
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 29, 2002 or

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

For the transition period from _____ to _____

Commission file number 000-12933

LAM RESEARCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

94-2634797

(I.R.S. Employer Identification Number)

**4650 Cushing Parkway
Fremont, California 94538**

(Address of principal executive offices including zip code)

(510) 572-0200

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO ,

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES NO ,

As of January 31, 2003, there were 125,965,982 shares of Registrant's Common Stock outstanding.

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LAM RESEARCH CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

| | December 29, 2002 | June 30, 2002 |
|--|----------------------|------------------|
| | ----- (unaudited) | ----- (1) |
| Assets | | |
| Cash and cash equivalents..... | \$ 159,377 | \$ 172,431 |
| Short-term investments..... | 392,659 | 701,774 |
| Accounts receivable, net..... | 119,873 | 132,113 |
| Inventories..... | 146,671 | 180,799 |
| Other current assets..... | 14,489 | 43,080 |
| Deferred income taxes..... | 128,715 | 125,227 |
| | ----- | ----- |
| Total current assets..... | 961,784 | 1,355,424 |
| Property and equipment, net..... | 57,511 | 67,496 |
| Restricted cash..... | 61,907 | 70,983 |
| Deferred income taxes..... | 88,307 | 86,231 |
| Other assets..... | 64,706 | 52,157 |
| | ----- | ----- |
| Total assets..... | \$ 1,234,215 | \$ 1,632,291 |
| | ===== | ===== |
| Liabilities and stockholders' equity | | |
| Trade accounts payable..... | \$ 22,931 | \$ 59,806 |
| Accrued expenses and other current liabilities..... | 152,305 | 159,012 |
| Deferred profit..... | 58,091 | 63,435 |
| Current portion of long-term debt and other long-term liabilities | 5,288 | 315,291 |
| | ----- | ----- |
| Total current liabilities..... | 238,615 | 597,544 |
| Long-term debt and other long-term liabilities less current portion..... | 372,848 | 359,691 |
| | ----- | ----- |
| Total liabilities..... | 611,463 | 957,235 |
| Commitments and contingencies | | |
| Preferred stock, at par value of \$0.001 per share; authorized -- 5,000 shares, none outstanding..... | -- | -- |
| Common stock, at par value of \$0.001 per share; authorized -- 400,000 shares; issued and outstanding -- 125,505 shares at December 29, 2002 and 127,978 shares at June 30, 2002..... | 126 | 128 |
| Additional paid-in capital..... | 550,030 | 542,228 |
| Deferred compensation..... | (3,189) | -- |
| Treasury stock, at cost..... | (50,246) | (9,100) |
| Accumulated other comprehensive loss..... | (17,120) | (15,240) |
| Retained earnings..... | 143,151 | 157,040 |
| | ----- | ----- |
| Total stockholders' equity..... | 622,752 | 675,056 |
| | ----- | ----- |
| Total liabilities and stockholders' equity. \$ | 1,234,215 | \$ 1,632,291 |
| | ===== | ===== |

(1) Derived from June 30, 2002 audited financial statements.

See Notes to Condensed Consolidated Financial Statements.

LAM RESEARCH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 29, 2002 | December 30, 2001 | December 29, 2002 | December 30, 2001 |
| Total revenue..... | \$ 184,569 | \$ 259,173 | \$ 382,089 | \$ 598,753 |
| Cost of goods sold..... | 112,380 | 193,745 | 230,906 | 407,614 |
| Cost of goods sold - restructuring charges (recoveries)..... | (301) | -- | (301) | 7,600 |
| Cost of goods sold - patent settlement | -- | 38,780 | -- | 38,780 |
| Total cost of goods sold..... | 112,079 | 232,525 | 230,605 | 453,994 |
| Gross margin | 72,490 | 26,648 | 151,484 | 144,759 |
| Research and development..... | 39,739 | 49,734 | 81,121 | 96,964 |
| Selling, general and administrative... | 31,715 | 43,524 | 65,074 | 90,689 |
| Restructuring charges, net..... | 2,053 | 33,773 | 2,053 | 47,221 |
| Total operating expenses..... | 73,507 | 127,031 | 148,248 | 234,874 |
| Operating income(loss) | (1,017) | (100,383) | 3,236 | (90,115) |
| Other income (expense), net..... | 2,989 | 18,498 | (14,080) | 319 |
| Income(loss) before income taxes..... | 1,972 | (81,885) | (10,844) | (89,796) |
| Income tax expense(benefit) | 493 | (30,230) | 1,391 | (29,221) |
| Net income (loss) | \$ 1,479 | \$ (51,655) | \$ (12,235) | \$ (60,575) |
| Net income (loss) per share: | | | | |
| Basic net income (loss) per share.... | \$ 0.01 | \$ (0.41) | \$ (0.10) | \$ (0.48) |
| Diluted net income (loss) per share.. | \$ 0.01 | \$ (0.41) | \$ (0.10) | \$ (0.48) |
| Number of shares used in per share calculations: | | | | |
| Basic..... | 125,411 | 125,674 | 126,171 | 125,507 |
| Diluted..... | 128,537 | 125,674 | 126,171 | 125,507 |

See Notes to Condensed Consolidated Financial Statements.

LAM RESEARCH CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

| | Six Months Ended | |
|--|----------------------|----------------------|
| | December 29, 2002 | December 30, 2001 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net loss..... | \$ (12,235) | \$ (60,575) |
| Adjustments to reconcile net loss to net cash provided by (used for) operating activities: | | |
| Loss (gain) on equity derivative contracts in in company stock | 16,407 | (890) |
| Depreciation and amortization..... | 21,295 | 31,709 |
| Amortization of premiums on securities..... | 848 | -- |
| Deferred income taxes..... | (5,564) | (32,263) |
| Restructuring charges, net..... | 1,752 | 54,821 |
| Patent settlement | -- | 33,780 |
| Asset impairment charge..... | -- | 9,500 |
| Amortization of deferred compensation..... | 173 | -- |
| Other..... | 245 | -- |
| Change in working capital accounts..... | (9,347) | (13,969) |
| | ----- | ----- |
| Net cash provided by operating activities..... | 13,574 | 22,113 |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Capital expenditures | (5,764) | (4,848) |
| Purchases of available-for-sale securities..... | (140,388) | (1,436,159) |
| Sales of available-for-sale securities..... | 448,655 | 1,299,803 |
| Restricted cash released upon settlement of equity derivative contracts in company stock..... | 9,076 | -- |
| Other, net..... | 704 | 1,399 |
| | ----- | ----- |
| Net cash provided by/(used for) investing activities | 312,283 | (139,805) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Principal payments and redemptions on long-term debt and capital lease obligations..... | (310,019) | (6,477) |
| Treasury stock purchases..... | (39,122) | (10,678) |
| Reissuances of treasury stock..... | 4,753 | 6,520 |
| Proceeds from issuance of common stock..... | 4,438 | 7,268 |
| | ----- | ----- |
| Net cash used for financing activities..... | (339,950) | (3,367) |
| | ----- | ----- |
| Effect of exchange rate changes on cash..... | 1,039 | 278 |
| Net decrease in cash and cash equivalents..... | (13,054) | (120,781) |
| Cash and cash equivalents at beginning of period.... | 172,431 | 221,659 |
| | ----- | ----- |
| Cash and cash equivalents at end of period..... | \$ 159,377 | \$ 100,878 |
| | ===== | ===== |

See Notes to Condensed Consolidated Financial Statements.

LAM RESEARCH CORPORATION NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 29, 2002

(Unaudited)

NOTE A -- BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Lam Research Corporation (the "Company" or "Lam") for the fiscal year ended June 30, 2002, which are included in the Annual Report on Form 10-K, File Number 0-12933. Lam's Form 10-K is available online at the Securities and Exchange Commission website on the Internet. The address of that site is <http://www.sec.gov>. Lam also posts the Form 10-K on the corporate website at <http://www.lamrc.com>.

The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 29, 2003 and includes 52 weeks. The quarter ended December 29, 2002 included 13 weeks and the quarter ended December 30, 2001 included 14 weeks.

NOTE B -- RECENT ACCOUNTING PRONOUNCEMENTS

Impairment or Disposals of Long-Lived Assets: In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 144 ("FAS 144") "Accounting for the Impairment or Disposal of Long-Lived Assets". FAS 144 supersedes FAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and applies to all long-lived assets (including discontinued operations). The Company adopted FAS 144 effective at the beginning of fiscal 2003. The adoption of FAS 144 did not have a material impact on the Company's consolidated financial position or operating results.

Costs associated with Exit or Disposal Activities: In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" ("FAS 146"). FAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" ("EITF 94-3"). The principal difference between FAS 146 and EITF 94-3 relates to FAS 146's requirements for the timing of recognizing a liability for a cost associated with an exit or disposal activity. FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3 a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. FAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early adoption encouraged. The Company early-adopted FAS 146 and applied its accounting provisions to the restructuring activities initiated during the quarter ended December 29, 2002 (see Note L). No restructuring activities were initiated during the quarter ended September 29, 2002.

Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others: In December 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN 45 also requires the guarantor to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee. FIN 45 does not provide guidance on the subsequent measurement of the guarantor's recognized liability over the term of the related guarantee. FIN 45 also incorporates, without change, the guidance in FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others" which is superseded by FIN 45. FIN 45's disclosure requirements are effective for financial statements for periods ending after December 15, 2002. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued after December 31, 2002. FIN 45 is not anticipated to have a material impact on the Company's current financial position or results of operations.

Accounting for Stock-Based Compensation - Transition and Disclosure: In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("FAS 148"), which amends FAS 123, "Accounting for Stock-Based Compensation". FAS 148 provides alternative methods of transition for a voluntary change to the "fair value" method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 and requires prominent disclosure in both annual and interim financial statements of the method of accounting for stock-based employee compensation and the effect of the method used on a company's financial position and results of operations. The transition guidance and annual disclosure requirements of FAS 148 are effective for fiscal years ending after December 15, 2002. The Company is required to adopt the interim disclosure requirements of FAS 148 for financial statements in its fiscal quarter ended March 30, 2003. The Company intends to continue to account for awards issued to employees under its stock purchase and stock option plans under the provisions of Accounting Principles Board Opinion No. 25 "Accounting For Stock Issued to Employees" ("APB 25") using the "intrinsic value" method. Accordingly, the adoption of FAS 148 is not anticipated to have a material impact on the Company's financial position or results of operations.

Consolidation of Variable Interest Entities: In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements". FIN 46 establishes accounting guidance for consolidation of a variable interest entity ("VIE"), sometimes formerly referred to as a

special purpose entity. In general, a VIE is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE. FIN 46 provides guidance for determining when an entity, the Primary Beneficiary, should consolidate another entity, a VIE, that functions to support the activities of the Primary Beneficiary. FIN 46 will require the consolidation of a VIE by a company if that company is subject to a majority of the risk of loss from the VIE's activities or entitled to receive a majority of the VIE's residual returns or both. The Company believes the adoption of FIN 46 could potentially result in the Company having to consolidate the operating results of certain VIEs which are lessors under some of the Company's operating lease agreements and recognize the assets and related liabilities of the VIEs on the Company's balance sheet. The effective date of the new rules under FIN 46 on the Company's existing operating leases is the first fiscal quarter of 2004, and immediately on any new leases entered into after January 31, 2003, which utilize VIEs or equivalent lease structures. The Company is reviewing the new interpretation but has not yet determined the impact FIN 46 will have on its financial position or results of operations.

NOTE C -- INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market. Inventories consist of the following:

| | December 29, 2002 | June 30, 2002 |
|----------------------|----------------------|------------------|
| | ----- | |
| | (in thousands) | |
| Raw materials..... | \$ 89,725 | \$ 108,595 |
| Work-in-process..... | 37,188 | 45,309 |
| Finished goods..... | 19,758 | 26,895 |
| | ----- | |
| | \$ 146,671 | \$ 180,799 |
| | ===== | |

NOTE D -- PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

| | December 29, 2002 | June 30, 2002 |
|--|----------------------|------------------|
| | ----- | |
| | (in thousands) | |
| Manufacturing and office equipment . | \$ 120,975 | \$ 123,117 |
| Leasehold improvements..... | 66,490 | 65,749 |
| Furniture and fixtures..... | 5,215 | 5,246 |
| Computer equipment and software..... | 73,195 | 73,769 |
| | ----- | |
| | 265,875 | 267,881 |
| Less accumulated depreciation and amortization..... | (208,364) | (200,385) |
| | ----- | |
| | \$ 57,511 | \$ 67,496 |
| | ===== | |

NOTE E --INTANGIBLE ASSETS

Effective July 1, 2002, the beginning of fiscal 2003, the Company adopted Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("FAS 142"). FAS 142 requires that goodwill and certain other intangible assets be tested for impairment at least annually and written down only when determined to be impaired, replacing the previous accounting practice of ratably amortizing these items over their estimated useful lives. Intangible assets other than goodwill that have a finite life continue to be amortized over their useful lives. The Company has no goodwill or intangible assets with indefinite lives. The Company's finite-lived intangible assets consist of purchased intellectual property rights and the licensed use of patents that are being amortized over their expected useful lives. Consequently, there was no impact on the Company's financial position or results of operations upon the adoption of FAS 142.

The Company's finite-lived intangible assets consist of the following:

| | December 29, 2002 | | June 30, 2002 | |
|--------------------------------|-------------------|--------------|---------------|--------------|
| | ----- | | ----- | |
| | Gross | Accumulated | Gross | Accumulated |
| | Carrying | Amortization | Carrying | Amortization |
| | Amount | Amount | Amount | Amount |
| | ----- | | | |
| | (in thousands) | | | |
| Intellectual property rights.. | \$ 3,500 | \$ 1,700 | \$ 3,500 | \$ 1,350 |
| Licenses..... | 2,700 | 1,080 | 2,700 | 540 |
| | ----- | | | |

\$ 6,200 \$ 2,780 \$ 6,200 \$ 1,890
 =====

Total amortization expense for the three- and six-month periods ended December 29, 2002, was \$445,000 and \$890,000, respectively compared to \$175,000 and \$350,000, respectively, for three- and six-month periods ended December 30, 2001. Intellectual property rights have an estimated useful life of 5 years and licenses have an estimated useful life of 2.5 years. The weighted-average amortization period of all intangible assets is approximately 4.0 years.

Estimated future intangible asset amortization expense for the remainder of fiscal 2003, and for the five fiscal years thereafter, is as follows:

| Period | Amount |
|--------------------------------|----------------|
| ----- | |
| | (in thousands) |
| Remainder of fiscal 2003... \$ | 890 |
| Fiscal 2004..... | 1,780 |
| Fiscal 2005..... | 550 |
| Fiscal 2006..... | 200 |
| Thereafter..... | - |
| | ----- |
| | \$ 3,420 |
| | ===== |

NOTE F -- DEFERRED COMPENSATION

During the quarter ended December 29, 2002, the Company recorded \$3.4 million of deferred compensation in stockholders' equity, which was offset by a corresponding entry in Additional Paid-In Capital in Stockholders' Equity, in connection with the modification of terms of a fixed stock option award previously issued to an officer. The modification extended the contractual life of the stock option for a period of three years and added additional vesting requirements. However, no changes were made to either the number of shares of the Company's stock subject to the option nor the option's exercise price. Accordingly, the modification resulted in the remeasurement of compensation expense based on the option's intrinsic value on the date of modification in accordance with the provisions of APB 25 and Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB Opinion No. 25" ("FIN 44"). The deferred compensation balance of \$3.4 million will be amortized ratably over the vesting period of the modified options, or 16 quarters. Compensation expense of \$173,000 was recognized in the December 2002 quarter. In addition, when the Nasdaq National Market closing price of Lam's common stock reaches or exceeds \$20.00 per share, all unvested shares will immediately vest and become exercisable on that date and all remaining deferred compensation will be recognized as compensation expense.

NOTE G -- OTHER INCOME (EXPENSE), NET

The significant components of Other Income (Expense), net are as follows:

| | Three Months Ended | | Six Months Ended | |
|--|----------------------|----------------------|----------------------|----------------------|
| | December 29, 2002 | December 30, 2001 | December 29, 2002 | December 30, 2001 |
| | ----- | | | |
| | (in thousands) | | | |
| Gain (loss) on equity derivative contracts in company stock..... | \$ -- | \$ 18,884 | \$ (16,407) | \$ 890 |
| Interest expense..... | (934) | (7,484) | (4,604) | (14,718) |
| Interest income..... | 4,115 | 8,210 | 9,830 | 17,278 |
| Foreign exchange gain (loss) | 88 | 270 | (881) | (866) |
| Other, net | (280) | (1,382) | (2,018) | (2,265) |
| | ----- | ----- | ----- | ----- |
| | \$ 2,989 | \$ 18,498 | \$ (14,080) | \$ 319 |
| | ===== | ===== | ===== | ===== |

NOTE H -- NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net income by the weighted- average number of common shares outstanding during the period. The computation of basic net income (loss) per share for all periods presented is derived from the information on the face of the income statement, and there are no reconciling items in either the numerator or denominator.

Diluted net income (loss) per share is computed as though all potential common shares that are dilutive were outstanding during the period. The following table provides a reconciliation of the denominators of the basic and diluted computations for net income (loss) per share.

