,326	$ 15,207
Net income per share:				
Basic	$ 0.11	$ 0.14	$ 0.06	$ 0.24
Diluted	$ 0.10	$ 0.13	$ 0.05	$ 0.22
Weighted-average shares:				
Basic	77,693	68,947	75,516	64,704
Diluted	82,610	73,899	80,526	70,080

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

SunPower Corporation

Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended October 1, 2006
Cash flows from operating activities:		
Net income	$ 4,326	$ 15,207
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	17,727	11,647
Amortization of intangibles	21,408	3,526
Amortization of debt issuance costs	999	
Impairment of acquisition-related intangibles	14,068	
Stock-based compensation	37,197	3,706
Purchased in-process research and development	9,575	
Gain on sale of fixed assets		(16)
Deferred income taxes and other tax liabilities	(10,532)	682
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	10,347	(21,569)
Costs and estimated earnings in excess of billings	(69,766)	
Inventories	(48,028)	(12,831)
Prepaid expenses and other assets	(8,062)	(1,925)
Deferred project costs	14,637	
Advances to suppliers	(33,560)	(19,443)
Accounts payable and other accrued liabilities	9,823	21,163
Accounts payable to Cypress	(1,029)	1,371
Billings in excess of costs and estimated earnings	(17,490)	
Advances from customers	29,803	3,097
Net cash provided by (used in) operating activities	(18,557)	4,615
Cash flows from investing activities:		
Increase in restricted cash	(24,492)	
Purchase of property, plant and equipment	(162,480)	(64,618)
Purchase of available-for-sale securities	(58,570)	(25,897)
Proceeds from sale of available-for-sale securities	16,496	6,000
Proceeds from sale of fixed assets		91
Note receivable from SP Systems		(10,000)
Cash paid for acquisition, net of cash acquired	(98,645)	
Net cash used in investing activities	(327,691)	(94,424)
Cash flows from financing activities:		
Proceeds from issuance of convertible debt	425,000	
Convertible debt issuance costs	(10,942)	
Principal payments on line of credit and notes payable	(3,563)	
Proceeds from issuance of common stock, net	167,379	197,431
Proceeds from exercise of stock options	6,868	2,521
Net cash provided by financing activities	584,742	199,952
Effect of exchange rate changes on cash and cash equivalents	3,087	

Net increase in cash and cash equivalents		241,581		110,143
Cash and cash equivalents at beginning of period		165,596		143,592
Cash and cash equivalents at end of period	$	407,177	$	253,735
Non-cash investing and financing activities:				
Issuance of common stock for purchase acquisition	$	111,266		
Stock options assumed in relation to acquisition		21,280		
Change in goodwill relating to adjustments to acquired net assets		1,798		

The accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

SunPower Corporation

Notes to Condensed Consolidated Financial Statements

Note 1. The Company and Basis of Presentation

The Company

SunPower Corporation (together with its subsidiaries, the Company or SunPower), a majority-owned subsidiary of Cypress Semiconductor Corporation (Cypress), was originally incorporated in the State of California on April 24, 1985. In October 1988, the Company organized as a business venture to commercialize high-efficiency solar cell technologies. The Company designs, manufactures and markets high-performance solar electric power technologies. The Company s solar cells and solar panels are manufactured using proprietary processes and technologies based on more than 15 years of research and development. The Company s solar power products are sold through the components business segment.

On November 10, 2005, the Company reincorporated in Delaware and filed an amendment to its certificate of incorporation to effect a 1-for-2 reverse stock split of the Company s outstanding and authorized shares of common stock. All share and per share figures presented herein have been adjusted to reflect the reverse stock split.

In November 2005, the Company raised net proceeds of $145.6 million in an initial public offering (the IPO) of 8.8 million shares of class A common stock at a price of $18.00 per share. In June 2006, the Company completed a follow-on public offering of 7.0 million shares of its class A common stock, at a per share price of $29.50, and received net proceeds of $197.4 million. In July 2007, the Company completed a follow-on public offering of 2.7 million shares of its class A common stock, at a discounted per share price of $64.50, and received net proceeds of $167.4 million.

In February 2007, the Company issued $200.0 million in principal amount of its 1.25% senior convertible debentures to Lehman Brothers Inc. (Lehman Brothers) and lent 2.9 million shares of its class A common stock to an affiliate of Lehman Brothers. Net proceeds from the issuance of senior convertible debentures in February 2007 were $194.0 million. The Company did not receive any proceeds from the 2.9 million lent shares of its class A common stock, but received a nominal lending fee (see Note 15). In July 2007, the Company issued $225.0 million in principal amount of its 0.75% senior convertible debentures to Credit Suisse Securities (USA) LLC (Credit Suisse) and lent 1.8 million shares of its class A common stock to an affiliate of Credit Suisse. Net proceeds from the issuance of senior convertible debentures in July 2007 were $220.1 million. The Company did not receive any proceeds from the 1.8 million lent shares of class A common stock, but received a nominal lending fee (see Note 15).

In January 2007, the Company completed the acquisition of PowerLight Corporation (PowerLight), a privately-held company which developed, engineered, manufactured and delivered large-scale solar power systems for residential, commercial, government and utility customers worldwide. These activities are now performed by the Company s systems business segment. As a result of the acquisition, PowerLight became an indirect wholly owned subsidiary of the Company. In June 2007, the Company changed PowerLight s name to SunPower Corporation, Systems (SP Systems), to capitalize on SunPower s name recognition. The Company believes the acquisition will enable it to develop the next generation of solar products and solutions that will accelerate reduction in solar system cost to compete with retail electric rates without incentives and simplify and improve customer experience. The total consideration for the transaction was $334.4 million, consisting of $120.7 million in cash and $213.7 million in common stock and related acquisition costs (see Note 6).

Cypress made a significant investment in the Company in 2002. On November 9, 2004, Cypress completed a reverse triangular merger with the Company in which all of the outstanding minority equity interest of SunPower was retired, effectively giving Cypress 100% ownership of all of the Company s then outstanding shares of capital stock but leaving its unexercised warrants and options outstanding. After completion of the Company s IPO in November 2005, Cypress held, in the aggregate, 52,033,287 shares of class B common stock. On May 4, 2007, Cypress completed the sale of 7,500,000 shares of the Company s class B common stock in an offering pursuant to Rule 144 of the Securities Act. Such shares converted to 7,500,000 shares of class A common stock upon the sale. As of September 30, 2007, including the effect of the sale completed in May 2007, the public offerings of class A common stock in June 2006 and July 2007, and issuance of senior convertible debentures in February 2007 and July 2007, Cypress owned 44,533,287 shares of the Company s class B common stock, which represented approximately 57% of the total outstanding shares of the Company s common stock, or approximately 53% of such shares on a fully diluted basis after taking into account outstanding stock options (or 50% of such shares on a fully diluted basis after taking into account outstanding stock options and loaned shares to underwriters of the Company s convertible indebtedness), and 90% of the voting power of the Company s total outstanding common stock.

The financial statements include allocations of certain Cypress expenses, including legal, tax, treasury, information technology, employee benefits and other Cypress corporate services and infrastructure costs. The expense allocations have been determined based on a method that Cypress and the Company consider to be a reasonable reflection of the utilization of services provided or the benefit received by the Company. The financial information included herein may not be indicative of the consolidated financial position, operating results, and cash flows of the Company in the future, or what they would have been had the Company been a separate stand-alone entity during the periods presented. See Note 8 for additional information on the transactions with Cypress.

As of September 30, 2007, the Company had an accumulated deficit of $27.7 million and, with the exception of fiscal 2006, the quarter ended April 1, 2007, and the quarter ended September 30, 2007, has a history of operating losses. The Company is subject to a number of risks including, but not limited to, an industry-wide shortage of polysilicon, potential downward pressure on product pricing as new polysilicon manufactures begin operating and the worldwide supply of solar cells and panels increases, the possible reduction or elimination of government and economic incentives that encourage industry growth, the challenges to reducing costs of installed solar systems by 50% by 2012 to maintain competitiveness, difficulties in maintaining or increasing the Company s growth rate and managing such growth, and accurately predicting warranty claims. Please see PART II OTHER INFORMATION, Item 1A. Risk Factors for additional information on risks.

Fiscal Year

The Company reports on a fiscal-year basis and ends its quarters on the Sunday closest to the end of the applicable calendar quarter, except in a 53-week fiscal year, in which case the additional week falls into the fourth quarter of that fiscal year. Both fiscal 2006 and 2007 consist of 52 weeks. The third quarter of fiscal 2007 ended on September 30, 2007 and the third quarter of fiscal 2006 ended on October 1, 2006.

Significant Accounting Policies

The Company s significant accounting policies are disclosed in the Company s Form 10-K for the year ended December 31, 2006 and have not changed materially as of September 30, 2007, with the exception of the following:

In connection with the acquisition of SP Systems on January 10, 2007, the following accounting policies were adopted as of the quarter ended April 1, 2007:

Revenue and Cost Recognition for Construction Contracts

The Company recognizes revenues from fixed price contracts under AICPA Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, using the percentage-of-completion method of accounting. Under this method, revenue is recognized as work is performed based on the percentage of incurred costs to estimated total forecasted costs utilizing the most recent estimates of forecasted costs.

Incurred costs include all direct material, labor, subcontract costs, and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs. Job material costs are included in incurred costs when the job materials have been installed. Where contracts stipulate that title to job materials transfers to the customer before installation has been performed, revenue is deferred and recognized upon installation, in accordance with the percentage-of-completion method of accounting. Job materials are considered installed materials when they are permanently attached or fitted to the solar power system as required by the job s engineering design.

Due to inherent uncertainties in estimating cost, job costs estimates are reviewed and/or updated by management working within the systems segment. The systems segment determines the completed percentage of installed job materials at the end of each month; generally this information is also reviewed with the customer s on-site representative. The completed percentage of installed job materials is then used for each job to calculate the month-end job material costs incurred. Direct labor, subcontractor, and other costs are charged to contract costs as incurred. Provisions for estimated losses on uncompleted contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. Contracts may include profit incentives such as milestone bonuses. These profit incentives are included in the contract value when their realization is reasonably assured.

As of September 30, 2007, the asset Costs and estimated earnings in excess of billings, which represents revenues recognized in excess of amounts billed, was $79.4 million. The liability Billings in excess of costs and estimated earnings, which represents billings in excess of revenues recognized, was $20.0 million. Ending balances in Costs and estimated earnings in excess of billings and Billings in excess of costs and estimated earnings are highly dependent on contractual billing schedules which are not necessarily related to the timing of revenue recognition.

Cash in Restricted Accounts

As of September 30, 2007, the Company provided security for advance payments made by NorSun AS (NorSun) in the form of $20.0 million held in an escrow account. Commencing in 2010 and continuing through 2019, the balance in the escrow account will be reduced as the advance payments are to be applied as a credit against NorSun s polysilicon purchases from the Company. The funds held in the escrow account may be released in exchange for letters of credit issued under the secured letter of credit facility at any time. In addition, the Company enters into various contractual agreements to build turnkey photovoltaic projects for developers in Europe, Korea and the United States. As part of the contractual agreements with the developers in Europe and Korea, the Company may receive advance payments that are secured by providing letters of credit issued by Wells Fargo Bank, National Association (Wells Fargo) to the developers. In certain developer contracts, the Company is required to provide construction period letters of credit to assure the developers of contract completion, for a period of approximately one year. In many cases, the Company is also asked to issue warranty period letters of credit to assure the developers that the Company will meet its warranty obligations, typically for the first two years after the project is installed. The Company issues letters of credit for such purposes through its line of credit facility with Wells Fargo. The credit agreement with Wells Fargo requires the Company to collateralize the full value of letters of credit issued under the secured letter of credit facility for such purposes with cash placed in an interest bearing restricted account with Wells Fargo. As long as the secured letters of credit are outstanding, the Company will not be able to withdraw the associated funds in the restricted account, though all interest earned on such restricted funds can be withdrawn periodically. As of September 30, 2007, outstanding secured letters of credit issued by Wells Fargo that related to contractual agreements with the developers in Europe and Korea totaled $9.2 million (see Note 14).

Deferred Project Costs

Deferred project costs represent uninstalled materials on contracts for which title had transferred to the customer and are recognized as deferred assets until installation. As of September 30, 2007, deferred project costs totaled $11.5 million.

Foreign Currency Translation

Assets and liabilities of the Company s wholly-owned foreign subsidiaries are translated from their respective functional currencies at exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average exchange rates prevailing during the applicable period. The resulting translation adjustment as of September 30, 2007 was a $5.4 million gain which is reflected as a component of accumulated other comprehensive income (loss) in stockholders equity.

Basis of Presentation

The accompanying Condensed Consolidated Interim Financial Statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission regarding interim financial reporting. The year-end Condensed Balance Sheet data was derived from audited financial statements. Accordingly, these financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the Financial Statements and Notes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2006. In the opinion of management, the accompanying Condensed Consolidated Financial Statements contain all adjustments, consisting only of normal recurring adjustments, which the Company believes are necessary for a fair statement of the Company s financial position as of September 30, 2007 and its results of operations for the three and nine months ended September 30, 2007 and October 1, 2006, respectively. These Condensed Consolidated Financial Statements are not necessarily indicative of the results to be expected for the entire year.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, and Related Implementation Issues (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a Company s financial statements in accordance with FASB 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN 48 in the first quarter of fiscal 2007 (see Note 11).

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value instruments. This statement does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of this statement are to be applied prospectively as of the beginning of the fiscal year in which this statement is initially applied, with any transition adjustment recognized as a cumulative effect adjustment to the opening balance of retained earnings. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007. The Company has not determined the effect, if any, the adoption of this statement will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, (SFAS No. 159), which provides companies an option to report selected financial assets and liabilities at fair value. SFAS No. 159 requires companies to provide information helping financial statement users to understand the effect of a company s choice to use fair value on its earnings, as well as to display the fair value of the assets and liabilities a company has chosen to use fair value for on the face of the balance sheet. Additionally, SFAS No. 159 establishes presentation and disclosure requirements designed to simplify comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The statement is effective as of the beginning of an entity s first fiscal year beginning after November 15, 2007. The Company has not determined the effect, if any, the adoption of this statement will have on its consolidated financial statements.

