Solectron

1996 ANNUAL REPORT

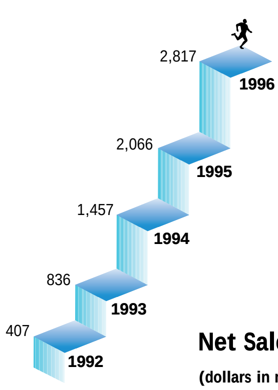
Moving Forward

SOLECTRON

Company Profile

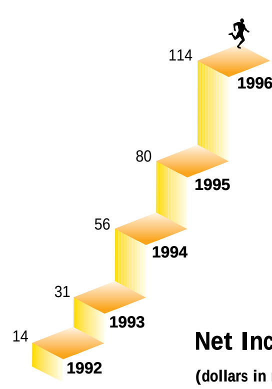
Founded in 1977, Solectron Corporation today is a worldwide provider of electronics manufacturing services to original equipment manufacturers (OEMs). These services include product design and engineering, prototype development, supply base and logistics management, board and sub-systems assembly, systems assembly and service, testing, product upgrade and repair, and warranty

support. Solectron is committed to our customers, delivering the quality, responsiveness, flexibility, and continuous improvement they require for ongoing success. Our constant dedication to quality earned us the Malcolm Baldrige National Quality Award in 1991, and our customers have honored us with more than 100 recognition awards, 25 of which we received this year.



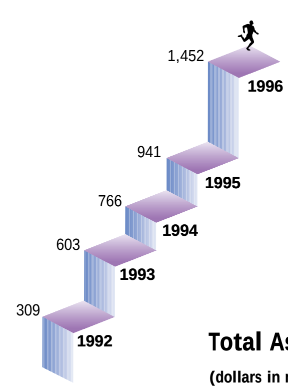
Net Sales

(dollars in millions)



Net Income

(dollars in millions)



Total Assets

(dollars in millions)

Financial Summary

FIVE YEAR SELECTED

Highlights

For the years ended August 31, (in thousands, except per share data)	96	95	94	93	92
Consolidated Statements of Income Data					
Net sales	**$2,817,191**	$2,065,559	$1,456,779	$ 836,326	$ 406,883
Operating income	**175,425**	123,434	88,350	53,140	27,153
Income before income taxes	**173,077**	120,494	84,159	48,613	24,144
Net income	**114,232**	79,526	55,545	30,600	14,488
Fully diluted net income per share	**$ 2.17**	$ 1.62	$ 1.18	$ 0.75	$ 0.44
Consolidated Balance Sheet Data					
Working capital	**$ 786,355**	$ 355,603	$ 309,203	$ 265,025	$ 199,254
Total assets	**1,452,198**	940,855	766,395	603,285	308,737
Long-term debt and capital lease obligations	**386,927**	30,043	140,709	137,011	130,933
Shareholders' equity	**700,569**	538,141	330,789	260,980	104,245

1996

Moving Forward

Moving Strategically

September 95
Expanded Milpitas, California and Charlotte, North Carolina operations

November 95
Founded Solectron GmbH in Boeblingen, Germany

February 96
Assigned Investment Grade rating of BBB- by Standard & Poors

March 96
Established systems facility in Johor, Malaysia

Established subsidiary in Suzhou, China

April 96
Founded Solectron Texas in Austin, Texas

Ranked number seven in shareholder friendliness by NCII

May 96
Expanded Penang, Malaysia operations

Adding Capabilities

September 95
Established Solectron Technical Center to centralize research and development

March 96
Acquired Fine Pitch Technology, Inc. to expand prototype services

May 96
Expanded service and support center for product upgrade and repair

June 96
Created high-velocity facility for rapid, high-volume systems assembly and fulfillment

Navigating Globally

September 95
Walter Wilson, Senior V.P., named President of Solectron North America

November 95
Wolf Michael appointed Managing Director of Solectron GmbH

December 95
David Kynaston named V.P. and President of Solectron Europe

Iain Kennedy appointed Managing Director of Solectron Scotland, Ltd.

February 96
Shinji Ayao named President of Solectron Japan, Inc.

March 96
Saeed Zohouri, Senior V.P. and Chief Technology Officer, appointed President of Solectron California Corporation

Lawrence Dean named Senior Executive of Fine Pitch Technology,

April 96
Ronald Shelly named President of Solectron Texas

Heinz Fridrich elected to the Board of Directors

1996

Message

Koichi Nishimura, Ph.D., President and Chief Executive Officer, Solectron Corporation (left) and Charles A. Dickinson, Chairman of the Board, Solectron Corporation (right)

To Our Shareholders, Customers, Suppliers, Employees, and Friends:

With strong forward momentum, Solectron reached many milestones in fiscal year 1996. Through the dedication and outstanding efforts of our employees, the Company earned record revenues and income and provided higher levels of service and support to our customers around the world. We acquired new manufacturing facilities and expanded existing ones, added capabilities to meet customers' evolving needs, and strengthened our management team and processes for enhanced global operations. These accomplishments reinforced Solectron's position as a leader in the growing electronics manufacturing services (EMS) industry, and kept us on-track in our ongoing journey to consistently provide value for all Solectron stakeholders. **Record Financial Results:** As original equipment manufacturers (OEMs) continued to outsource more of their electronics manufacturing, Solectron's net sales for fiscal year 1996 grew to a record \$2.8 billion, a 36% increase over the prior year's \$2.1 billion. Net income was \$114.2 million, a 44% increase over last year's \$79.5 million. Fully diluted earnings per share were \$2.17 per share as compared with \$1.62 per share in 1995. Operating returns together with a continued focus on asset management yielded consistent and above industry average returns on equity, assets, and sales. **Funding Our Growth:** To support Solectron's growth we completed two debt offerings—one for \$230 million in convertible, subordinated notes and the other for \$150 million in senior notes. Part of the proceeds was used to complete our acquisition of Texas Instruments' Custom Manufacturing Services business in Texas and Malaysia. During 1996, the Company's outstanding \$30 million zero-coupon, subordinated notes were converted into common stock, strengthening our balance sheet. his year we were pleased to receive Standard & Poor's Investment Grade rating of BBB-. And in a study conducted by the nonprofit, Washington, D.C.-based National Council for Individual Investors (NCII), Solectron was ranked number seven among 1,000 shareholder-friendly companies. NCII based its rankings on each company's stock performance and corporate governance policies. These ratings underscore Solectron's **commitment** to continually lowering our cost of capital and providing the greatest possible value for our shareholders.

Expanding Globally: Being close to customers—in our ability to understand and meet their diverse manufacturing needs—is a Solectron imperative. It enables us to anticipate customers' rapidly changing requirements and **deliver** exactly what they need, precisely when they need it. And by providing manufacturing sites where customers need us around the world, we help them lower their total cost of ownership—keeping costs down, quality up, and minimizing their products' time to market.

To more efficiently and **effectively** serve our varied customers in all parts of the world, Solectron acquired strategic new facilities and expanded existing ones in 1996.

North America: In response to continued strong demand for our

Worldwide Locations

	Established
Milpitas, California	1977
Penang, Malaysia	1991
Charlotte, North Carolina	1992
Bordeaux, France	1992
Tokyo, Japan	1992
Everett, Washington	1993
Dunfermline, Scotland	1993
Boeblingen, Germany	1995
Austin, Texas	1996
Johor, Malaysia	1996
Suzhou, China	1996
Fine Pitch Technology	
San Jose, California	1996
Mountain View, California	1996
Santa Ana, California	1996

MOVING **Strategically**

- Solectron GmbH established in Boeblingen, Germany
- New facility opened in Johor, Malaysia
- Solectron Texas founded in Austin, Texas
- Subsidiary established in Suzhou, China

NEW **Locations**

services in North America, we increased our California manufacturing capacity by 290,000 square feet, and added 36,000 square feet in North Carolina. We also acquired Texas Instruments' (TI) Custom Manufacturing Services (CMS) business. Under terms of the agreement, Solectron purchased TI's CMS operations in Austin, Texas—which now conducts business under the name Solectron Texas—and its CMS assets in Malaysia. **Asia:** In Asia, the TI CMS business is transitioning to Solectron's Penang, Malaysia operation. This year, we also added 30,000 square feet at the Penang location and opened a second Malaysian facility in Johor to **respond** to customers' logistical needs in the region. In addition, we established a subsidiary in Suzhou, China, positioning the Company to take advantage of emerging **opportunities** in this part of the world. **Europe:** In Europe, we completed our acquisition of Hewlett-Packard's printed circuit assembly operation in Boeblingen, Germany. Focused on low-volume, high-mix manufacturing, this new facility, now operating as Solectron GmbH, is strategically situated in the heart of the European electronics industry,

EXPANDING

Sites

- **36,000 sq. ft. expansion in Charlotte, North Carolina**
- **290,000 sq. ft. added in Milpitas, California**
- **30,000 sq. ft. expansion in Penang, Malaysia**

"With manufacturing facilities throughout the world, Solectron offers our customers timely access to the markets they serve — including the fast growing markets in Asia. Our global account managers work closely with customers to ensure that our capabilities provide the best worldwide manufacturing solutions to fit their needs."