Three Months Ended Six Months Ended

| | December 29, 2002 | December 30, 2001 | December 29, 2002 | December 30, 2001 |
|--|----------------------|----------------------|----------------------|----------------------|
| (in thousands, except per share data) | | | | |
| Numerator: | | | | |
| Net income (loss)..... | \$ 1,479 | \$ (51,655) | \$ (12,235) | \$ (60,575) |
| Denominator: | | | | |
| Basic average shares outstanding..... | 125,411 | 125,674 | 126,171 | 125,507 |
| Effect of potential dilutive securities: Employee stock plans | 3,126 | -- | -- | -- |
| Diluted average shares outstanding.... | 128,537 | 125,674 | 126,171 | 125,507 |
| Net income (loss) per share - Basic..... | \$0.01 | (\$0.41) | (\$0.10) | (\$0.48) |
| Net income (loss) per share - Diluted... | \$0.01 | (\$0.41) | (\$0.10) | (\$0.48) |

For the three-month period ended December 29, 2002, warrants and Convertible Subordinated 4% Notes ("4% Notes") were outstanding, but all 8,677,000 weighted-average potential common shares issuable upon the exercise or conversion of these securities were excluded from the computation of diluted net income per common share because the effect was antidilutive. For the six-month period ended December 29, 2002 options, warrants and 4% Notes were outstanding, but all 12,058,000, weighted-average potential common shares were excluded from the computation of diluted net loss per common share because the effect was antidilutive. For the three- and six-month periods ended December 30, 2001 options, warrants and Convertible Subordinated 4% and 5% Notes were outstanding, but all 24,293,000 and 24,746,000 weighted- average potential common shares, respectively, issuable upon the exercise or conversion of these securities were excluded from the computation of diluted net loss per common share because the effect was antidilutive due to the net loss recorded for the period.

In addition for the three- and six-month periods ended December 29, 2002, options to purchase 18,770,000 and 18,737,000 shares of common stock were outstanding, respectively, but were excluded from the computation of diluted net income (loss) per common share because the exercise price of these options exceeded the average market price of the Company's stock for the period and, therefore, was antidilutive. For the three- and six-month periods ended December 30, 2001, options to purchase 5,639,000 and 5,233,000 shares of common stock were outstanding, respectively, but were excluded from the computation of diluted net loss per common share because the exercise price of these options exceeded the average market price of the Company's stock for the period and, therefore, was antidilutive.

NOTE I - COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss), net of tax, are as follows:

| | Three Months Ended | | Six Months Ended | |
|--|----------------------|----------------------|----------------------|----------------------|
| | December 29, 2002 | December 30, 2001 | December 29, 2002 | December 30, 2001 |
| (in thousands) | | | | |
| Net income (loss) | \$ 1,479 | \$ (51,655) | \$ (12,235) | \$ (60,575) |
| Foreign currency translation adjustment..... | 1,115 | 1,584 | (1,075) | 5,026 |
| Unrealized gain (loss) on fair value of derivative financial instruments, net..... | (603) | 713 | (1,388) | 788 |
| Unrealized gain on financial instruments, net..... | 583 | -- | 583 | -- |
| Comprehensive income (loss) | \$ 2,574 | \$ (49,358) | \$ (14,115) | \$ (54,761) |

Accumulated other comprehensive loss, net of tax, is as follows:

| | December 29, 2002 | June 30, 2002 |
|--|----------------------|------------------|
| (in thousands) | | |
| Accumulated foreign currency translation adjustment..... | (\$17,533) | (\$16,458) |
| Accumulated unrealized gain (loss) on derivative financial instruments..... | (170) | 1,218 |
| Accumulated unrealized gain on financial instruments..... | 583 | -- |
| Accumulated other comprehensive loss..... | (\$17,120) | (\$15,240) |

NOTE J -- GUARANTEES

In November 2002, the FASB issued FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". FIN 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN 45 also requires a company ("the guarantor") to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee.

Lease agreements relating to certain buildings at the Company's Fremont, California campus require the Company to guarantee up to 85% of the residual values of the leased buildings at the end of the lease term (in the case that the Company does not renew the lease, assist the lessor in the building's resale, and the sale price is less than the lessor's cost). The maximum potential amount of future payments associated with the guaranteed residual values total \$97.1 million at the end of the respective lease terms (\$44.4 million in 2003, \$25.2 million in 2005 and \$27.5 million in 2006). The terms of the guarantees are equal to the remaining terms of the related lease agreements, which range from three months to three years. In addition, the Company has issued certain indemnifications to its lessors under certain of its operating lease agreements, such as, indemnification for environmental matters. The Company has entered into certain insurance contracts to minimize its exposure related to such indemnifications. As of December 29, 2002, the Company has not recorded any liability on its financial statements in connection with these guarantees, as the Company does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

Additionally, one of the Company's lease agreements includes collateral restrictions that require the Company to maintain a certain amount of cash, \$51.4 million at December 29, 2002, in restricted specified interest bearing accounts. These restricted cash accounts must be maintained through March 2003 (unless the agreement is otherwise terminated or the amount of required cash collateral is reduced), as the underlying building financing obligation is paid down by the Company. These restricted cash accounts are classified as a long-term asset on the Balance Sheet as of December 29, 2002. (See Note P)

The Company has an agreement with a syndicate of financial institutions that guarantees the payment of its Japanese subsidiary's three-year Yen-denominated term loan for approximately ¥6.0 billion (\$50.0 million at December 29, 2002). The entire principal amount of the term loan is due at maturity, June 11, 2004. The Yen-denominated loan is included in Long-term Debt and Other Long-term Liabilities in the unaudited condensed consolidated balance sheet as of December 29, 2002. The guarantee is effective for the term of the loan. The maximum potential amount of future payments the Company could be required to make under this agreement at December 29, 2002, is \$50.0 million and is currently reflected on the unaudited condensed consolidated balance sheet (See Note P). The Company has agreements with two financial institutions that guarantee payment of its Japanese subsidiary's overdraft protection obligation. The maximum potential amount of future payments the Company could be required to make under these agreements at December 29, 2002, is approximately \$5.0 million, the amount available under the overdraft protection agreement. At December 29, 2002, the Company's Japanese subsidiary did not owe any amounts under this agreement. The Company has not recorded any liability on its financial statements in connection with these guarantees.

The Company has an agreement with a financial institution to sell the institution specific U.S. Dollar- denominated receivables generated from the sale of its systems, subject to 100% recourse if not paid within 90 days. To mitigate its exposure related to recourse, the Company insures these sold receivables for approximately 90% of their value. The Company guarantees payment of the remaining uninsured receivable value in the event that the payment obligation is not satisfied. Based on historical payment patterns, the Company has experienced limited default on payment obligations and therefore, believes the risk of loss is minimal. The term of these guarantees is from 90 days past the due date of the receivable, until collected. At December 29, 2002, the maximum potential amount of future payments the Company could be required to make under this agreement is \$3.3 million. As of December 29, 2002, the Company has not recorded any liability on its financial statements in connection with these guarantees as the Company does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

The Company provides a contractual parts and labor warranty on its systems, for a period, which runs generally 12 months from system acceptance, not to exceed 14 months from the date of shipment of the system to the customer. The amount is based on actual historical warranty spending activity by type of system, customer, and geographic region, modified for any known differences such as the impact of system reliability improvements.

Changes in the Company's product warranty reserves during the six months ended at December 29, 2002, were as follows:

| | (in thousands) |
|--|----------------|
| Balance at June 30, 2002..... | \$ 16,762 |
| Warranties issued during the period | 9,736 |
| Settlements made during the period | (8,851) |
| Change in liability for pre-existing warranties during the period, including expirations .. | (686) |
| Balance at December 29, 2002 | \$ 16,961 |

NOTE K -- DERIVATIVE INSTRUMENTS AND HEDGING

The Company carries derivative financial instruments (derivatives) on the balance sheet at their fair value. The Company acquires and holds derivative financial instruments to hedge a variety of risks and exposures including interest rate fluctuation risks associated with our long-term debt, foreign currency exchange rate fluctuations on the value of expected cash flows from forecasted revenue transactions denominated in Japanese Yen and foreign currency denominated assets. Changes in the fair value of derivatives that are not designated or that do not qualify as hedges under Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133") are recognized in earnings immediately. The Company does not use derivatives for trading purposes.

The Company's policy is to attempt to minimize short-term business exposure to foreign exchange risks using the most effective and efficient methods to eliminate or reduce such exposures. In Japan, the Company generally sells its systems, spare parts and services under contracts denominated in Japanese Yen. Therefore, in the normal course of business, the Company's financial position is routinely subjected to market risk associated with foreign currency rate fluctuations. To protect against the reduction in value of forecasted Yen-denominated cash flows resulting from sales in Japanese Yen, the Company has instituted a foreign currency cash flow hedging program. The Company enters into foreign currency forward exchange contracts generally expiring within 12 months, and no later than 24 months. These foreign currency forward exchange contracts, designated as cash flow hedges, are carried on the Company's balance sheet at fair value with the effective portion of the contracts' gains or losses included in Accumulated Other Comprehensive Income (Loss) and subsequently recognized in earnings in the same period the hedged revenue is recognized.

For the three- and six-month periods ended December 29, 2002, the Company recognized a \$56,000 loss and a \$26,000 gain, respectively, for cash flow hedges that had been discontinued, because the original forecasted transactions did not occur. The gain and loss are recorded in Other Income (Expense), net, in the respective December 29, 2002 Condensed Consolidated Statements of Operations.

The following table summarizes activity in Accumulated Other Comprehensive Income (Loss), net of tax, related to derivatives classified solely as cash flow hedges held by the Company during the six months ended December 29, 2002:

| | (in thousands) |
|--|----------------|
| | ----- |
| Deferred cash flow hedging gains at June 30, 2002..... | \$ 1,218 |
| Reclassified into earnings from other comprehensive income..... | (147) |
| Changes in fair value of derivative financial instruments, net..... | (1,241) |
| | ----- |
| Deferred cash flow hedging losses at December 29, 2002..... | \$ (170) |
| | ===== |

At December 29, 2002, the Company expects to reclassify the balance of deferred hedging gains and losses, net, included in Accumulated Other Comprehensive Income (Loss) to earnings during the next 12 months due to the recognition in earnings of the hedged forecasted transactions.

The Company also enters into foreign currency forward contracts to hedge the gains and losses generated by the remeasurement of Yen denominated intercompany receivables. Under FAS 133, these are not designated hedges. Therefore, the change in fair value of these derivatives is recorded into earnings as a component of Other Income (Expense), net and offsets the change in fair value of the foreign currency denominated intercompany receivables.

The Company also has a policy to minimize, where possible and practical, the impact of interest rate exposure associated with its interest rate sensitive investments and debt obligations. To limit the impact relating to interest rate exposure associated with its fixed rate 4% Convertible Subordinated Notes ("4% Notes"), the Company is a party to an interest rate swap agreement ("the swap") with a notional amount of \$300.0 million. Under the terms of the swap, the Company exchanges the fixed interest payments on its 4% Notes for variable interest payments based on the London Interbank Offered Rate ("LIBOR"). The swap is accounted for as a fair value hedge under the provisions of FAS 133. Fluctuations in the fair value of the 4% Notes, resulting from changes in the LIBOR interest rate sensitive component, are recorded in earnings, and offset by changes in the fair value of the swap, which are also recorded in earnings.

As a result of designating the swap as a hedge of its 4% Notes, the carrying value of the 4% Notes is adjusted to reflect changes in fair value attributable to changes in the benchmark interest rate. For the three and six months ended December 29, 2002, the carrying value of the 4% Notes included in Long-Term Debt and Other Long-Term Liabilities was increased by \$1.5 million and \$14.2 million, respectively, (to \$317.7 million at December 29, 2002) with the corresponding loss for the three- and six-month periods recorded in Other Income (Expense), net. Over the same three- and six-month periods, the fair value of the swap, included in Long-Term Assets, increased by \$1.5 million and \$14.0 million, respectively, (to \$17.3 million at December 29, 2002) with the corresponding offsetting gains for the three- and six-month periods recorded in Other Income (Expense), net.

For the three- and six-month periods ended December 29, 2002, the Company recognized net losses of \$35,000 and \$172,000, respectively, in Other Income (Expense), net, resulting from hedge ineffectiveness related to differences in changes in the fair value of the swap and changes in the fair value of the 4% Notes.

NOTE L -- RESTRUCTURING ACTIVITIES

June 2001 Plan

In April 2001, the Company announced its intention to reduce its global workforce up to 15% during the fourth quarter of fiscal 2001 ("the June 2001 Plan"). The reduction in force was driven by the then anticipated level of decline in the Company's revenues due to the forecasted level of contraction of the Company's served market from calendar year 2000. During the fourth quarter of fiscal 2001, the appropriate level of management necessary to commit to the specific actions of the plan approved the June 2001 Plan. The Company began implementing the announced restructuring plan and reduced its workforce by approximately 11% prior to June 24, 2001. The Company recorded a restructuring charge of \$16.8 million which included severance and benefits for involuntarily terminated employees, charges for remaining lease payments and leasehold improvements on vacated facilities, and charges for inventories of a product line that has been discontinued. In addition, the Company consolidated its Fremont manufacturing facilities and wrote-off the carrying cost of abandoned facility assets.

During the fourth quarter of fiscal 2002, the Company recovered approximately \$2.3 million of restructuring charges originally recorded under the June 2001 Plan. Of this amount \$1.4 million was recovered due to outplacement services guaranteed by the Company for terminated employees and other employee benefit costs not being fully utilized. The Company also recovered \$0.9 million from certain product line inventory previously segregated and written off. During the second quarter of fiscal 2003, the Company completed the remaining elements of its restructuring activities under the June 2001 Plan and recovered an additional \$0.6 million of restructuring charges. Of this amount \$0.5 million was recovered due to lower than estimated employee termination costs.

Below is a table summarizing activity relating to the June 2001 Plan:

| | Severance and Benefits | Lease Payments on Vacated Facilities | Abandoned Fixed Assets | Discontinued Inventory | Other Exit Costs | Total |
|-------------------------------------|------------------------------|---|------------------------------|---------------------------|------------------------|-----------|
| (in thousands) | | | | | | |
| June 2001 provision..... | \$ 8,282 | \$ 1,312 | \$ 3,036 | \$ 3,732 | \$ 407 | \$ 16,769 |
| Cash payments..... | (4,067) | -- | -- | -- | -- | (4,067) |
| Non-cash charges..... | -- | -- | (3,036) | (3,732) | (10) | (6,778) |
| Balance at June 24, 2001..... | 4,215 | 1,312 | -- | -- | 397 | 5,924 |
| Recovery of assets..... | -- | -- | -- | 889 | -- | 889 |
| Cash payments..... | (1,507) | (706) | -- | -- | (27) | (2,240) |
| Non-cash charges..... | (819) | -- | -- | -- | (322) | (1,141) |
| Reversal of restructuring charges.. | (1,359) | -- | -- | (889) | -- | (2,248) |
| Balance at June 30, 2002..... | 530 | 606 | -- | -- | 48 | 1,184 |
| Recovery of assets..... | -- | -- | -- | 31 | -- | 31 |
| Cash payments..... | (17) | (212) | -- | -- | -- | (229) |
| Non-cash charges..... | (13) | -- | -- | -- | -- | (13) |
| Reversal of restructuring charges.. | (500) | -- | -- | (31) | (48) | (579) |
| Balance at December 29, 2002..... | \$ -- | \$ 394 | \$ -- | \$ -- | \$ -- | \$ 394 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to June 24, 2001, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced.

Lease Payments on Vacated Facilities relates to 24 months of rent (or the remainder of the lease term, if less) after the abandonment of certain facilities currently under long-term operating lease agreements. The Company estimated, given prevailing real estate market conditions at that time, that it would take approximately 24 months to sublease its vacated buildings in Fremont, California. When applicable, anticipated future sublease income relating to vacated buildings has been offset against the charge for the remaining lease payments.

The Company wrote-off all leasehold improvements relating to the vacated buildings of approximately \$1.5 million, as these items will have no future economic benefit and have been abandoned. In addition, certain demonstration equipment and manufacturing inventory were abandoned and written-off.

Other exit costs relate to customer accommodations for the discontinued product line and expenses associated with capital improvements to the vacated facilities.

September 2001 Plan

By mid to late summer of 2001, further deterioration in semiconductor sales resulted in a lower outlook for the wafer fabrication equipment market and therefore in the Company's revenues. Consequently, in August 2001, the Company announced a new plan ("the September 2001 Plan") to further reduce its fixed cost infrastructure, including an approximate 10% reduction-in-force. During the first quarter of fiscal 2002, the September 2001 Plan was approved by the appropriate level of management necessary to commit to the specific actions of the plan. The Company began implementing the announced restructuring activities and reduced its workforce by approximately 550 employees, prior to September 23, 2001. The Company recorded a restructuring charge of \$21.0

million which included severance and benefits for involuntarily terminated employees, charges for remaining lease payments and leasehold improvements on vacated facilities, and write-offs for inventories of selected, older product lines that were discontinued.

During the fourth quarter of fiscal 2002, the Company recovered approximately \$1.8 million of restructuring charges originally recorded under the September 2001 Plan. Of this amount \$0.7 million was recovered due to outplacement services guaranteed by the Company for terminated employees and other employee benefit costs not being fully utilized. The Company also recovered \$0.8 million from certain of its older discontinued inventories previously segregated and written-off and \$0.3 million due to lower than estimated expenses relating to a vacated facility lease that ended during the June 2002 quarter. During the second quarter of fiscal 2003, the Company completed certain elements of its restructuring activities under the September 2001 Plan and recovered an additional \$0.7 million of restructuring charges. Of this amount \$0.4 million was recovered due to lower than previously estimated employee severance and termination costs. The Company also recovered \$0.3 million from the sale of certain of its older discontinued inventories previously segregated and written-off. In addition, based on prevailing real estate market conditions, the Company revised its estimate of the length of time required to sublease one of its vacated buildings in Fremont, California. As a result of the change in estimate, the Company recorded an additional \$0.6 million relating to remaining lease payments on vacated facilities under long-term operating lease agreements.