In September 2007, the FASB issued a proposed FASB Staff Position APB 14-a, which clarifies the accounting for convertible debt instruments that may be settled in cash upon conversion. The proposed guidance, if issued in final form, would significantly impact the accounting for instruments commonly referred to as Instruments B and Instruments C from Emerging Issue Task Force (EITF) Issue No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion, and any other convertible debt instruments that allow settlement in any combination of cash and shares at the issuer s option. The proposed guidance would require the issuer to separately account for the liability and equity components of the instrument in a manner that reflects interest expense equal to the issuer s non-convertible debt borrowing rate. The proposed guidance, if approved, would be effective for fiscal years beginning after December 15, 2007, and retrospective application would be required for all periods presented. The proposed guidance, if issued in final form, would have a significant impact on the Company s outstanding convertible debt balance of $425.0 million (see Note 15). The Company is currently evaluating the potential impact of this proposed guidance on its results of operations and financial condition.

Note 2. Balance Sheet Components

(In thousands)		September 30, 2007		December 31, 2006
Inventories:				
Raw materials*	$	62,101	$	8,703
Work-in-process		2,399		79
Finished goods		35,440		13,998
	$	99,940	$	22,780

* Raw materials include solar panels purchased from third-party vendors, installation materials for systems projects, polysilicon and other raw materials for solar cell manufacturing as of September 30, 2007.

Prepaid expenses and other current assets:				
Deferred tax asset, current portion	$	10,372	$	1,446
Note receivable from SP Systems				10,000
VAT receivable, current portion		4,950		48
Prepaid materials		3,211		
Unbilled earned rebates		2,666		
Other receivables		9,673		3,556
Other prepaid expenses		4,795		1,605
	$	35,667	$	16,655
Property, plant and equipment, net:				
Land and buildings	$	7,482	$	7,304
Manufacturing equipment		164,430		120,104
Computer equipment		9,791		2,496
Furniture and fixtures		180		83
Leasehold improvements		112,245		45,175
Construction-in-process (manufacturing facility in the Philippines)		97,836		53,252
		391,964		228,414
Less: Accumulated depreciation and amortization		(43,775)		(25,986)
	$	348,189	$	202,428
Intangible assets:				
Patents and purchased technology	$	51,398	$	21,950
Tradenames		1,603		1,603
Backlog		11,787		
Customer relationships and other		23,193		463
		87,981		24,016
Accumulated amortization of intangible assets:				
Patents and purchased technology		(17,459)		(8,973)
Tradenames		(743)		(548)
Backlog		(8,513)		
Customer relationships and other		(3,188)		(446)
		(29,903)		(9,967)
	$	58,078	$	14,049

The estimated future amortization expense related to intangible assets as of September 30, 2007 is as follows:

2007 (remaining three months)	$	6,858
2008		15,350
2009		14,740
2010		13,228
2011 and beyond		7,902
	$	58,078

(In thousands)		September 30, 2007		December 31, 2006
Other long-term assets:				
VAT receivable, net of current portion	$	19,731	$	
Debt issuance costs		9,943		
Investment in joint venture		4,560		4,994
Other		987		1,639
	$	35,221	$	6,633
Accrued liabilities:				
Income taxes payable	$	10,872	$	1,995
Employee compensation and employee benefits		9,093		3,961
Warranty reserve, current portion		8,983		3,446
Foreign exchange derivative liability		8,411		4,849
VAT payable		7,772		575
Sales tax payable		1,151		426
Other		10,260		3,333
	$	56,542	$	18,585
Long-term liabilities:				
Warranty reserve, net of current portion	$	5,928	$	
Other		2,789		
	$	8,717	$	

Note 3. Investments

Cash and cash equivalents, short-term investments and restricted cash classified as available-for-sale securities were comprised of the following:

	September 30, 2007								December 31, 2006							
			Unrealized								Unrealized					
(In thousands)		Cost		Gross Gains		Gross Losses		Fair Value		Cost		Gross Gains		Gross Losses		Fair Value
Money market securities	$	354,702	$		$		$	354,702	$	135,298	$		$		$	135,298
Corporate securities		45,642		9				45,651		13,400						13,400
Commercial paper		65,521		1				65,522		28,739				(4)		28,735
Government sponsored agencies		5,000		1				5,001								
Total available-for-sale securities	$	470,865	$	11	$		$	470,876	$	177,437	$		$	(4)	$	177,433

The classification and contractual maturities of available-for-sale securities is as follows:

(In thousands)		September 30, 2007		December 31, 2006
Included in:				
Cash and cash equivalents	$	383,264	$	160,937
Short-term investments		58,570		16,496
Restricted cash		29,042		
	$	470,876	$	177,433
Contractual maturities:				
Due in less than one year	$	443,426	$	164,033

Due from one to 30 years		27,450		13,400
	$	470,876	$	177,433

From time to time the Company invests in auction rate securities, which are bought and sold in the marketplace through a bidding process sometimes referred to as a Dutch Auction, and which are classified as short-term investments and carried at their market values. After the initial issuance of the securities, the interest rate on the securities resets periodically, at intervals set at the time of issuance (e.g., every seven, twenty-eight, or thirty-five days; every six months; etc.), based on the market demand at the reset period. The stated or contractual maturities for these securities, however, generally are 20 to 30 years. Despite the long-term maturities, the Company has the ability and intent, if necessary, to liquidate any of these investments in order to meet its working capital needs within its normal operating cycles. At September 30, 2007, the Company had $27.5 million invested in auction rate securities as compared to $13.4 million invested in auction rate securities at December 31, 2006.

The Company classifies these investments as available-for-sale securities under SFAS No. 115 Accounting for Investment in Certain Debt and Equity Securities (SFAS No. 115). As these securities trade at their par values, no gains or losses are recorded in comprehensive income.

Note 4. Net Income per Share

Basic net income per share is computed using the weighted-average common shares outstanding. Diluted net income per share is computed using the weighted-average common shares outstanding plus any potentially dilutive securities outstanding during the period using the treasury stock method, except when their effect is anti-dilutive. Potentially dilutive securities include stock options, restricted stock and convertible debentures.

Holders of the Company s senior convertible debentures may, under certain circumstances at their option, convert the senior convertible debentures into cash and, if applicable, shares of the Company s class A common stock at the applicable conversion rate, at any time on or prior to maturity (see Note 15). Pursuant to EITF 90-19, Convertible Bonds with Issuer Options to Settle for Cash upon Conversion, the senior convertible debentures are included in the calculation of diluted net income per share if their inclusion is dilutive under the treasury stock method.

The following is a summary of all outstanding anti-dilutive potential common shares:

	As of	
(In thousands)	**September 30, 2007**	**October 1, 2006**
Stock options	18	74
Restricted stock	421	
July 2007 debentures	449	

The following table sets forth the computation of basic and diluted weighted-average common shares:

	Three Months Ended		Nine Months Ended	
(In thousands)	**September 30, 2007**	**October 1, 2006**	**September 30, 2007**	**October 1, 2006**
Basic weighted-average common shares	77,693	68,947	75,516	64,704
Effect of dilutive securities:				
Stock options	3,826	4,845	4,402	5,318
Restricted stock	398	107	341	58

February 2007 debentures	693		267	
Weighted-average common shares for diluted computation	82,610	73,899	80,526	70,080

Basic weighted-average common shares includes 1.1 million shares of class A common stock issued in relation to the acquisition of SP Systems which are subject to certain transfer restrictions and a repurchase option by the Company, both of which lapse semi-annually over a two-year period by one quarter of the shares every six months. In addition, basic weighted-average common shares excludes 2.9 million shares of class A common stock lent to an affiliate of Lehman Brothers in connection with the Company s issuance of $200.0 million in principal amount of its 1.25% senior convertible debentures in February 2007 and 1.8 million shares of class A common stock lent to an affiliate of Credit Suisse in connection with the Company s issuance of $225.0 million in principal amount of its 0.75% senior convertible debentures in July 2007 (see Note 15).

Dilutive potential common shares includes approximately 0.7 million and 0.3 million shares for the three and nine months ended September 30, 2007, respectively, for the impact of $200.0 million in principal amount of the Company s 1.25% senior convertible debentures issued in February 2007 as the Company has experienced a substantial increase in its common stock price. Under the treasury stock method, such senior convertible debentures will generally have a dilutive impact on net income per share if the Company s average stock price for the period exceeds the conversion price for the senior convertible debentures.

As of September 30, 2007, anti-dilutive potential common shares includes approximately 0.4 million shares for the impact of the Company s 0.75% senior convertible debentures issued in July 2007 as the Company s average stock price for the period did not exceed the conversion price for the senior convertible debentures. Therefore, such senior convertible debentures are excluded from the summary of all outstanding dilutive potential common shares.

Note 5. Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Comprehensive income includes unrealized gains and losses on the Company s available-for-sale investments, derivatives and cumulative translation adjustments.

The components of comprehensive income, net of tax, were as follows:

	Three Months Ended		Nine Months Ended	
(In thousands)	**September 30, 2007**	**October 1, 2006**	**September 30, 2007**	**October 1, 2006**
Net income	$ 8,431	$ 9,568	$ 4,326	$ 15,207
Cumulative translation adjustment	3,498		5,395	
Unrealized gain (loss) on derivatives, net of tax	(1,862)	1,326	(1,058)	(979)
Total comprehensive income	$ 10,067	$ 10,894	$ 8,663	$ 14,228

Note 6. Business Combinations

PowerLight Acquisition

On January 10, 2007, the Company completed its acquisition of PowerLight. The results of PowerLight have been included in the consolidated results of the Company from January 10, 2007. As a result of the PowerLight acquisition, all of the outstanding shares of PowerLight, and a portion of each vested option to purchase shares of PowerLight, were cancelled, and all of the outstanding options to purchase shares of PowerLight (other than the portion of each vested option that was cancelled) were assumed by the Company in exchange for aggregate consideration of (i) approximately $120.7 million in cash plus (ii) a total of 5,708,723 shares of the Company s class A common stock, inclusive of (a) 1,601,839 shares of the Company s class A common stock which may be issued upon the exercise of assumed vested and unvested PowerLight stock options, which options vest on the same schedule as the assumed PowerLight stock options, and (b) 1,145,643 shares of the Company s class A common stock issued to employees of PowerLight in connection with the acquisition which, along with 530,238 of the shares issuable upon exercise of assumed PowerLight stock options, are subject to certain transfer restrictions and a repurchase option by the Company, both of which lapse over a two-year period following the acquisition under the terms of certain equity restriction agreements. The Company under the terms of the acquisition agreement also issued an additional 204,623 shares of restricted class A common stock to certain employees of PowerLight, which shares are subject to certain transfer restrictions which will lapse over 4 years. In June 2007, the Company changed PowerLight s name to SunPower Corporation, Systems (SP Systems), to capitalize on SunPower s name recognition.

The total consideration related to the acquisition is as follows:

(In thousands)	Shares	Fair Value at January 10, 2007
Purchase consideration:		
Cash		$ 120,694
Common stock	2,961	111,266
Stock options assumed that are fully vested	618	21,280
Direct transaction costs		2,958
Total purchase consideration	3,579	256,198
Future stock compensation:		
Restricted stock	1,146	43,046
Stock options assumed that are unvested	984	35,126
Total future stock compensation	2,130	78,172
Total purchase consideration and future stock compensation	5,709	$ 334,370

Purchase Price Allocation

Under the purchase method of accounting, the total purchase price as shown in the table above was allocated to SP Systems net tangible and intangible assets based on their estimated fair values as of January 10, 2007. The purchase price has been allocated based on management s best estimates. The fair value of the Company s class A common stock issued was determined based on the average closing prices for a range of trading days around the announcement date (November 15, 2006) of the transaction. The fair value of stock options assumed was estimated using the Black-Scholes model with the following assumptions: volatility of 90%, expected life ranging from 2.7 years to 6.3 years, and risk-free interest rate of 4.6%.

The allocation of the purchase price and the estimated useful lives associated with certain assets on January 10, 2007 was as follows:

(In thousands)		Amount	Estimated Useful Life
Net tangible assets	$	13,925	n.a.
Patents and purchased technology		29,448	4 years
Tradenames		15,535	5 years
Backlog		11,787	1 year
Customer relationships		22,730	6 years
In-process research and development		9,575	n.a.
Unearned stock compensation		78,172	n.a.
Deferred tax liability		(21,964)	n.a.
Goodwill		175,162	n.a.
Total purchase consideration and future stock compensation	$	334,370	

Net tangible assets acquired on January 10, 2007 consisted of the following:

(In thousands)		Amount
Cash and cash equivalents	$	22,049
Restricted cash		4,711
Accounts receivable, net		40,080
Costs and estimated earnings in excess of billings		9,136
Inventories		28,146
Deferred project costs		24,932
Prepaid expenses and other assets		23,740
Total assets acquired		152,794
Accounts payable		(60,707)
Billings in excess of costs and estimated earnings		(35,887)
Other accrued expenses and liabilities		(42,275)
Total liabilities assumed		(138,869)
Net assets acquired	$	13,925

Acquired identifiable intangible assets. The fair value attributed to purchased technology and patents was determined using the relief from royalty method, which calculated the present value of the royalty savings by applying a royalty rate of 2.5% and a discount rate of 25% to the appropriate revenue streams. The fair value of purchased technology and patents is being amortized over 4 years on a straight-line basis. Amortization expense for the three and nine months ended September 30, 2007 was as follows:

(In thousands)		Three Months Ended		Nine Months Ended
Cost of systems revenue	$	4,787	$	15,297
Selling, general and administrative		947		2,736
Total amortization expense	$	5,734	$	18,033

The fair value of tradenames was determined using the royalty savings approach method, using a royalty rate of 1% and a discount rate of 25%. The fair value of tradenames was valued at $15.5 million and ascribed a useful life of 5 years. The determination of the fair value and useful life of the tradename was based on the Company s strategy of continuing to market its systems products and services under the PowerLight brand. Based on the Company s change in branding strategy and changing PowerLight s name to

SunPower Corporation, Systems, during the quarter ended July 1, 2007, the Company recognized an impairment charge of $14.1 million, which represented the net book value of the PowerLight tradename.

The fair value attributed to customer relationships was determined using the multi-period excess earnings method with a discount rate of 22%. The fair value of customer relationships is being amortized over 6 years on a straight-line basis.

The fair value attributed to order backlog was determined using the multi-period excess earnings method with a discount rate of 20%. The fair value of order backlog is being amortized over 1 year on a straight-line basis.

In-process research and development. SP Systems in-process research and development consisted of two components: design automation tool and tracking systems and other, which have not yet reached technological feasibility and have no alternative future uses.