Ken Tsai
Senior Vice President, President of Solectron Asia

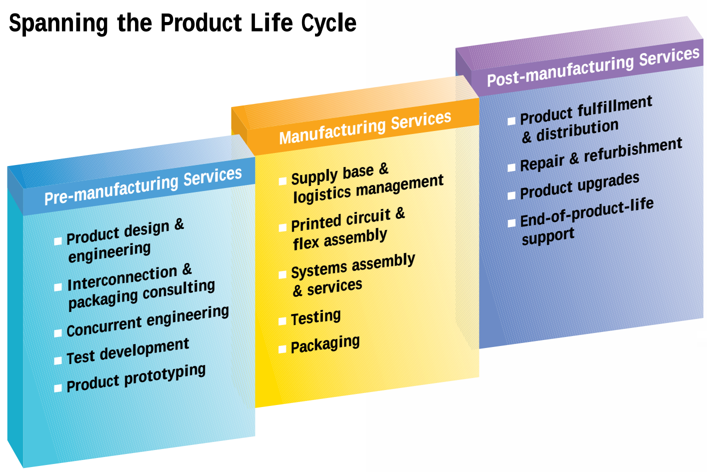
enabling us to build important relationships with European customers and suppliers. **Delivering Total Solutions:** To stay competitive, many OEMs are focusing on core competencies—such as research, sales, and marketing—and **outsourcing** more electronics manufacturing activities. Taking advantage of this growing trend, Solectron is adding capabilities that meet customers' growing expectations for a broader spectrum of services along the manufacturing value chain. In addition to printed circuit board and systems assembly services, our offerings span the manufacturing cycle—from product design to warranty support. **Pre-manufacturing Services:** This year's establishment of the Solectron Technical Center provides a central resource from which customers can leverage Solectron's pre-manufacturing **expertise**, including product design and engineering, advanced technology consultation, concurrent engineering, test development, and prototype capabilities. In March, we acquired Fine Pitch Technology, Inc., a leading provider of quick-turn printed circuit assembly prototype services, which now operates as a wholly owned subsidiary of Solectron.

ADDING
Capabilities

- **Centralized research and development center**
- **Expanded prototype capabilities via acquisition of Fine Pitch Technology, Inc.**
- **Added ASIC design expertise via Texas Instruments' CMS acquisition**

FOCUSED
Growth

Spanning the Product Life Cycle



Complementing our current pre-manufacturing services, Fine Pitch Technology's capabilities allow us to **support** customer design teams who need virtually instant access to highly complex printed circuit board prototypes. Fine Pitch's resources also enhance Solectron's established ability to help customers select components and solve design-for-manufacturability challenges. And our acquisition of Texas Instruments' CMS operations has given Solectron valuable expertise in the design of much-in-**demand** application specific integrated circuits (ASICs). **Manufacturing Services:** Solectron also expanded our printed circuit board and systems assembly and services operations in 1996. We are enhancing our manufacturing capabilities to meet the demand for increased **performance** in smaller, more complex electronics products. This year we integrated ball grid array assembly capabilities into our printed circuit board production processes at Solectron facilities worldwide. We are also adding capabilities that will enable the Company to address strategic new business areas. Solectron established a high-velocity, high-volume operation this year to take greater advantage

FULL-SERVICE
Manufacturing

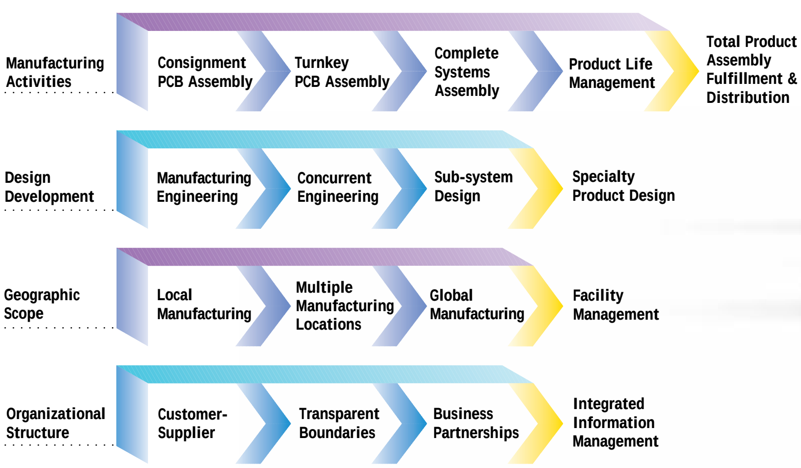
- **Integrated ball grid array assembly capability into printed circuit board operations**
- **Created high-velocity, high-volume operation for systems assembly and service**
- **Expanded upgrade and repair processes and facilities**

"Today's complex electronics products require sophisticated manufacturing capabilities. Our customers focus on product development and marketing and rely on us for manufacturing expertise. Our full-service approach gives customers a partner who manages the complete manufacturing cycle—from design development through warranty support."

Saeed Zohouri, Ph.D.
Senior Vice President, Chief Technology Officer
and President of Solectron California Corporation

of the opportunities to build systems products for our customers. This business is characterized by short manufacturing cycle times, high asset turnover rates, **flexible** production of varying product configurations, and management of fulfillment and distribution. **Post-manufacturing Services:** For those needing services at the end of the manufacturing chain, we expanded our upgrade and repair capabilities. This is a growing market, as OEMs consider repair services to be a critical part of their strategic offerings to their customers, and are looking for outsourcing **partners** who can provide a total and seamless solution. This wide array of capabilities is helping us gain business from OEMs in a broad range of industries, including telecommunications, information technology, test and instrumentation, medical diagnostics, automotive, avionics, and industrial equipment. **A Strong Team Worldwide:** Having the right people and processes throughout all parts of the organization—throughout all parts of the world—enables Solectron to successfully navigate an increasingly competitive **global** landscape. Led by a strong management team, Solectron's worldwide workforce is committed

Electronics Manufacturing Services Relationship Evolution



DELIVERING

Value

NAVIGATING

Globally

"Our philosophy is to nurture mutually-rewarding relationships with our customers. This year we added key people, critical processes, and more capabilities in more locations to deliver on our partnership commitments to our customers around the world."

Koichi Nishimura, Ph.D.
President and Chief Executive Officer

to being responsive—to customers, suppliers, and each other. This enables us to quickly take action—implementing changes, minimizing risks, and cutting time to market—helping to increase our customers', as well as our own, profitability.

1996, we made key appointments that will help the Company maintain the strong regional focus that is so important for **success** in today's worldwide marketplace. Our infrastructure enables us to leverage globally and execute locally, providing Solectron customers with responsive service wherever they are. Also this year, we welcomed Heinz Fridrich to the Company's board of directors. Solectron will benefit from Mr. Fridrich's depth of knowledge in electronics manufacturing gained in his long career as an IBM Corporation executive in Europe and the United States. **Giving Customers an Edge:** We strive to give our customers the time and cost advantages they need to stay a step ahead in their ever-more competitive markets, from our advanced technology **leadership** to our strong supply base management to our continuous improvement efforts. Our new product introduction initiative identifies the best possible methods for bring-

OPTIMIZING

Processes

- **New product introduction initiative**
- **Customer focus team approach**
- **Business processes integration**

"Our customers and suppliers are making significant investments in Information Technology. They don't want these benefits to stop at their company boundaries. Together, we are eliminating the organizational barriers so that Solectron becomes an effective extension of their core processes and system capabilities."

Ken Ouchi, Ph.D.
Vice President, Chief Information Officer

1996 Customer Awards

3COM Corporation
Outstanding Delivery Performance Award

Allied Signal/Aerospace
Support Award

Apple Computers
Outstanding Customer Service & Contribution Award
Significant Contribution Award

Bay Networks, Inc.
Appreciation Awards (2)
Outstanding Achievement Award
Pinnacle Meritorious Achievement Awards (2)
Quality Award

Hewlett-Packard Company
Outstanding Effort Award

Honeywell Inc.
Outstanding Contribution Award

IBM Corporation
Program Support Award

Intel Corporation
Commitment to Continuous Improvement Awards (2)
Outstanding Delivery Performance Award

LTX Corporation
Highest Quality Award

NCR Corporation
Supplier Award

Philips Components
Customer Contribution Award

PictureTel Corporation
Outstanding Quality Performance Award

Silicon Graphics, Inc.
Teamwork and Dedication Award
Superior Quality Performance Award

Sun Microsystems, Inc.
Meritorious Performance Award

Toshiba Personal Computers Division
Outstanding Performance & Quality Performance Award

Watkins-Johnson Company
Successful Turnkey Conversion Award

Quality Achievement Award

On April 1, 1996, Solectron Texas was awarded the Texas Quality Award from the Quality Texas Foundation.

ing products into mass production, optimizing the resources and capacity of our operations while shortening a product's time to market—a win-win situation for our customers and Solectron. To take **collaboration** to the next level, we are implementing information technology and communications systems that eliminate the barriers between our own and our customers' organizations, enabling us to become more closely aligned and increasingly responsive to customers' changing needs. With our strong commitment to helping customers gain a competitive **advantage**, Solectron was gratified to receive 25 awards from our customers in 1996.

A Year of Continued Growth: We accomplished a great deal in 1996, bringing new places, new people, and new processes on board. We believe that opportunities for Solectron continue to abound in the global electronics manufacturing services industry, where an increasing number of OEMs are considering outsourcing to be a primary manufacturing **strategy** rather than just a supplemental one. We believe that Solectron is well positioned to take advantage of this expanding outsourcing trend, and appreciate your ongoing support as we strive to keep moving forward for continued growth.