Below is a table summarizing activity relating to the September 2001 Plan:

| | Severance and Benefits | Lease Payments on Vacated Facilities | Abandoned Fixed Assets | Discontinued Inventory | Total |
|-------------------------------------|------------------------------|---|------------------------------|---------------------------|-----------|
| (in thousands) | | | | | |
| September 2001 provision..... | \$ 10,767 | \$ 1,746 | \$ 935 | \$ 7,600 | \$ 21,048 |
| Recovery of assets..... | -- | -- | -- | 785 | 785 |
| Cash payments..... | (8,135) | (762) | -- | -- | (8,897) |
| Non-cash charges..... | (1,035) | -- | (935) | (7,600) | (9,570) |
| Reversal of restructuring charges.. | (695) | (317) | -- | (785) | (1,797) |
| Balance at June 30, 2002..... | 902 | 667 | -- | -- | 1,569 |
| Recovery of assets..... | -- | -- | -- | 270 | 270 |
| Cash payments..... | (131) | (266) | -- | -- | (397) |
| Reversal of restructuring charges.. | (416) | -- | -- | (270) | (686) |
| Additional restructuring charges... | -- | 636 | -- | -- | 636 |
| Balance at December 29, 2002..... | \$ 355 | \$ 1,037 | \$ -- | \$ -- | \$ 1,392 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to September 23, 2001, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced. The remainder of the Severance and Benefits reserve balance of \$0.4 million, as of December 29, 2002, is anticipated to be utilized by the end of the 2003 fiscal year.

Lease Payments on Vacated Facilities generally relates to 24 months of rent (or the remainder of the lease term, if less) after the abandonment of certain facilities currently under long-term operating lease agreements. The Company initially estimated, given prevailing real estate market conditions at that time, that it would take approximately 24 months to sublease its vacated facilities in Fremont, California. The Company revised its estimate, based on subsequent real estate market conditions, and extended its estimate of lease payments on one of its vacated facilities in the September 2001 Plan to the end of the lease in June 2004.

The Company wrote-off all leasehold improvements relating to the vacated buildings of approximately \$0.9 million, as these items have no future economic benefit and have been abandoned. Additionally, the Company exited selected, older product lines and wrote-off the related discontinued manufacturing inventory.

December 2001 Plan

The continued and severe degradation in the wafer fabrication equipment market in late calendar year 2001 and its impact on the Company's near-term financial forecast necessitated another restructuring plan ("the December 2001 Plan"). On December 20, 2001, the Company publicly announced its intention to reduce its global employment by approximately 12%, and further consolidate its facilities. During the second fiscal quarter of 2002, the December 2001 Plan was approved by the appropriate level of management necessary to commit to the specific actions of the plan. The Company began implementing the announced restructuring activities and reduction of its workforce by approximately 470 employees, prior to December 30, 2001. The Company recorded a restructuring charge of \$33.8 million relating to severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities and the write-off of related leasehold improvements and fixed assets.

During the second quarter of fiscal 2003, the Company recovered \$3.7 million of restructuring charges originally recorded under the December 2001 Plan. Of this amount, \$2.1 million was recovered due to lower severance and termination costs. The Company also recovered \$1.6 million from vacated facilities' leases due to actual expenses being lower than estimated. During the second quarter of fiscal 2003, the Company also recorded additional restructuring charges of \$0.5 million relating to the December 2001 Plan. Based on prevailing real estate market conditions, the Company revised its estimates of the length of time required to sublease one of its vacated buildings in Fremont, California and recorded an additional \$0.4 million for remaining lease payments on vacated facilities under long-term operating lease agreements. The Company also determined that additional facility restoration costs, in order to fulfill the Company's contractual obligations under the terms of the lease agreement, were needed relating to

another of the Company's vacated buildings in the December 2001 Plan and recorded an additional \$0.1 million restructuring charge.

Below is a table summarizing activity relating to the December 2001 Plan:

| | Severance and Benefits | Lease Payments on Vacated Facilities | Abandoned Fixed Assets | Total |
|-------------------------------------|------------------------|--------------------------------------|------------------------|-----------|
| (in thousands) | | | | |
| December 2001 provision..... | \$ 14,208 | \$ 9,637 | \$ 9,928 | \$ 33,773 |
| Cash payments..... | (9,122) | (386) | -- | (9,508) |
| Non-cash charges..... | (1,529) | (127) | (9,928) | (11,584) |
| Balance at June 30, 2002..... | 3,557 | 9,124 | -- | 12,681 |
| Recovery of assets..... | -- | -- | 18 | 18 |
| Cash payments..... | (1,052) | (1,385) | -- | (2,437) |
| Reversal of restructuring charges.. | (2,118) | (1,609) | (18) | (3,745) |
| Additional restructuring charges... | -- | 450 | -- | 450 |
| Balance at December 29, 2002..... | \$ 387 | \$ 6,580 | \$ -- | \$ 6,967 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to December 30, 2001, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced. The remainder of the Severance and Benefits reserve balance of \$0.4 million, as of December 29, 2002, is anticipated to be utilized by the end of the 2003 fiscal year.

Lease Payments on Vacated Facilities generally relates to 24 months of rent (or the remainder of the lease term, if less) after the abandonment of certain facilities currently under long-term operating lease agreements. The Company initially estimated, given prevailing real estate market conditions at that time, that it would take approximately 24 months to sublease its vacated facilities in Fremont, California. The Company revised its estimate, based on subsequent real estate market conditions, and extended its estimate of lease payments on one of its vacated facilities in the December 2001 Plan to the end of the lease in January 2005.

The Company wrote off leasehold improvements relating to the vacated buildings of approximately \$8.8 million, as these items will have no future economic benefit and have been abandoned. Additionally, certain fixed assets of approximately \$1.1 million associated with these facilities had no future economic benefit and have been abandoned and written-off.

December 2002 Plan

In response to the continued depressed conditions in the semiconductor industry and after evaluating the Company's employee base, outsourcing plan and its impact on manufacturing and administrative facilities and near-term financial forecast, senior management of the Company committed to an incremental set of cost reduction and exit activities in the quarter ended December 29, 2002 ("the December 2002 Plan"). The December 2002 Plan was accounted for under the provisions of FAS 146, which the Company early adopted in the December 2002 quarter. The December 2002 Plan was approved by the appropriate level of management necessary to commit to the specific actions of the Plan, and the Company began carrying out the announced restructuring activities prior to December 29, 2002 by reducing its global workforce by approximately 120 people and further consolidating its worldwide sales and support facilities. The Company recorded a restructuring charge of \$5.7 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities and the write-off of related leasehold improvements.

Below is a table summarizing activity relating to the December 2002 Plan:

| | Severance and Benefits | Payments on Vacated Facilities | Abandoned Fixed Assets | Total |
|-----------------------------------|------------------------|--------------------------------|------------------------|----------|
| (in thousands) | | | | |
| December 2002 provision..... | \$ 3,257 | \$ 1,945 | \$ 474 | \$ 5,676 |
| Cash payments..... | (821) | (98) | -- | (919) |
| Non-cash charges..... | -- | -- | (474) | (474) |
| Balance at December 29, 2002..... | \$ 2,436 | \$ 1,847 | \$ -- | \$ 4,283 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to December 29, 2002, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced. The remainder of the Severance and Benefits reserve balance of \$2.4 million as of December 29, 2002, is anticipated to be utilized by the end of the 2003 calendar year.

Lease Payments on Vacated Facilities are based on management's estimates based on known prevailing real estate market conditions at that time. Under the provisions of FAS 146, the restructuring charges for lease payments on vacated facilities were

recognized, as the related facilities were no longer occupied by the Company at December 29, 2002.

The Company wrote off leasehold improvements relating to the vacated buildings of approximately \$0.5 million, as these items will have no future economic benefit and have been abandoned.

NOTE M -- REDEMPTION OF CONVERTIBLE SUBORDINATED NOTES

The Company's 5% Convertible Subordinated Notes matured on September 2, 2002 and were repaid in full. This resulted in a cash outlay of approximately \$309.8 million.

NOTE N - EQUITY DERIVATIVE CONTRACTS IN COMPANY STOCK

The Company's equity derivatives acquired in June 1999, included certain put and call options indexed to its own stock. Application of EITF 00-19, "Determination of Whether Share Settlement is Within the Control of the Issuer", for the purposes of applying EITF Issue No. 96-13, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", required these previously purchased instruments to be recorded at their fair value at the end of each reporting period, commencing in June 2001, with the change in fair value recorded as a gain or loss in the Company's statement of operations. The Company's equity derivatives were collateralized by restricted cash of \$9.1 million and could not be settled in unregistered shares. They were classified as Other Short-Term Assets (\$24.8 million), at the end of fiscal 2002.

On August 23, 2002, the Company settled its equity derivative contracts by purchasing approximately 3.5 million shares of Lam common stock at an average price of \$11.19 per share for a total cash payment of \$39.1 million. By settling the equity derivative contracts, the Company was able to repurchase the shares at a discount of \$8.4 million (\$2.41 per share) from their then market value. As a result of this transaction, the Company recognized an increase in treasury stock of \$47.6 million.

Based on the \$13.60 market price of the Company's common stock at the contract settlement date, the fair value of the equity derivative contracts declined by \$16.4 million to \$8.4 million, from their June 30, 2002 fair value of \$24.8 million. This \$16.4 million reduction in the equity derivative contracts' fair value was recorded as a non-taxable loss in Other Income (Expense), net, in the three months ended September 29, 2002 and six months ended December 29, 2002.

NOTE O -- LITIGATION

See Part II, item 1 for discussion of litigation.

NOTE P -- SUBSEQUENT EVENTS

On January 28, 2003, the Company's Japanese subsidiary repaid its ¥6.0 billion (\$50.0 million at December 29, 2002) Japanese term loan in full. The repayment of the term loan reduced cash by \$50.0 million and reduced long-term liabilities by the same amount.

On February 7, 2003, the Company provided \$59.0 million of additional cash collateral under two of its operating lease agreements. The collateralization reduced cash, cash equivalents and short-term investments by \$59.0 million and increased restricted cash by \$59.0 million. The collateralization transaction had no impact on total cash, cash equivalents, short-term investments and restricted cash.

During January 2003, the Company announced plans for further facility consolidations from January 2003 through September 2003. The Company anticipates it will incur restructuring charges of approximately \$10.0 million during the January 2003 to September 2003 period.

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

Forward Looking Statements

With the exception of historical facts, the statements contained in this discussion are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, and are subject to the Safe Harbor provisions created by these statutes. Such forward-looking statements include, but are not limited to, statements that relate to our future revenue and income, product development, demand, acceptance and market share, competitiveness, gross margins, levels of research and development, outsourcing plans and operating expenses, our management's plans and objectives for our current and future operations, and the sufficiency of financial resources to support future operations and capital expenditures. Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value and effect, including those discussed below under the heading Risk Factors, and other documents we may file from time to time with the Securities and Exchange Commission, specifically our last filed Annual Report on Form 10-K for the fiscal year ended June 30, 2002. Such risks, uncertainties and changes in condition, significance, value and effect could cause our actual results to differ materially from those expressed herein and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known. We undertake no obligation to release any revisions to these forward-looking statements, which may be made to reflect events or circumstances, which occur after the date hereof.

Documents To Review In Connection With Management's Analysis Of Financial Condition and Results Of Operations

This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes presented in this Form 10-Q and the financial statements and notes in our last filed Annual Report on Form 10-K for a full understanding of our financial position at December 29, 2002 and results of operations for the three- and six-month periods ended December 29, 2002.

RESULTS OF OPERATIONS

Lam Research Corporation is a leading supplier of technically complex thin film selective removal equipment used during the fabrication process of semiconductors. Our product offerings include single wafer plasma etch systems with a wide range of applications, Chemical Mechanical Planarization ("CMP") and post-CMP wafer cleaning systems. Demand for our equipment can fluctuate significantly from period to period as a result of various factors, including but not limited to, economic conditions, supply and demand for semiconductors, customer capacity requirements, and our ability to develop and market competitive, new products. For these and other reasons, our results of operations for the three- and six-month periods ended December 29, 2002 may not necessarily be indicative of future operating results.

Total Revenue

Our total revenues for the three- and six-month periods ended December 29, 2002 were \$184.6 million and \$382.1 million respectively, a decrease of 28.8% and 36.2%, respectively, compared to the corresponding periods in the prior year. This decrease in our revenues is due to reduced capital equipment expenditures by our customers in response to the over capacity in the semiconductor industry. The decrease in total revenues for the December 2002 quarter compared to the September 2002 quarter is due in part to lower spares shipments and our customers extending their December shutdowns.

The geographic breakdown of revenue was as follows:

| | Three Months Ended | | Six Months Ended | |
|--------------------|--------------------|-------------------|-------------------|-------------------|
| | December 29, 2002 | December 30, 2001 | December 29, 2002 | December 30, 2001 |
| North America..... | 31% | 27% | 27% | 27% |
| Europe..... | 16% | 22% | 17% | 23% |
| Asia Pacific..... | 46% | 30% | 47% | 35% |
| Japan..... | 7% | 21% | 9% | 15% |

The decline in revenues primarily from Japan and Europe has resulted in a greater proportion of revenue from Asia Pacific in the first half of fiscal 2003 compared to the same period in fiscal 2002.

Our current estimate for the March 2003 quarter is for revenues of approximately \$180.0 million.

Gross Margin

Our gross margins as a percentage of revenue were 39.3% and 39.6% for the three- and six- month periods ended December 29, 2002, compared to 10.3% and 24.2% for the corresponding periods one year ago. Excluding an inventory charge of approximately \$24.1 million and a patent litigation settlement charge of \$38.8 million, gross margins as a percentage of revenue were 34.5% and 34.7% for the three- and six-month periods a year ago. The improvement in adjusted gross margin as a percent of revenue for the three-and six-month periods of fiscal 2003, compared to the corresponding periods of fiscal 2002 can be attributed to cost reductions associated with our outsourcing programs. The sequential decrease from the September 2002 quarter in gross margin as a percent of revenue is primarily due to lower spares shipments and under-utilization of our field service resources.

Research and Development

Research and Development ("R&D") expenses for the three- and six-month periods ended December 29, 2002, were \$39.7 million and \$81.1 million, 20.1% and 16.3% lower, respectively, than the comparable year-ago periods. Excluding a \$5.3 million impairment charge related to the write-down of selected R&D equipment recorded in the December 2001 quarter, R&D expenses for the three- and six-month periods ended December 29, 2002 were 10.6% and 11.5% lower, respectively, than the comparable year-ago periods. The decrease in absolute dollars for the three- and six-month periods of fiscal 2003 compared to the corresponding periods in fiscal 2002 is primarily due to personnel reductions and on-going cost containment activities.

R&D expenses as a percentage of revenue for the three and six months ended December 29, 2002, were 21.5% and 21.2%, respectively, compared to 19.2% and 16.2%, respectively, of revenue for the corresponding periods a year ago. The increase in R&D expenses as a percentage of revenue for the three- and six-months ended December 29, 2002, compared to the corresponding periods a year ago, is a function of the decrease in our revenues as well as our continued investment in strategic research and development programs.

In subsequent quarters, we expect to at least maintain present levels of investment in development of new products and enhancements to current offerings.

Selling, General and Administrative

Selling, General and Administrative ("SG&A") expenses for the three- and six-month periods ended December 29, 2002 were \$31.7 million and \$65.1 million, 27.1% and 28.2% lower, respectively, than SG&A expenses in the corresponding fiscal 2002 period. Excluding a \$4.2 million impairment charge to write-down demonstration equipment recorded in the December 2001 quarter, SG&A expenses for the three- and six-month periods ended December 29, 2002 were 19.3% and 24.8% lower, respectively, than the comparable year-ago periods. The decrease in absolute dollars in the first half of fiscal 2003 compared to the corresponding periods in fiscal 2002 is primarily due to personnel reductions implemented during fiscal 2002 and cost reduction programs.

As a percentage of total revenue, SG&A expenses for the three and six months ended December 29, 2002, were 17.2% and 17.0%, respectively, compared to 16.8% and 15.1%, respectively, of total revenue for the comparable period in fiscal 2002. The increase as a percentage of revenue for the three and six months ended December 29, 2002, as compared to the corresponding period a year ago, reflects the decrease in our revenues due to the contraction of the semiconductor equipment market.

We expect SG&A expenses to rise in absolute dollars in the March 2003 quarter partly due to the increased number of working days in the March quarter compared to the prior period.

Restructuring Activities

We have developed restructuring plans in response to changes in business outlook with the intent to align our cost structure with anticipated revenue levels. Expenses have been incurred associated with cost reduction activities including downsizing and reorganizations and business exit activities related to discontinued product lines. Accounting for restructuring activities requires an evaluation of formally agreed upon and approved plans. Although management makes every attempt to consolidate all known restructuring activities into one plan, the nature of our extreme cycles and rapidly changing environment places practical limitations on achieving this objective. The recognition of a restructuring event does not necessarily exclude similar but unrelated actions in future periods.

June 2001 Plan

In April 2001, we announced our intention to reduce our global workforce up to 15% during the fourth quarter of fiscal 2001 ("the June 2001 Plan"). The reduction in force was driven by the then anticipated level of decline in our revenues due to the forecasted level of contraction of our served market from calendar year 2000. During the fourth quarter of fiscal 2001, the appropriate level of management necessary to commit to the specific actions of the plan approved the June 2001 Plan. We began implementing the announced restructuring plan and reduced our workforce by approximately 11% prior to June 24, 2001. We recorded a restructuring charge of \$16.8 million which included severance and benefits for involuntarily terminated employees, charges for remaining lease payments and leasehold improvements on vacated facilities, and charges for inventories of a product line that has been discontinued. In addition, we consolidated our Fremont manufacturing facilities and wrote-off the carrying cost of abandoned facility assets.