Goodwill. Approximately $177.0 million had been allocated to goodwill within the systems segment, which represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets of SP Systems. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), goodwill will not be amortized but instead will be tested for impairment at least annually (more frequently if certain indicators are present). In the event that management determines that the value of goodwill has become impaired, the Company will incur an accounting charge for the amount of the impairment during the fiscal quarter in which the determination is made. During the nine months ended September 30, 2007, the Company recorded an adjustment of $1.8 million to increase goodwill acquired in connection with the purchase of SP Systems on January 10, 2007. This adjustment was recorded to reflect an additional loss provision on a construction project that was contracted as of the acquisition date and which has subsequently been determined to have a larger loss than originally estimated as well as adjustments to the value of certain acquired assets and liabilities. Goodwill that resulted from the acquisition of SP Systems is not deductible for tax purposes.

Of the cash and shares issued in the acquisition, approximately $24.2 million in cash and 724,000 shares, with a total aggregate value of $84.2 million as of September 30, 2007, are being held in escrow as security for the indemnification obligations of certain former SP Systems shareholders and will be released over a period of five years ending January 10, 2012. In addition, the Company issued an additional 204,623 shares of restricted class A common stock to certain employees of SP Systems, which shares are subject to certain transfer restrictions that lapse over a period of four years ending January 10, 2011.

In conjunction with the acquisition, Cypress entered into a commitment letter with the Company during the fourth quarter of fiscal 2006 under which Cypress agreed to lend to the Company up to $130.0 million in cash to be used to facilitate the financing of the acquisition or working capital requirements. In February 2007, Cypress and the Company mutually terminated the commitment letter. No borrowings were outstanding at the termination date.

The Company accounted for its acquisition of SP Systems in accordance with SFAS No. 141, Business Combinations (SFAS No. 141). Accordingly, all intercompany receivables and payables related to SP Systems were eliminated in purchase accounting effective January 10, 2007.

Supplemental information on an unaudited pro forma basis, as if the acquisition of SP Systems were completed at the beginning of the years 2007 and 2006, is as follows:

	Three Months Ended		Nine Months Ended	
(In thousands, except per share amounts)	**September 30, 2007**	**October 1, 2006**	**September 30, 2007**	**October 1, 2006**
Revenue	$ 234,334	$ 121,076	$ 552,761	$ 278,092
Net income (loss)	$ 8,431	$ (7,671)	$ 2,218	$ (49,175)
Basic net income (loss) per share	$ 0.11	$ (0.11)	$ 0.03	$ (0.73)
Diluted net income (loss) per share	$ 0.10	$ (0.11)	$ 0.03	$ (0.73)

The unaudited pro forma supplemental information is based on estimates and assumptions, which the Company believes are reasonable. The unaudited pro forma supplemental information includes non-recurring in-process research and development charge of $9.6 million recorded in the first quarter ended April 1, 2007 and April 2, 2006. The unaudited pro forma supplemental information prepared by management is not necessarily indicative of the Condensed Consolidated Financial position or results of income in future periods or the results that actually would have been realized had the Company and SP Systems been a combined company during the specified periods.

In-Process Research and Development (IPR&D) Charge

In connection with the acquisition of SP Systems, the Company recorded an IPR&D charge of $9.6 million in the first quarter of fiscal 2007, as technological feasibility associated with the in-process research and development projects had not been established and no alternative future use existed.

The Company identified in-process research and development projects in areas for which technological feasibility had not been established and no alternative future use existed. These in-process research and development projects consisted of two components: design automation tool and tracking systems and other. In assessing the projects, the Company considered key characteristics of the technology as well as its future prospects, the rate technology changes in the industry, product life cycles, and various projects stage of development.

The value of in-process research and development was determined using the income approach method, which calculated the sum of the discounted future cash flows attributable to the projects once commercially viable using a 40% discount rate, which were derived from a weighted-average cost of capital analysis and adjusted to reflect the stage of completion of the projects and the level of risks associated with the projects. The percentage of completion for each project was determined by identifying the research and development expenses invested in the project as a ratio of the total estimated development costs required to bring the project to technical and commercial feasibility. The following table summarizes certain information of each significant project:

Design Automation Tool	Stage of Completion		Total Cost Incurred to Date		Total Remaining Costs	Completion Date
As of January 10, 2007 (acquisition date)	5%	$	0.2 million	$	2.4 million	December 2010
As of September 30, 2007	30%	$	0.8 million	$	1.8 million	June 2009

Tracking System and Other	Stage of Completion		Total Cost Incurred to Date		Total Remaining Costs	Completion Date
As of January 10, 2007 (acquisition date)	30%	$	0.2 million	$	0.6 million	July 2007
As of September 30, 2007	100%	$	0.8 million	$		June 2007

Status of In-Process Research and Development Projects:

As of September 30, 2007, the Company has incurred total post-acquisition costs of approximately $0.6 million related to the design automation tool project and estimates that an additional investment of $1.8 million will be required to complete the project. The Company expects to complete the design automation tool project by June 2009, approximately one and a half years earlier than the original estimate.

During the second quarter of fiscal 2007, the Company had completed the tracking systems project and incurred total project costs of $0.8 million, of which $0.6 million was incurred after the acquisition.

The development of the design automation tool remains a significant risk due to factors including the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for new products, and competitive threats. The nature of the efforts to develop these technologies into commercially viable products consists primarily of planning, designing, experimenting, and testing activities necessary to determine that the technologies can meet market expectations, including functionality and technical requirements. Failure to bring these products to market in a timely manner could result in a loss of market share or a lost opportunity to capitalize on emerging markets and could have a material adverse impact on the Company s business and operating results.

Note 7. Advances to Suppliers and Other Current Assets

The Company has entered into agreements with various polysilicon, ingot, wafer, solar cells and solar module vendors and manufacturers. These agreements specify future quantities and pricing of products to be supplied by the vendors for periods up to 13 years. Certain agreements also provide for penalties or forfeiture of advanced deposits in the event the Company terminates the arrangements (see Note 13).

Furthermore, under certain of these agreements, the Company is required to make prepayments to the vendors over the terms of the arrangements. In the third quarter of fiscal 2007, the Company paid advances totaling $15.0 million in accordance with the terms of existing supply agreements. The Company may also, from time to time, make advance payments in connection with purchases of services and manufacturing equipment from a variety of vendors and suppliers. As of September 30, 2007, advances to suppliers totaled $111.2 million, the current portion of which is $16.6 million.

The Company s future prepayment obligations related to these agreements as of September 30, 2007 are as follows (in thousands):

2007 (remaining three months)	$	50,490
2008		58,359
2009		48,840
2010		11,100
	$	168,789

On October 4, 2007, the Company paid an additional advance of $44.9 million in accordance with the terms of existing supply agreements.

Note 8. Transactions with Cypress

Purchases of Imaging and Infrared Detector Products from Cypress

The Company purchases wafers from Cypress at intercompany prices which are consistent with Cypress internal transfer pricing methodology. The Company is evaluating various strategic alternatives relating to its future plans for this business.

Manufacturing Services in Texas

The Company originally made its imaging and infrared detector and solar power products at its former Sunnyvale, California facility. In May 2002, the Company installed certain tenant improvements to build a pilot wafer fabrication line for a newly designed solar cell in a Cypress facility located in Texas. The Company then paid pro rata costs for materials and Cypress personnel to operate the facility which made the Company s pre-commercial production solar cells until the Philippines facility came on line in November 2004. In late 2004, the Company moved its imaging and infrared detector production lines to the Cypress Texas facility and continues to pay the costs of materials and Cypress personnel to operate the facility.

Administrative Services Provided by Cypress

Cypress has seconded employees and consultants to the Company for different time periods for which the Company pays their fully-burdened compensation. In addition, Cypress personnel render services to the Company to assist with administrative functions such as legal, tax, treasury, information technology, employee benefits and other Cypress corporate services and infrastructure. Cypress bills the Company for a portion of the Cypress employees fully-burdened compensation. In the case of the Philippines subsidiary, which entered into a services agreement for such secondments and other consulting services in January 2005, the Company pays the fully-burdened compensation plus 10%. Amounts paid for these services are recorded as general and administrative expenses in the accompanying statements of operations.

Leased Facility in the Philippines

In 2003, the Company and Cypress reached an understanding that the Company would build out and occupy a building owned by Cypress for its wafer fabrication facility in the Philippines. The Company entered into a lease agreement for this facility, which expires in July 2021. Under the lease, the Company will pay Cypress at a rate equal to the cost to Cypress for that facility (including taxes, insurance, repairs and improvements) until the earlier of November 2015 or a change in control of the Company occurs, which includes such time as Cypress ceases to own at least a majority of the aggregate number of shares of all classes of the Company s common stock then outstanding. Thereafter, the Company will pay market rate rent for the facility. The Company will have the right to purchase the facility from Cypress at any time at Cypress original purchase price of approximately $8.0 million, plus interest computed on a variable index starting on the date of purchase by Cypress until the sale to the Company, unless such purchase option is exercised after a change of control of the Company, in which case the purchase price shall be at a market rate, as reasonably determined by Cypress. The lease agreement also contains certain indemnification and exculpation provisions by the Company for the benefit of Cypress as lessor.

Leased Facility in California

On May 15, 2006, the Company entered into a lease agreement for its 43,732 square foot headquarters, which is located in a building owned by Cypress in San Jose, California, for $6.0 million over the five-year term of the lease. On July 1, 2007, the Company entered into an amendment to the lease agreement, increasing the rentable square footage and the total lease obligations to 51,228 and $6.9 million, respectively, over the five-year term of the lease. In the event Cypress decides to sell the building, the Company has the right of first refusal to purchase the building at a fair market price which will be based on comparable sales in the area.

Purchases of imaging and infrared detector products from Cypress, manufacturing services provided by Cypress in Texas, administrative services provided by Cypress and the facilities leased from Cypress in the Philippines and in California aggregated $1.6 million and $6.1 million for the three and nine months ended September 30, 2007, respectively, and $3.5 million and $9.6 million for the three and nine months ended October 1, 2006, respectively.

2005 Separation and Service Agreements

On October 6, 2005, the Company entered into a series of separation and services agreements with Cypress. Among these agreements are a master separation agreement, a sublease of the land and a lease for the building in the Philippines (see above); a three-year wafer manufacturing agreement for detector products at inter-company pricing; a three-year master transition services agreement under which Cypress would allow the Company to continue to utilize services provided by Cypress such as corporate accounting, legal, tax, information technology, human resources and treasury administration at Cypress cost; an asset lease under which Cypress will lease certain manufacturing assets from the Company; an employee matters agreement under which the Company s employees would be allowed to continue to participate in certain Cypress health insurance and other employee benefits plans; an indemnification and insurance matters agreement; an investor rights agreement; and a tax sharing agreement. All of these agreements, except the tax sharing agreement and the manufacturing asset lease agreement, became effective at the time of completion of the Company s initial public offering in November 2005.

Master Separation Agreement

In October 2005, the Company entered into a master separation agreement containing the framework with respect to the Company s separation from Cypress. The master separation agreement provides for the execution of various ancillary agreements that further specify the terms of the separation.

Wafer Manufacturing Agreement

The Company has entered into an agreement with Cypress to continue to make infrared and imaging detector products for the Company at prices consistent with the then current Cypress transfer pricing, which is equal to the forecasted cost to Cypress to manufacture the wafers, for the earlier of the next three years or until a change in control of the Company occurs, which includes until such time as Cypress ceases to own at least a majority of the aggregate number of shares of all classes of the Company common stock then outstanding, after which a new supply agreement may be negotiated or the Company and Cypress will negotiate a reasonable winding-up procedure. In addition, the Company may use other Cypress fabs for development work on a cost per activity basis.

The Company will indemnify Cypress for any liabilities that arise only to the extent that they are based on claims of infringement based on the Company s design specifications that the Company submits to Cypress for the manufacture of the Company s products. Cypress will indemnify the Company for liabilities that arise only to the extent that they are based on claims that the manufacturing, assembling, product testing or packaging process that Cypress uses for the Company s products infringes or violates upon the intellectual property rights of third parties or Cypress unauthorized use of the Company s design specifications or proprietary information.

Master Transition Services Agreement

The Company has also entered into a master transition services agreement which would govern the provisions of services to SunPower by Cypress, such as: financial services, human resources, legal matters, training programs, and information technology.

For a period of three years following the Company s November 2005 initial public offering of 8.8 million shares of class A common stock (IPO) or earlier if a change of control of the Company occurs, Cypress would provide these services and the Company would pay Cypress for services provided to the Company, at Cypress cost (which, for purposes of the master transition services agreement, will mean an appropriate allocation of Cypress full salary and benefits costs associated with such individuals as well as any out-of-pocket expenses that Cypress incurs in connection with providing the Company with those services) or at the rate negotiated with Cypress. Cypress will have the ability to deny requests for services under this agreement if, among other things, the provisions of such services creates a conflict of interest, causes an adverse consequence to Cypress, requires Cypress to retain additional employees or other resources or the provision of such services become impracticable as a result or cause outside of the control of Cypress. In addition, Cypress will incur no liability in connection with the provision of these services. The master transition services agreement also contains certain indemnification provisions by the Company for the benefit of Cypress.

Lease for Manufacturing Assets

In 2005 the Company entered into a lease with Cypress under which Cypress leases from the Company certain manufacturing assets owned by the Company and located in Cypress Texas manufacturing facility. The term of the lease is 27 months and it expires on December 31, 2007. Under this lease, Cypress is reimbursing the Company s cost of approximately $0.7 million divided over the life of the leasehold improvements.

Employee Matters Agreement

The Company entered into an employee matters agreement with Cypress to allocate assets, liabilities and responsibilities relating to its current and former U.S. and international employees and its employees participation in the employee benefits plans that Cypress sponsors and maintains.

The Company s eligible employees generally remain able to participate in Cypress benefit plans, as they may change from time to time. The Company is responsible for all liabilities incurred with respect to the Cypress plans by the Company as a participating company in such plans. The Company intends to have its own benefit plans established by the time its employees no longer are eligible to participate in Cypress benefit plans. Once the Company has established its own benefit plans, the Company will have the ability to modify or terminate each plan in accordance with the terms of those plans and the Company s policies. It is the Company s intent that employees not receive duplicate benefits as a result of participation in its benefit plans and the corresponding Cypress benefit plans.

All of the Company s eligible employees are able to continue to participate in Cypress health plans, life insurance and other benefit plans as they may change from time to time, until the earliest of, (1) a change of control of the Company occurs, which includes such time as Cypress ceases to own at least a majority of the aggregate number of shares of all classes of the Company s common stock then outstanding, (2) such time as the Company s status as a participating company under the Cypress plans is not permitted by a Cypress plan or by applicable law, (3) such time as Cypress determines in its reasonable judgment that the Company s status as a participating company under the Cypress plans has or will adversely affect Cypress, or its employees, directors, officers, agents, affiliates or its representatives, or (4) such earlier date as the Company and Cypress mutually agree. However, to avoid redundant benefits, the Company s employees will generally be precluded from participating in Cypress stock option plans and stock purchase plans.