Charles A. Dickinson
Chairman of the Board

Koichi Nishimura, Ph.D.
President and Chief Executive Officer

August 31, 1996

SUBSEQUENT Events

- **On September 6, 1996, Solectron Technology, Sdn. Bhd. was named the 1996 recipient of the Malaysian Prime Minister's Quality Management Excellence Award.**
- **On September 16, 1996, Solectron's Board of Directors elected Koichi Nishimura, Ph.D. as the Chairman of the Board of Directors. Dr. Nishimura will continue to serve as the President and Chief Executive Officer of the Company. The retiring chairman, Mr. Charles Dickinson, will continue to serve as a member of the Company's Board of Directors.**
- **On September 26, 1996, Solectron Corporation announced its agreement to acquire FORCE COMPUTERS Inc. via a pooling-of-interests merger. FORCE COMPUTERS is a designer and manufacturer of systems and boards for embedded VMEbus applications. The transaction is expected to be completed in November 1996.**
- **On October 10, 1996, Solectron Technology, Inc. was announced as the winner of the 1996 North Carolina Quality Leadership Award.**

Consolidated Financial Statements

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Unaudited Quarterly Financial Information

For each fiscal quarter during the two fiscal years ended August 31, (in thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1996				
Net sales	**$690,624**	**$657,176**	**$680,554**	**$788,837**
Gross profit	**$ 66,346**	**$ 65,361**	**$ 71,793**	**$ 78,878**
Gross margin	**9.6%**	**9.9%**	**10.5%**	**10.0%**
Operating income	**$ 40,803**	**$ 41,944**	**$ 44,701**	**$ 47,977**
Operating margin	**5.9%**	**6.4%**	**6.6%**	**6.1%**
Net income	**$ 27,347**	**$ 27,650**	**$ 27,720**	**$ 31,515**
Primary net income per share	**$ 0.54**	**$ 0.54**	**$ 0.53**	**$ 0.59**
Fully diluted net income per share	**$ 0.52**	**$ 0.52**	**$ 0.53**	**$ 0.59**
1995				
Net sales	$ 506,678	$471,266	$ 516,892	$ 570,723
Gross profit	$ 45,443	$ 46,369	$ 52,379	$ 57,639
Gross margin	9.0%	9.8%	10.1%	10.1%
Operating income	$ 28,721	$ 28,419	$ 31,917	$ 34,377
Operating margin	5.7%	6.0%	6.2%	6.0%
Net income	$ 18,194	$ 18,034	$ 20,328	$ 22,970
Primary net income per share	$ 0.43	$ 0.43	$ 0.48	$ 0.48
Fully diluted net income per share	$ 0.38	$ 0.38	$ 0.42	$ 0.45

Common Stock Information

The following table sets forth the quarterly high and low per share sales prices of the common stock for the two-year period ended August 31, 1996, as quoted on the New York Stock Exchange Composite Tape.

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Per share trading price range	**1996**	**1995**	**1996**	**1995**	**1996**	**1995**	**1996**	**1995**
High	**43⅝**	31⅜	**50⅛**	27¼	**50**	31	**43⅞**	38⅝
Low	**35**	24¾	**36½**	22½	**40¼**	22⅞	**31**	30⅛

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements which involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward looking statements as a result of certain factors, including those factors set forth under "Trends and Uncertainties" below.

General

Solectron's net sales are derived from sales to electronics systems original equipment manufacturers (OEMs). The majority of the Company's customers compete in the telecommunications, computer peripherals, workstation, and personal computer sectors of the electronics industry segment. The Company uses advanced manufacturing technologies in assembly and manufacturing management of complex printed circuit boards and electronics systems. The Company also provides pre-manufacturing and post-manufacturing services. A discussion of some of the potential fluctuations in operating results is discussed under "Trends and Uncertainties" below.

The Company's operating results are affected by a number of factors, including the material content and volume of products built, manufacturing efficiencies, utilization of capacity, start-up costs associated with new customer projects, the degree of turnkey manufacturing, and price competition. Turnkey manufacturing currently represents a substantial portion of the Company's sales. Turnkey projects, in which the Company procures some or all of the components necessary for production, typically generate higher net sales and higher gross profits with lower gross profit percentages than consignment projects due to the inclusion in the Company's operating results of sales and costs associated with the purchase and sale of components. During the past few years, the Company has assembled products with varying degrees of material content, which has caused the Company's gross margin to fluctuate. In addition, the degree of startup costs and inefficiencies associated with new sites and new customer projects has affected the Company's gross margin.

The Company has manufacturing operations in eleven locations, five of which are in the United States, three are in Europe, two in Malaysia, and one is currently being developed in China. The U.S. sites include the site in Austin, Texas, which was purchased from Texas Instruments Incorporated in March 1996 for approximately $132 million. The acquisition resulted in approximately $38 million in goodwill.

On September 25, 1996, the Company executed a definitive agreement to acquire Force Computers Inc., a designer and provider of OEM computer platforms for the embedded market. The transaction is valued at approximately $187.5 million and will be accounted for using the pooling-of-interests method of accounting. The transaction is subject to a number of closing conditions and is expected to close in November 1996.

As the Company manages its existing operations and expands geographically, it may experience certain inefficiencies due to the management of geographically dispersed operations. See "Trends and Uncertainties" below for further discussion of some of the potential fluctuations in operating results associated with the management of growth and geographic expansion, including the pending acquisition of Force Computers.

Results of Operations

The electronics industry is subject to rapid technological change, product obsolescence, and price competition. These and other factors affecting the electronics industry, or any of the Company's major customers in particular, could have a material adverse effect on the Company's results of operations. See "Trends and Uncertainties — Potential Fluctuations in Operating Results and Competition" below for further discussion of potential fluctuations in operating results.

The following table sets forth, for the periods indicated, the percentage of net sales of certain items in the Consolidated Statements of Income. The financial information and the discussion below should be read in conjunction with the Consolidated Financial Statements and Notes thereto.

Years ended August 31,	96	95	94
Net sales	**100.0%**	100.0%	100.0%
Cost of sales	**90.0**	90.2	90.0
Gross profit	**10.0**	9.8	10.0
Operating expenses:			
Selling, general and administrative	**3.6**	3.6	3.6
Research and development	**0.2**	0.2	0.3
Operating income	**6.2**	6.0	6.1
Net interest expense	**0.1**	0.1	0.3
Income before income taxes	**6.1**	5.9	5.8
Income taxes	**2.1**	2.0	2.0
Net income	**4.0%**	3.9%	3.8%

Net Sales

Over the past several years the Company's net sales have grown significantly, primarily due to an increasing trend toward outsourcing within the electronics industry. In fiscal 1996, net sales grew to approximately $2.8 billion, an increase of $752 million, or 36%, over the previous year. Net sales in fiscal 1995 were $2.1 billion, an increase of $609 million, or 42%, over fiscal 1994. The sales increase in fiscal 1996 was due to increased orders from both new and existing customers at existing sites, the acquisition of the Custom Manufacturing Services (CMS) business from Texas Instruments Incorporated (TI) in March 1996, the acquisition of the German site in November 1995, and continued growth in the Company's business overall. The increase in fiscal 1995 over fiscal 1994 was due to increased orders from existing customers, the addition of new customers, and growth in the Company's turnkey business.

The Company's largest customer during fiscal 1996 was Hewlett-Packard Company (HP). Net sales to HP in fiscal 1996 were 11% of consolidated net sales. Net sales to HP in fiscal 1995 were less than 10% of consolidated net sales. The Company's largest customer during fiscal 1995 was International Business Machines Corporation (IBM) with net sales of 21% of 1995 consolidated net sales. Net sales to IBM in fiscal 1996 were less than 10% of consolidated net sales. The decrease in sales to IBM, as a percentage of consolidated net sales, reflects both a decrease in actual sales volume to IBM and an overall increase in the Company's total consolidated net sales from all other customers. The decrease in actual sales volume to IBM is primarily due to the expiration of the manufacturing services agreement with IBM at the Company's Bordeaux, France facility which expired on December 31, 1995. The Company has no other significant agreements of this type with any of its customers.

Over the last three years, the number of customers which represent more than 10% of consolidated net sales has declined. During the same period, the percentage of total sales represented by the Company's top ten customers has declined from 70% in 1994 and 1995, to 64% in 1996. These changes have occurred primarily due to the Company's ability to obtain significant new business from other customers, thereby reducing its dependency on these accounts. The Company is still dependent upon continued revenues from HP and the rest of its top ten customers and there can be no guarantee that these or any other customers will not increase or decrease as a percentage of consolidated net sales either individually or as a group. Consequently, any material decrease in sales to these or other customers could have a material adverse effect on the Company's results of operations.

Net sales at the Company's foreign sites, as a whole, grew at a slower rate over the last year than aggregate net sales at the Company's domestic sites. Foreign locations contributed 30% of consolidated net sales in fiscal 1996, compared to 38% for fiscal 1995. The principal reason for the difference in overall sales growth rates between domestic and foreign sites was the acquisition of the CMS business from TI, which is almost entirely comprised of domestic sales, and the expiration of the manufacturing services agreement with IBM at the Company's Bordeaux, France facility. Sales at the new site in Germany partially offset the decline of sales at the Bordeaux site.

As a result of the Company's foreign sales and facilities, the Company's operations are subject to risks of doing business abroad. While to date these dynamics have not had a materially adverse impact on the Company's results of operations, there can be no assurance that there will not be such an impact in the future. See "Trends and Uncertainties — International Operations" below for a further discussion of potential fluctuations in operating results associated with the risks of doing business abroad.