During the fourth quarter of fiscal 2002, we recovered approximately \$2.3 million of restructuring charges originally recorded under the June 2001 Plan. Of this amount \$1.4 million was recovered due to outplacement services guaranteed by us for terminated employees and other employee benefit costs not being fully utilized. We also recovered \$0.9 million from certain of our product line inventory previously segregated and written off. During the second quarter of fiscal 2003, we completed the remaining elements of our restructuring activities under the June 2001 Plan and recovered an additional \$0.6 million of restructuring charges. Of this amount \$0.5 million was recovered due to lower than estimated employee termination costs.

Below is a table summarizing activity relating to the June 2001 Plan:

| | Severance and Benefits | Lease Payments on Vacated Facilities | Abandoned Fixed Assets | Discontinued Inventory | Other Exit Costs | Total |
|-------------------------------------|------------------------------|---|------------------------------|---------------------------|------------------------|-----------|
| (in thousands) | | | | | | |
| June 2001 provision..... | \$ 8,282 | \$ 1,312 | \$ 3,036 | \$ 3,732 | \$ 407 | \$ 16,769 |
| Cash payments..... | (4,067) | -- | -- | -- | -- | (4,067) |
| Non-cash charges..... | -- | -- | (3,036) | (3,732) | (10) | (6,778) |
| Balance at June 24, 2001..... | 4,215 | 1,312 | -- | -- | 397 | 5,924 |
| Recovery of assets..... | -- | -- | -- | 889 | -- | 889 |
| Cash payments..... | (1,507) | (706) | -- | -- | (27) | (2,240) |
| Non-cash charges..... | (819) | -- | -- | -- | (322) | (1,141) |
| Reversal of restructuring charges.. | (1,359) | -- | -- | (889) | -- | (2,248) |
| Balance at June 30, 2002..... | 530 | 606 | -- | -- | 48 | 1,184 |
| Recovery of assets..... | -- | -- | -- | 31 | -- | 31 |
| Cash payments..... | (17) | (212) | -- | -- | -- | (229) |
| Non-cash charges..... | (13) | -- | -- | -- | -- | (13) |
| Reversal of restructuring charges.. | (500) | -- | -- | (31) | (48) | (579) |
| Balance at December 29, 2002..... | \$ -- | \$ 394 | \$ -- | \$ -- | \$ -- | \$ 394 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to June 24, 2001, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could

determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced.

Lease Payments on Vacated Facilities relates to 24 months of rent (or the remainder of the lease term, if less) after the abandonment of certain facilities currently under long-term operating lease agreements. We estimated, given prevailing real estate market conditions at that time, that it would take approximately 24 months to sublease our vacated buildings in Fremont, California. When applicable, anticipated future sublease income relating to vacated buildings has been offset against the charge for the remaining lease payments.

We wrote-off all leasehold improvements relating to the vacated buildings of approximately \$1.5 million, as these items will have no future economic benefit and have been abandoned. In addition, certain demonstration equipment and manufacturing inventory were abandoned and written-off.

Other exit costs relate to customer accommodations for the discontinued product line and expenses associated with capital improvements to the vacated facilities.

September 2001 Plan

By mid to late summer of 2001, further deterioration in semiconductor sales resulted in a lower outlook for the wafer fabrication equipment market and therefore in our revenues. Consequently, in August 2001, we announced a new plan ("the September 2001 Plan") to further reduce our fixed cost infrastructure, including an approximate 10% reduction-in-force. During the first quarter of fiscal 2002, the September 2001 Plan was approved by the appropriate level of management necessary to commit to the specific actions of the plan. We began implementing the announced restructuring activities and reduced our workforce by approximately 550 employees, prior to September 23, 2001. We recorded a restructuring charge of \$21.0 million which included severance and benefits for involuntarily terminated employees, charges for remaining lease payments and leasehold improvements on vacated facilities, and write-offs for inventories of selected, older product lines that were discontinued.

During the fourth quarter of fiscal 2002, we recovered approximately \$1.8 million of restructuring charges originally recorded under the September 2001 Plan. Of this amount \$0.7 million was recovered due to outplacement services guaranteed by us for terminated employees and other employee benefit costs not being fully utilized. We also recovered \$0.8 million from certain of our older discontinued inventories previously segregated and written-off and \$0.3 million due to lower than estimated expenses relating to a vacated facility lease that ended during the June 2002 quarter. During the second quarter of fiscal 2003, we completed certain elements of our restructuring activities under the September 2001 Plan and recovered an additional \$0.7 million of restructuring charges. Of this amount \$0.4 million was recovered due to lower than previously estimated employee severance and termination costs. We also recovered \$0.3 million from the sale of certain of our older discontinued inventories previously segregated and written-off. In addition, based on prevailing real estate market conditions, we revised our estimate of the length of time required to sublease one of our vacated buildings in Fremont, California. As a result of the change in estimate, we recorded an additional \$0.6 million relating to remaining lease payments on vacated facilities under long-term operating lease agreements.

Below is a table summarizing activity relating to the September 2001 Plan:

| | Severance and Benefits | Lease Payments on Vacated Facilities | Abandoned Fixed Assets | Discontinued Inventory | Total |
|-------------------------------------|------------------------------|---|------------------------------|---------------------------|-----------|
| | | | (in thousands) | | |
| September 2001 provision..... | \$ 10,767 | \$ 1,746 | \$ 935 | \$ 7,600 | \$ 21,048 |
| Recovery of assets..... | -- | -- | -- | 785 | 785 |
| Cash payments..... | (8,135) | (762) | -- | -- | (8,897) |
| Non-cash charges..... | (1,035) | -- | (935) | (7,600) | (9,570) |
| Reversal of restructuring charges.. | (695) | (317) | -- | (785) | (1,797) |
| Balance at June 30, 2002..... | 902 | 667 | -- | -- | 1,569 |
| Recovery of assets..... | -- | -- | -- | 270 | 270 |
| Cash payments..... | (131) | (266) | -- | -- | (397) |
| Reversal of restructuring charges.. | (416) | -- | -- | (270) | (686) |
| Additional restructuring charges... | -- | 636 | -- | -- | 636 |
| Balance at December 29, 2002..... | \$ 355 | \$ 1,037 | \$ -- | \$ -- | \$ 1,392 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to September 23, 2001, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced. The remainder of the Severance and Benefits reserve balance of \$0.4 million, as of December 29, 2002, is anticipated to be utilized by the end of the 2003 fiscal year.

Lease Payments on Vacated Facilities generally relates to 24 months of rent (or the remainder of the lease term, if less) after the abandonment of certain facilities currently under long-term operating lease agreements. We initially estimated, given prevailing real estate market conditions at that time, that it would take approximately 24 months to sublease our vacated facilities in Fremont, California. We revised our estimate, based on subsequent real estate market conditions, and extended our estimate of lease payments on one of our vacated facilities in the September 2001 Plan to the end of the lease in June 2004.

We wrote-off all leasehold improvements relating to the vacated buildings of approximately \$0.9 million as these items have no future economic benefit and have been abandoned. Additionally, we exited selected, older product lines and wrote-off the related discontinued manufacturing inventory.

December 2001 Plan

The continued and severe degradation in the wafer fabrication equipment market in late calendar year 2001 and its impact on our near-term financial forecast necessitated another restructuring plan ("the December 2001 Plan"). On December 20, 2001, we publicly announced our intention to reduce our global employment by approximately 12%, and further consolidate our facilities. During the second fiscal quarter of 2002, the December 2001 Plan was approved by the appropriate level of management necessary to commit to the specific actions of the plan. We began implementing the announced restructuring activities and reduction of our workforce by approximately 470 employees, prior to December 30, 2001. We recorded a restructuring charge of \$33.8 million relating to severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities and the write-off of related leasehold improvements and fixed assets.

During the second quarter of fiscal 2003, we recovered \$3.7 million of restructuring charges originally recorded under the December 2001 Plan. Of this amount, \$2.1 million was recovered due to lower severance and termination costs. We also recovered \$1.6 million from vacated facilities' leases due to actual expenses being lower than estimated. During the second quarter of fiscal 2003, we also recorded additional restructuring charges of \$0.5 million relating to the December 2001 Plan. Based on prevailing real estate market conditions, we revised our estimates of the length of time required to sublease one of our vacated buildings in Fremont, California and recorded an additional \$0.4 million for remaining lease payments on vacated facilities under long-term operating lease agreements. We also determined that additional facility restoration costs, in order to fulfill our contractual obligations under the terms of the lease agreement, were needed relating to another of our vacated buildings in the December 2001 Plan and recorded an additional \$0.1 million restructuring charge.

Below is a table summarizing activity relating to the December 2001 Plan:

| | Severance and Benefits | Lease Payments on Vacated Facilities | Abandoned Fixed Assets | Total |
|-------------------------------------|------------------------------|---|------------------------------|-----------|
| | (in thousands) | | | |
| December 2001 provision..... | \$ 14,208 | \$ 9,637 | \$ 9,928 | \$ 33,773 |
| Cash payments..... | (9,122) | (386) | -- | (9,508) |
| Non-cash charges..... | (1,529) | (127) | (9,928) | (11,584) |
| Balance at June 30, 2002..... | 3,557 | 9,124 | -- | 12,681 |
| Recovery of assets..... | -- | -- | 18 | 18 |
| Cash payments..... | (1,052) | (1,385) | -- | (2,437) |
| Reversal of restructuring charges.. | (2,118) | (1,609) | (18) | (3,745) |
| Additional restructuring charges... | -- | 450 | -- | 450 |
| Balance at December 29, 2002..... | \$ 387 | \$ 6,580 | \$ -- | \$ 6,967 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to December 30, 2001, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced. The remainder of the Severance and Benefits reserve balance of \$0.4 million, as of December 29, 2002, is anticipated to be utilized by the end of the 2003 fiscal year.

Lease Payments on Vacated Facilities generally relates to 24 months of rent (or the remainder of the lease term, if less) after the abandonment of certain facilities currently under long-term operating lease agreements. We initially estimated, given prevailing real estate market conditions at that time, that it would take approximately 24 months to sublease our vacated facilities in Fremont, California. We revised our estimate, based on subsequent real estate market conditions, and extended our estimate of lease payments on one of our vacated facilities in the December 2001 Plan to the end of the lease in January 2005.

We wrote off leasehold improvements relating to the vacated buildings of approximately \$8.8 million, as these items will have no future economic benefit and have been abandoned. Additionally, certain fixed assets of approximately \$1.1 million associated with these facilities had no future economic benefit and have been abandoned and written-off.

December 2002 Plan

In response to the continued depressed conditions in the semiconductor industry and after evaluating our employee base, outsourcing plan and its impact on our manufacturing and administrative facilities and our near-term financial forecast, our senior management committed to an incremental set of cost reduction and exit activities in the quarter ended December 29, 2002 ("the December 2002 Plan"). The December 2002 Plan was accounted for under the provisions of Statement of Financial Accounting Standards No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" ("FAS 146"), which we early adopted in the December 2002 quarter. The December 2002 Plan was approved by the appropriate level of management necessary to commit to the specific actions of the Plan, and we began carrying out the announced restructuring activities prior to December 29, 2002 by reducing our global workforce by approximately 120 people and further consolidating our worldwide sales and support facilities.

We recorded a restructuring charge of \$5.7 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities and the write-off of related leasehold improvements.

Below is a table summarizing activity relating to the December 2002 Plan:

| | Severance and Benefits | Payments on Vacated Facilities | Abandoned Fixed Assets | Total |
|-----------------------------------|------------------------------|--------------------------------------|------------------------------|----------|
| | (in thousands) | | | |
| December 2002 provision..... | \$ 3,257 | \$ 1,945 | \$ 474 | \$ 5,676 |
| Cash payments..... | (821) | (98) | -- | (919) |
| Non-cash charges..... | -- | -- | (474) | (474) |
| Balance at December 29, 2002..... | \$ 2,436 | \$ 1,847 | \$ -- | \$ 4,283 |

Severance and Benefits relates to the salary and fringe benefit expense for involuntarily terminated employees. Prior to December 29, 2002, management, with the proper level of authority, approved and committed to the plan of termination, determined the benefits the terminated employees would receive and communicated the severance package to employees in enough detail that they could determine their type and amount of benefit. The termination of the impacted employees occurred as soon as practical after the plan of restructuring was announced. The remainder of the Severance and Benefits reserve balance of \$2.4 million as of December 29, 2002, is anticipated to be utilized by the end of the 2003 calendar year.

Lease Payments on Vacated Facilities are based on management's estimates based on known prevailing real estate market conditions at that time. Under the provisions of FAS 146, the restructuring charges for lease payments on vacated facilities were recognized, as the related facilities were no longer occupied at December 29, 2002.

We wrote off leasehold improvements relating to the vacated buildings of approximately \$0.5 million, as these items will have no future economic benefit and have been abandoned.

We have consolidated manufacturing, distribution, and administrative facilities as the transition to outsource providers has resulted in excess facilities. We expect further facilities consolidation associated with our outsourcing plans. Accordingly, we anticipate incurring additional restructuring costs of approximately \$10.0 million during the January 2003 to September 2003 period.

Tax Expenses

Income tax expense for the three- and six-month periods ended December 29, 2002, was recorded using a 25% estimated effective tax rate. Income tax benefit for the quarter ended December 30, 2001, was recorded using a 30% tax benefit rate estimate and an income tax benefit for the quarter ended September 23, 2001, was recorded using a 10% tax benefit rate estimate. The gain or loss from the change in fair value of our equity derivatives indexed to our stock was non-taxable. Our fiscal 2003 tax rate estimate is based on our current profitability outlook offset by our continued and substantial investments in research and development programs qualifying for R&D tax benefits. The increase in our tax benefit rate estimate in the December 2001 quarter compared to the September 2001 quarter resulted from our then estimated fiscal 2002 profitability and the tax benefit of R&D credits being proportionately greater due to the lower projected pretax income and our continued investment in engineering and development programs qualifying for R&D tax benefits.

Redemption of Convertible Subordinated Notes

Our 5% Convertible Subordinated Notes matured on September 2, 2002 and were repaid in full. This resulted in a cash outlay of approximately \$309.8 million.

Equity Derivative Contracts In Company Stock

Our equity derivatives acquired in June 1999, included certain put and call options indexed to our own stock. Application of Emerging Issues Task Force ("EITF") Issue No. 00-19, "Determination of Whether Share Settlement is Within the Control of the Issuer", for the purposes of applying EITF Issue No. 96-13, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock", required these previously purchased instruments to be recorded at their fair value at the end of each reporting period, commencing in June 2001, with the change in fair value recorded as a gain or loss in our statement of operations. Our equity derivatives were collateralized by restricted cash of \$9.1 million and could not be settled in unregistered shares. They were classified as Other Short-Term Assets (\$24.8 million), at the end of fiscal 2002.

On August 23, 2002, we settled our equity derivative contracts by purchasing approximately 3.5 million shares of Lam common stock at an average price of \$11.19 per share for a total cash payment of \$39.1 million. By settling the equity derivative contracts, we were able to repurchase the shares at a discount of \$8.4 million (\$2.41 per share) from their then market value. As a result of this transaction, we recognized an increase in treasury stock of \$47.6 million.

Based on the \$13.60 market price of our common stock at the contract settlement date, the fair value of the equity derivative contracts declined by \$16.4 million to \$8.4 million, from their June 30, 2002 fair value of \$24.8 million. This \$16.4 million reduction in the equity derivative contracts' fair value was recorded as a non-taxable loss in Other Income (Expense), net, in the three months ended September 29, 2002 and six months ended December 29, 2002.

Critical Accounting Policies and Estimates

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that could affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition: We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, collectibility is reasonably assured, and we have completed our system installation obligations and received customer acceptance, or are otherwise released from our installation or customer acceptance obligations. In the event terms of the sale provide for a lapsing customer acceptance period, we recognize revenue upon the expiration of the lapsing acceptance period or customer acceptance whichever occurs first. In circumstances where the practices of a customer do not provide for a written acceptance and in addition, the terms of sale do not include a lapsing acceptance provision, we will recognize revenue where it can be reliably demonstrated that the delivered system meets all of the customer specifications. Revenue related to spare parts sales, system upgrade kits and remanufactured systems is generally recognized upon shipment. Revenue related to services is generally recognized upon performance of the services requested by a customer order. Revenue for extended maintenance service contracts with a term more than one month is recognized on a straight-line basis over the term of the contract.

We changed our revenue recognition policy in the fourth quarter of fiscal 2001, effective June 26, 2000, based on guidance provided in Securities and Exchange Commission ("SEC"), Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." At December 29, 2002, the deferred revenue balance was approximately \$104.2 million.

Derivatives: We hold derivative financial instruments to hedge a variety of risk exposures including interest rate risks associated with our long-term debt, foreign currency exchange rate fluctuations on the value of our cash flows from forecasted revenue denominated in Japanese Yen and foreign currency denominated assets. Derivatives that qualify for hedge accounting is discussed in detail in Note K to our December 29, 2002, unaudited condensed consolidated financial statements. We do not purchase derivatives for speculative or for trading purposes. To qualify for hedge accounting, the hedge relationship must meet criteria relating both to the derivative instrument and the hedged item. These include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows will be measured.

When derivative instruments are designated and qualify as effective hedges of identified fair value exposures, we are able to offset changes in the fair value of the identified exposures by changes in the fair value of the hedging instruments. When derivative instruments are designated and qualify as effective cash flow hedges, we are able to defer changes in the fair value of the hedging instrument within Accumulated Other Comprehensive Income (Loss) until the hedged exposure is realized. Consequently, with the exception of immaterial hedge ineffectiveness recognized, our results of operations are not subject to fluctuation as a result of changes in the fair value of the derivative instruments. If hedges are not highly effective or if we did not believe that forecasted transactions would occur, we may not be able to account for our investments in derivative instruments as hedges. If this were to occur in a future period, changes in the fair values of our derivative instruments would be recognized in operations without the benefits of offsets or deferrals of changes in fair value arising from hedge accounting treatment.