With respect to the Cypress 401(k) Plan, the Company is obligated to establish its own 401(k) Plan within 90 days of separation from Cypress, and Cypress will transfer all accounts in the Cypress 401(k) Plan held by the Company s employees to the Company s 401(k) Plan.

Indemnification and Insurance Matters Agreement

The Company will indemnify Cypress and its affiliates, agents, successors and assigns from all liabilities arising from environmental conditions existing on, under, about or in the vicinity of any of the Company s facilities, or arising out of operations occurring at any of the Company s facilities, including the California facilities, whether prior to or after the separation; existing on, under, about or in the vicinity of the Philippines facility which the Company occupies, or arising out of operations occurring at such facility, whether prior to or after the separation, to the extent that those liabilities were caused by the Company; arising out of hazardous materials found on, under or about any landfill, waste, storage, transfer or recycling site and resulting from hazardous materials stored, treated, recycled, disposed or otherwise handled by any of the Company s operations or the Company s California and Philippines facilities prior to the separation; and arising out of the construction activity conducted by or on behalf of the Company at Cypress Texas facility.

The indemnification and insurance matters agreement and the master transition services agreement also contain provisions governing the Company s insurance coverage, which are under the Cypress insurance policies (other than the Company s directors and officers insurance, for which the Company has its own separate policy) until the earliest of (1) a change of control of the Company, which includes such time as Cypress ceases to own at least a majority of the aggregate number of shares of all classes of the Company s common stock then outstanding, (2) the date on which Cypress insurance carriers do not permit the Company to remain on Cypress policies, (3) the date on which Cypress cost of insurance under any particular insurance policy increases, directly or indirectly, due to the Company s inclusion or participation in such policy, (4) the date on which the Company s coverage under the Cypress policies causes a real or potential conflict of interest or hardship for Cypress, as determined solely by Cypress or (5) the date on which Cypress and the Company mutually agree to terminate this arrangement. Prior to that time, Cypress will maintain insurance policies on the Company s behalf, and the Company shall reimburse Cypress for expenses related to insurance coverage during this period. The Company will work with Cypress to secure additional insurance if desired and cost effective.

Investor Rights Agreement

The Company has entered into an investor rights agreement with Cypress providing for specified (1) registration and other rights relating to the Company s shares of the Company s common stock, (2) information and inspection rights, (3) coordination of auditing practices and (4) approval rights with respect to certain transactions.

Tax Sharing Agreement

The Company has entered into a tax sharing agreement with Cypress providing for each of the party s obligations concerning various tax liabilities. The tax sharing agreement is structured such that Cypress will pay all federal, state, local and foreign taxes that are calculated on a consolidated or combined basis (while being a member of Cypress consolidated or combined group pursuant to federal, state, local and foreign tax law). The Company s portion of such tax liability or benefit will be determined based upon its separate return tax liability as defined under the tax sharing agreement. Such liability or benefit will be based on a pro forma calculation as if the Company were filing a separate income tax return in each jurisdiction, rather than on a combined or consolidated basis with Cypress subject to adjustments as set forth in the tax sharing agreement.

After the date the Company ceases to be a member of Cypress consolidated group for federal income tax purposes or state income tax purposes, as and to the extent that the Company becomes entitled to utilize on the Company s separate tax returns portions of those credit or loss carryforwards existing as of such date, the Company will distribute to Cypress the tax effect, estimated to be 34% for federal income tax purposes, of the amount of such tax loss carryforwards so utilized, and the amount of any credit carryforwards so utilized. The Company will distribute these amounts to Cypress in cash or in the Company s shares, at the Company s option. As of December 31, 2006, the Company has $28.0 million of federal net operating loss carryforwards and approximately $4.8 million of California net operating loss carryforwards meaning that such potential future payments to Cypress, which would be made over a period of several years, would therefore aggregate approximately $10.0 million.

Upon completion of its follow-on public offering of common stock in June 2006, the Company is no longer considered to be a member of Cypress consolidated group for federal income tax purposes. Accordingly, the Company will be subject to the obligations payable to Cypress for any federal income tax credit or loss carryforwards utilized in its federal tax returns in subsequent periods, as explained in the preceding paragraph.

The Company will continue to be jointly and severally liable for any tax liability as governed under federal, state and local law during all periods in which it is deemed to be a member of the Cypress consolidated or combined group. Accordingly, although the tax sharing agreement allocates tax liabilities between Cypress and all its consolidated subsidiaries, for any period in which the Company is included in Cypress consolidated group, the Company could be liable in the event that any federal tax liability was incurred, but not discharged, by any other member of the group.

If Cypress distributes the Company s class B common stock to Cypress stockholders in a transaction intended to qualify as a tax-free distribution under Section 355 of the Code, Cypress intends to obtain an opinion of counsel and/or a ruling from the Internal Revenue Service (IRS) to the effect that such distribution qualifies under Section 355 of the Code. Despite such an opinion or ruling, however, the distribution may nonetheless be taxable to Cypress under Section 355(e) of the Code if 50% or more of the Company s voting power or economic value is acquired as part of a plan or series of related transactions that includes the distribution of the Company s stock. The tax sharing agreement includes the Company s obligation to indemnify Cypress for any liability incurred as a result of issuances or dispositions of the Company s stock after the distribution, other than liability attributable to certain dispositions of the Company s stock by Cypress, that cause Cypress distribution of shares of the Company s stock to its stockholders to be taxable to Cypress under Section 355(e) of the Code.

The tax sharing agreement further provides for cooperation with respect to tax matters, the exchange of information and the retention of records which may affect the income tax liability of either party. Disputes arising between Cypress and the Company relating to matters covered by the tax sharing agreement are subject to resolution through specific dispute resolution provisions contained in the agreement.

Note 9. Foreign Currency Derivatives

The Company has non-U.S. subsidiaries that operate and sell the Company s products in various global markets, primarily in Europe. As a result, the Company is exposed to risks associated with changes in foreign currency exchange rates. It is the Company s policy to use various hedge instruments to manage the exposures associated with purchases of foreign sourced equipment, net asset or liability positions of its subsidiaries and forecasted revenues and expenses. The Company does not enter into foreign currency derivative financial instruments for speculative or trading purposes.

As of September 30, 2007, the Company s hedge instruments consisted of foreign currency option contracts and foreign currency forward exchange contracts. The Company calculates the fair value of its option and forward contracts based on market volatilities, spot rates and interest differentials from published sources.

In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), the Company accounts for its hedges of forecasted foreign currency revenues as cash flow hedges and hedges of firmly committed purchase contracts denominated in foreign currency as fair value hedges.

Cash Flow Hedges: Hedges of forecasted foreign currency denominated revenues are designated as cash flow hedges and changes in fair value of the effective portion of hedge contracts are recorded in accumulated other comprehensive income (loss) in stockholders equity in the Condensed Consolidated Balance Sheets. Amounts deferred in accumulated other comprehensive income (loss) are reclassified into the Condensed Consolidated Statement of Operations in the periods in which the hedged exposure impacts earnings. The effective portion of unrealized gains (losses) recorded in accumulated other comprehensive income (loss), net of tax, was a $1.9 million loss and a $1.3 million gain for the three months ended September 30, 2007 and October 1, 2006, respectively, and a $1.1 million loss and a $1.0 million loss for the nine months ended September 30, 2007 and October 1, 2006, respectively. As of September 30, 2007 and December 31, 2006, the Company had outstanding cash flow hedge forward contracts with an aggregate notional value of $89.6 million. As of September 30, 2007 and December 31, 2006, the Company had outstanding cash flow hedge option contracts with an aggregate notional value of $53.2 million and $16.0 million, respectively. The maturity dates of the outstanding contracts ranged from October 2007 to July 2008.

Fair Value Hedges: On occasion, the Company commits to purchase equipment in foreign currency, predominantly Euros. When these purchases are hedged and qualify as firm commitments under SFAS No. 133, they are designated as fair value hedges and changes in the fair value of the firm commitment derivative contract are recognized in the Condensed Consolidated Statement of Operations. Under fair value hedge treatment, the changes in the firm commitment on a spot to spot basis are recorded in property and equipment, net, in the Condensed Consolidated Balance Sheet and in other income (expense), net, in the Condensed Consolidated Statement of Operations. As of September 30, 2007, the Company had no outstanding fair value hedges.

Both cash flow hedges and fair value hedges are tested for effectiveness each period on a spot to spot basis using the dollar-offset method. Both the excluded time value and any ineffectiveness, which were not significant for all periods, are recorded in other income (expense), net.

In addition, the Company began hedging the net balance sheet effect of Euro denominated assets and liabilities in 2005 primarily for Euro denominated receivables from customers, prepayments to suppliers and advances received from customers. The Company records its hedges of foreign currency denominated monetary assets and liabilities at fair value with the related gains or losses recorded in other income. The gains or losses on these contracts are substantially offset by transaction gains or losses on the underlying balances being hedged. As of September 30, 2007 and December 31, 2006, the Company held forward contracts with an aggregate notional value of $37.2 million and $37.6 million, respectively, to hedge the risks associated with Euro foreign currency denominated assets and liabilities.

Note 10. Stock-Based Compensation

The following table summarizes the consolidated stock-based compensation expense, by type of awards:

	Three Months Ended		Nine Months Ended	
(In thousands)	September 30, 2007	October 1, 2006	September 30, 2007	October 1, 2006
Employee stock options	$ 4,183	$ 918	$ 13,776	$ 3,090
Non-employee stock options				304
Restricted stock	9,047	260	23,595	403
Change in stock-based compensation capitalized in inventory	134	(21)	(174)	(91)
Total stock-based compensation expense	$ 13,364	$ 1,157	$ 37,197	$ 3,706

The following table summarizes the consolidated stock-based compensation expense by line item in the Consolidated Statements of Operations:

	Three Months Ended		Nine Months Ended	
(In thousands)	September 30, 2007	October 1, 2006	September 30, 2007	October 1, 2006
Cost of revenue	$ 3,588	$ 200	$ 9,036	$ 628
Research and development	404	336	1,253	1,019
Sales, general and administrative	9,372	621	26,908	2,059
Total stock-based compensation expense	$ 13,364	$ 1,157	$ 37,197	$ 3,706

As stock-based compensation expense recognized in the Condensed Consolidated Statements of Operations is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R), Share-Based Payment (SFAS No. 123(R)), requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

Consolidated net cash proceeds from the issuance of shares under the Company s employee stock plans were $1.9 million and $6.9 million for the three and nine months ended September 30, 2007, respectively, and $0.7 million and $2.5 million for the three and nine months ended October 1, 2006, respectively. No income tax benefit was realized from stock option exercises during the three and nine months ended September 30, 2007 and October 1, 2006. As required, the Company presents excess tax benefits from the exercise of stock options, if any, as financing cash flows rather than operating cash flows.

The following table summarizes the unrecognized stock-based compensation costs by type of awards:

(In thousands, except years)	As of September 30, 2007	Weighted-Average Amortization Period (in years)
Stock options	$ 27,163	1.6
Restricted stock	30,020	3.4

Shares subject to re-vesting restrictions		26,643	1.3
Total unrecognized stock-based compensation balance	$	83,826	

Valuation Assumptions

The Company estimates the fair value of its stock-based awards using the Black-Scholes valuation model (Black-Scholes model). The determination of fair value of share-based payment awards on the date of grant using the Black-Scholes model is affected by the stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

Assumptions used in the determination of fair value of share-based payment awards using the Black-Scholes model were as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2007*	October 1, 2006	September 30, 2007	October 1, 2006
Expected term	6.5 years	6.5 years	6.5 years	6.5 years
Risk-free interest rate	4.61%	4.60%	4.60%	4.92%
Volatility	90%	90%	90%	92%
Dividend yield	0%	0%	0%	0%

* No stock options granted in the three months ended September 30, 2007

The Company utilizes the simplified method under the provisions of Staff Accounting Bulletin No. 107 (SAB No. 107) for estimating expected term, instead of its historical exercise data. The Company elected not to base the expected term on historical data because of the significant difference in its status before and after the effective date of SFAS No. 123(R). The Company was a privately-held company until its IPO, and the only available liquidation event for option holders was Cypress s buyout of minority interests in November 2004. At all other times, optionees could not cash out on their vested options. From the time of the Company s IPO in November 2005 through May 2006 when lock-up restrictions expired, a majority of the optionees were unable to exercise vested options.

Because of the limited history of its stock price returns, the Company does not believe that its historical volatility would be representative of the expected volatility for its equity awards. Accordingly, the Company has chosen to use the historical volatility rates for a publicly-traded U.S.-based direct competitor to calculate the volatility for its granted options.

The interest rate is based on the U.S. Treasury yield curve in effect at the time of grant. Since the Company does not pay and does not expect to pay dividends, the expected dividend yield is zero.

Equity Incentive Program

On May 4, 2007, the Company s stockholders approved an additional increase in the number of shares available for future issuance by 925,000 shares under the Company s Amended and Restated 2005 Stock Incentive Plan under which the Company may issue restricted shares, stock appreciation rights, stock units, incentive or non-statutory stock options to purchase common stock or stock purchase rights to directors, employees and consultants. The following table summarizes the Company s stock option activities:

	Shares (in thousands)	Weighted-Average Exercise Price Per Share
Options outstanding as of December 31, 2006	4,980	$ 3.97
Options exchanged/assumed in connection with SP Systems acquisition	1,602	5.54
Exercised	(720)	2.78
Forfeited	(33)	19.13
Options outstanding as of April 1, 2007	5,829	4.47
Granted	18	56.20
Exercised	(1,153)	2.57
Forfeited	(35)	10.64
Outstanding as of July 1, 2007	4,659	5.09
Granted		
Exercised	(533)	3.56
Forfeited	(11)	5.87
Outstanding as of September 30, 2007	4,115	5.29
Exercisable as of September 30, 2007	1,301	3.67

Information regarding the Company s outstanding stock options as of September 30, 2007 was as follows:

	Options Outstanding				Options Exercisable			
Range of Exercise Price	**Shares (in thousands)**	**Weighted-Average Remaining Contractual Life (in years)**	**Weighted-Average Exercise Price per Share**	**Aggregate Intrinsic Value (in thousands)**	**Shares (in thousands)**	**Weighted-Average Remaining Contractual Life (in years)**	**Weighted-Average Exercise Price per Share**	**Aggregate Intrinsic Value (in thousands)**
$ 0.04 0.75	707	4.42	$ 0.32	$ 58,294	255	5.17	$ 0.50	$ 21,005
0.88 2.66	291	7.14	2.05	23,524	91	6.91	1.97	7,358
3.30 4.95	2,368	7.10	3.32	188,240	844	7.07	3.31	67,069
7.00 16.20	384	7.90	8.38	28,599	79	7.90	8.39	5,883
17.00 56.20	365	8.79	26.97	20,397	32	8.67	31.06	1,676
	4,115	6.87	5.29	$ 319,054	1,301	6.77	3.67	$ 102,991

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on the Company s closing stock price of $82.82 at September 30, 2007, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable was 1.3 million shares as of September 30, 2007.