The Company's operations in Milpitas, California contributed a substantial portion of the Company's net sales and operating income during fiscal 1996, 1995, and 1994. The performance of this operation is expected to continue as a significant factor in the overall financial performance of the Company. Any material adverse change to the customer base, product mix, efficiency, or other attributes of this site could have a material adverse effect on the Company's consolidated results of operations.

The Company believes that its ability to continue to achieve growth will depend upon growth in sales to existing customers for their current and future product generations, successful marketing to new customers and future geographic expansion. Customer contracts can be canceled and volume levels can be changed or delayed. The timely replacement of delayed, canceled or reduced orders with new business cannot be assured. In addition, there can be no assurance that any of the Company's current customers will continue to utilize the Company's services. Because of these factors, there can be no assurance that the Company's historical revenue growth rate will continue. See "Trends and Uncertainties" below for a discussion of certain factors affecting the management of growth, geographic expansion and potential fluctuations in sales and results of operations.

Gross Profit

Gross profit increased by $80.5 million, or 40%, in fiscal 1996 compared to fiscal 1995 and $55.5 million, or 38%, during fiscal 1995 compared to fiscal 1994. The gross margin increased to 10.0% in fiscal 1996, from 9.8% in fiscal 1995. The gross margin was also 10.0% in fiscal 1994. The slight increase in the gross margin in fiscal 1996 compared to fiscal 1995 resulted from manufacturing efficiencies realized at the Company's Charlotte, North Carolina and Milpitas, California sites, increased utilization of the facilities in Charlotte, North Carolina, and product mix. Offsetting these factors were continued inefficiencies at the Scotland site which are partially driven by slower than expected revenue growth. Also, the acquisition of the Austin, Texas site in March 1996, which currently has a lower gross margin than the Company as a whole, negatively impacted the Company's overall margin. However, the Austin site continues to experience improvements in its margins. In fiscal 1995, the Company's gross margin was lower than in fiscal 1994 primarily due to underutilization of its facility in France and manufacturing inefficiencies at the Scotland and North Carolina sites.

For the foreseeable future, the Company's gross margin is expected to depend primarily on product mix, production efficiencies, utilization of manufacturing capacity, integration of newly acquired businesses, the percentage of sales derived from turnkey manufacturing, and pricing within the electronics industry. There can be no assurance that the Company's gross margin will not decrease in future periods. See "Trends and Uncertainties — Potential Fluctuations in Operating Results" below for a discussion of certain factors that may affect the Company's gross margin.

Selling, General, and Administrative Expenses

Selling, general, and administrative (SG&A) expenses increased to $100.3 million in fiscal 1996, compared to $73.6 million in fiscal 1995 and $53.8 million in fiscal 1994. However, SG&A expenses as a percentage of net sales volume remained constant at 3.6% in fiscal 1996, 1995, and 1994, reflecting the Company's intention to continue developing its infrastructure but also to limit its growth in SG&A spending relative to its growth in revenue. The dollar increases in SG&A expenses during these periods were primarily due to growth in personnel and related departmental expenses at all locations and continuing investments in information systems. These expenditures are designed to support the increased size and complexity of the Company's business. The acquisitions of the sites in Germany and Texas and to a lesser extent, Fine Pitch Technology, Inc., during fiscal 1996 as well as the acquisitions of the sites in Scotland and Washington during fiscal 1994 also contributed to the increase in SG&A expenses over the three years presented. The Company anticipates SG&A expenses will increase in absolute amounts in the future as the Company builds the infrastructure necessary to support its current and prospective business. See "Trends and Uncertainties — Management of Growth," and "Potential Fluctuations in Operating Results."

Research and Development Expenses

Research and development activities have been focused primarily on the development of prototype and engineering design capabilities, fine pitch interconnecting technologies (which include ball-grid array, tape-automated bonding, multichip modules, chip-on-flex, chip-on-board, and flip chip), high reliability environmental stress test technology, and the implementation of environmentally-friendly assembly processes, such as VOC-free and no-clean. Research and development expenses increased to $6.7 million in fiscal 1996 from $4.8 million in fiscal 1995 and $4.2 million in fiscal 1994.

Net Interest Expense

Net interest expense was $2.3 million in fiscal 1996, compared to $2.9 million in fiscal 1995 and $4.2 million in fiscal 1994. However, both interest expense and interest income increased significantly during fiscal 1996. The increase in interest expense is due to the two debt offerings which occurred in the second and third quarters. The Company expects interest expense for fiscal 1997 to be approximately $25 million. The increase in interest income is due to the income earned on the remaining undeployed portions of the cash raised from the two debt offerings. The Company expects to utilize more of the undeployed cash during fiscal 1997 in order to fund anticipated future growth. The decrease in fiscal 1995 compared to fiscal 1994 was primarily due to the voluntary conversion of nearly 80% of the Company's outstanding zero-coupon subordinated notes during the fourth quarter of fiscal 1995. See "Trends and Uncertainties — Management of Growth," and "Potential Fluctuations in Operating Results."

Income Taxes

Income taxes increased to $58.8 million in fiscal 1996 from $41.0 million in fiscal 1995 and $28.6 million in fiscal 1994, due primarily to increased income before income taxes. The Company's effective income tax rate remained constant at 34% in fiscal 1996, 1995, and 1994. The effective income tax rate is largely a function of the balance between income from domestic and foreign operations. Foreign operations for the Company are generally taxed at lower rates than in the United States. At its Penang, Malaysia site, the Company currently benefits from a tax holiday that expires in January 1997. The Company is seeking to obtain a new tax holiday which, if granted, would last for five years. If the new tax holiday is not granted, the Company's effective income tax rate would likely increase.

Liquidity and Capital Resources

Working capital was $786 million at the end of fiscal 1996, compared to $356 million at the end of fiscal 1995. In addition to increases in working capital generated from existing sites, the increase over fiscal 1995 is largely due to the additional cash and investments on hand as a result of the two debt offerings during fiscal 1996 (discussed below) and an increase in working capital resulting from the acquisition of the sites in Germany and Texas. As the Company continues to grow in size it will generally require greater amounts of working capital to support its operations. During 1995 the increase in working capital was financed by cash generated from operations.

Net cash used in investing activities was $360 million in fiscal 1996, consisting primarily of the CMS acquisition from TI for approximately $132 million, $123 million in net investments of monies raised during the debt offerings, and capital expenditures of $115 million primarily for surface mount assembly and test equipment to meet current and expected production levels.

In addition to planned increases in working capital to support anticipated increases in net sales, the Company also expects capital expenditures in fiscal 1997 to be in the range of $130 million to $170 million. Beginning in September 1997, the Company will be required to pledge approximately $52 million of cash or marketable securities as collateral for its obligation under the terms of the Company's operating lease for certain of its facilities in Milpitas, California. The lease expires in September 1999. The Company intends to re-negotiate the terms of the lease before September 1997.

In addition to the Company's working capital as of August 31, 1996, which includes cash and cash equivalents of $229 million and short-term investments of $182 million, the Company also has available a $100 million unsecured domestic revolving credit facility, subject to financial covenants and restrictions, and $48.2 million in available foreign credit facilities. During the third quarter of fiscal 1996, the remaining outstanding zero-coupon, subordinated notes converted to common stock. The result of the conversions in the third quarter, was a reduction in long-term debt of approximately $30 million and an increase in common stock of approximately $30 million. During fiscal 1996 the Company completed two private financings. The first was for $230 million aggregate principal amount of 6% convertible, subordinated notes due 2006. It was completed at the end of the second quarter of fiscal 1996. The second offering, completed early in the third quarter of fiscal 1996, was for $150 million aggregate principal amount of $7\frac{3}{8}$% senior notes due 2006. Approximately $132 million of the proceeds from these two offerings (collectively the "notes") was used to complete the CMS transaction in March 1996. The remainder of the proceeds is being used to finance the working capital for the Company's expected growth. Interest expense on the notes is expected to be approximately $25 million annually and will be offset in part by interest earned on undeployed cash and short-term investments. The Company believes the proceeds from the notes together with the cash generated from operations and the Company's available credit will provide adequate working capital for fiscal 1997.

Trends and Uncertainties

Customer Concentration; Dependence on the Electronics Industry

During fiscal 1996 the Company's sales volume in the personal computer and peripheral segments experienced significant fluctuations. While the Company's declines in sales revenues in some segments were offset by increases in sales revenues in other market segments, there can be no assurance that sales within any particular market segment will not experience decreases which could have an adverse effect on the Company's sales.

A small number of customers are currently responsible for a significant portion of the Company's net sales. During the fiscal year ended August 31, 1996, the Company's ten largest customers accounted for over 64% of consolidated net sales and in the fiscal years 1995 and 1994, the Company's ten largest customers accounted for 70% of consolidated net sales. The Company is dependent upon continued revenues from its top ten customers. The percentage of the Company's sales to its major customers may fluctuate from period to period. Significant reductions in sales to any of these customers could have a material adverse effect on the Company's results of operations. The Company has no firm long-term volume purchase commitments from its customers, and over the past few years has experienced reduced lead-times in customer orders. In addition, customer contracts can be canceled and volume levels can be changed or delayed. The timely replacement of canceled, delayed or reduced contracts with new business cannot be assured. These risks are increased because a majority of the Company's sales are to customers in the electronics industry, which is subject to rapid technological change and product obsolescence. The factors affecting the electronics industry in general, or any of the Company's major customers in particular, could have a material adverse effect on the Company's results of operations.