To hedge foreign currency risks, we use foreign currency exchange forward contracts. These forward contracts are valued using standard valuation formulas with assumptions about future foreign currency exchange rates derived from existing exchange rates and interest rates observed in the market.

We consider our most current outlook in determining the level of foreign currency denominated intercompany revenues to hedge. We combine these forecasts with historical trends to establish the portion of our expected volume to be hedged. The revenues are hedged for exposures to fluctuations in foreign currency exchange rates. Should the level of revenues expected not occur, our investments in derivatives used to hedge changes in foreign currency exchange rates may not qualify for hedge accounting.

To hedge interest rate risk, an interest rate swap is used in connection with our Convertible Subordinated Notes ("4% Notes") in which we pay a variable rate and receive a fixed rate. This instrument is valued using the market standard methodology of netting the discounted future fixed cash receipts and the discounted expected variable cash payments arising under the swap. The variable cash payments are based on an expectation of future interest rates derived from observed market interest rate curves. We have not changed our methods of calculating fair values or developing the underlying assumptions. The values of these derivatives will change over time as cash receipts and payments are made and as market conditions change. In future periods, if changes in the fair value of the swap are no longer effective at hedging changes in the fair value of our fixed rate 4% Notes, the interest rate swap may no longer qualify for hedge accounting treatment. Information about the fair values, notional amounts, and contractual terms of these instruments can be found in Note E to our audited consolidated financial statements and the section titled "Quantitative and Qualitative Disclosures About Market Risk" included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2002, and herein in Note K to the unaudited condensed consolidated financial statements as of and for the six months ended December 29, 2002.

We do not believe we are exposed to more than a nominal amount of credit risk in our interest rate and foreign currency hedges, as counterparties are established and well-capitalized financial institutions. Our exposures are in liquid currencies (Japanese Yen), so there is minimal risk that appropriate derivatives to maintain our hedging program would not be available in the future.

Inventory Valuation: Inventories are stated at the lower of cost (first-in, first-out method) or market using standard costs, which approximate actual cost. We maintain a perpetual inventory system and continuously record the quantity on-hand and standard cost for each product, including purchased components, subassemblies and finished goods. We maintain the integrity of perpetual inventory records through periodic physical counts of quantities on hand. Finished goods are reported as inventories until the point of title transfer to the customer. Generally, title transfer is documented in the terms of sale. When the terms of sale do not specify when title transfers, we assume title transfers when we complete physical delivery of the products.

Standard costs are generally re-assessed at least annually and reflect achievable acquisition costs, generally the most recent vendor contract prices for purchased parts and currently obtainable assembly and test labor and overhead for manufactured products. Manufacturing labor and overhead costs are attributed to individual product standard costs at a level planned to absorb spending at average utilization volumes. All intercompany profits related to the sale and purchase of inventory between our legal entities are eliminated from our consolidated financial statements.

Assembly outsourcing programs implemented in fiscal 2002 have altered and will continue to alter the composition of reported cost of sales. Over time, proportionately more costs will comprise purchased materials and less will represent manufacturing labor and overhead, reflecting the substitution of our assembly activities with the purchase of completed modules and integrated units from new outsource assembly vendors.

Management evaluates the need to record adjustments for impairment of inventory at least quarterly. Our policy is to assess the valuation of all inventories, including manufacturing raw materials, work-in-process, finished goods and spare parts in each reporting period. Obsolete inventory or inventory in excess of management's estimated usage requirements over the next 12 to 36 months based on estimated customer product orders is written-down to its estimated market value, if less than cost. Inherent in the estimates of market value are management's forecasts related to our future manufacturing schedules, customer demand, technological and or market obsolescence, general semiconductor market conditions, possible alternative uses and ultimate realization of excess inventory. If future customer demand or market conditions are less favorable than our projections, additional inventory write-downs may be required, and would be reflected in cost of sales in the period the revision is made.

Installation and Warranty: Typically, part of marketing and selling semiconductor capital equipment includes installing and providing parts and service warranty to customers as part of the overall price of the system. We generally record actual labor and material expenses for installation activities to cost of sales upon revenue recognition. We also provide a contractual parts and labor warranty on our systems, for a period, which runs generally 12 months from system acceptance, not to exceed 14 months from the date of shipment of the system to the customer. We record a provision for estimated warranty expenses to cost of sales for each system upon revenue recognition. The amount recorded is based on actual historical warranty spending activity by type of system, customer, and geographic region, modified for any known differences such as the impact of system reliability improvements. Where customer and system specific warranty reserves are established, all actual parts and labor costs incurred in subsequent periods are charged to those established reserves through the application of detailed project record keeping.

Actual warranty expenses are incurred on a system-by-system basis, and overall, may differ from our original estimates. While we periodically monitor the performance and cost of warranty activities, if actual costs incurred are different than our estimates, we may recognize adjustments to provisions in the period in which those differences arise or are identified. Accordingly, actual costs that exceed the estimates are expensed as incurred and, at the same time, additional probable and estimable liabilities may be recorded.

We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. Historically, including the most recent six months ended December 29, 2002, all warranty obligations have been determined with reasonable estimates.

In addition to the provision of standard warranties, we provide customer-paid extended warranty services. Revenues for extended maintenance and warranty services, with a term of more than one month, are recognized on a prorated straight-line basis over the term of the contract. Related costs are recorded either as incurred or when related liabilities are determined to be probable and estimable.

At December 29, 2002, warranty reserves were \$17.0 million.

Employee Stock Purchase Plan and Employee Stock Option Plans: We account for our stock purchase plan and stock option plans under the provisions of Accounting Principles Board Opinion No. 25 "Accounting For Stock Issued to Employees" ("APB 25") and Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB Opinion No. 25" ("FIN 44") and make pro forma footnote disclosures as though the "fair value" method under Statement of Financial Accounting Standard No. 123, "Accounting For Stock-Based Compensation" ("FAS 123"), were followed. Our employee stock purchase plan is a non-compensatory plan and our stock option plans are accounted for using the intrinsic value method under the provisions of APB 25.

Pro forma Net Income (Loss) and Net Income (Loss) per share disclosed in the footnotes to our annual consolidated financial statements are estimated using a Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and which are fully transferable. In addition, the Black-Scholes model requires the input of highly subjective assumptions, including expected stock price volatility and the estimated life of each option. Because our stock-based awards to employees have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion the existing models do not necessarily provide a reliable measure of the fair value of our stock-based awards to employees.

Deferred Income Taxes: We record a valuation allowance to reduce our deferred taxes to the amount that is more likely than not to be realized. We have considered future estimated taxable income and feasible tax planning strategies in determining the need for a valuation allowance. In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment to the deferred tax assets would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more likely than not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed. Our current valuation allowance covers the tax benefit from the exercise of employee stock options and foreign tax credits. When the stock option tax benefits are realized, the valuation allowance will be reversed and credited to capital in excess of par value. When the foreign tax credits are realized, the valuation allowance will be reversed through the tax provision (benefit) in the statement of operations.

Recent Accounting Pronouncements

Impairment or Disposals of Long-Lived Assets: In August 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 144 ("FAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets". FAS 144 supersedes FAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and applies to all long-lived assets (including discontinued operations). We adopted FAS 144 effective at the beginning of fiscal 2003. The adoption of FAS 144 did not have a material impact on our consolidated financial position or operating results.

Costs associated with Exit or Disposal Activities: In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146 "Accounting for Costs Associated with Exit or Disposal Activities" ("FAS 146"). FAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" ("EITF 94-3"). The principal difference between FAS 146 and EITF 94-3 relates to FAS 146's requirements for the timing of recognizing a liability for a cost associated with an exit or disposal activity. FAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3 a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. FAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early adoption encouraged. We early-adopted FAS 146 and applied its accounting provisions to the restructuring activities initiated during the quarter ended December 29, 2002. No restructuring activities were initiated during the quarter ended September 29, 2002.

Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others: In December 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN 45 also requires a company ("the guarantor") to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee. FIN 45 does not provide guidance on the subsequent measurement of the guarantor's recognized liability over the term of the related guarantee. FIN 45 also incorporates, without change, the guidance in FASB Interpretation No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others", which is being superseded. FIN 45's disclosure requirements are effective for financial statements for periods ending after December 15, 2002. The initial recognition and initial measurement provisions of FIN 45 are applicable on a prospective basis to guarantees issued after December 31, 2002. FIN 45 is not anticipated to have a material impact on our current financial position or results of operations.

Accounting for Stock-Based Compensation- Transition and Disclosure: In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("FAS 148"), which amends FAS 123, "Accounting for Stock-Based Compensation". FAS 148 provides alternative methods of transition for a voluntary change to the "fair value" method of accounting for stock-based employee compensation. In addition, FAS 148 amends the disclosure requirements of FAS 123 and will require companies to prominently disclose in both annual and interim financial statements the company's method of accounting for stock-based employee compensation and the effect of the method used on the company's financial position and results of operations. The transition guidance and annual disclosure requirements of FAS 148 are effective for fiscal years ending after December 15, 2002. We are required to adopt the interim disclosure requirements of FAS 148 for financial statements in our fiscal quarter ended March 30, 2003. We intend to continue to account for awards issued to employees under our stock purchase and stock option plans under the provisions of Accounting Principles Board Opinion No. 25 "Accounting For Stock Issued to Employees" ("APB 25") using the "intrinsic value" method. Accordingly, the adoption of FAS 148 is not anticipated to have a material impact on our financial position or results of operations.

Consolidation of Variable Interest Entities: In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements". FIN 46 establishes accounting guidance for consolidation of a variable interest entity ("VIE"), sometimes formerly referred to as a special purpose entity. In general, a VIE is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 applies to any business enterprise, both public and private, that has a controlling interest, contractual relationship or other business relationship with a VIE. FIN 46 provides guidance for determining when an entity, the Primary Beneficiary, should consolidate another entity, a VIE, that functions to support the activities of the Primary Beneficiary. FIN 46 will require the consolidation of a VIE by a company if that company is subject to a majority of the risk of loss from the VIE's activities or entitled to receive a majority of the VIE's residual returns or both. We believe the adoption of FIN 46 could potentially result in our having to consolidate the operating results of certain VIEs which are lessors under some of our operating lease agreements and recognize the assets and related liabilities of the VIEs on our balance sheet. The effective date

of the new rules under FIN 46 on our current operating leases is the first fiscal quarter of 2004, and immediately on any new leases entered into after January 31, 2003, which utilize VIEs or equivalent lease structures. We are reviewing the new interpretation but have not yet determined the impact FIN 46 will have on our financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents, short-term investments, and restricted cash totaled \$613.9 million as of December 29, 2002 compared with \$945.2 million at June 30, 2002. During the quarter ended September 29, 2002, we repaid our 5% convertible subordinated notes, principal amount of \$309.8 million, and purchased Lam common stock for \$39.1 million in connection with the settlement of our equity derivative contracts.

Net cash provided from operations for the six months ended December 29, 2002, was \$13.6 million. A net loss of \$12.2 million adjusted for non-cash charges of \$35.1 million resulted in positive cash flow of \$22.9 million, and was partially offset by uses of cash due to changes in working capital totaling \$9.3 million. Non-cash charges included items such as depreciation and amortization, deferred income taxes, restructuring charges and the adjustment for the loss on equity derivative contracts indexed to our stock. Significant changes in working capital included inventory reductions of \$30.4 million and decreases in accounts receivables of \$11.2 million offset by decreases of \$47.6 million in accounts payables and other accrued liabilities and \$5.3 million of decreases in deferred profit.

Net cash provided by investing activities for the six months ended December 29, 2002, was \$312.3 million. We sold \$308.3 million, net, of short-term investments that were primarily used to repay our 5% convertible subordinated notes in September 2002. Net capital expenditures used \$5.8 million and our restricted cash decreased \$9.1 million primarily due to the settlement of our equity derivative contracts.

Net cash used by financing activities for the six months ended December 29, 2002, was \$340.0 million and consisted primarily of the repayment of our 5% convertible subordinated notes in the amount of \$309.8 million. In connection with the settlement of our equity derivative contract, we purchased Lam common stock for \$39.1 million. We also reissued \$4.8 million from treasury stock through our employee stock purchase programs. Net proceeds from the issuance of our common stock from stock option exercises totaled \$4.4 million.

We have an agreement to sell specific U.S. Dollar-denominated receivables, subject to recourse provisions to a financial institution. During the three- and six-month periods ended December 29, 2002, we sold \$25.0 million and \$46.8 million, respectively, of these receivables, the cash flows of which are included in operating activities. At December 29, 2002, \$28.0 million of these receivables remained uncollected, of which \$3.3 million were subject to recourse provisions.

Our contractual cash obligations and commitments relating to our debt obligations, lease payments and outsourcing activities are as follows:

| Fiscal year, (1) | Debt and Other | | Outsourcing and Consignment Contracts |
|-----------------------------|--------------------------|---------------------|---|
| | Long-Term Liabilities | Operating Leases | |
| | (in thousands) | | |
| Through June 29, 2003 | \$ 2,788 | \$ 54,094 | \$ 26,127 |
| 2004 through 2006 | 375,348 | 86,762 | 14,893 |
| 2007 through 2008 | - | 4,847 | 1,762 |
| Thereafter..... | - | 1,628 | - |
| Total | \$ 378,136 | \$ 147,331 | \$ 42,782 |

(1) The Company's fiscal year end falls on the last Sunday of June each year

Debt financing includes our 4% Convertible Subordinated Notes and a Yen-denominated term loan.

Details of the 4% Notes are:

| | |
|-------------------|---|
| Description | 4% Convertible Subordinated Notes, "4% Notes" |
| Offering Date | May 2001 |
| Offering Amount | \$300.0 million |
| Maturity Date | June 1, 2006 |
| Offering Expenses | \$8.5 million incurred at the time of offering, ratably amortized to other income (expense), net over the term of the 4% Notes. |

| | |
|---------------------|---|
| | Remaining unamortized balance of \$5.7 million and \$6.7 million at December 29, 2002 and June 30, 2002, respectively. |
| Interest Rate terms | 4% payable on June 1 and December 1 of each year, commencing December 1, 2001 |
| Conversion Rights | Convertible into Lam Common Stock at any time prior to close of business on the maturity date, unless previously redeemed, at a conversion price of \$44.93 per share subject to anti-dilution adjustments |
| Redemption terms | Redeemable at Lam option, beginning June 5, 2004 with at least 20 days and no more than 60 days notice, at redemption prices starting at 101.0% and at diminishing prices thereafter, plus accrued interest |
| Security | 4% Notes are unsecured and subordinated in right of payment in full to all existing and future senior indebtedness of the company |

During the fourth quarter of fiscal 2001, we entered into a three-year Yen-denominated term loan for approximately ¥6.0 billion (\$50.0 million at December 29, 2002) with a syndicate of financial institutions, in order to fund our Japanese subsidiary operations. The entire principal amount under the term loan was due at maturity, June 11, 2004, and had a floating interest rate based on the Tokyo Interbank Offered Rate ("TIBOR"), which at December 29, 2002, was 2.6% per annum. On January 28, 2003, we repaid this loan in full.

During the third quarter of fiscal 2002, we entered into an interest rate swap agreement with a notional amount of \$300 million in order to hedge changes in the fair value of the Company's 4% Notes, attributable to changes in the benchmark interest rate. The transaction exchanged 4% fixed interest payments for variable interest payments based on the LIBOR based interest rate, resulting in interest expense savings of approximately \$2.7 million and \$5.2 million for the three- and six-month periods ended December 29, 2002. Should 6-month LIBOR interest rates rise above approximately 5% per annum in future periods, incremental interest expense to the Company may be incurred. Under the terms of the transaction, we must provide collateral to match any mark-to-market exposure on the swap. The amount of collateral required totals a minimum of \$6.0 million plus an amount equal to the mark-to-market exposure on the swap. Therefore, the amount of cash collateral we will have to post in the future will fluctuate from quarter-to-quarter commensurate with the mark-to-market exposure on the swap instrument. Generally the required collateral will rise as interest rates rise. At the end of the quarter ended December 29, 2002, we have \$10.5 million in restricted cash on our balance sheet (classified as a long-term asset) related to this transaction.

During the second quarter of fiscal 2002 we signed a final settlement agreement with Varian Semiconductor Equipment Associates, Inc. ("Varian") in connection with the patent infringement litigation filed by Varian in October 1993. Under the terms of the settlement agreement, Varian granted us a nonexclusive license to the patents involved in the litigation. We agreed to pay Varian \$20.0 million in cash (\$5.0 million in December 2001 and the balance of \$15.0 million to be paid quarterly over the next 3 years). The contractual cash obligations and commitments table presented above contains our cash obligations related to the Varian settlement.

We lease most of our administrative, R&D and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases, which expire at various dates through 2021. All of our facility leases for buildings located at our Fremont, California headquarters and certain operating leases provide us with an option to extend the leases for additional periods. Certain of our other facility leases provide for periodic rent increases based on the general rate of inflation.

Lease agreements relating to certain buildings at our Fremont, California campus, require us to provide guaranteed residual values totaling \$97.1 million at the end of the respective lease terms which are reflected in the preceding table (\$44.4 million in March 2003, \$25.2 million in 2005 and \$27.5 million in 2006). Presently, we account for these leases as operating leases, and the lessor owns and accounts for the leased assets and related liabilities. The FASB has issued FIN 46, an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements". FIN 46 establishes accounting guidance for consolidation of VIEs, and we believe the adoption of FIN 46 could result in us having to consolidate the operating results of certain VIEs and recognize the assets and related liabilities the first fiscal quarter of 2004, and immediately on any new leases entered into after January 31, 2003, which utilize VIEs. We are reviewing the new interpretation but have not yet determined the impact FIN 46 will have on our financial position or results of operations.