The following table summarizes the Company s non-vested stock options and restricted stock activities:

	Stock Options		Restricted Stock	
	Shares (in thousands)	**Weighted-Average Exercise Price Per Share**	**Shares (in thousands)**	**Weighted-Average Grant Date Fair Value Per Share**
Outstanding as of December 31, 2006	3,141	$ 4.45	229	$ 35.40
Granted	1,602	5.54	270	41.68
Vested	(993)	2.75	(8)	33.34
Forfeited	(33)	2.78	(4)	39.86
Outstanding as of April 1, 2007	3,717	5.39	487	38.89
Granted	18	56.20	335	49.88
Vested	(386)	5.71	(38)	40.09
Forfeited	(35)	2.57	(15)	43.52
Outstanding as of July 1, 2007	3,314	5.66	769	43.53
Granted			212	63.33
Vested	33	3.92	(20)	37.36
Forfeited	(533)	3.56	(62)	54.39
Outstanding as of September 30, 2007	2,814	6.04	899	47.60

Stock Unit Plan:

As of September 30, 2007, the Company has granted approximately 236,000 units to approximately 2,219 employees in the Philippines at an average unit price of $39.80 in relation to its 2005 Stock Unit Plan, under which participants are awarded the right to receive cash payments from the Company in an amount equal to the appreciation in the Company s common stock between the award date and the date the employee redeems the award. A maximum of 300,000 stock units may be subject to stock unit awards granted under the 2005 Stock Unit Plan. For the three and nine months ended September 30, 2007, total compensation expense associated with the 2005 Stock Unit Plan was $0.7 million and $1.5 million, respectively.

Note 11. Income Taxes

The Company s effective rate of income tax provision (benefit) was 14.2% and (205.4)% for the three and nine months ended September 30, 2007, respectively, and the effective rate of income tax provision was 8% for each of the three and nine months ended October 1, 2006. The tax provision (benefit) for the three and nine months ended September 30, 2007 was primarily attributable to the recognition of deferred tax assets to the extent of deferred tax liabilities as a result of the Company s acquisition of SP Systems and the effect of amortization of purchased intangible assets on deferred tax liability, partially offset by non-U.S. taxes on income earned in certain countries that was not offset by current year net operating losses in other countries. The tax provision for the three and nine months ended October 1, 2006 was attributable to non-U.S. taxes on income earned in certain countries that was not offset by current year net operating losses in other countries.

Unrecognized Tax Benefits

The Company adopted the provisions of FIN 48 on January 1, 2007. As of January 1, 2007, the total amount of unrecognized tax benefits recorded in the Condensed Consolidated Balance Sheet was approximately $1.1 million, which, if recognized, would affect the Company s effective tax rate. The additional amount of unrecognized tax benefits accrued during the nine months ended September 30, 2007 was $3.2 million. Management believes that events that could occur in the next 12 months and cause a change in unrecognized tax benefits include, but are not limited to, the following:

- completion of examinations of the Company s tax returns by the U.S. or foreign taxing authorities; and

- expiration of statute of limitations on the Company s tax returns.

The calculation of unrecognized tax benefits involves dealing with uncertainties in the application of complex global tax regulations. Uncertainties include, but are not limited to, the impact of legislative, regulatory, and judicial developments, transfer pricing and the application of withholding taxes. Management regularly assesses the Company s tax positions in light of legislative, bilateral tax treaty, regulatory and judicial developments in the countries in which the Company does business. Management determined that an estimate of the range of reasonably possible change in the amounts of unrecognized tax benefits within the next 12 months cannot be made.

Classification of Interest and Penalties

The Company s policy is to classify interest expense and penalty, if any, as components of income tax provision in the Condensed Consolidated Statements of Operations. No material amount has been accrued through the nine months ended September 30, 2007.

Tax Years and Examination

The following table summarizes the Company s major tax jurisdictions and the tax years that remain subject to examination by these jurisdictions as of January 1, 2007:

Tax Jurisdictions	**Tax Years**
United States	2003 and onward
California	2002 and onward

Additionally, while years prior to 2003 for the U.S. corporate tax return are not open for assessment, the IRS can adjust net operating loss and research and development carryovers that were generated in prior years and carried forward to 2003.

The IRS is currently conducting an audit of SP Systems federal income tax returns for fiscal 2004 and 2005. As of September 30, 2007, no material adjustments have been proposed by the IRS. Changes to SP Systems pre-acquisition tax liabilities, if any, would be recorded as a purchase price adjustment. Management believes that the ultimate outcome of the IRS examination will not have a material impact on the Company s financial position or results of operations.

Note 12. Segment and Geographical Information

Prior to fiscal year 2007, the Company operated in one business segment comprising the design, manufacture and sale of solar electric power products, imaging and infrared detectors based on its proprietary processes and technologies. Effective January 10, 2007, the Company operated in two business segments: systems and components. The systems segment generally represents sales directly to systems owners of engineering, procurement, construction and other services relating to solar electric power systems that integrate the Company s solar panels and balance of systems components, as well as materials sourced from other manufactures. The components segment primarily represents sales of the Company s solar cells, solar panels and inverters to solar systems installers and other resellers. In addition, the components segment includes sales of imaging and infrared detectors to OEMs. The Chief Operating Decision Maker (CODM), as defined by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS No. 131), assesses the performance of both operating segments using information about its revenue and gross margin.

The following tables present revenue by geography and segment, gross margin by segment, revenue by significant customer and property, plant and equipment information based on geographic region. Revenue is based on the destination of the shipments. Property, plant and equipment are based on the physical location of the assets:

	Three Months Ended		Nine Months Ended	
	September 30, 2007	October 1, 2006	September 30, 2007	October 1, 2006
Revenue by geography:				
United States	56%	34%	46%	30%
Europe:				
Spain	25%	%	28%	%
Germany	10%	51%	10%	51%
Other	7%	11%	12%	12%
Asia and other	2%	4%	4%	7%
	100%	100%	100%	100%
Revenue by segment:				
Systems	67%	%	62%	%
Components	33%	100%	38%	100%
	100%	100%	100%	100%
Gross margin by segment:				
Systems	14%	%	15%	%
Components	21%	23%	24%	20%

Significant Customers:

		Three Months Ended		Nine Months Ended	
Customer	**Business Segment**	**September 30, 2007**	**October 1, 2006**	**September 30, 2007**	**October 1, 2006**
MMA Renewable Ventures	Systems	30%	%	17%	%
SolarPack	Systems	21%	%	21%	%
Solon AG	Components	*	24%	10%	27%
Conergy AG	Components	*	26%	*	24%
SP Systems	Components	n.a.	19%	n.a.	16%

* denotes less than 10% during the period

(In thousands)	**September 30, 2007**	**December 31, 2006**
Property, plant and equipment by geography:		
United States	$ 13,293	$ 8,051
Philippines	334,896	192,335
China		2,042
	$ 348,189	$ 202,428

Note 13. Commitments and Contingencies

Operating Lease Commitments

The Company leases its San Jose, California facility under a non-cancelable operating lease from Cypress, which expires on April 30, 2011 (see Note 8). The lease also requires the Company to pay property taxes, insurance and certain other costs. The Company also leases its solar cell manufacturing facility in the Philippines from Cypress, under a lease which expires in July 2021 (see Note 8). In December 2005, the Company entered into a 5-year operating lease from an unaffiliated third party for an additional building in the Philippines. The Company also has various lease arrangements for offices in Berkeley, California which expire between 2007 and 2009, as well as for a field office in New Jersey, which expires in 2011. In December 2006, the Company (through SP Systems acquired on January 10, 2007) entered into an eleven-year lease agreement for its facility in Richmond, California, which the Company expects to occupy in the first quarter of 2008. Future minimum obligations under all non-cancelable operating leases as of September 30, 2007 are as follows (in thousands):

2007 (remaining three months)	$	862
2008		4,205
2009		4,256
2010		4,250
2011		3,102
Thereafter		19,665
	$	36,340

Purchase Commitments

The Company purchases raw materials for inventory, services and manufacturing equipment from a variety of vendors. During the normal course of business, in order to manage manufacturing lead times and help assure adequate supply, the Company enters into agreements with contract manufacturers and suppliers that either allow them to procure goods and services based upon specifications defined by the Company, or that establish parameters defining the Company s requirements. In certain instances, these agreements allow the Company the option to cancel, reschedule or adjust the Company s requirements based on its business needs prior to firm orders being placed. Consequently, only a portion of the Company s recorded purchase commitments arising from these agreements are firm, non-cancelable and unconditional commitments.

The Company also has agreements with several suppliers of polysilicon, ingots, wafers, solar cells and solar panels and which specify future quantities and pricing of products to be supplied by the vendors for periods up to 13 years and provide for certain consequences, such as forfeiture of advanced deposits and liquidated damages relating to previous purchases, in the event that the Company terminates the arrangements (see Note 7).

At September 30, 2007, total obligations related to such supplier agreements was $2.3 billion of which $250.3 million was related to a joint venture (as discussed below). The Company s non-cancelable purchase orders related to equipment and building improvements totaled approximately $93.7 million.

Future minimum obligations under supplier agreements and non-cancelable purchase orders as of September 30, 2007 are as follows (in thousands):

2007 (remaining three months)	$	180,581
2008		277,376
2009		431,123
2010		417,371
2011		425,659
Thereafter		678,782
	$	2,410,892

Joint Ventures

In the third quarter of fiscal 2006, the Company entered into an agreement with Woongjin Coway Co., Ltd. (Woongjin), a provider of environmental products located in Korea, to form Woongjin Energy Co., Ltd (Woongjin Energy), a joint venture to manufacture monocrystalline silicon ingots. Under the joint venture, the Company and Woongjin have funded the joint venture through capital investments. In addition, Woongjin Energy obtained a $33.0 million loan originally guaranteed by Woongjin. The

Company will supply polysilicon and technology required for the silicon ingot manufacturing to the joint venture, and the Company will procure the manufactured silicon ingots from the joint venture. Woongjin Energy began manufacturing in the third quarter of fiscal 2007, and the Company expects to purchase approximately $250.3 million of silicon ingots from Woongjin Energy under a five-year agreement.

The Company has invested $4.6 million in the joint venture comprised of a 19.9% equity investment valued at $1.3 million and a $3.3 million convertible note that is convertible at the Company s option into an additional 20.1% equity ownership in the joint venture. The Company accounted for its joint venture in Woongjin Energy using the equity method of accounting, in which the entire minority investment of $4.6 million is classified as other long-term assets in the Consolidated Balance Sheet and the Company s share of Woongjin Energy s losses totaling $0.2 million for the three and nine months ended September 30, 2007 is included in other income (expense), net in the Consolidated Statements of Operations. Neither party has contractual obligations to provide any additional funding to the joint venture.

On October 18, 2007, the Company entered into an agreement with Woongjin and Woongjin Holdings Co., Ltd. (Woongjin Holdings), whereby Woongjin transferred its 80.1% equity investment held in Woongjin Energy to Woongjin Holdings and Woongjin Holdings assumed all rights and obligations formerly owned by Woongjin under the joint venture agreement described above, including the $33.0 million loan guarantee.

On October 1, 2007, the Company entered into an agreement with First Philippine Electric Corporation (First Philec) to form First Philec Solar Corporation (First Philec Solar), a joint venture to provide wafer slicing services of silicon ingots to the Company. The Company will have a 20.0% equity investment in the joint venture and will account for its joint venture in First Philec Solar using the equity method of accounting. This joint venture will operate in the Philippines, with silicon ingots to be supplied primarily from the Company. The Company expects to purchase an aggregate quantity of silicon wafers sufficient to support up to approximately 660 megawatts annually of solar cell manufacturing production based on the Company s expected silicon utilization through the five-year wafering supply and sales agreement, which is anticipated to begin in the second half of 2008 when First Philec Solar s proposed manufacturing capacity is expected to become operational.

The Company is currently reviewing the qualitative and quantitative attributes of its joint ventures that are in the development stage to determine whether they will need to be consolidated in the Company s financial statements in the future.

Product Warranties

The Company warrants or guarantees the performance of its solar panels at certain levels of power output for extended periods, usually 25 years. It also warrants that the solar cells will be free from defects for at least ten years. Therefore, the Company maintains warranty reserves to cover potential liability that could result from these guarantees. The Company s potential liability is generally in the form of product replacement. Warranty reserves are based on the Company s best estimate of such liabilities and are recognized as a cost of revenue. The Company continuously monitors product returns for warranty failures and maintains a reserve for the related warranty expenses based on historical experience of similar products as well as various other assumptions that are considered reasonable under the circumstances. Warranty charges were $1.4 million and $7.0 million during the three and nine months ended September 30, 2007, respectively, and $0.8 million and $2.3 million during the three and nine months ended October 1, 2006, respectively.

The Company generally provides warranty on systems for a period of five years. The Company s estimated warranty cost for each project is accrued and the related costs are charged against the warranty accrual when incurred. It is not possible to predict the maximum potential amount of future warranty-related expenses under these or similar contracts due to the conditional nature of the Company s obligations and the unique facts and circumstances involved in each particular contract. Historically, warranty costs related to contracts have been within management s expectations.

