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Spansion may go public this week

Company looking to raise money to pay off debt, upgrade plants.

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Spansion Inc., a memory-chip maker that proposes to spin off from Advanced Micro Devices Inc., is expected to conduct its initial public stock offering this week while hoping that investors forgive its recent string of unprofitable quarters.

Spansion, which runs the Fab 25 chip factory in Southeast Austin and employs about 1,000 people here, is one of the largest makers of flash chips that go into cell phones, communications gear and other products.

Even though Spansion is headquartered in Sunnyvale, Calif., this would be the first major Austin-related stock offering since August 2004, when American Campus Communities Inc. went public. It's also the first U.S. chip spinoff since Austin-based Freescale Semiconductor Inc. had its public stock offering in July 2004, raising $1.58 billion.

Spansion also is one of the first companies going public in this country to make its executive presentations to institutional investors available to the public via Internet webcast with the encouragement of federal securities regulators. Until now, such "road shows" were seen only by people connected with Wall Street firms and big investors that are major buyers of new stock offerings.

Spansion is in one of the hottest areas of semiconductors: flash memory chips that are the lifeblood of cell phones, MP3 players and other small electronic devices. But it's also one of the most cutthroat markets, with competitors such as Intel and Samsung, the world's largest chip companies.

Because Spansion makes its own chips, it must absorb the enormous costs involved in chip manufacturing. A factory can cost more than $3 billion to build and outfit. Upgrades cost hundreds of millions. And Spansion is about to embark on a major upgrade campaign.

Based on its presentation to investors, it's clear that's at least part of why Spansion is doing an IPO.

The company wants to raise more than $600 million by selling 39.2 million shares of common stock with a proposed price of between $16 and $18 a share. It also plans to issue about $400 million in debt securities to repay some of its debts, including those it owes to its present owners, AMD and Japan's Fujitsu Ltd.

The company said it plans to increase capital spending on things such as plants and equipment to more than $800 million in 2006, about $300 million more than 2005.

Spansion, founded in 1993 as a joint venture between chip maker AMD and computer company Fujitsu, will have the advantage of being entirely focused on flash.

But the company is a relatively small player in an intensely competitive market, competing against larger companies including Intel Corp. and Europe's STMicroelectronics.

Financially, the company remains a turnaround opportunity. Spansion lost $256.6 million on sales of $1.41 billion through the first nine months of 2005. Its sales were down 20 percent from 2004, mostly because of price declines for flash-memory chips.

The company has told investors that it expects to post another loss in its fourth quarter, which ends this month.

A logical move

Analysts say the Spansion spinoff makes sense for both AMD and its memory subsidiary.

AMD can focus on its profitable microprocessor business, which is growing rapidly, without worrying about the financial drag from Spansion.

Analyst Cody Acree with Legg Mason Inc. in Dallas expects AMD's earnings to improve dramatically next year with the spinoff.

AMD, which owns 60 percent of Spansion, expects to see its ownership shrink to about 38 percent after the offering. The reduced ownership means Spansion will have a reduced impact on AMD's quarterly financial results.

Currently, as majority owner of the company, AMD has to report all of Spansion's net losses as its own. That makes the memory company a bigger drag on AMD's quarterly financial results.

In the third quarter, AMD posted a profit of $76 million on sales of $1.52 billion, but its earnings were depressed by a $50 million operating loss by Spansion.

As a minority owner, AMD will count only its share of Spansion's results.

And competitive pressures against Spansion might recede with the spinoff. Acree wonders whether Intel will want to compete as hard in the flash memory market once its rival in microprocessors, AMD, is largely removed from the picture.

"Flash is this extraneous thing for Intel's business," Acree says. "Are they as motivated to be a flash-memory player in the future if they are not in there to disrupt AMD?"

STMicro, Acree said, also has expressed its doubts of remaining in the business.

Despite its challenges, Spansion holds out several reasons for hope of better days ahead.

It has developed a cost-efficient memory design, called MirrorBit, that is gaining ground with customers. It also is developing another flash design technology called Ornand, which it hopes will broaden its market well beyond cell phone manufacturers and makers of communications gear. The 10 largest cell phone makers all are Spansion customers.

"We are a pure-play company, and our customer base is very solid and allowing us to grow going forward," Spansion head Bertrand Cambou said in the road show webcast.

Spansion appears to be making its stock offering just as prices for flash memory chips start firming up. The average selling price for flash chips was declining rapidly early in 2005, but prices began firming in the third quarter.

Analyst Jim Handy with Semico Research Corp. says the part of the flash market that Spansion competes in, called NOR flash, should grow to $8.8 billion in 2006, up 14 percent for the year.

"If you want to time a (stock offering), you want to do it when the flash market is looking good, and it is certainly looking good right now," Handy said.

Possible bumps ahead

But Spansion faces several immediate challenges: The company told investors that management intends to take steps to cut spending and "streamline operations," which sometimes means cutting jobs.

Just where those job cuts will come is not known. Spansion has agreed with Fujitsu that it will limit its job cuts to 10 percent at its three factories in Japan for up to 15 months after the stock offering, according to the prospectus.

Spansion appears ready, however, to invest substantially in upgrading its plants. The company has declared its intention to shift part of its chip production to more efficient manufacturing technology that uses larger silicon wafers that are 300 millimeters (about 12 inches) in diameter.

With less than $200 million in cash, the company appears to lack the resources to build a 300-millimeter factory, which would cost at least $2.5 billion. But Spansion has told analysts that it might retrofit Austin's Fab 25 with the equipment to process the larger wafers, which yield more than twice as many chips as the 200-millimeter wafers that the factory presently works with.

Cambou, a French-born executive, has run Spansion for the past two years. The chairman of the company will be AMD CEO Hector Ruiz, who owns more than 4.4 million of Spansion's shares and options.

It was Ruiz who famously said in January that Spansion's depressed results for the fourth quarter of 2004 "make me want to puke."

Within a few months of that statement, AMD made its first proposal to spin off Spansion as a separate company.

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