Management of Growth; Geographic Expansion

The Company has experienced substantial growth over the last five fiscal years, with net sales increasing from $265 million in fiscal 1991 to $2.8 billion in fiscal year 1996. In recent years, the Company has acquired facilities in six locations, including the Company's most recent purchase of the CMS business of TI. In September 1996, the Company entered into an agreement to purchase Force Computers Inc. There can be no assurance that the Company's historical revenue growth will continue. There can also be no assurance that the Company will successfully manage the integration of the CMS business, or that the Company will successfully manage the integration of the Force Computers business, if the transaction closes, or any other business it may acquire in the future. As the Company manages its existing operations and expands geographically, it may experience certain inefficiencies as it integrates new operations and manages geographically dispersed operations. In addition, the Company's results of operations could be adversely affected if its new facilities do not achieve growth sufficient to offset increased expenditures associated with geographic expansion. Should the Company increase its expenditures in anticipation of a future level of sales which does not materialize, its profitability would be adversely affected. On occasion, customers may require rapid increases in production which can place an excessive burden on the Company's resources.

CMS Acquisition from Texas Instruments Incorporated

The acquisition of the contract manufacturing services (CMS) business from Texas Instruments Incorporated (TI) entails a number of risks, including successfully managing the transition of customers from TI to Solectron, transitioning business from Kuala Lumpur to Penang, transitioning employees at the Austin site from TI to Solectron, integrating purchasing operations and information systems, and managing a larger and more geographically disparate business. In addition, the CMS business will increase the Company's expenses and working capital requirements. The Company believes it has adequate resources and capabilities to successfully manage the integration of the CMS business into Solectron's business. In the event the Company is unsuccessful in these efforts, the Company's results of operations could be materially adversely affected.

Pending Acquisition of Force Computers Inc.

In September 1996, the Company entered into an agreement to purchase Force Computers Inc., a designer and provider of OEM computer platforms for the embedded market. The proposed acquisition is expected to close in November 1996, subject to various conditions to closing, including termination of the waiting period under applicable antitrust laws and receipt of necessary third party consents. The proposed acquisition of Force Computers entails a number of risks, including successfully managing the integration of the operations, retention of key employees at Force Computers, and managing an increasingly larger and more geographically disparate business. In addition, the Company has no significant prior experience in managing and operating a computer platform design business. There can be no assurance the Company will successfully manage this business or obtain the anticipated customer synergies. In the event the Company is unsuccessful in integrating and managing the Force Computers business, the acquisition could require significant additional management attention. If the Company is unsuccessful in integrating and managing the Force Computers business, the Company's results of operations could be materially adversely affected.

International Operations

During fiscal 1996, foreign locations contributed approximately 30% of consolidated net sales. As a result of its foreign sales and facilities, the Company's operations are subject to risks of doing business abroad, including but not limited to, fluctuations in the value of currency, tax rates and export duties, changes to import and export regulations (including quotas), possible restrictions on the transfer of funds, employee turnover, labor unrest, longer payment cycles, greater difficulty in collecting accounts receivable, the burdens and costs of compliance with a variety of foreign laws and, in certain parts of the world, political instability. While to date these factors have not had an adverse impact on the Company's results of operations, there can be no assurance that there will not be such an impact in the future. In addition, at its Penang, Malaysia site, the Company currently benefits from a tax holiday which expires in January 1997. The Company is seeking to have the tax holiday extended. If the tax holiday is not extended, the Company's effective income tax rate would likely increase.

Availability of Components

A substantial portion of the Company's net sales are derived from turnkey manufacturing in which the Company provides both materials procurement and assembly services. In turnkey manufacturing, the Company potentially bears the risk of component price increases, which could adversely affect the Company's gross profit margins. At various times there have been shortages of components in the electronics industry. If significant shortages of components should occur, the Company may be forced to delay manufacturing and shipments, which could have a material adverse effect on the Company's results of operations.

While the availability of raw materials appears adequate to meet the Company's current revenue projections, component availability to support revenue increases beyond the Company's current plans is limited. Furthermore, availability of customer-consigned parts and unforeseen shortages of components on the world market are beyond the Company's control and could adversely affect revenue levels and operating efficiencies.

Potential Fluctuations in Operating Results

The Company's margins and operating results are affected by a number of factors, including product mix, additional costs associated with new projects, price erosion within the electronics industry, capacity utilization, price competition, the degree of automation that can be used in the assembly process, the efficiencies that can be achieved by the Company in managing inventories and fixed assets, the timing of orders from major customers, fluctuations in demand for customer products, the timing of expenditures in anticipation of increased sales, customer product delivery requirements, and increased costs and shortages of components or labor. The Company's turnkey manufacturing, which typically results in higher net sales and gross profits but lower gross profit margins than consignment assembly and testing services, represents a substantial percentage of net sales. All of these factors can cause fluctuations in the Company's operating results over time. Because of these factors, there can be no assurance that the Company's margins or results of operations will not fluctuate or decrease in the future.

Competition

The electronics assembly and manufacturing industry is comprised of a large number of companies, several of which have achieved substantial market share. The Company also faces competition from current and prospective customers which evaluate Solectron's capabilities against the merits of manufacturing products internally. Solectron competes with different companies depending on the type of service or geographic area. Certain of the Company's competitors have broader geographic breadth. They also may have greater manufacturing, financial, research and development, and marketing resources than the Company. The Company believes that the primary basis of competition in its targeted markets is manufacturing technology, quality, responsiveness, the provision of value-added services, and price. To be competitive, the Company must provide technologically advanced manufacturing services, high product quality levels, flexible delivery schedules, and reliable delivery of finished products on a timely and price-competitive basis. The Company currently may be at a competitive disadvantage as to price when compared to manufacturers with lower cost structures, particularly with respect to manufacturers with facilities established where labor costs are lower.

Intellectual Property Protection

The Company's ability to compete may be affected by its ability to protect its proprietary information. The Company obtained a limited number of U.S. patents in 1995 related to the process and equipment used in its surface mount technology. The Company believes these patents are valuable. However, there can be no assurance that these patents will provide meaningful protection for the Company's manufacturing process and equipment innovations.

The Company's management believes it has not infringed on any patents, however, there can be no assurance that third parties will not assert infringement claims against the Company or its customers in the future. In the event a third party does assert an infringement claim, the Company may be required to expend significant resources to develop a non-infringing manufacturing process or to obtain licenses to the manufacturing process which is the subject of litigation. There can be no assurance that the Company would be successful in such development or that any such licenses would be available on commercially acceptable terms, if at all. In addition, such litigation could be lengthy and costly and could have a material adverse effect on the Company's financial condition regardless of the outcome of such litigation.

Environmental Compliance

The Company is subject to a variety of environmental regulations relating to the use, storage, discharge and disposal of hazardous chemicals used during its manufacturing process. Any failure by the Company to comply with present and future regulations could subject it to future liabilities or the suspension of production. In addition, such regulations could restrict the Company's ability to expand its facilities or could require the Company to acquire costly equipment or incur other significant expenses to comply with environmental regulations.

Dependence on Key Personnel and Skilled Employees

The Company's continued success depends to a large extent upon the efforts and abilities of key managerial and technical employees. The loss of services of certain key personnel could have a material adverse effect on the Company. The Company's business also depends upon its ability to continue to attract and retain senior managers and skilled employees. Failure to do so could adversely affect the Company's operations.

Possible Volatility of Market Price of Common Stock

The trading price of the common stock is subject to significant fluctuations in response to variations in quarterly operating results, general conditions in the electronics industry, and other factors. In addition, the stock market is subject to price and volume fluctuations which affect the market price for many high technology companies in particular, and which often are unrelated to operating performance.

Consolidated Balance Sheets

As of August 31, (in thousands)	96	95
Assets		
Current assets:		
Cash and cash equivalents	**$ 228,830**	$ 89,959
Short-term investments	**181,520**	58,643
Accounts receivable, less allowances of $2,992 and $3,501, respectively	**341,200**	254,898
Inventories	**368,862**	298,809
Prepaid expenses and other current assets	**24,312**	24,049
Total current assets	**1,144,724**	726,358
Net property and equipment	**249,570**	203,609
Other assets	**57,904**	10,888
Total assets	**$1,452,198**	$940,855
Liabilities and Shareholders' Equity		
Current liabilities:		
Accrued interest and current portion of long-term debt	**$ 14,094**	$ 4,796
Accounts payable	**280,840**	310,680
Accrued employee compensation	**38,216**	28,705
Accrued expenses	**9,280**	15,264
Other current liabilities	**15,939**	11,310
Total current liabilities	**358,369**	370,755
Long-term debt and capital lease obligations	**386,927**	30,043
Other long-term liabilities	**6,333**	1,916
Total liabilities	**751,629**	402,714
Shareholders' equity:		
Preferred stock, no par value; 1,200 shares authorized; no shares issued	**—**	—
Common stock, no par value; 80,000 shares authorized; 52,511 and 49,584 shares issued and outstanding, respectively	**378,319**	329,265
Retained earnings	**320,553**	206,321
Cumulative translation adjustment and other	**1,697**	2,555
Total shareholders' equity	**700,569**	538,141
Commitments		
Total liabilities and shareholders' equity	**$1,452,198**	$940,855