The following summarizes activity within accrued warranty:

(In thousands)	Three Months Ended September 30, 2007	Three Months Ended October 1, 2006	Nine Months Ended September 30, 2007	Nine Months Ended October 1, 2006
Balance at beginning of the period	$ 14,314	$ 1,988	$ 3,446	$ 574
SP Systems accrued balance at date of acquisition			6,542	
Accruals for warranties during the period	1,373	750	6,961	2,327
Settlements made during the period	(776)		(2,038)	(163)
Balance at the end of the period	$ 14,911	$ 2,738	$ 14,911	$ 2,738

Indemnifications

The Company is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in connection with contracts and license agreements or the sale of assets, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of warranties, representations and covenants related to such matters as title to assets sold, negligent acts, damage to property, validity of certain intellectual property rights, non-infringement of third-party rights, and certain tax related matters. In each of these circumstances, payment by the Company is typically subject to the other party making a claim to the Company pursuant to the procedures specified in the particular contract. These procedures usually allow the Company to challenge the other party s claims or, in case of breach of intellectual property representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, the Company s obligations under these agreements may be limited in terms of activity (typically to replace or correct the products or terminate the agreement with a refund to the other party), duration and/or amounts. In some instances, the Company may have recourse against third parties and/or insurance covering certain payments made by the Company.

Note 14. Line of Credit

On December 2, 2005, the Company entered into a $25.0 million three-year revolving credit facility (the Facility) with affiliates of Credit Suisse and Lehman Brothers. The Facility was collateralized by substantially all of the Company s assets, including the stock of its foreign subsidiaries. Borrowings under the Facility were conditioned upon customary conditions as well as (1) with respect to the first $10.0 million drawn on the Facility, maintenance of cash collateral to the extent of outstanding borrowings (excluding amounts borrowed), and (2) with respect to the remaining $15.0 million of the Facility, satisfaction of a coverage test which was based on the ratio of the Company s cash flow to capital expenditures. There were no borrowings ever made under the Facility. The Company terminated its agreement with affiliates of Credit Suisse and Lehman Brothers on July 13, 2007.

In connection with the SP Systems acquisition on January 10, 2007, the Company assumed a line of credit SP Systems had with Union Bank of California, N.A. (UBOC) with an outstanding balance of approximately $3.6 million. During the first quarter of fiscal 2007, the Company paid off the outstanding balance in full.

On January 10, 2007, the Company amended and restated the loan agreement with UBOC. The amended and restated loan agreement provided for a $10.0 million trade finance credit facility, which was scheduled to expire on April 30, 2007. This facility allowed the Company to issue commercial and standby letters of credit, but did not provide for any loans. All of the assets of SP Systems secured this trade finance facility. In addition, the agreement required that SP Systems maintain cash equal to the value of letters of credit outstanding in restricted accounts as collateral for letters of credit issued by the bank. On April 27, 2007, the Company through SP Systems entered into an amendment to the loan agreement to, among other things, extend the maturity date to July 31, 2007, and remove the requirement to have cash collateral for letters of credit. The Company guaranteed $10.5 million in connection with the April 27, 2007 amendment including the $10 million trade credit facility and a separate $0.5 million credit card facility through UBOC. The Company s line of credit with UBOC expired on July 31, 2007.

On July 13, 2007, the Company entered into a credit agreement with Wells Fargo that replaced the credit lines with Credit Suisse, Lehman Brothers, and UBOC. On August 20, 2007, the Company entered into an amendment to the credit agreement. As amended, the credit agreement provides for a $50.0 million unsecured revolving credit line, with a $40.0 million unsecured letter of credit subfeature, and a separate $50.0 million secured letter of credit facility. The Company may borrow up to $50.0 million and request that Wells Fargo issue up to $40.0 million in letters of credit under the unsecured letter of credit subfeature through July 31, 2008. Letters of credit issued under the subfeature reduce the Company s borrowing capacity under the revolving credit line. The Company may request that Wells Fargo issue up to $50.0 million in letters of credit under the secured letter of credit facility through July 31, 2012. As detailed in the agreement, the Company will pay interest on outstanding borrowings and a fee for outstanding letters of credit. The Company has the ability at any time to prepay outstanding loans. All borrowings must be repaid by July 31, 2008, and all letters of credit issued under the unsecured letter of credit subfeature shall expire on or before July 31, 2008 unless the Company provides by such date collateral in the form of cash or cash equivalents in the aggregate amount available to be drawn under letters of credit outstanding at such time. All letters of credit issued under the secured letter of credit facility shall expire no later than July 31, 2012. The Company concurrently entered into a security agreement with Wells Fargo, granting a security interest in a deposit account to secure its obligations in connection with any letters of credit that might be issued under the credit agreement. In connection with the credit agreement, SunPower North America, Inc., a wholly-owned subsidiary of the Company, and SP Systems, another wholly-owned subsidiary of the Company, entered into an associated continuing guaranty with Wells Fargo. The terms of the credit agreement include certain conditions to borrowings, representations and covenants, and events of default customary for financing transactions of this type.

As of September 30, 2007, one letter of credit totaling $20.0 million was issued by Wells Fargo under the unsecured letter of credit subfeature and five letters of credit totaling $9.2 million were issued by Wells Fargo under the secured letter of credit facility.

On September 30, 2007, cash available to be borrowed under the unsecured revolving credit line was $30.0 million and letter of credit capacities available to be issued by Wells Fargo under the unsecured letter of credit subfeature and secured letter of credit facility were $20.0 million and $40.8 million, respectively.

Note 15. Senior Convertible Debentures and Share Loan Arrangements

February 2007 Debt Issuance

In February 2007, the Company issued $200.0 million in principal amount of its 1.25% senior convertible debentures (the February 2007 Debentures). Interest on the February 2007 Debentures will be payable on February 15 and August 15 of each year, commencing August 15, 2007. The February 2007 Debentures will mature on February 15, 2027. Holders may require the Company to repurchase all or a portion of their February 2007 Debentures on each of February 15, 2012, February 15, 2017 and February 15, 2022, or if the Company experiences certain types of corporate transactions constituting a fundamental change. In addition, the Company may redeem some or all of the February 2007 Debentures on or after February 15, 2012. The February 2007 Debentures are initially convertible, subject to certain conditions, into cash up to the lesser of the principal amount or the conversion value. If the conversion value is greater than $1,000, then the excess conversion value will be convertible into common stock. The initial effective conversion price of the February 2007 Debentures is approximately $56.75 per share, which represents a premium of 27.5% to the closing price of the SunPower common stock on the date of issuance. The applicable conversion rate will be subject to customary adjustments in certain circumstances.

The February 2007 Debentures are senior, unsecured obligations of the Company, ranking equally with all existing and future senior unsecured indebtedness of the Company. The February 2007 Debentures are effectively subordinated to the Company s secured indebtedness to the extent of the value of the related collateral and structurally subordinated to indebtedness and other liabilities of the Company s subsidiaries. The February 2007 Debentures do not contain any covenants or sinking fund requirements.

July 2007 Debt Issuance

In July 2007, the Company issued $225.0 million in principal amount of its 0.75% senior convertible debentures (the July 2007 Debentures). Interest on the July 2007 Debentures will be payable on February 1 and August 1 of each year, commencing February 1, 2008. The July 2007 Debentures will mature on August 1, 2027. Holders may require the Company to repurchase all or a portion of their July 2007 Debentures on each of August 1, 2010, August 1, 2015, August 1, 2020, and August 1, 2025, or if the Company is involved in certain types of corporate transactions constituting a fundamental change. In addition, the Company may redeem some or all of the July 2007 Debentures on or after August 1, 2010. The July 2007 Debentures are initially convertible, subject to certain conditions, into cash up to the lesser of the principal amount or the conversion value. If the conversion value is greater than $1,000, then the excess conversion value will be convertible into cash, common stock or a combination of cash and common stock, at the Company s election. The initial effective conversion price of the February 2007 Debentures is approximately $82.24 per share, which represents a premium of 27.5% to the closing price of the SunPower common stock on the date of issuance. The applicable conversion rate will be subject to customary adjustments in certain circumstances.

The July 2007 Debentures are senior, unsecured obligations of the Company, ranking equally with all existing and future senior unsecured indebtedness of the Company. The July 2007 Debentures are effectively subordinated to the Company s secured indebtedness to the extent of the value of the related collateral, and structurally subordinated to indebtedness and other liabilities of the Company s subsidiaries. The July 2007 Debentures do not contain any covenants or sinking fund requirements.

February 2007 Amended and Restated Share Loan Arrangement

Concurrent with the offering of the February 2007 Debentures, the Company lent 2.9 million shares of its class A common stock, all of which are being borrowed by an affiliate of Lehman Brothers Inc. (LBIE), one of the underwriters of the February 2007 Debentures. The lent shares are to be used to facilitate the establishment by investors in the February 2007 Debentures and July 2007 Debentures of hedged positions in the Company s class A common stock. Under the share lending agreement, LBIE has the ability to offer any of the 1.0 million shares that remain in LBIE s possession to facilitate hedging arrangements for subsequent purchasers of both the February 2007 Debentures and July 2007 Debentures and, with the Company s consent, purchasers of securities the Company may issue in the future. The Company did not receive any proceeds from that offering of class A common stock, but received a nominal lending fee of $0.001 per share for each share of common stock that is loaned pursuant to the share lending agreement described below.

Share loans under the share lending agreement will terminate and the borrowed shares must be returned to the Company under the following circumstances: (i) LBIE may terminate all or any portion of a loan at any time; (ii) the Company may terminate any or all of the outstanding loans upon a default by LBIE under the share lending agreement, including a breach by LBIE of any of its representations and warranties, covenants or agreements under the share lending agreement, or the bankruptcy of LBIE; or (iii) if the Company enters into a merger or similar business combination transaction with an unaffiliated third party (as defined in the agreement), all outstanding loans will terminate on the effective date of such event. In addition, LBIE has agreed to return to the Company any borrowed shares in its possession on the date anticipated to be five business days before the closing of certain merger or similar business combinations described in the share lending agreement.

Any shares loaned to LBIE will be issued and outstanding for corporate law purposes and, accordingly, the holders of the borrowed shares will have all of the rights of a holder of the Company s outstanding shares, including the right to vote the shares on all matters submitted to a vote of the Company s stockholders and the right to receive any dividends or other distributions that the Company may pay or make on its outstanding shares of class A common stock.

While the share lending agreement does not require cash payment upon return of the shares, physical settlement is required (i.e., the loaned shares must be returned at the end of the arrangement). In view of this and the contractual undertakings of LBIE in the share lending agreement, which have the effect of substantially eliminating the economic dilution that otherwise would result from the issuance of the borrowed shares, the Company believes that under generally accepted accounting principles of the United States, the borrowed shares will not be considered outstanding for the purpose of computing and reporting earnings per share. Notwithstanding the foregoing, the shares will nonetheless be issued and outstanding and will be eligible for trading on The Nasdaq Global Market.

July 2007 Share Loan Arrangement

Concurrent with the offering of July 2007 Debentures, the Company lent 1.8 million shares of its class A common stock, all of which are being borrowed by an affiliate of Credit Suisse Securities (USA) LLC (CSI), one of the underwriters of the July 2007 Debentures. The Company did not receive any proceeds from that offering of class A common stock, but received a nominal lending fee of $0.001 per share for each share of common stock that is loaned pursuant to the share lending agreement described below.

Share loans under the share lending agreement will terminate and the borrowed shares must be returned to the Company under the following circumstances: (i) CSI may terminate all or any portion of a loan at any time; (ii) the Company may terminate any or all of the outstanding loans upon a default by CSI under the share lending agreement, including a breach by CSI of any of its representations and warranties, covenants or agreements under the share lending agreement, or the bankruptcy of CSI; or (iii) if the Company enters into a merger or similar business combination transaction with an unaffiliated third party (as defined in the agreement), all outstanding loans will terminate on the effective date of such event. In addition, CSI has agreed to return to the Company any borrowed shares in its possession on the date anticipated to be five business days before the closing of certain merger or similar business combinations described in the share lending agreement. Except in limited circumstances, any such shares returned to the Company cannot be reborrowed.

Any shares loaned to CSI will be issued and outstanding for corporate law purposes and, accordingly, the holders of the borrowed shares will have all of the rights of a holder of the Company s outstanding shares, including the right to vote the shares on all matters submitted to a vote of the Company s stockholders and the right to receive any dividends or other distributions that the Company may pay or make on its outstanding shares of class A common stock.

While the share lending agreement does not require cash payment upon return of the shares, physical settlement is required (i.e., the loaned shares must be returned at the end of the arrangement). In view of this and the contractual undertakings of CSI in the share lending agreement, which have the effect of substantially eliminating the economic dilution that otherwise would result from the issuance of the borrowed shares, the Company believes that under generally accepted accounting principles of the United States, the borrowed shares will not be considered outstanding for the purpose of computing and reporting earnings per share. Notwithstanding the foregoing, the shares will nonetheless be issued and outstanding and will be eligible for trading on The Nasdaq Global Market.

Note 16. Subsequent Events

Joint Venture Agreement with First Philippine Electric Corporation

On October 1, 2007, the Company entered into an agreement with First Philec to form First Philec Solar, a joint venture to provide wafer slicing services of silicon ingots to the Company. The Company will have a 20.0% equity investment in the joint venture and will account for its joint venture in First Philec Solar using the equity method of accounting. This joint venture will operate in the Philippines, with silicon ingots to be supplied primarily from the Company. The Company expects to purchase an aggregate quantity of silicon wafers sufficient to support up to approximately 660 megawatts annually of solar cell manufacturing production based on the Company s expected silicon utilization through the five-year wafering supply and sales agreement, which is anticipated to begin in the second half of 2008 when First Philec Solar s proposed manufacturing capacity is expected to become operational (see Note 13).

Advances to Suppliers

On October 4, 2007, the Company paid an additional advance of $44.9 million in accordance with the terms of existing supply agreements (see Note 7).

Engineering, Procurement and Construction Agreement with Sedwick Corporate, S.L.

On October 10, 2007, the Company entered into an Engineering, Procurement and Construction Agreement with Sedwick Corporate, S.L. Under the terms of the agreement, the Company will design and construct a solar photovoltaic plant representing approximately 18 megawatts peak power in the municipality of Olivenza (Badajoz) Spain.

Joint Venture Agreement with Woongjin Holdings Co., Ltd.

On October 18, 2007, the Company entered into an agreement with Woongjin and Woongjin Holdings, whereby Woongjin transferred its 80.1% equity investment held in Woongjin Energy to Woongjin Holdings and Woongjin Holdings assumed all rights and obligations formerly owned by Woongjin under the joint venture agreement (see Note 13).

Engineering, Procurement and Construction Agreements with Corporate Affiliates of The Naturener Group

On November 6, 2007, the Company entered into Engineering, Procurement and Construction Agreements with Naturener Solar Tinajeros, S.L.U, Moralas Renovables, S.L. and Almuradiel Solar, S.L., each of which are corporate affiliates of The Naturener Group. Under the terms of the agreements, the Company will design and construct three solar photovoltaic plants representing a combined total of approximately 21 megawatts peak power in the Castilla La Mancha region of Spain. The agreements also include, to various degrees, termination rights in favor of either party in the event certain of the following conditions precedent are not met by specified deadlines: receipt of confirmation of the availability of bank financing, receipt of necessary permits, licenses or other governmental approvals, receipt of satisfactory final site reports, and/or the confirmation and review of technical specifications.