Additionally, one of our lease agreements includes collateral restrictions that require us to maintain a certain amount of cash, \$51.4 million at December 29, 2002, in restricted specified interest bearing accounts. These restricted cash accounts must be maintained through March 2003 (unless the agreement is otherwise terminated or the amount of required cash collateral is reduced), as the underlying building financing obligation is paid down by us. On February 7, 2003, we provided \$59.0 million of additional cash collateral under two of our operating lease agreements. The collateralization will reduce cash, cash equivalents and short-term investments by \$59.0 million and increase restricted cash by \$59.0 million. The collateralization transaction will have no impact on total cash, cash equivalents, short-term investments and restricted cash.

During the six months ended December 29, 2002, we entered into agreements to outsource certain elements of our transactional general and administrative functions. Furthermore, during the second half of fiscal 2002, we entered into agreements with third parties to outsource certain elements of our manufacturing, warehousing, logistics, facilities maintenance and information technology functions. These outsourced services should provide us with more flexibility to scale our operations in a more timely manner to respond to the cyclical nature of our business. The contractual cash obligations and commitments table presented above contains our minimum outsourcing obligations at December 29, 2002 under these arrangements. Actual expenditures will vary based on the volume of transactions and length of contractual service provided. In addition to minimum spending commitments, these agreements provide for potential cancellation charges including the assumption of leases, assets and employees.

Consignment inventories, which are owned by vendors but located in our discrete storage locations and warehouses, are not reported as inventory until title is transferred to us or our purchase obligation is determined. At December 29, 2002, vendor owned inventories held at Lam and not reported as inventory were approximately \$9.0 million.

Given the cyclical nature of the semiconductor equipment industry, we believe that maintenance of sufficient liquidity reserves is important to ensure our ability to sustain levels of investment in R&D and capital infrastructure through ensuing business cycles. Based upon our current business outlook, our levels of cash, cash equivalents, and short-term investments at December 29, 2002, combined with cash conservation activities, are expected to be sufficient to support our presently anticipated levels of operations, investments, and capital expenditures, through at least the end of calendar year 2003.

In the longer-term, liquidity will depend to a great extent on our future revenues, and our ability to appropriately size our business based on demand for our products.

Risk Factors

Our Quarterly Revenues and Operating Results are Unpredictable

Our revenues and operating results may fluctuate significantly from quarter to quarter due to a number of factors, not all of which are in our control. These factors include, but are not limited to:

- economic conditions in the electronics and semiconductor industry generally, and the equipment industry specifically;
- the extent that customers use our products and services in their business;
- customer acceptances of equipment;
- the size and timing of orders from customers;
- customer cancellations or delays in our shipments, installations and/or acceptances;
- our ability in a timely manner to develop, introduce and market new, enhanced and competitive products;
- our competitors' introduction of new products;
- legal or technical challenges to our products and technology;
- new or modified accounting regulations;
- changes in average selling prices and product mix;
- changes in import/export regulations;
- exchange rate fluctuations; and
- exposure on interest rate swap agreements.

We manage our expense levels based in part on our expectations of future revenues. If revenue levels in a particular quarter do not meet our expectations, our operating results may be adversely affected. We derive our revenue primarily from the shipment and acceptance of a relatively small number of high-priced systems. Our systems can range in price from approximately \$400,000 to \$4 million per unit. Because our operating expenses are based on anticipated future revenues, and a high percentage of those expenses are relatively fixed, a change in the timing of recognition of revenue and the level of gross profit from a single transaction can unfavorably affect operating results in a particular quarter.

Our operating results for a quarter may suffer substantially if:

- we ship fewer systems than we anticipate in any quarter;
- our customers delay final acceptance of our shipments;
- we do not receive anticipated purchase orders in time to enable shipment or acceptance of equipment during a given quarter;
- one or more customers delays or cancels anticipated shipments and/or installations;
- shipments are delayed by procurement shortages or manufacturing or transportation difficulties; or
- our suppliers or outsource vendors fail to perform their obligations in a manner consistent with our expectations.

Further, because a significant amount of our manufacturing, R&D and administrative operations and capacity is located at our Fremont, California facility, natural, physical, logistical or other events or disruptions affecting this facility (including labor disruptions, earthquakes and power failures) could adversely impact our financial performance.

Variations in the Amount of Time it Takes for Our Customers to Accept Our Systems May Cause Fluctuation in Our Operating Results

We generally recognize revenue for new equipment on the date of customer acceptance or the date the contractual customer acceptance provisions lapse. As a result, the fiscal period in which we are able to recognize new systems revenues is subject to the length of time that our customers require to evaluate the performance of our equipment after shipment and installation, which could cause our quarterly operating results to fluctuate.

The Semiconductor Equipment Industry is Volatile and Reduced Product Demand has a Negative Impact on Shipments

Our business depends on the capital equipment expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits and products using integrated circuits. The semiconductor industry is cyclical in nature and historically experiences periodic downturns. During calendar year 2001 and the first half of calendar year 2002, semiconductor manufacturers canceled or delayed delivery of orders as a result of overcapacity. The resulting demand contraction had a negative impact on the level of system shipments during fiscal 2002 compared to fiscal 2001. The downturn is extending to the second quarter of fiscal 2003, as our customers remain cautious about their levels of capital expenditures.

Fluctuating levels of investment by the semiconductor manufacturers and pricing volatility are expected to continue to materially affect our aggregate shipments, revenues and operating results. We will attempt to respond to these fluctuations with cost management programs aimed at alignment of our expenditures with anticipated revenue streams, which sometimes result in restructuring charges. Even during periods of reduced revenues, we must invest in research and development and maintain extensive ongoing worldwide customer service and support capabilities to remain competitive, which may temporarily harm our financial results.

We Depend on New Products and Processes for Our Success. For this Reason, We are Subject to Risks Associated with Rapid Technological Change

Rapid technological changes in semiconductor manufacturing processes subject us to increased pressure to develop technological advances enabling such processes. We believe that our future success depends in part upon our ability to develop, manufacture, and successfully introduce new products with improved capabilities and to continue to enhance our existing products. Due to the risks inherent in transitioning to new products, we strive to accurately forecast demand for new products while managing the transition from older products. If new products have reliability or quality problems our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may be unable to develop and manufacture new products successfully, or new products that we introduce may fail in the marketplace, which would materially and adversely affect our results from operations.

We expect to continue to make significant investments in research and development and to pursue joint development relationships with customers or other members of the industry. We must manage product transitions and joint development relationships successfully, as introduction of new products could adversely affect our sales of existing products. Future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both. We may be unable in a timely manner to develop and introduce new products or enhancements to our existing products which satisfy customer needs or achieve market acceptance. In addition, in connection with the development of new products, we will invest in pilot production inventory. Our failure to complete commercialization of these new products in a timely manner could result in inventory obsolescence, which would adversely affect our financial results.

We are Subject to Risks Associated with the Introduction of New Products

We expect to face significant competition from multiple current and future competitors. We believe that other companies are developing systems and products that are competitive to ours and are planning to introduce new products, which may affect our ability to sell our products. Furthermore, our own introduction of new products represents significant investments of our resources and their success, or lack thereof, could have a material effect on our financial results.

We are Subject to Risks Relating to Product Concentration and Lack of Product Revenue Diversification

We derive a substantial percentage of our revenues from a limited number of products, and we expect these products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of our primary products is, therefore, critical to our future success. Our business, operating results, financial condition, and cash flows could therefore be adversely affected by:

- a decline in demand for our products;
- a failure to achieve continued market acceptance of our products;
- an improved version of products being offered by a competitor in the market we participate in;
- technological change that we are unable to address with our products; and
- a failure to release new enhanced versions of our products on a timely basis.

We are Dependent Upon a Limited Number of Key Suppliers

We obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. Generally, each of our key suppliers has a one-year blanket purchase contract or general purchase agreement under which we may

issue purchase orders. We may renew these contracts periodically. In most cases, these component suppliers sold us products during at least the last four years, and we expect that we will continue to renew these contracts in the future or that we will otherwise replace them with competent alternative source suppliers. Several of our outsourced assembly suppliers are new providers to Lam. Where practical, our intent is to establish alternative sources. Nevertheless, a prolonged inability to obtain certain components could impair our ability to ship products, lower our revenues and thus adversely affect our operating results and result in damage to our customer relationships.

Our Outsource Providers May Fail to Perform as We Expect

We are expanding the roles that outsource providers play in our business. We anticipate that these outsource providers will play key roles in our manufacturing operations and in many of our transactional and administrative functions. Although we aim at selecting reputable providers and secure their performance on terms documented in written contracts, it is possible that one or more of these providers will fail to perform as we expect and such failure could have an adverse impact on our business. In addition, the expanded role of outsource providers will require us to implement changes to our existing operations and to adopt new procedures to deal with and manage the performance of these outsource providers. Any delay or failure in the implementation of our operational changes and new procedures could adversely affect our customer relationships and/or have a negative effect on our operating results.

Once a Semiconductor Manufacturer Commits to Purchase a Competitor's Semiconductor Manufacturing Equipment, the Manufacturer Typically Continues to Purchase that Competitor's Equipment, Making it More Difficult for Us to Sell our Equipment to that Customer

Semiconductor manufacturers must make a substantial investment to qualify and integrate wafer processing equipment into a semiconductor production line. We believe that once a semiconductor manufacturer selects a particular supplier's processing equipment, the manufacturer generally relies upon that equipment for that specific production line application. Accordingly, we expect it to be more difficult to sell to a given customer if that customer initially selects a competitor's equipment.

We May Lack the Financial Resources or Technological Capabilities of Certain of Our Competitors Needed to Capture Increased Market Share

We believe that to remain competitive we will require significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide, and to invest in product and process research and development. Certain of our competitors have substantially greater financial resources and more extensive engineering, manufacturing, marketing, and customer service and support resources than we do and therefore have the potential to increasingly dominate the semiconductor equipment industry. In addition, there are smaller, emerging semiconductor equipment companies that may provide innovative technology that may have performance advantages over systems we currently, or expect to, offer.

We anticipate our competitors will continue to improve the design and performance of their current products and processes and to introduce new products and processes with enhanced performance characteristics. If our competitors enter into strategic relationships with leading semiconductor manufacturers covering products similar to those we sell or may develop, it could adversely affect our ability to sell products to those manufacturers. In addition, competitors with higher levels of financial resources than we have may deeply discount or give away products similar to those we sell. For these reasons, we may fail to continue to compete successfully worldwide.

Our present or future competitors may be able to develop products comparable or superior to those we offer or may adapt more quickly to new technologies or evolving customer requirements. In particular, while we currently are developing additional product enhancements that we believe will address future customer requirements, we may fail in a timely manner to complete the development or introduction of these additional product enhancements successfully, or these product enhancements may not achieve market acceptance or be competitive. Accordingly, we may be unable to continue to compete in our markets, competition may intensify or future competition may have a material adverse effect on our revenues, operating results, financial condition, and/or cash flows.

Our Future Success Depends on International Sales

Non-U.S. sales accounted for approximately 71% of our total revenue in fiscal 2002, 70% in fiscal 2001 and 71% in fiscal 2000. We expect that international sales will continue to account for a significant portion of our total revenue in future years. International sales are subject to risks, including, but not limited to:

- foreign exchange risks;
- changing import/export requirements;
- foreign trade disputes; and
- economic, political, banking and currency problems in the relevant region.

We currently enter into foreign currency forward contracts to minimize the short-term impact of exchange rate fluctuations on Yen-denominated sales and assets, and will continue to enter into hedging transactions for the purposes outlined in the foreseeable future.

A Failure to Comply with Environmental Regulations May Adversely Affect Our Operating Results

We are subject to a variety of governmental regulations related to the discharge or disposal of toxic, volatile or otherwise hazardous chemicals. We believe that we are in general compliance with these regulations and that we have obtained (or will obtain or are otherwise addressing) all necessary environmental permits to conduct our business. These permits generally relate to the disposal of hazardous wastes. Nevertheless, the failure to comply with present or future regulations could result in fines being imposed on us, suspension of production, cessation of our operations or reduction in our customers' acceptance of our products. These regulations could require us to alter our current operations, to acquire significant equipment or to incur substantial other expenses to comply with environmental regulations. Our failure to control the use, sale, transport or disposal of hazardous substances could subject us to future liabilities.

If We are Unable to Adjust the Scale of Our Business in Response to Rapid Changes in Demand in the Semiconductor Equipment Industry, Our Operating Results and Our Ability to Compete Successfully May Be Impaired

The business cycle in the semiconductor equipment industry is characterized by frequent periods of rapid change in demand that challenge our management to adjust spending on operating activities. During periods of rapid growth or decline in demand for our products and services, we face significant challenges in maintaining adequate financial and business controls, management processes, information systems and procedures on a timely basis and training, managing and appropriately sizing our work force. Our success will depend, to a significant extent, on the ability of our executive officers and other members of our senior management to identify and respond to these challenges effectively. If we do not adequately meet these challenges, our gross margins and earnings may be impaired during periods of demand decline and we may lack the infrastructure and resources to scale up our business to meet customer expectations and compete successfully during periods of demand growth.

If We Choose to Acquire or Dispose of Product Lines and Technologies, We May Encounter Unforeseen Costs and Difficulties that Could Impair Our Financial Performance

An important element of our management strategy is to review acquisition prospects that would complement our existing products, augment our market coverage and distribution ability, or enhance our technological capabilities. As a result, we may make acquisitions of complementary companies, products or technologies, or we may reduce or dispose of certain product lines or technologies, which no longer fit our long-term strategies. Managing an acquired business, disposing of product technologies or reducing personnel entail numerous operational and financial risks, including difficulties in assimilating acquired operations and new personnel or separating existing business or product groups, diversion of management's attention away from other business concerns, amortization of acquired intangible assets and potential loss of key employees or customers of acquired or disposed operations among others. There can be no assurance that we will be able to achieve and manage successfully any such integration of potential acquisitions, disposition of product lines or technologies, or reduction in personnel or that our management, personnel or systems will be adequate to support continued operations. Any such inabilities or inadequacies could have a material adverse effect on our business, operating results, financial condition, and cash flows.

In addition, any acquisitions could result in changes such as potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, the amortization of related intangible assets and goodwill impairment charges, any of which could materially adversely affect our business, financial condition, and results of operations and/or the price of our Common Stock.

The Market for Our Common Stock is Extremely Volatile, which May Affect our Ability to Raise Capital or Make Acquisitions

The market price for our Common Stock is extremely volatile and has fluctuated significantly over the past years. The trading price of our Common Stock could continue to be highly volatile and fluctuate widely in response to factors, including but not limited to the following:

- general market, semiconductor, or semiconductor equipment industry conditions;
- global economic fluctuations;
- variations in our quarterly operating results;
- variations in our revenues or earnings from levels that securities analysts forecast;
- announcements of restructurings, technological innovations, reductions in force, departure of key employees, consolidations of operations or introduction of new products;
- government regulations;
- developments in, or claims relating to, patent or other proprietary rights;
- disruptions with key customers or suppliers; or
- political, economic or environmental events occurring globally or in any of our key sales regions.

In addition, the stock market experiences significant price and volume fluctuations. Historically, we have witnessed significant volatility in the price of our Common Stock due in part to the actual or anticipated movement in interest rates and the price of and markets for semiconductors. These broad market and industry factors have and may again adversely affect the price of our

Common Stock, regardless of our actual operating performance. In the past, following volatile periods in the price of stock, many companies become the object of securities class action litigation. If we are sued in a securities class action, we could incur substantial costs, and it could divert management's attention and resources and have an unfavorable impact on the price for our Common Stock.

Risk Associated With Our Interest Rate Swap Agreement

We aim to limit the impact of interest rate exposure associated with our interest rate sensitive investments and debt obligations. To minimize the effect of the interest rate exposure associated with our 4% Convertible Subordinated Notes, we have entered into an interest rate swap agreement with a notional amount of \$300 million. We entered into the swap in order to hedge changes in the fair value of our 4% Notes, attributable to changes in the benchmark interest rate, by swapping 4% fixed interest payments for variable interest payments based on the LIBOR based interest rate.

If 6-month LIBOR based interest rates remain at current levels or decrease we expect the swap will result in interest savings. However, a rise in 6-month LIBOR based interest rates above approximately 5% per annum in future periods could result in incremental levels of interest expense.

The Potential Anti-Takeover Effects of Our Bylaws Provisions and the Rights Plan We Have in Place May Affect Our Stock Price and Inhibit a Change of Control Desired by Some of Our Stockholders

In 1997, we adopted a Rights Plan (the "Rights Plan") in which rights were distributed as a dividend at the rate of one right for each share of our Common Stock, held by stockholders of record as of the close of business on January 31, 1997, and thereafter. In connection with the adoption of the Rights Plan, our Board of Directors also adopted a number of amendments to our Bylaws, including amendments requiring advance notice of stockholder nominations of directors and stockholder proposals.

Our Rights Plan may have certain anti-takeover effects. Our Rights Plan will cause substantial dilution to a person or group that attempts to acquire Lam in certain circumstances. Accordingly, the existence of the Rights Plan and the issuance of the related rights may deter certain acquirers from making takeover proposals or tender offers. The Rights Plan, however, is not intended to prevent a takeover. Rather it is designed to enhance the ability of our Board of Directors to negotiate with a potential acquirer on behalf of all of our stockholders.

In addition, our Certificate of Incorporation authorizes issuance of 5,000,000 shares of undesignated Preferred Stock. Our Board of Directors, without further stockholder approval, may issue this Preferred Stock on such terms as the Board of Directors may determine, which also could have the effect of delaying or preventing a change in control of Lam. The issuance of Preferred Stock could also adversely affect the voting power of the holders of our Common Stock, including causing the loss of voting control. Moreover, Section 203 of the Delaware General Corporation Law restricts certain business combinations with "interested stockholders", as defined by that statute.