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income

Years ended August 31, (in thousands, except per share data)	96	95	94
Net sales	$2,817,191	$2,065,559	$1,456,779
Cost of sales	2,534,813	1,863,729	1,310,451
Gross profit	282,378	201,830	146,328
Operating expenses:			
Selling, general and administrative	100,260	73,554	53,816
Research and development	6,693	4,842	4,162
Operating income	175,425	123,434	88,350
Interest income	13,302	6,611	6,484
Interest expense	(15,650)	(9,551)	(10,675)
Income before income taxes	173,077	120,494	84,159
Income taxes	58,845	40,968	28,614
Net income	$ 114,232	$ 79,526	$ 55,545
Net income per share:			
Primary	$ 2.19	$ 1.82	$ 1.32
Fully diluted	$ 2.17	$ 1.62	$ 1.18
Weighted average number of shares:			
Primary	52,127	43,773	42,205
Fully diluted	55,177	52,582	52,033

See accompanying notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

(In thousands)	Common Stock Shares	Common Stock Amount	Retained Earnings	Cumulative Translation Adjustment and Other	Total Shareholders' Equity
Balances as of August 31, 1993	40,636	$ 197,739	$ 71,250	$(8,009)	$ 260,980
Options exercised	527	3,601	—	—	3,601
Stock issued under employee purchase plan	126	2,697	—	—	2,697
Conversion of long-term debt	13	174	—	—	174
Tax benefit associated with exercise of stock options	—	2,046	—	—	2,046
Net income	—	—	55,545	—	55,545
Cumulative translation adjustment and other	—	—	—	5,746	5,746
Balances as of August 31, 1994	41,302	206,257	126,795	(2,263)	330,789
Options exercised	573	7,858	—	—	7,858
Stock issued under employee purchase plan	131	2,901	—	—	2,901
Conversion of long-term debt	7,578	110,915	—	—	110,915
Tax benefit associated with exercise of stock options	—	1334	—	—	1334
Net income	—	—	79,526	—	79,526
Cumulative translation adjustment and other	—	—	—	4,818	4,818
Balances as of August 31, 1995	49,584	329,265	206,321	2,555	538,141
Options exercised	619	10,164	—	—	10,164
Stock issued under employee purchase plan	139	4,339	—	—	4,339
Conversion of long-term debt	1,973	30,402	—	—	30,402
Stock issued in business combination	196	1,668	—	—	1,668
Tax benefit associated with exercise of stock options	—	2,481	—	—	2,481
Net income	—	—	114,232	—	114,232
Cumulative translation adjustment and other	—	—	—	(858)	(858)
Balances as of August 31, 1996	**52,511**	**$378,319**	**$320,553**	**$ 1,697**	**$700,569**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Years ended August 31, (in thousands)	96	95	94
Cash flows from operating activities:			
Net income	**$ 114,232**	$ 79,526	$ 55,545
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**84,804**	61,416	45,708
Interest accretion on zero-coupon subordinated notes	**1,173**	8,240	8,894
Interest accrual on long-term debt	**12,507**	—	—
Other	**5,629**	3,763	2,349
Changes in operating assets and liabilities:			
Accounts receivable	**(32,379)**	(64,906)	(51,870)
Inventories	**(27,053)**	(63,654)	(66,221)
Prepaid expenses and other current assets	**(234)**	(4,566)	(6,470)
Accounts payable	**(56,784)**	63,681	65,283
Accrued expenses and other current liabilities	**8,753**	3,223	12,689
Net cash provided by operating activities	**110,648**	86,723	65,907
Cash flows from investing activities:			
Purchases of short-term investments	**(781,266)**	(183,299)	(338,192)
Sales and maturities of short-term investments	**658,436**	218,805	380,335
Purchase of facilities	**(131,893)**	—	(14,383)
Capital expenditures	**(115,446)**	(113,613)	(58,959)
Other	**9,806**	(426)	(1,998)
Net cash used in investing activities	**(360,363)**	(78,533)	(33,197)
Cash flows from financing activities:			
Proceeds from bank lines of credit	**6,340**	4,366	—
Proceeds from long-term debt	**380,000**	—	—
Debt acquisition costs	**(7,808)**	—	—
Repayments of long-term debt and capital lease obligations	**(4,796)**	(3,484)	(8,864)
Net proceeds from sale of common stock	**14,503**	10,759	6,298
Net cash provided by (used in) financing activities	**388,239**	11,641	(2,566)
Effect of exchange rate changes on cash and cash equivalents	**347**	2,222	2,530
Net increase in cash and cash equivalents	**138,871**	22,053	32,674
Cash and cash equivalents at beginning of year	**89,959**	67,906	35,232
Cash and cash equivalents at end of year	**$ 228,830**	$ 89,959	$ 67,906

Supplemental Disclosures

	96	95	94
Cash paid:			
Interest	**$ 517**	$ 482	$ 1,242
Income taxes	**54,937**	44,429	25,551
Non-cash investing and financing activities:			
Issuance of common stock upon conversion of long-term debt	**30,402**	110,915	174
Issuance of common stock for business combination	**1,668**	—	—
Tax benefit associated with exercise of stock options	**2,481**	1,334	2,046

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

(a) Description of Operations and Principles of Consolidation

Solectron Corporation (the Company) is an independent provider of customized manufacturing services to original equipment manufacturers in the electronics industry and operates in this one industry segment. The Company's primary services include materials procurement, materials management, and the manufacture and testing of printed circuit board assemblies. In addition, the Company provides consultation on board design and manufacturability, as well as system level assembly and test, flexible cable assembly, refurbishment, disk duplication, packaging, and remanufacturing services. These services include turnkey services, where the Company procures certain or all of the materials required for product assembly, and consignment services, where the customer supplies the materials necessary for product assembly. Turnkey services include material procurement and warehousing in addition to manufacturing, and involve greater resource investment than consignment services. The Company has manufacturing operations located in the United States, Europe, and Asia.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of intercompany accounts and transactions.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Cash Equivalents and Short-Term Investments

Cash equivalents are highly liquid investments purchased with an original maturity of less than three months. Short-term investments are investment grade short-term debt instruments with original maturities greater than three months and less than two years.

Investments in debt securities are classified as "available-for-sale." Such investments are recorded at fair value, as determined from quoted market prices, and the cost of securities sold is determined based on the specific identification method. Unrealized gains and losses are reported as a component of shareholders' equity. See Note 2.

(c) Inventories

Inventories are stated at the lower of weighted average cost or market. See Note 3.

(d) Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization are computed based on the shorter of the estimated useful lives or the lease terms of the respective assets, using the straight-line method. Estimated useful lives are presented below. See Note 4.

Machinery and equipment	2 – 5 years
Equipment recorded under capital lease	3 – 5 years
Furniture and fixtures	3 – 5 years
Leasehold improvements	Lease term
Buildings	6 – 50 years

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of" effective September 1, 1996. This statement requires long-lived assets to be evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The adoption of SFAS No. 121 is not expected to have a material impact on the Company's consolidated results of operations.

(e) Other Assets

Other assets include goodwill related to the purchase of facilities and equipment described in Note 14 and debt issuance costs associated with the outstanding convertible and senior notes described in Note 6. Debt issuance costs are amortized using the straight-line method over the debt term (ten years). Goodwill is also amortized using the straight-line method over ten years.

(f) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. When necessary, a valuation allowance is recorded to reduce tax assets to an amount whose realization is more likely than not.

(g) Net Income Per Share

Primary net income per share is computed using the weighted average number of common shares and dilutive common equivalent shares outstanding during the related period. Common equivalent shares consist of stock options which are computed using the treasury stock method. Fully diluted net income per share assumes full conversion of the Company's outstanding convertible notes.

(h) Revenue Recognition

The Company recognizes revenue upon shipment of product to its customers.

(i) Employee Stock Plans

The Company accounts for its stock option plan and its employee stock purchase plans in accordance with provisions of the Accounting Principles Board's Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." In 1995, the Financial Accounting Standards Board released SFAS No. 123, "Accounting for Stock Based Compensation." SFAS No. 123 provides an alternative to APB 25 and is effective for fiscal years beginning after December 15, 1995. The Company intends to continue to account for its employee stock plans in accordance with the provisions of APB 25. Accordingly, SFAS No. 123 will not have any impact on the Company's reported financial position or results of operations.

(j) Foreign Currency

Assets and liabilities of foreign subsidiaries where the local currency is the functional currency are translated at year-end exchange rates. The effects of these translation adjustments are reported as a separate component of shareholders' equity. Exchange gains and losses arising from transactions denominated in a currency other than the functional currency of the entity involved and remeasurement adjustments for foreign operations where the United States dollar is the functional currency are included in income. To date, the effect on income of such amounts has been immaterial.

(k) Derivatives

Gains and losses on foreign currency forward exchange contracts designated as hedges of assets and liabilities are included in income concurrently with the offsetting losses and gains on the related balance sheet item. Gains and losses on hedges of firm commitments and anticipated transactions are deferred and included in the basis of the transaction when it occurs. See Note 7.

(l) Year-End

The Company's financial reporting year consists of either 52-week or 53-week periods ending on the last Friday in August. Fiscal years 1994 and 1995 each contained 52 weeks, and fiscal year 1996 contained 53 weeks. For purposes of presentation in the accompanying financial statements and notes thereto, the Company has indicated its accounting years as ending on August 31.