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

Cautionary Statement Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are statements that do not represent historical facts. We use words such as may, will, should, could, would, expect, plan, *anticipate, believe, estimate, predict, potential, and continue and similar expressions to identify forward-looking statements. Forward-looking statements in this press release include, but are not limited to, the company s plans and expectations regarding our ability to obtain polysilicon ingots or wafers, future financial results, operating results, business strategies, projected costs, products, competitive positions, management s plans and objectives for future operations, and industry trends. These forward-looking statements are based on information available to us as of the date of this release and current expectations, forecasts and assumptions and involve a number of risks and uncertainties that could cause actual results to differ materially from those anticipated by these forward-looking statements. Such risks and uncertainties include a variety of factors, some of which are beyond our control. Please see PART II. OTHER INFORMATION, Item 1A. Risk Factors for additional information on risks and our other filings with the Securities and Exchange Commission. These forward-looking statements should not be relied upon as representing our views as of any subsequent date, and we are under no obligation to, and expressly disclaim any responsibility to, update or alter our forward-looking statements, whether as a result of new information, future events or otherwise.*

The following information should be read in conjunction with the Consolidated Financial Statements and the accompanying Notes to Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. Our fiscal quarters end on the Sunday closest to the end of the applicable calendar quarter. All references to fiscal periods apply to our fiscal quarters or year which ends on the Sunday closest to the calendar month end.

Overview

We design, manufacture and market high-performance solar electric power technologies. Our solar cells and solar panels are manufactured using proprietary processes and technologies based on more than 15 years of research and development. We believe our solar cells have the highest conversion efficiency, a measurement of the amount of sunlight converted by the solar cell into electricity, of all the solar cells available for the mass market. Our solar power products are sold through our components business segment, or our components segment. In January 2007, we acquired SP Systems, which developed, engineered, manufactured and delivered large-scale solar power systems. These activities are now performed by our systems business segment, or our systems segment. Our solar power systems, which generate electric energy, integrate solar cells and panels manufactured by us as well as other suppliers.

Components segment: Our components segment sells solar power products, including solar cells, solar panels and inverters, which convert sunlight to electricity compatible with the utility network. We believe our solar cells provide the following benefits compared with conventional solar cells:

superior performance, including the ability to generate up to 50% more power per unit area;

superior aesthetics, with our uniformly black surface design that eliminates highly visible reflective grid lines and metal interconnect ribbons; and

efficient use of silicon, a key raw material used in the manufacture of solar cells.

We sell our solar components products to installers and resellers for use in residential and commercial applications where the high efficiency and superior aesthetics of our solar power products provide compelling customer benefits. We also sell products for use in multi-megawatt solar power plant applications. In many situations, we offer a materially lower area-related cost structure for our customers because our solar panels require a substantially smaller land area than conventional solar technology and half or less of the land area of commercial solar thin film technologies. We sell our products in countries in Europe, Asia and North America, principally in regions where government incentives have accelerated solar power adoption.

We manufacture our solar cells at our manufacturing facilities in the Philippines. We currently operate four cell manufacturing lines in our first solar cell manufacturing facility, with a total rated manufacturing capacity of approximately 108 megawatts per year. In addition, we recently began operating the first two lines in a second solar cell manufacturing facility in the Philippines, which is designed to house up to twelve manufacturing lines. We expect three manufacturing lines in this new facility to be operational by the end of 2007, resulting in a total of seven manufacturing lines with an aggregate production capacity of 214 megawatts per year. By the end of 2008, we plan to operate 12 solar cell manufacturing lines with an aggregate manufacturing capacity of 306 megawatts per year. We have previously announced plans to begin production as soon as late 2009 on the first line of a third solar cell manufacturing facility designed to have an aggregate manufacturing capacity of 500 megawatts per year.

We manufacture our solar panels at our automated panel manufacturing factory located in the Philippines. Our solar panels are also manufactured for us by a third-party subcontractor in China. We currently operate one solar panel manufacturing line with a rated manufacturing capacity of 30 megawatts of solar panels per year. We plan to begin operating a second solar panel manufacturing facility by the end of 2007 that is designed to house up to ten manufacturing lines. We have ordered equipment for three new solar panel manufacturing lines that we expect to begin operating in the fourth quarter of 2007 and the first quarter of 2008. We expect to move our currently operating manufacturing line to this facility in the future. In addition, our SunPower branded inverters are manufactured for us by multiple suppliers.

Systems segment: We sell solar power systems, which may include services such as development, engineering, procurement of permits and equipment, construction management, access to financing, monitoring and maintenance, directly to system owners. Our systems segment is comprised primarily of the business we acquired from SP Systems in January 2007. Our customers include commercial and governmental entities, investors, utilities and production home builders. We work with construction, system integration and financing companies to deliver our solar power systems to customers. Our solar power systems generate electricity over a system design life typically exceeding 25 years and are principally designed to be used in large-scale applications with system ratings of more than 300 kilowatts. Worldwide, we have completed or are in the process of completing over 350 projects, rated in aggregate at over 200 megawatts peak capacity.

We have solar power system projects completed or in the process of being completed in various countries including Germany, Portugal, South Korea, Spain and the United States. In the United States, we sell distributed rooftop and ground-mounted solar power systems as well as central-station power plants. Distributed solar power systems are typically rated up to one megawatt of capacity to provide a supplemental, distributed source of electricity for a customer s facility. Many customers choose to purchase solar electricity from our systems under a power purchase agreement with a financing company which buys the system from us. For example, we are currently constructing an approximately 15 megawatt solar power plant at Nellis Air Force Base in Nevada, which will be operated under a power purchase agreement structure. In Europe and South Korea, our products and systems are typically purchased by a financing company and operated as a central station solar power plant. These power plants are rated with capacities of approximately one to 20 megawatts, and generate electricity for sale under tariff to regional and public utilities.

We manufacture certain of our solar power system products at our manufacturing facilities in California and at other facilities located close to our customers. Some of our solar power system products are also manufactured for us by third-party suppliers.

PowerLight Acquisition

On January 10, 2007, we completed our acquisition of PowerLight. Upon the completion of the acquisition, all of the outstanding shares of PowerLight, and a portion of each vested option to purchase shares of PowerLight, were cancelled, and all of the outstanding options to purchase shares of PowerLight (other than the portion of each vested option that was cancelled) were assumed by us in exchange for aggregate consideration of (i) approximately $120.7 million in cash plus (ii) a total of 5,708,723 shares of class A common stock, inclusive of (a) 1,601,839 shares of class A common stock which may be issued upon the exercise of assumed vested and unvested PowerLight stock options and (b) 1,145,643 shares of class A common stock issued to employees of PowerLight in connection with the acquisition which, along with 530,238 of the shares issuable upon exercise of assumed PowerLight stock options, are subject to certain transfer restrictions and a repurchase option held by us, both of which lapse over a two-year period following the acquisition under the terms of equity restriction agreements. Under the terms of the acquisition agreement, we also issued an additional 204,623 shares of restricted class A common stock to certain employees of PowerLight, which shares are subject to certain transfer restrictions which will lapse over 4 years. In June 2007, we changed PowerLight s name to SunPower Corporation, Systems, or SP Systems, to capitalize on SunPower s name recognition.

The total consideration related to the acquisition was as follows:

(In thousands)	**Shares**		**Fair Value at January 10, 2007**
Purchase consideration:			
Cash		$	120,694
Common stock	2,961		111,266
Stock options assumed that are fully vested	618		21,280
Direct transaction costs			2,958
Total purchase consideration	3,579		256,198
Future stock compensation:			
Restricted stock	1,146	$	43,046
Stock options assumed but that are unvested	984		35,126
Total future stock compensation	2,130		78,172
Total purchase consideration and future stock compensation	5,709	$	334,370

Purchase Price Allocation

Under the purchase method of accounting, the total purchase price as shown in the table above was allocated to SP Systems net tangible and intangible assets based on their estimated fair values as of January 10, 2007. The purchase price has been allocated based on management s best estimates. The fair value of our class A common stock issued was determined based on the average closing prices for a range of trading days around the announcement date (November 15, 2006) of the transaction. The fair value of stock options assumed was estimated using the Black-Scholes model with the following assumptions: volatility of 90%, expected life ranging from 2.7 years to 6.3 years, and risk-free interest rate of 4.6%.

The allocation of the purchase price and the estimated useful lives associated with the acquired assets and liabilities on January 10, 2007 was as follows:

(In thousands)		**Amount**	**Estimated Useful Life**
Net tangible assets	$	13,925	n.a.
Patents and purchased technology		29,448	4 years
Tradenames		15,535	5 years
Backlog		11,787	1 year
Customer relationships		22,730	6 years
In-process research and development		9,575	n.a.

Unearned stock compensation		78,172	n.a.
Deferred tax liability		(21,964)	n.a.
Goodwill		175,162	n.a.
Total purchase consideration and future stock compensation	$	334,370	

Relationship with Cypress Semiconductor Corporation

Cypress made a significant investment in SunPower in 2002. On November 9, 2004, Cypress completed a reverse triangular merger with us in which all of the outstanding minority equity interest of SunPower was retired, effectively giving Cypress 100% ownership of all of our then outstanding shares of capital stock but leaving our unexercised warrants and options outstanding. After completion of our initial public offering in November 2005, Cypress held, in the aggregate, 52,033,287 shares of class B common stock.

On May 4, 2007, Cypress completed the sale of 7,500,000 shares of class B common stock in an offering pursuant to Rule 144 of the Securities Act. Such shares converted to 7,500,000 shares of class A common stock upon the sale. As of September 30, 2007, including the effect of the sale completed in May 2007, public offerings of class A common stock in June 2006 and July 2007, and issuance of senior convertible debentures in February 2007 and July 2007, Cypress owned 44,533,287 shares of class B common stock, which represented approximately 57% of the total outstanding shares of our common stock, or approximately 53% of such shares on a fully diluted basis after taking into account outstanding stock options (or 50% of such shares on a fully diluted basis after taking into account outstanding stock options and loaned shares to underwriters of our convertible indebtedness), and 90% of the voting power of our total outstanding common stock. Cypress, its successors in interest or its subsidiaries may convert their shares of class B common stock into shares of class A common stock on a one-for-one basis at any time. Cypress announced on October 6, 2006 and reiterated on October 19, 2006 that it was exploring ways in which to allow its stockholders to fully realize the value of its investment in SunPower. Cypress has made public statements since October 19, 2006 that were consistent with these announcements.

Critical Accounting Policies

Our critical accounting policies are disclosed in our Form 10-K for the year ended December 31, 2006 and have not changed materially as of September 30, 2007, with the exception of the following which were adopted as of the quarter ended April 1, 2007, in connection with the acquisition of SP Systems on January 10, 2007:

Revenue and Cost Recognition for Construction Contracts

We recognize revenues from fixed price contracts under AICPA Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, using the percentage-of-completion method of accounting. Under this method, revenue is recognized as work is performed based on the percentage of incurred costs to estimated total forecasted costs utilizing the most recent estimates of forecasted costs.

Incurred costs include all direct material, labor, subcontract costs, and those indirect costs related to contract performance, such as indirect labor, supplies, tools and repairs. Job material costs are included in incurred costs when the job materials have been installed. Where contracts stipulate that title to job materials transfers to the customer before installation has been performed, revenue is deferred and recognized upon installation, in accordance with the percentage-of-completion method of accounting. Job materials are considered installed materials when they are permanently attached or fitted to the solar power system as required by the job s engineering design.

Due to inherent uncertainties in estimating cost, job costs estimates are reviewed and/or updated by management working within the systems segment. The systems segment determines the completed percentage of installed job materials at the end of each month; generally this information is also reviewed with the customer s on-site representative. The completed percentage of installed job materials is then used for each job to calculate the month-end job material costs incurred. Direct labor, subcontractor, and other costs are charged to contract costs as incurred. Provisions for estimated losses on uncompleted contracts, if any, are recognized in the period in which the loss first becomes probable and reasonably estimable. Contracts may include profit incentives such as milestone bonuses. These profit incentives are included in the contract value when their realization is reasonably assured.

As of September 30, 2007, the asset, Costs and estimated earnings in excess of billings, which represents revenues recognized in excess of amounts billed, was $79.4 million. The liability, Billings in excess of costs and estimated earnings, which represents billings in excess of revenues recognized, was $20.0 million. Ending balances in Costs and estimated earnings in excess of billings and Billings in excess of costs and estimated earnings are highly dependent on contractual billing schedules which are not necessarily related to the timing of revenue recognition.

Cash in Restricted Accounts

As of September 30, 2007, we provided security for advance payments made by NorSun AS, or NorSun, in the form of $20.0 million held in an escrow account. Commencing in 2010 and continuing through 2019, the balance in the escrow account will be reduced as the advance payments are to be applied as a credit against NorSun s polysilicon purchases from us. The funds held in the escrow account may be released in exchange for letters of credit issued under the secured letter of credit facility at any time. In addition, we enter into various contractual agreements to build turnkey photovoltaic projects for developers in Europe, Korea and the United States. As part of the contractual agreements with the developers in Europe and Korea, we may receive advance payments that are secured by providing letters of credit issued by Wells Fargo Bank, National Association, or Wells Fargo, to the developers. In certain developer contracts, we are required to provide construction period letters of credit to assure the developers of contract completion, for a period of approximately one year. In many cases, we are also asked to issue warranty period letters of credit to assure the developers that we will meet our warranty obligations, typically for the first two years after the project is installed. We issue letters of credit for such purposes through our line of credit facility with Wells Fargo. The credit agreement with Wells Fargo requires us to collateralize the full value of letters of credit issued under the secured letter of credit facility for such purposes with cash placed in an interest bearing restricted account with Wells Fargo. As long as the secured letters of credit are outstanding, we will not be able to withdraw the associated funds in the restricted account, though all interest earned on such restricted funds can be withdrawn periodically. As of September 30, 2007, outstanding secured letters of credit issued by Wells Fargo that related to contractual agreements with the developers in Europe and Korea totaled $9.2 million (see Note 14 to the Condensed Consolidated Financial Statements).

Deferred Project Costs

Deferred project costs represent uninstalled materials on contracts for which title had transferred to the customer and are recognized as deferred assets until installation. As of September 30, 2007, deferred project costs totaled $11.5 million.