Intellectual Property and Other Claims Against Us Can Be Costly and Could Result in the Loss of Significant Rights which are Necessary to Our Continued Business and Profitability

Third parties may assert infringement, unfair competition or other claims against us. From time to time, other parties send us notices alleging that our products infringe their patent or other intellectual property rights. In addition, our Bylaws and indemnity agreements with certain officers, directors and key employees provide that we will indemnify officers and directors against losses that they may incur in legal proceedings resulting from their service to Lam. In such cases, it is our policy either to defend the claims or to negotiate licenses on commercially reasonable terms. However, we may be unable in the future to negotiate necessary licenses on commercially reasonable terms, or at all, and any litigation resulting from these claims by other parties may materially adversely affect our business and financial results.

In September 1999, Tegal Corporation sued us seeking monetary damages and injunctive relief based on our alleged infringement of certain patents Tegal holds. Specifically, Tegal identified our 4520XLe and Exelan products as infringing the patents Tegal asserted. All Tegal's claims regarding the 4520XLe were voluntarily dismissed by Tegal during August 2002. In January 2003, the United States District Court granted Lam's motion for summary judgment of noninfringement on Tegal's sole remaining claim. In granting Lam's motion, the Court found that Lam's Exelan products did not literally infringe Tegal's claim, and further found that Tegal was precluded from asserting infringement against Exelan products under the doctrine of equivalents. Tegal has indicated that it intends to appeal the Court's order and findings; however, there have been no findings in the action, which have caused us reasonably to believe that any infringement, if found, or any damages, if awarded, could have a material adverse effect on our operating results or our financial position.

Litigation is inherently uncertain, and we may fail to prevail in this litigation. However, certain elements of Tegal's complaint have been dismissed since inception of the suit, and we believe that the Tegal lawsuit will not materially adversely affect our operating results or financial position. See Part II Item 1 of this Form 10-Q for a discussion of the Tegal lawsuit.

We May Fail to Protect Our Proprietary Technology Rights, which Would Affect Our Business

Our success depends in part on our proprietary technology. While we attempt to protect our proprietary technology through patents, copyrights and trade secret protection, we believe that our success also depends on increasing our technological expertise, continuing our development of new systems, increasing market penetration and growth of our installed base, and providing comprehensive support and service to our customers. However, we may be unable to protect our technology in all instances, or our

competitors may develop similar or more competitive technology independently. We currently hold a number of United States and foreign patents and pending patent applications. However, other parties may challenge or attempt to invalidate or circumvent any patents the United States or foreign governments issue to us or these governments may fail to issue pending applications. In addition, the rights granted or anticipated under any of these patents or pending patent applications may be narrower than we expect or in fact provide no competitive advantages

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

For financial market risks related to changes in interest rates and foreign currency exchange rates, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in the Company's Annual Report on Form 10-K for the year ended June 30, 2002.

During the third quarter of fiscal 2002, we entered into an interest rate swap agreement with a notional amount of \$300 million in order to hedge changes in the fair value of our 4% Convertible Subordinated Notes, attributable to changes in the benchmark interest rate. The transaction exchanged 4% fixed interest payments for variable interest payments based on the LIBOR based interest rate, resulting in interest expense savings of approximately \$2.7 million and \$5.2 million for the three- and six-month periods ended December 29, 2002. Should 6-month LIBOR interest rates rise above approximately 5% per annum in future periods, incremental interest expense may be incurred.

ITEM 4. Controls and Procedures

(a). Within the 90 days prior to the date of filing of this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chairman and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-14 and 13a-15. Based upon that evaluation, our Chairman and Chief Executive Officer along with our Chief Financial Officer concluded that our disclosure controls and procedures are reasonably effective in timely alerting them to material information relating to the Company (including our consolidated subsidiaries) required to be included in our periodic SEC filings.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to correct any material deficiencies that we may discover. Our goal is to ensure that our senior management has timely access to material information that could affect our business. While we believe the present design of our disclosure controls and procedures is reasonably effective to achieve our goal, future events affecting our business may cause us to modify our disclosure controls and procedures. It should be noted that the design of any system of controls is based in part upon certain assumptions about the likelihood of certain events, and there can be no assurance that any design can succeed in achieving its stated goals under all potential conditions, regardless of how remote.

(b). There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

In September 1999, Tegal Corporation ("Tegal") brought suit against us seeking monetary damages and injunctive relief based on our alleged infringement of certain patents held by Tegal. Specifically, Tegal identified our 4520XLe and Exelan products as infringing the patents Tegal is asserting. On our motion, this case was transferred to the United States District Court for the Northern District of California. In view of appellate rulings by the Court of Appeals for the Federal Circuit on issues appealed by Tegal in respect of prior litigation between Tegal and Tokyo Electron Ltd. and Tokyo Electron America, Tegal in June 2002 moved to dismiss its claims against Lam in connection with Lam's 4520XLe products. In July 2002, a claims construction hearing was held in the United States District Court to construe a single term in Tegal's sole remaining asserted claim. All Tegal's claims regarding the 4520XLe were voluntarily dismissed by Tegal during August 2002. In January 2003, the United States District Court granted Lam's motion for summary judgment of noninfringement on Tegal's sole remaining claim. In granting Lam's motion, the Court found that Lam's Exelan products did not literally infringe Tegal's claim, and further found that Tegal was precluded from asserting infringement against Exelan products under the doctrine of equivalents. Tegal has indicated that it intends to appeal the Court's order and findings; however, there have been no findings in the action, which have caused us reasonably to believe that any infringement, if found, or any damages, if awarded, could have a material adverse effect on our operating results or our financial position.

From time to time, we have received notices from third parties alleging infringement of such parties' patent or other intellectual property rights by our products. In such cases it is our policy to defend the claims, or if considered appropriate, negotiate licenses on commercially reasonable terms. However, no assurance can be given that we will be able in the future to negotiate necessary licenses on commercially reasonable terms, or at all, or that any litigation resulting from such claims would not have a material adverse effect on our consolidated financial position or operating results.

ITEM 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Stockholders of Lam Research Corporation was held at the principal office of the Company at 4650 Cushing Parkway, Fremont, California 94538 on November 7, 2002.

Out of 125,257,046 shares of Common Stock (as of the record date of September 13, 2002) entitled to vote at the meeting, 116,464,014 shares were present in person or by proxy.

The vote for nominated directors, to serve for the ensuing year, and until their successors are elected, was as follows:

| <u>NOMINEE</u> | <u>IN FAVOR</u> | <u>WITHHELD</u> |
|-----------------------|-----------------|-----------------|
| James W. Bagley | 116,093,733 | 370,281 |
| David G. Arscott | 115,701,605 | 762,409 |
| Robert M. Berdahl | 114,094,561 | 2,369,453 |
| Richard J. Elkus, Jr. | 115,721,774 | 742,240 |
| Jack R. Harris | 114,080,038 | 2,383,976 |
| Grant M. Inman | 115,701,019 | 762,995 |
| Kenneth M. Thompson | 114,097,979 | 2,366,035 |

The results of voting on the following items were as set forth below:

Ratification of appointment of Ernst & Young LLP as independent auditors for the Company for the fiscal year ending June 29, 2003:

| <u>IN FAVOR</u> | <u>OPPOSED</u> | <u>ABSTAIN</u> |
|-----------------|----------------|----------------|
| 113,122,585 | 3,255,777 | 85,652 |

ITEM 6. Exhibits and Reports on Form 8-K

a. Exhibits:

- 4.8 Amended and restated 1997 Stock Incentive Plan.
- 4.12 Amended and restated 1999 Stock Option Plan.
- 10.79 Amendment to Stock Option Grant for James W. Bagley.
- 99.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b. Reports on Form 8-K

We did not file any reports on Form 8-K during the quarter ended December 29, 2002.

LAM RESEARCH CORPORATION

SIGNATURES

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

Date: February 7, 2003

LAM RESEARCH CORPORATION
(Registrant)

By: /s/ Mercedes Johnson

Mercedes Johnson
Senior Vice President, Finance and Chief Financial Officer
(Chief Accounting Officer)

**CERTIFICATION PURSUANT TO RULE 15d-14
OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James W. Bagley, Chairman and Chief Executive Officer of Lam Research Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

February 7, 2003

/s/ James W. Bagley
James W. Bagley
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO RULE 15d-14
OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Mercedes Johnson, Senior Vice President, Finance, Chief Financial Officer and Chief Accounting Officer of Lam Research Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

February 7, 2003

/s/ Mercedes Johnson
Mercedes Johnson

Senior Vice President, Finance
Chief Financial Officer and
Chief Accounting Officer

LAM RESEARCH CORPORATION

1997 STOCK INCENTIVE PLAN

Amended and restated effective as of October 16, 2002

1. GENERAL PURPOSE OF PLAN; DEFINITIONS.

The name of this plan is the Lam Research Corporation 1997 Stock Incentive Plan (the "Plan"). The purpose of the Plan is to enable the Company to attract and retain highly qualified personnel who will contribute to the Company's success by their ability, ingenuity and industry and to provide incentives to the participating officers, directors, employees, consultants and advisors that are linked directly to increases in stockholder value and will therefore inure to the benefit of all stockholders of the Company.

For purposes of the Plan, the following terms shall be defined as set forth below:

1. "Administrator" means the Board, or if and to the extent the Board does not administer the Plan, the Committee in accordance with Section 2.
2. "Annual Non-Employee Director Stock Option" means an annual grant of Stock Options to a non-employee director of the Company pursuant to Section 6.
3. "Award" means Stock Options, Restricted Stock awards, Deferred Stock awards, Performance Shares, Restricted Stock Units, or any combination of the foregoing awarded under this Plan.
4. "Board" means the Board of Directors of the Company.
5. "Code" means the Internal Revenue Code of 1986, as amended from time to time, or any successor thereto.
6. "Committee" means the Stock Committee of the Board or any Committee the Board may subsequently appoint to administer the Plan. To the extent applicable, the Committee shall be composed entirely of individuals who meet the qualifications referred to in Section 162(m) of the Code and Rule 16b-3 under the Securities Exchange Act of 1934, as amended. If at any time or to any extent the Board shall not administer the Plan, then the functions of the Board specified in the Plan shall be exercised by the Committee.
7. "Company" means Lam Research Corporation, a Delaware corporation (or any successor corporation).
8. "Deferred Stock" means an award made pursuant to Section 7 below of the right to receive Stock at the end of a specified deferral period.
9. "Disability" means the inability of a Participant to perform substantially his or her duties and responsibilities to the Company by reason of a physical or mental disability or infirmity (i) for a continuous period of six months, or (ii) at such earlier time as the Participant submits medical evidence satisfactory to the Administrator that he or she has a physical or mental disability or infirmity which will likely prevent him or her from returning to the performance of his or her work duties for six months or longer. The date of such Disability shall be on the last day of such six-month period or the day on which the Participant submits such satisfactory medical evidence, as the case may be.
10. "Effective Date" shall mean the date set forth in Section 11.
11. "Eligible Recipient" means an officer, director, employee, consultant or advisor of the Company or any Subsidiary.
12. "Fair Market Value" means, as of any given date, with respect to any awards granted hereunder, (A) if the Stock is publicly traded, the closing sale price of the Stock on such date as reported in the Western Edition of the Wall Street Journal, or the average of the closing price of the Stock on each day on which the Stock was traded over a period of up to twenty trading days immediately prior to such date, (B) the fair market value of the Stock as determined in accordance with a method prescribed in the agreement evidencing any award hereunder, or (C) the fair market value of the Stock as otherwise determined by the Administrator in the good faith exercise of its discretion.
13. "Incentive Stock Option" means any Stock Option intended to be designated as an "incentive stock option" within the meaning of Section 422 of the Code.
14. "Non-Qualified Stock Option" means any Stock Option that is not an Incentive Stock Option, including any Stock Option that provides (as of the time such option is granted) that it will not be treated as an Incentive Stock Option.
15. "Parent Corporation" means any corporation (other the Company) in an unbroken chain of corporations ending with the Company, if each of the corporations in the chain (other than the Company) owns stock possessing 50% or more of the combined voting power of all classes of stock in one of the other corporations in the chain.
16. "Participant" means any Eligible Recipient selected by the Administrator, pursuant to the Administrator's authority in Section 2 below, to receive grants of Stock Options, Restricted Stock awards, Deferred Stock awards, Performance Shares, Restricted Stock Unit awards or any combination of the foregoing and each non-employee director of the Company who receives an Annual Non-Employee Director Stock Option pursuant to Section 6.
17. "Performance Share" means an award of shares of Stock pursuant to Section 7 that is subject to restrictions based upon the attainment of specified performance objectives.

18. "Restricted Stock" means an award granted pursuant to Section 7 of shares of Stock subject to certain restrictions.
19. "Restricted Stock Unit" means an award granted pursuant to Section 7 which may be settled in whole or in part in cash or shares of Stock upon satisfaction of certain vesting conditions.
20. "Stock" means the common stock, par value \$.001 per share, of the Company.
21. "Stock Option" means any option to purchase shares of Stock granted pursuant to Section 5 or any Annual Non-Employee Director Stock Option granted pursuant to Section 6.
22. "Subsidiary" means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company, if each of the corporations (other than the last corporation) in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

2. ADMINISTRATION.

The Plan shall be administered in accordance with the requirements of Section 162(m) of the Code (but only to the extent necessary to maintain qualification of the Plan under Section 162(m) of the Code) and, to the extent applicable, Rule 16b-3 under the Securities Exchange Act of 1934, as amended ("Rule 16b-3") by the Board or by the Committee which shall be appointed by the Board and which shall serve at the pleasure of the Board.

Pursuant to the terms of the Plan, the Administrator shall have the power and authority to grant to Eligible Recipients pursuant to the terms of the Plan: (a) Stock Options, (b) Restricted Stock, (c) Deferred Stock, (d) Performance Shares, (e) Restricted Stock Units, or (f) any combination of the foregoing.

In particular, the Administrator shall have the authority:

- a. to select those Eligible Recipients who shall be Participants;
- b. to determine whether and to what extent Stock Options, Restricted Stock, Deferred Stock, Performance Shares, Restricted Stock Units or a combination of the foregoing, are to be granted hereunder to Participants;
- c. to determine the number of shares of Stock to be covered by each such award granted hereunder;
- d. to determine the terms and conditions, not inconsistent with the terms of the Plan, of any award granted hereunder (including, but not limited to, (x) the restrictions applicable to Restricted or Deferred Stock awards and the conditions under which restrictions applicable to such Restricted or Deferred Stock shall lapse, and (y) the performance goals and periods applicable to an award of Performance Shares or Restricted Stock Units); and
- e. to determine the terms and conditions, not inconsistent with the terms of the Plan, which shall govern all written instruments evidencing the Stock Options, Restricted Stock, Deferred Stock, Performance Shares, Restricted Stock Units or any combination of the foregoing granted hereunder to Participants.

The Administrator shall have the authority, in its discretion, to adopt, alter and repeal such administrative rules, guidelines and practices governing the Plan as it shall from time to time deem advisable; to interpret the terms and provisions of the Plan and any award issued under the Plan (and any agreements relating thereto); and to otherwise supervise the administration of the Plan.

All decisions made by the Administrator pursuant to the provisions of the Plan shall be final and binding on all persons, including the Company and the Participants.

3. STOCK SUBJECT TO PLAN.

The total number of shares of Stock reserved and available for issuance under the Plan is nine million (as adjusted for the Company's three-for-one stock split of March 2000); provided, however, that the number of shares so reserved shall automatically be increased at the beginning of each calendar quarter if and to the extent that, as of such date, the quotient determined by dividing (x) the total number of shares of Stock reserved for issuance under all of Lam's stock-based incentive plans pursuant to outstanding and future awards by (y) the sum of (i) the total number of shares of Stock outstanding plus (ii) the number determined under clause (x), is less than 20%, such that immediately following any such increase such quotient will equal 18.5%; and provided, further, that the number of shares reserved for issuance under the Plan shall in no event exceed fifteen million shares as adjusted for the Company's three-for-one stock split of March 2000 and as shall be further adjusted to take into account additional changes in capitalization as set forth below. Such shares may consist, in whole or in part, of authorized and unissued shares or treasury shares. The aggregate number of shares of Stock as to which Stock Options, Restricted Stock, Deferred Stock, Performance Shares and Restricted Stock Units may be granted to any individual during any calendar year may not, subject to adjustment as provided in this Section 3, exceed 20% of the shares of Stock reserved for the purposes of the Plan in accordance with the provisions of this Section 3.

Consistent with the provisions of Section 162(m) of the Code, as from time to time applicable, to the extent that (i) a Stock Option expires or is otherwise terminated without being exercised, (ii) any shares of Stock subject to any Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit award granted hereunder are forfeited; or (iii) any shares subject to Restricted Stock Unit awards are settled in cash rather than in Stock, such shares shall again be available for issuance in connection with future awards under the Plan. If any shares of

Stock have been pledged as collateral for indebtedness incurred by a Participant in connection with the exercise of a Stock Option and such shares are returned to the Company in satisfaction of such indebtedness, such shares shall again be available for issuance in connection with future awards under the Plan.

In the event of any merger, reorganization, consolidation, recapitalization, stock dividend or other change in corporate structure affecting the Stock, a substitution or adjustment shall be made in (i) the aggregate number of shares reserved for issuance under the Plan, (ii) the kind, number and option price of shares subject to outstanding Stock Options granted under the Plan, and (iii) the kind, number and purchase price of shares issuable pursuant to awards of Restricted Stock, Deferred Stock, Performance Shares and Restricted Stock Units, as may be determined by the Administrator, in its sole discretion. Such other substitutions or adjustments shall be made as may be determined by the Administrator, in its sole discretion. In connection with any event described in this paragraph, the Administrator may provide, in its discretion, for the cancellation of any outstanding awards and payment in cash or other property therefor.