Note 2: Cash, Cash Equivalents, and Short-Term Investments

Cash, cash equivalents, and short-term investments consisted of the following at August 31:

(in thousands)	Cash and Cash Equivalents	Short-Term Investments
1996		
Cash	**$ 30,865**	**$ —**
Money market funds	**76,595**	**—**
Certificates of deposit	**31,779**	**12,308**
U.S. government securities	**44,922**	**139,202**
Corporate obligations	**34,680**	**29,179**
Municipal obligations	**9,989**	**—**
Other	**—**	**831**
	$228,830	**$181,520**
1995		
Cash	$ 32,050	$ —
Money market funds	41,342	—
Certificates of deposit	11,909	7,944
U.S. government securities	—	11,225
Municipal obligations	3,000	39,474
Other	1,658	—
	$ 89,959	$ 58,643

As of August 31, 1996 and 1995, unrealized gains and losses were not material. As of August 31, 1996, all of the Company's short-term investments mature within two years, except approximately $10 million of market option investments which have stated maturities greater than fifteen years. For these securities, the company has the option of adjusting the respective interest rates or liquidating these investments at face value on stated auction dates at intervals up to 28 days.

Note 3: Inventories

Inventories as of August 31, 1996 and 1995 consisted of:

(in thousands)	96	95
Raw materials	**$253,646**	$206,221
Work-in-process	**115,216**	92,588
	$368,862	$298,809

Note 4: Property and Equipment

Property and equipment as of August 31, 1996 and 1995 consisted of:

(in thousands)	96	95
Land, buildings, and improvements	**$ 37,872**	$ 36,100
Machinery and equipment	**344,812**	261,702
Furniture and fixtures	**55,591**	36,296
Leasehold improvements	**27,749**	15,923
Construction-in-progress	**773**	908
	466,797	350,929
Less accumulated depreciation and amortization	**217,227**	147,320
Net property and equipment	**$249,570**	$203,609

Note 5: Lines of Credit

The Company has $100 million available under an unsecured domestic revolving line of credit expiring June 30, 1997, which, at the Company's option, currently bears interest at either the bank's prime rate, the London interbank offering rate (LIBOR) plus 0.75%, or the bank's certificate of deposit rate plus 0.75%. As of August 31, 1996 and 1995, there were no borrowings under this line of credit. The agreement contains certain financial covenants, restricts capital purchases, acquisitions and other indebtedness, and restricts the payment of cash dividends and repurchases of the Company's stock in the open market. The agreement also stipulates that if the Company pledges any cash, cash equivalents, or short-term investments, the amount of available borrowing under this line of credit will be reduced.

The Company also has $66.2 million in foreign lines of credit and other bank facilities. Borrowings are payable on demand. The interest rates range from the bank's prime lending rate to the bank's prime rate plus 2.0%. As of August 31, 1996, borrowings and restricted amounts under these lines of credit were $18.0 million.

Note 6: Long-Term Debt

Long-term debt and capital lease obligations at August 31, 1996 and 1995 consisted of:

(in thousands)	96	95
6% subordinated notes due 2006, face value $230,000, convertible into 3,402 shares of common stock.	**$236,976**	$ —
7⅜% senior notes due 2006, face value $150,000.	**155,257**	—
7% zero-coupon, subordinated notes due 2012, convertible into 1,973 shares of common stock at the end of 1995. Converted into common stock during 1996.	**—**	30,043
Other	**8,788**	4,796
Total long-term debt and capital lease obligations	**401,021**	34,839
Less current portion of long-term debt and capital lease obligations	**14,094**	4,796
	$386,927	$30,043

In February 1996, the Company issued 6% convertible, subordinated notes due 2006 for an aggregate principal amount of $230 million. These notes are in denominations of and have a maturity value of $1,000 each payable on March 1, 2006. Interest is payable semi-annually at 6%. The notes are subordinated to all existing and future senior indebtedness of the Company. Each note is convertible at any time by the holder into shares of common stock at a conversion price of $67.61 per share. Beginning on March 3, 1999, the notes are redeemable for cash at the option of the Company, in whole or in part, at redemption prices ranging from 104.2% of the principal amount in 1999, to 100% of the principal amount in year 2006. Upon a change in control of the Company, each holder of the notes has the right to require the Company to repurchase the notes for 100% of the principal amount.

In March 1996, the Company issued $150 million aggregate principal amount of senior notes. The notes are in denominations of and have a maturity value of $1,000 each and are due on March 1, 2006. The notes pay interest at 7⅜% semi-annually. The notes may not be redeemed prior to maturity.

As of August 31, 1995, approximately 95,000 zero-coupon, subordinated notes were outstanding. In May 1996, the remainder of these notes were converted into approximately 1.97 million shares of common stock.

Note 7: Financial Instruments

Fair Value of Financial Instruments

The fair value of the Company's cash, cash equivalents, accounts receivable, and accounts payable approximates the carrying amount due to the relatively short maturity of these items. The fair value of the Company's short-term investments is determined based on quoted market prices. See Note 2.

Derivatives

The Company enters into forward exchange contracts to hedge foreign currency exposures on a continuing basis for periods consistent with its committed exposures. The Company's hedging transactions are considered non-trading and do not involve speculation. These transactions do not subject the Company to risk of accounting loss because gains and losses on these contracts offset losses and gains on the assets, liabilities, and transactions being hedged. The Company is exposed to credit-related losses in the event of non-performance by the parties in these contracts. However, because these contracts have maturities of less than three months, the amounts of unrealized gains and losses are immaterial. The Company had $37 million and $77 million of net foreign currency forward exchange contracts outstanding at the end of fiscal years 1996 and 1995, respectively, primarily for the purchase of European currencies.

Business and Credit Concentrations

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash, cash equivalents, short-term investments, and trade accounts receivable. The Company's cash, cash equivalents, and short-term investments are managed by recognized financial institutions which follow the Company's investment policy. The Company's investments are comprised of investment grade short-term debt instruments, and the Company's investment policy limits the amount of credit exposure in any one issue. Concentrations of credit risk in accounts receivable resulting from sales to major customers are discussed in Note 13. The Company generally does not require collateral for sales on credit. The Company closely monitors extensions of credit and has not experienced significant credit losses in the past.

Note 8: Commitments

The Company leases various facilities under operating lease agreements. The facility leases expire at various dates through 2001. Substantially all leases require the Company to pay property taxes, insurance, and normal maintenance costs. All of the Company's leases have fixed minimum lease payments except the lease for certain facilities in Milpitas, California. Payments under this lease are periodically adjusted based on LIBOR rates. This lease provides the Company with the option at the end of the lease of either acquiring the property at its original cost or arranging for the property to be acquired. The Company is contingently liable under a first loss clause for a decline in market value of the leased facilities up to $44.2 million in the event the Company does not purchase the property at the end of the five-year lease term. The Company must also maintain compliance with financial covenants similar to its credit facilities.

Future minimum payments related to lease obligations are $13.9 million, $12.4 million, $9.2 million, $6.2 million, and $1.1 million in each of the years in the five-year period ending August 31, 2001.

Rent expense was $17.0 million, $10.8 million, and $11.1 million for the years ended August 31, 1996, 1995, and 1994, respectively.

Note 9: Retirement Plans

The Company has various retirement plans which cover a significant number of its employees. The major pension plans are defined contribution plans, which provide pension benefits in return for services rendered, provide an individual account for each participant, and have terms that specify how contributions to the participant's account are to be determined rather than the amount of pension benefits the participant is to receive. Contributions to these plans are based on varying percentages of each participant's base salary. The Company's expense for the defined contribution plans totaled $2.3 million, $1.0 million, and $0.5 million in 1996, 1995, and 1994, respectively.

Note 10: Income Taxes

The components of income taxes are as follows (in thousands):

Years ended August 31,	96	95	94
Current:			
Federal	**$51,004**	$34,922	$17,682
State	**7,445**	4,370	4,151
Foreign	**4,204**	4,346	7,121
	62,653	43,638	28,954
Deferred:			
Federal	**(2,579)**	(3,474)	(313)
State	**(233)**	15	(67)
Foreign	**(996)**	789	40
Total	**$58,845**	$40,968	$28,614

The overall effective income tax rate (expressed as a percentage of financial statement income before income taxes) differs from the expected U.S. income tax rate as follows:

Years ended August 31,	96	95	94
Federal tax rate	**35.0%**	35.0%	35.0%
State income tax, net of federal tax benefit	**2.8**	2.4	3.2
Tax exempt interest	**(0.1)**	(0.7)	(1.0)
Income of foreign subsidiaries taxed at different rates	**(4.5)**	(4.2)	(3.5)
Other	**0.8**	1.5	0.3
Effective income tax rate	**34.0%**	34.0%	34.0%

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities are as follows (in thousands):

As of August 31,	96	95
Deferred tax assets:		
Accruals, allowances, and reserves	**$11,949**	$10,326
State income tax	**—**	920
Pre-operating costs	**234**	164
Acquired intangible assets	**875**	463
Other	**1,181**	278
Total deferred tax assets	**14,239**	12,151
Deferred tax liabilities:		
Plant and equipment	**(1,496)**	(1,779)
State income tax	**(469)**	—
Other	**(616)**	(2,070)
Deferred tax liabilities	**(2,581)**	(3,849)
Net deferred tax assets	**$11,658**	$ 8,302

Based on the Company's historical operating income, management believes it is more likely than not that the Company will realize the benefit of the deferred tax assets recorded and, accordingly, has established no valuation allowance.

Worldwide income before income taxes consisted of the following (in thousands):

Years ended August 31,	96	95	94
U.S.	**$140,900**	$ 91,537	$ 54,241
Non-U.S.	**32,177**	28,957	29,918
Total	**$173,077**	$120,494	$ 84,159

The Company has not provided for U.S. federal and foreign withholding taxes on approximately $84.6 million of foreign subsidiaries' undistributed earnings as of August 31, 1996 because such earnings are intended to be reinvested indefinitely. The amount of income tax liability that would result had such earnings been repatriated is estimated to be approximately $16 million.