Foreign Currency Translation

Assets and liabilities of our wholly-owned foreign subsidiaries are translated from their respective functional currencies at exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average exchange rates prevailing during the applicable period. The resulting translation adjustment as of September 30, 2007 was a $5.4 million gain which is reflected as a component of accumulated other comprehensive income (loss) in stockholders equity.

Purchase Accounting

We record all assets and liabilities acquired in purchase acquisitions, including goodwill, identified intangible assets and in-process research and development, at fair value as required by SFAS No. 141, Business Combinations . The initial recording of goodwill, identified intangible assets and in-process research and development requires certain estimates and assumptions especially concerning the determination of the fair values and useful lives of the acquired intangible assets. The judgments made in the context of the purchase price allocation can materially impact our future results of operations. Accordingly, for significant acquisitions, we obtain assistance from third-party valuation specialists. The valuations are based on information available at the acquisition date. Goodwill is not amortized but is subject to annual tests for impairment or more often if events or circumstances indicate they may be impaired. Other identified intangible assets are amortized over their estimated useful lives and are subject to impairment if events or circumstances indicate a possible inability to realize the carrying amount.

In-Process Research and Development Charge, or IPR&D Charge

In connection with the acquisition of SP Systems, we recorded an IPR&D charge of $9.6 million in the first quarter of fiscal 2007, as technological feasibility associated with the in-process research and development projects had not been established and no alternative future use existed.

We identified in-process research and development projects in areas for which technological feasibility had not been established and no alternative future use existed. These in-process research and development projects consisted of two components: design automation tool and tracking systems and other. In assessing the projects, we considered key characteristics of the technology as well as its future prospects, the rate technology changes in the industry, product life cycles, and various projects stage of development.

The value of in-process research and development was determined using the income approach method, which calculated the sum of the discounted future cash flows attributable to the projects once commercially viable using a 40% discount rate, which were derived from a weighted-average cost of capital analysis and adjusted to reflect the stage of completion of the projects and the level of risks associated with the projects. The percentage of completion for each project was determined by identifying the research and development expenses invested in the project as a ratio of the total estimated development costs required to bring the project to technical and commercial feasibility. The following table summarizes certain information of each significant project:

Design Automation Tool	Stage of Completion	Total Cost Incurred to Date	Total Remaining Costs	Completion Date
As of January 10, 2007 (acquisition date)	5%	$ 0.2 million	$ 2.4 million	December 2010
As of September 30, 2007	30%	$ 0.8 million	$ 1.8 million	June 2009

Tracking System and Other	Stage of Completion	Total Cost Incurred to Date	Total Remaining Costs	Completion Date
As of January 10, 2007 (acquisition date)	30%	$ 0.2 million	$ 0.6 million	July 2007
As of September 30, 2007	100%	$ 0.8 million	$	June 2007

Status of In-Process Research and Development Projects:

As of September 30, 2007, we have incurred total post-acquisition costs of approximately $0.6 million related to the design automation tool project and estimate that an additional investment of $1.8 million will be required to complete the project. We expect to complete the design automation tool project by June 2009, approximately one and a half years earlier than the original estimate.

During the second quarter of fiscal 2007, we completed the tracking systems project and incurred total project costs of $0.8 million, of which $0.6 million was incurred after the acquisition.

The development of the design automation tool remains a significant risk due to factors including the remaining efforts to achieve technical viability, rapidly changing customer markets, uncertain standards for new products, and competitive threats. The nature of the efforts to develop these technologies into commercially viable products consists primarily of planning, designing, experimenting, and testing activities necessary to determine that the technologies can meet market expectations, including functionality and technical requirements. Failure to bring these products to market in a timely manner could result in a loss of market share or a lost opportunity to capitalize on emerging markets and could have a material adverse impact on our business and operating results.

Results of Operations for Three-month and Nine-month Periods Ended September 30, 2007 and October 1, 2006

Revenue

The following table sets forth the percentage relationship of certain items to our revenue during the periods shown:

	Three Months Ended (in thousands)		Year-over -	Nine Months Ended (in thousands)		Year-over -
	September 30, 2007	**October 1, 2006**	**Year Change**	**September 30, 2007**	**October 1, 2006**	**Year Change**
Systems revenue	$ 157,734	$	n.a.	$ 340,266	$	n.a.
Components revenue	76,600	65,348	17%	210,181	162,001	30%
Total revenue	$ 234,334	$ 65,348	259%	$ 550,447	$ 162,001	240%

We generate revenue from two business segments, as follows:

1. Systems segment This segment represents sales of engineering, procurement, construction and other services relating to solar electric power systems that integrate our solar panels and balance of systems components, as well as materials sourced from other manufactures. Systems segment revenues for the three and nine months ended September 30, 2007 were $157.7 million and $340.3 million, respectively, which accounted for 67% and 62%,

respectively, of our total revenue. We had no systems segment revenue for the three and nine months ended October 1, 2006. Our systems segment revenue is largely dependent on the timing of revenue recognition on large construction projects and, accordingly, will fluctuate from period to period. Gross margin for the system segment was $22.6 million and $51.2 million for the three and nine months ended September 30, 2007, respectively, or 14% and 15% of systems segment revenue, respectively. Gross margin in our systems segment is affected by a number of factors, particularly the mix of projects sourced with our panels versus projects using solar panels purchased from other suppliers.

2. Components segment This segment primarily represents sales of our solar cells, solar panels and inverters to solar systems installers and other resellers. Components segment revenues to unaffiliated customers for the three and nine months ended September 30, 2007 were $76.6 million and $210.2 million, respectively, as compared to $65.3 million and $162.0 million for the three and nine months ended October 1, 2006, respectively. The components segment accounted for 33% and 38% of our total revenue for the three and nine months ended September 30, 2007, respectively, and 100% of our revenue for each of the three and nine months ended October 1, 2006. Gross margin for the components segment was $15.8 million and $49.5 million for the three and nine months ended September 30, 2007, respectively, or 21% and 24% of components segment revenue, respectively, as compared to $15.2 million and $32.3 million for the three and nine months ended October 1, 2006, or 23% and 20% of revenue, respectively.

During the three and nine-month periods ended September 30, 2007, our revenue of approximately $234.3 million and $550.4 million, respectively, represented increases of 259% and 240%, respectively, from revenue reported in the comparable periods of 2006. The marked increase in revenue during the three and nine-month periods ended September 30, 2007 compared to the same periods of 2006 resulted from the combination of an increase in components revenue of approximately $11.3 million and $48.2

million during the three and nine-month periods ended September 30, 2007, respectively, and the addition of $157.7 million and $340.3 million in systems revenue for the three and nine-month periods ended September 30, 2007, respectively, as a result of the acquisition of SP Systems. The increase in components revenue is attributable to the continued increase in the demand for our solar cells and solar panels since we began commercial production in late 2004 and continued increases in unit production and unit shipments of both solar cells and solar panels as we have expanded our solar manufacturing capacity. During the first three quarters of 2006, we had three solar cell manufacturing lines in operation with an approximate annual production capacity of 75 megawatts. Since then, we added a fourth 33 megawatt line during the fourth quarter of 2006, and we recently began commercial production on our 5th and 6th solar cell lines during the third quarter of 2007. Each of these lines has a rated solar cell production capacity of approximately 33 megawatts per year.

From 2005 through the third quarter of 2007, our components segment has experienced a modest increase in average selling prices for our solar products, primarily relating to our solar cells and solar panels. Accordingly, our components segments average selling prices were slightly higher during the three and nine-month periods ended September 30, 2007 compared to the same periods of 2006. However, we expect average selling prices for our solar power products to decline over time as the market becomes more competitive, as new products are introduced and as manufacturers are able to lower their manufacturing costs and pass on some of the savings to their customers, similar to our experience historically in our imaging products.

We have five customers that each accounted for more than 10 percent of our total revenue in one or more of the three and nine-month periods ended September 30, 2007 and October 1, 2006, as follows:

(percentage of total revenue)

		Three Months Ended		Nine Months Ended	
Customer	**Business Segment**	**September 30, 2007**	**October 1, 2006**	**September 30, 2007**	**October 1, 2006**
MMA Renewable Ventures	Systems	30%	%	17%	%
SolarPack	Systems	21%	%	21%	%
Solon AG	Components	*	24%	10%	27%
Conergy AG	Components	*	26%	*	24%
SP Systems	Components	n.a.	19%	n.a.	16%

* denotes less than 10% during the period

International sales comprise the majority of revenue for both our systems and components segments. International sales represented approximately 44% and 54% of our total revenue for the three and nine months ended September 30, 2007, respectively, as compared to 66% and 70% of our total revenue for the three and nine months ended October 1, 2006, respectively, and we expect international sales to remain a significant portion of overall sales for the foreseeable future. Domestic sales as a percentage of our total revenue increased approximately 22% and 16% for the three and nine months ended September 30, 2007, respectively, as compared to the three and nine months ended October 1, 2006, as a result of the inclusion of systems segment revenue in 2007.

Cost of Revenue

Cost of revenue as a percentage of revenue and the year-over-year change were as follows:

	Three Months Ended (in thousands)		Year-over - Year Change	Nine Months Ended (in thousands)		Year-over - Year Change
	September 30, 2007	October 1, 2006		September 30, 2007	October 1, 2006	
Cost of systems revenue	$ 135,111	$	n.a.	$ 289,095	$	n.a.
Cost of components revenue	60,818	50,164	21%	160,730	129,678	24%
Total cost of revenue	$ 195,929	$ 50,164	291%	$ 449,825	$ 129,678	247%
Total cost of revenue as a percentage of revenue	84%	77%		82%	80%	
Total gross margin percentage	16%	23%		18%	20%	

Detail to cost of revenue by segment for the three-month period ended is as follows:

	Systems (in thousands) September 30, 2007	Systems (in thousands) October 1, 2006	Year-over - Year Change	Components (in thousands) September 30, 2007	Components (in thousands) October 1, 2006	Year-over - Year Change
Amortization of purchased intangible assets	$ 4,787	$	n.a.	$ 1,123	$ 1,175	(4)%
Stock-based compensation	2,049		n.a.	1,539	200	670%
Factory pre-operating costs	162		n.a.	921		n.a.
All other cost of revenue	128,113		n.a.	57,235	48,789	17%
Total cost of revenue	$ 135,111	$	n.a.	$ 60,818	$ 50,164	21%
Total cost of revenue as a percentage of revenue	86%			79%	77%	
Total gross margin percentage	14%			21%	23%	

Detail to cost of revenue by segment for the nine-month period ended is as follows:

	Systems (in thousands) September 30, 2007	Systems (in thousands) October 1, 2006	Year-over - Year Change	Components (in thousands) September 30, 2007	Components (in thousands) October 1, 2006	Year-over - Year Change
Amortization of purchased intangible assets	$ 15,297	$	n.a.	$ 3,370	$ 3,526	(4)%
Stock-based compensation	6,235		n.a.	2,801	628	346%
Factory pre-operating costs	692		n.a.	3,185		n.a.
All other cost of revenue	266,871		n.a.	151,374	125,524	21%
Total cost of revenue	$ 289,095	$	n.a.	$ 160,730	$ 129,678	24%
Total cost of revenue as a percentage of revenue	85%			76%	80%	
Total gross margin percentage	15%			24%	20%	

Overall, our cost of revenue during the three and nine months ended September 30, 2007 were substantially higher than during the three and nine months ended October 1, 2006 primarily as a result of increased cost of revenue associated with operating more production lines and producing substantially higher unit volume in our components segment, as well as the inclusion of cost of systems revenue for the period subsequent to January 10, 2007. Our cost of revenue as a percentage of revenue increased to 84% and 82% for the three and nine months ended September 30, 2007, respectively, compared to 77% and 80% for the three and nine months ended October 1, 2006, respectively. Our cost of components revenue as a percentage of revenue remained relatively stable at 79% and 76% for the three and nine months ended September 30, 2007, respectively, compared to 77% and 80% for the three and nine months ended October 1, 2006, respectively. In the first quarter of 2007, our systems segment gross margin was substantially higher than in the second and third quarter of 2007 as a result of a favorable mix of business than is typical of this business. Overall, we believe this favorable mix of business improved our overall gross margin for the nine-month period ended September 30, 2007 by approximately four percentage points above what we expected from our systems segment. In addition, during the first quarter of 2007, we received a $2.7 million settlement from one of our suppliers in connection with defective materials sold to us during 2006. This settlement was reflected as a reduction to cost of revenues in the nine-month period ended September 30, 2007.

Our cost of revenue as a percentage of revenue during the first three quarters of 2007 compared to the first three quarters of 2006 reflects improved manufacturing economies of scale associated with markedly higher production volume and improved yields, offset by higher costs of raw materials such as polysilicon and a $4.8 million and $15.3 million increase in amortization of intangible assets for the three and nine months ended September 30, 2007, respectively, associated with our acquisition of SP Systems. Additionally, in the first three quarters of 2007, we incurred pre-operating costs associated with our new solar cell and solar panel manufacturing facilities. Our solar panel facility began production in the first quarter of 2007 and our solar cell line began production in the third quarter of 2007. Such pre-operating costs totaled $1.1 million and $3.9 million in the three and nine months ended September 30, 2007, respectively, and included compensation and training costs for factory workers and utilities and consumable materials associated with preproduction activities.

Our cost of components revenue consists primarily of silicon ingots and wafers used in the production of solar cells, along with other materials such as chemicals and gases that are needed to transform silicon wafers into solar cells. Other factors contributing to cost of revenue include amortization of intangible assets, depreciation, provisions for estimated warranty, salaries, personnel-related costs, facilities expenses and manufacturing supplies associated with solar cell fabrication. For our solar panels, our cost of revenue includes the cost of solar cells and raw materials such as glass, frame, backing and other materials, as well as the assembly costs we pay to our third-party subcontractor in China. Additionally, we recently began production within our own solar panel assembly facility in the Philippines which incurs labor, depreciation, utilities and other occupancy costs.

On November 9, 2004, Cypress acquired us in a transaction that effectively gave Cypress 100% ownership of all of our then outstanding shares of capital stock but left our unexercised warrants and options outstanding. As a result of that transaction, we were required to record Cypress cost of acquiring us in our financial statements, including its equity investment and pro rata share of our losses by recording intangible assets, including purchased technology, patents, trademarks and a distribution agreement. The fair value for these intangibles is being amortized as an element of cost of component revenue over two to six years on a straight-line basis. During each of the first three quarters of 2007 and 2006, amortization of these intangible assets was $1.1 million and $1.2 million, respectively.