The Company has a tax holiday in Malaysia which expires in January 1997. The Company is seeking a second tax holiday in Malaysia.

Note 11: Shareholders' Equity

(a) Stock Option Plans

The Company's stock option plans provide for grants of options to employees to purchase common stock at the fair market value of such shares on the grant date. The options vest over a four-year period beginning generally on the grant date. The term of the options is five years for options granted prior to November 17, 1993 and seven years for options granted thereafter. A summary of stock option activity under the plans follows:

Years ended August 31,	Number of Shares	Exercise Price
1996		
Outstanding at beginning of year	**3,991,840**	**$ 1.94–$37.38**
Granted	**1,586,939**	**35.25– 44.63**
Exercised	**(618,887)**	**1.94– 41.00**
Canceled	**(244,104)**	**13.81– 44.63**
Outstanding at end of year	**4,715,788**	**$ 7.00–$44.63**
Shares exercisable at end of year	**2,511,843**	**$ 7.00–$44.63**
1995		
Outstanding at beginning of year	4,067,143	$ 1.81–$30.75
Granted	778,250	26.63– 37.38
Exercised	(572,780)	1.81– 30.75
Canceled	(280,773)	1.94– 37.38
Outstanding at end of year	3,991,840	$ 1.94–$37.38
Shares exercisable at end of year	1,924,029	$ 1.94–$37.38

A total of 6,389,328 shares of common stock remain reserved for issuance under the plans as of August 31, 1996.

Each independent member of the Company's Board of Directors is granted 6,000 stock options each December 1 at the then current fair market value. Such options vest over one year.

(b) Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan (the Purchase Plan), employees meeting specific employment qualifications are eligible to participate and can purchase shares quarterly through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement or end of the offering period. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 10% of qualified compensation. As of August 31, 1996, 1,390,918 shares remain available for issuance under the Purchase Plan.

Note 12: Business Segment Information

Information about the Company's operations in different geographic regions is presented in the table below:

(in thousands)	Net Sales	Operating Income	Identifiable Assets
Fiscal 1996			
United States	**$1,981,788**	**$142,470**	**$1,117,875**
Europe	**490,606**	**7,775**	**224,172**
Asia	**344,797**	**25,180**	**110,151**
	$2,817,191	**$175,425**	**$1,452,198**
Fiscal 1995			
United States	$ 1,280,397	$ 94,078	$ 609,245
Europe	534,038	15,316	213,996
Asia	251,124	14,040	117,614
	$ 2,065,559	$ 123,434	$ 940,855
Fiscal 1994			
United States	$ 945,742	$ 58,488	$ 485,854
Europe	389,257	22,286	201,262
Asia	121,780	7,576	79,279
	$ 1,456,779	$ 88,350	$ 766,395

Note 13: Major Customers

Net sales to major customers as a percentage of consolidated net sales were as follows (* represents sales less than 10%):

Years ended August 31,	96	95	94
Hewlett-Packard	**11%**	*	*
IBM	*	21%	28%
Apple Computer	*	*	12%

As a result of sales to these and other of the Company's significant customers, the Company does have concentrations of credit risk. This situation is intensified due to the fact that the majority of the Company's customers are in the same industry. The Company believes its reserves for bad debt are adequate considering its concentrations of credit risk.

Note 14: Asset Acquisitions

In November 1995, the Company purchased certain assets from the printed circuit assembly operation of Hewlett-Packard GmbH, a subsidiary of Hewlett-Packard Company, located in Boeblingen, Germany. The purchase price for these assets was not material and was financed with existing cash and short-term investments.

In March 1996, the Company exchanged common stock and common stock options for all of the outstanding stock and options of Fine Pitch Technology, Inc., a provider of prototype services. This transaction was accounted for under the pooling-of-interests method. The results of operations for Fine Pitch Technology are not material to the Company's consolidated results of operations and accordingly, pro-forma information has not been disclosed and historical information has not been restated.

In March 1996, the Company completed its purchase of Texas Instruments Incorporated's Custom Manufacturing Services (CMS) business. This business, principally located in Austin Texas, was acquired for approximately $132 million. Under the terms of the agreement, Solectron purchased the CMS business in Austin, Texas and certain assets of the CMS business in Kuala Lumpur, Malaysia (collectively the CMS operations). The Company is moving the CMS business in Kuala Lumpur to Solectron's Penang, Malaysia operations over the course of approximately one year from the time of acquisition. This transaction was accounted for under the purchase method of accounting. The acquisition resulted in goodwill of approximately $38 million which is being amortized on a straight-line basis over 10 years.

The CMS operations' fiscal year ends July 31, 1996. The Company's consolidated financial position as of August 31, 1996 includes the financial position of the CMS operations as of July 31, 1996, and the Company's consolidated results of operations and cash flows for the year ended August 31, 1996 include the results of operations and cash flows of the CMS operations for the four-month period ended July 31, 1996.

The following pro forma combined financial information gives effect to the acquisition of the CMS operations on a purchase accounting basis for the years ended August 31, 1996 and 1995 as if the CMS operations had been acquired at the beginning of the periods presented. The preparation of this financial information requires the use of management's estimates. This pro forma financial information includes certain adjustments for goodwill amortization, increased depreciation expense, a decrease in interest income (related to the assumed liquidation of certain current investments for the purchase of the CMS operations), and the related income tax effects.

This pro forma combined information is not purported to be indicative of the results that would have actually been obtained if the combination had been in effect during the periods indicated, or that may be obtained in the future. In addition, it does not reflect the effects of any synergy that might be achieved from the newly combined operations.

Pro forma financial information:

Years ended August 31,	96	95
Net revenues	**$3,152,962**	$2,492,530
Net income	**115,085**	79,651
Primary earnings per share	**$ 2.21**	$ 1.82
Fully diluted earnings per share	**$ 2.19**	$ 1.62

Note 15: Subsequent Event (unaudited)

On September 25, 1996, the Company executed a definitive agreement to acquire Force Computers Inc., a designer and provider of OEM computer platforms for the embedded market. The transaction is to be accounted for under the pooling-of-interests method and is valued at approximately $187.5 million. The transaction is expected to close in November 1996.

Independent Auditors' Report

The Board of Directors and Shareholders
Solectron Corporation:

We have audited the accompanying consolidated balance sheets of Solectron Corporation and subsidiaries as of August 31, 1996 and 1995, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended August 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Solectron Corporation and subsidiaries as of August 31, 1996 and 1995, and the results of their operations and their cash flows for each of the years in the three-year period ended August 31, 1996, in conformity with generally accepted accounting principles.

KPMG PEAT MARWICK LLP

Palo Alto, California
September 13, 1996

Investor Information

Transfer Agent and Registrar

Boston EquiServe Limited Partnership
Shareholder Services
Canton, Massachusetts
Telephone: 617-575-3170

Price Range of Common Stock

The Company's common stock is traded on the New York Stock Exchange under the symbol SLR. No dividends have been paid on common stock.

Price range of common stock during fiscal 1996 (during year ended August 31, 1996):

High	Low
$50 1/8	$31

Annual Report and 10-K Report

Publications of interest to current and potential Solectron investors are available without charge upon request. These include annual reports and Forms 10-K and 10-Q filed with the Securities and Exchange Commission and financial earnings press releases.

Please direct inquiries to:

Investor Relations
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Milpitas, California 95035
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Certain company financial documents, including Forms 10-K and 10-Q, are available by facsimile twenty-four hours a day by calling 800-858-7058.

Corporate Information on the Internet

General: http://www.oakridge.com/solectron
Press releases: http://www.prnewswire.com

Annual Meeting

The 1996 annual meeting of Solectron shareholders will be:

Thursday, January 9, 1997
9:00 a.m. Pacific Standard Time
The Westin Hotel
Santa Clara, California

Corporate Counsel

Wilson, Sonsini, Goodrich & Rosati
Palo Alto, California

Certified Public Accountants

KPMG Peat Marwick LLP
Palo Alto, California

Corporate Information

Board of Directors

Koichi Nishimura, Ph.D.
Chairman of the Board
President and Chief Executive Officer,
Solectron Corporation

Winston H. Chen, Ph.D.
Chairman,
Paramitas Foundation

Richard A. D'Amore
General Partner
North Ridge Venture Partners

Charles A. Dickinson
Independent Consultant

Kenneth E. Haughton, Ph.D.
Independent Consultant

Heinz Fridrich
Faculty Member
University of Florida

Paul R. Low, Ph.D.
President, PRL Associates

W. Ferrell Sanders
General Partner,
Asset Management Company

Osamu Yamada
Advisor,
Mitsubishi Bank, Ltd.

Officers

Koichi Nishimura, Ph.D.
Chairman of the Board
President and Chief Executive Officer

David Kynaston
Vice President and President,
Solectron Europe

Stephen T. Ng
Senior Vice President and
Chief Materials Officer

Leslie T. Nishimura
Senior Vice President and President,
Solectron Washington, Inc.

Ken Tsai
Senior Vice President and President,
Solectron Asia

Susan S. Wang
Senior Vice President,
Chief Financial Officer
and Secretary

Walter W. Wilson
Senior Vice President and President,
Solectron North America

Saeed Zohouri, Ph.D.
Senior Vice President,
Chief Technology Officer and President,
Solectron California Corporation

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