4. ELIGIBILITY.

Officers, directors and employees of the Company or any Subsidiary, and consultants and advisors to the Company or any Subsidiary, who are responsible for or are in a position to contribute to the management, growth and/or profitability of the business of the Company shall be eligible to be granted Stock Options, Restricted Stock awards, Deferred Stock awards, Performance Shares or Restricted Stock Unit awards hereunder. The Participants under the Plan shall be selected from time to time by the Administrator, in its sole discretion, from among the Eligible Recipients recommended by the senior management of the Company, and the Administrator shall determine, in its sole discretion, the number of shares of Stock covered by each award.

5. DISCRETIONARY GRANTS OF STOCK OPTIONS.

Stock Options may be granted alone or in addition to other awards granted under the Plan. Any Stock Option granted under the Plan shall be in such form as the Administrator may from time to time approve, and the provisions of Stock Option awards need not be the same with respect to each optionee. Recipients of Stock Options shall enter into an award agreement with the Company, in such form as the Administrator shall determine, which agreement shall set forth, among other things, the exercise price of the option, the term of the option and provisions regarding exercisability of the option granted thereunder.

The Stock Options granted under the Plan may be of two types: (i) Incentive Stock Options and (ii) Non-Qualified Stock Options.

The Administrator shall have the authority to grant any officer or employee of the Company (including directors who are also officers of the Company) Incentive Stock Options, Non-Qualified Stock Options, or both types of Stock Options. Directors who are not officers of the Company, consultants and advisors may only be granted Non-Qualified Stock Options. To the extent that any Stock Option does not qualify as an Incentive Stock Option, it shall constitute a separate Non-Qualified Stock Option. More than one option may be granted to the same optionee and be outstanding concurrently hereunder.

Stock Options granted under the Plan shall be subject to the following terms and conditions and shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as the Administrator shall deem desirable:

1. **Option Price.** The option price per share of Stock purchasable under a Stock Option shall be determined by the Administrator in its sole discretion at the time of grant but shall not be less than 100% of the Fair Market Value of the Stock on such date. If an employee owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation and an Incentive Stock Option is granted to such employee, the option price of such Incentive Stock Option (to the extent required by the Code at the time of grant) shall be no less than 110% of the Fair Market Value of the Stock on the date such Incentive Stock Option is granted.
2. **Option Term.** The term of each Stock Option shall be fixed by the Administrator, but no Stock Option shall be exercisable more than ten years after the date such Stock Option is granted; provided, however, that if an employee owns or is deemed to own (by reason of the attribution rules of Section 424(d) of the Code) more than 10% of the combined voting power of all classes of stock of the Company or any Parent Corporation and an Incentive Stock Option is granted to such employee, the term of such Incentive Stock Option (to the extent required by the Code at the time of grant) shall be no more than five years from the date of grant.
3. **Exercisability.** Stock Options shall be exercisable at such time or times and subject to such terms and conditions as shall be determined by the Administrator at or after grant. The Administrator may provide, in its discretion, that any Stock Option shall be exercisable only in installments, and the Administrator may waive such installment exercise provisions at any time in whole or in part based on such factors as the Administrator may determine, in its sole discretion, including but not limited to in connection with any "change in control" of the Company, as defined in any stock option agreement or otherwise.

4. **Method of Exercise.** Subject to Section 5(3) above, Stock Options may be exercised in whole or in part at any time during the option period, by giving written notice of exercise to the Company specifying the number of shares to be purchased, accompanied by payment in full of the purchase price in cash or its equivalent as determined by the Administrator. As determined by the Administrator, in its sole discretion, payment in whole or in part may also be made (i) by means of any cashless exercise procedure approved by the Administrator, (ii) in the form of unrestricted Stock already owned by the optionee, or (iii) in the case of the exercise of a Non-Qualified Stock Option, in the form of Restricted Stock or Performance Shares subject to an award hereunder (based, in each case, on the Fair Market Value of the Stock on the date the option is exercised); provided, however, that in the case of an Incentive Stock Option, the right to make payment in the form of already owned shares may be authorized only at the time of grant. If payment of the option exercise price of a Non-Qualified Stock Option is made in whole or in part in the form of Restricted Stock or Performance Shares, the shares received upon the exercise of such Stock Option shall be restricted in accordance with the original terms of the Restricted Stock or Performance Share award in question, except that the Administrator may direct that such restrictions shall apply only to that number of shares equal to the number of shares surrendered upon the exercise of such option. An optionee shall generally have the rights to dividends and any other rights of a stockholder with respect to the Stock subject to the option only after the optionee has given written notice of exercise, has paid in full for such shares, and, if requested, has given the representation described in paragraph (1) of Section 10.

The Administrator may require the voluntary surrender of all or a portion of any Stock Option granted under this Plan or any other equity incentive plan of the Company or its Subsidiaries as a condition precedent to the grant of a new Award under this Plan or under any other equity incentive plan of the Company or its Subsidiaries. Subject to the provisions of this Plan, such new Award shall be exercisable at the price, during such period and on such other terms and conditions as are specified by the Administrator at the time the new Award is granted. Consistent with the provisions of Section 162(m), to the extent applicable, upon their surrender, Stock Options shall be canceled and the shares previously subject to such canceled Stock Options shall again be available for grants of Stock Options and other awards hereunder.

5. **Loans.** The Company may make loans available to Stock Option holders in connection with the exercise of outstanding options granted under the Plan, as the Administrator, in its discretion, may determine. Such loans shall (i) be evidenced by promissory notes entered into by the Stock Option holders in favor of the Company, (ii) be subject to the terms and conditions set forth in this Section 5(5) and such other terms and conditions, not inconsistent with the Plan, as the Administrator shall determine, (iii) bear interest, if any, at such rate as the Administrator shall determine, and (iv) be subject to Board approval (or to approval by the Administrator to the extent the Board may delegate such authority). In no event may the principal amount of any such loan exceed the sum of (x) the exercise price less the par value (if any) of the shares of Stock covered by the option, or portion thereof, exercised by the holder, and (y) any Federal, state, and local income tax attributable to such exercise. The initial term of the loan, the schedule of payments of principal and interest under the loan, the extent to which the loan is to be with or without recourse against the holder with respect to principal or interest and the conditions upon which the loan will become payable in the event of the holder's termination of employment shall be determined by the Administrator. Unless the Administrator determines otherwise, when a loan is made, shares of Stock having a Fair Market Value at least equal to the principal amount of the loan shall be pledged by the holder to the Company as security for payment of the unpaid balance of the loan, and such pledge shall be evidenced by a pledge agreement, the terms of which shall be determined by the Administrator, in its discretion; provided, however, that each loan shall comply with all applicable laws, regulations and rules of the Board of Governors of the Federal Reserve System and any other governmental agency having jurisdiction.
6. **Non-Transferability of Options.** Unless otherwise determined by the Administrator in accordance with Rule 16b-3, no Stock Option shall be transferable by the optionee, and all Stock Options shall be exercisable, during the optionee's lifetime, only by the optionee.
7. **Termination of Employment or Service.** If an optionee's employment with or service as a director, consultant or advisor to the Company terminates by reason of death, Disability or for any other reason, the Stock Option may thereafter be exercised to the extent provided in the applicable subscription or award agreement, or as otherwise determined by the Administrator.
8. **Annual Limit on Incentive Stock Options.** To the extent that the aggregate Fair Market Value (determined as of the date the Incentive Stock Option is granted) of shares of Stock with respect to which Incentive Stock Options granted to an Optionee under this Plan and all other option plans of the Company or its Parent Corporation become exercisable for the first time by the Optionee during any calendar year exceeds \$100,000, such Stock Options shall be treated as Non-Qualified Stock Options.

6. ANNUAL NON-EMPLOYEE DIRECTOR STOCK OPTION GRANTS

Each non-employee director of the Company shall automatically be granted a Non-Qualified Stock Option to purchase 6,000 shares of Stock on December 15 of each calendar year, or if December 15 in any particular year is not a business day on the first business day thereafter (an "Annual Non-Employee Director Stock Option"). The terms and conditions of the Annual Non-Employee Director Stock Options granted pursuant to this Section 6 shall be as follows:

1. **Option Term.** The term of the option shall be ten (10) years from the date of grant.

2. **Exercise Price.** The exercise price per share of Stock subject to such option shall be 100% of the Fair Market Value of the Stock on the date of grant.
3. **Vesting and Exercisability.** The option shall be 100% vested and exercisable as of the date of grant.
4. **Non-Transferability of Options.** Unless otherwise determined by the Administrator in accordance with Rule 16b-3, the option shall not be transferable by the optionee, and shall be exercisable, during the optionee's lifetime, only by the optionee.
5. **Payment of Exercise Price.** The exercise price of such option shall be paid in cash or its equivalent as determined by the Administrator.
6. **Termination of Service.** If a non-employee director ceases to serve as a director of the Company the option shall terminate immediately (except in the event of the Outside Director's death, Disability or retirement, as described below):
 - a. In the event a non-employee director's continuous status as an outside director terminates as a result of his or her disability, he or she may, but only within twelve (12) months from the date of termination, exercise his or her options.
 - b. In the event of the death of a non-employee director, the options may be exercised at any time within twelve (12) months following the date of death by the optionee's estate or by a person who acquired the right to exercise the options by bequest or inheritance.
 - c. In the event of the retirement of a non-employee director, the director's length of service as a director shall determine the time period for exercising options:
 - i. for non-employee directors with less than one (1) year of service prior to retirement, the director may exercise his or her options at any time within three (3) months following retirement;
 - ii. for non-employee directors with more than one (1) year but less than three (3) years of service prior to retirement, the director may exercise his or her options at any time within six (6) months following retirement;
 - iii. for non-employee directors with more than three (3) years but less than five (5) years of service prior to retirement, the director may exercise his or her options at any time within twelve (12) months following retirement; and
 - iv. for non-employee directors with more than five (5) years of service prior to retirement, the director may exercise his or her options at any time within eighteen (18) months following retirement.

In no event shall the options be exercisable after expiration of the Option Term. If the options are not exercised (to the extent they were entitled to be exercised) within the time specified above, the options shall terminate.

7. RESTRICTED STOCK, DEFERRED STOCK, PERFORMANCE SHARES AND RESTRICTED STOCK UNITS.

(1) **General.** Restricted Stock, Deferred Stock, Performance Shares or Restricted Stock Unit awards may be issued either alone or in addition to other awards granted under the Plan. The Administrator shall determine the Participants to whom, and the time or times at which, grants of Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards shall be made; the number of shares to be awarded; the price, if any, to be paid by the recipient of Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards; the Restricted Period (as defined in paragraph (3) hereof) applicable to Restricted Stock or Deferred Stock awards; the performance objectives applicable to Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards; the date or dates on which restrictions applicable to such Restricted Stock or Deferred Stock awards shall lapse during such Restricted Period; the date or dates on which the Participant's rights in the Restricted Stock Units shall vest; and all other conditions of the Restricted Stock, Deferred Stock, Performance Share and Restricted Stock Unit awards. The Administrator may also condition the grant of Restricted Stock, Deferred Stock awards, Performance Shares or Restricted Stock Units upon the exercise of Stock Options, or upon such other criteria as the Administrator may determine, in its sole discretion. The provisions of Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards need not be the same with respect to each recipient. In the discretion of the Administrator, loans may be made to Participants in connection with the purchase of Restricted Stock under substantially the same terms and conditions as provided in Section 5(5) herein with respect to the exercise of Stock Options.

(2) **Awards and Certificates.** The prospective recipient of a Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit award shall not have any rights with respect to such Award, unless and until such recipient has executed an agreement evidencing the Award (a "Restricted Stock Award Agreement," "Deferred Stock Award Agreement," "Performance Share Award Agreement," or Restricted Stock Unit Award Agreement," as appropriate) and delivered a fully executed copy thereof to the Company, within a period of sixty days (or such other period as the Administrator may specify) after the Date of Grant. Except as otherwise provided below in this Section 7(2), (i) each Participant who is awarded Restricted Stock or Performance Shares shall be issued a stock certificate in respect of such shares of Restricted Stock or Performance Shares; and (ii) such certificate shall be registered in the name of the Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award.

The Company may require that the stock certificates evidencing Restricted Stock or Performance Share awards hereunder be held in the custody of the Company until the restrictions thereon shall have lapsed, and that, as a

condition of any Restricted Stock award or Performance Share award, the Participant shall have delivered a stock power, endorsed in blank, relating to the Stock covered by such award.

With respect to Deferred Stock and Restricted Stock Unit awards (to the extent, if any, that Restricted Stock Unit awards shall be settled in shares of Stock), at the expiration of the Restricted Period or upon the vesting and settlement of the Restricted Stock Units, stock certificates in respect of such shares of Deferred Stock or Stock issuable pursuant to the vesting of a Restricted Stock Unit shall be delivered to the Participant, or his or her legal representative, or the shares of Stock issued pursuant to a Deferred Stock or Restricted Stock Unit award shall be otherwise distributed to the Participant, in a number equal to the number of shares of Stock covered by the Deferred Stock or Restricted Stock Unit award. As appropriate, applicable legends may be placed on stock certificates issued pursuant to a Deferred Stock or Restricted Stock Unit award.

(3) **Restrictions and Conditions.** The Restricted Stock, Deferred Stock, Performance Share and Restricted Stock Unit awards granted pursuant to this Section 7 shall be subject to the following restrictions and conditions:

(a) Subject to the provisions of the Plan and the Restricted Stock Award Agreement, Deferred Stock Award Agreement, Performance Share Award Agreement, or Restricted Stock Unit Award Agreement, as appropriate, governing such Award, during such period as may be set by the Administrator commencing on the Date of Grant (the "Restricted Period"), the Participant shall not be permitted to sell, transfer, pledge or assign shares of Restricted Stock, Deferred Stock or Performance Shares or shall not be vested in the rights to the Restricted Stock Units awarded under this Plan; provided that the Administrator may, in its sole discretion, provide for the lapse of such restrictions or the vesting in such rights in installments and may accelerate or waive such restrictions or vesting in whole or in part based on the attainment of certain performance related goals, the Participant's termination of employment or service, death or Disability or the occurrence of a "Change of Control" as defined in the agreement evidencing such award or otherwise.

(b) Except as provided in paragraph (3)(a) of this Section 7 or in the Award agreement, the Participant shall generally have, with respect to the shares of Restricted Stock or Performance Shares, all of the rights of a stockholder with respect to such stock during the Restricted Period. The Participant shall generally not have the rights of a stockholder with respect to stock subject to Deferred Stock awards during the Restricted Period or with respect to unissued Stock subject to Restricted Stock Unit awards; provided, however, that dividends declared during the Restricted Period with respect to the number of shares covered by a Deferred Stock award shall be paid to the Participant. With respect to Restricted Stock Unit awards, prior to settlement or forfeiture, any Restricted Stock Unit award may, at the Administrator's discretion, carry with it a right to dividend equivalents. Such right entitles the Participant to be credited with an amount equal to all cash dividends paid on one share of Stock while the Restricted Stock Unit is outstanding. Dividend equivalents may be converted into additional Restricted Stock Units. Settlement of dividend equivalents may be made in the form of cash, in the form of shares of Stock, or in a combination of both. Prior to distribution, any dividend equivalents that are not paid shall be subject to the same conditions and restrictions as the Restricted Stock Units to which they attach. Certificates for shares of unrestricted Stock shall be delivered to the Participant promptly after, and only after, the Restricted Period shall expire without forfeiture in respect of such shares of Restricted Stock, Performance Shares or Deferred Stock, or upon vesting, without forfeiture, in Restricted Stock Units, except as the Administrator, in its sole discretion, shall otherwise determine.

(c) The rights of holders of Restricted Stock, Deferred Stock, Performance Share and Restricted Stock Unit awards upon termination of employment or service for any reason during the Restricted Period or prior to completion of vesting in the Restricted Stock Units shall be set forth in the Restricted Stock Award Agreement, Deferred Stock Award Agreement, Performance Share Award Agreement or Restricted Stock Unit Award, as appropriate, governing such awards.

(d) Settlement of vested Restricted Stock Units may be made in the form of (i) cash, (ii) shares of Stock, or (iii) any combination of both, as determined by the Administrator. The actual number of Restricted Stock Units eligible for settlement may be larger or smaller than the number included in the original Award, based on predetermined performance factors. Methods of converting Restricted Stock Units into cash may include (without limitation) a method based on the average Fair Market Value of a share of Stock over a series of trading days. Vested Restricted Stock Units may be settled in a lump sum or in installments. The distribution may occur or commence when all vesting conditions applicable to the Restricted Stock Units have been satisfied or lapsed, or it may be deferred to any later date. The amount of a deferred distribution may be increased by an interest factor or by dividend equivalents. Until a Restricted Stock Unit award is settled, the number of such Restricted Stock Units shall be subject to adjustment pursuant to Section 3.

(e) With respect to awards intended to constitute "qualified performance based compensation" for purposes of Section 162(m) of the Code, the applicable performance goals shall be based upon earnings, earnings per share, revenue growth or return on equity.

8. AMENDMENT AND TERMINATION.

The Board may amend, alter or discontinue the Plan, but no amendment, alteration, or discontinuation shall be made that would impair the rights of a Participant under any award theretofore granted without such Participant's

consent, or that without the approval of the stockholders (as described below) would:

1. except as provided in Section 3, increase the total number of shares of Stock reserved for the purpose of the Plan;
2. change the class of directors, officers, employees, consultants and advisors eligible to participate in the Plan;
3. extend the maximum option period under paragraph (2) of Section 5 of the Plan; or
4. change the material terms of grants of Annual Non-Employee Director Stock Options pursuant to Section 6.

Notwithstanding the foregoing, stockholder approval under this Section 8 shall only be required at such time and under such circumstances as stockholder approval would be required under Section 162(m) of the Code or other applicable law, rule or regulation with respect to any material amendment to any employee benefit plan of the Company.

The Administrator may amend the terms of any award theretofore granted, prospectively or retroactively, but, subject to Section 3 above, no such amendment shall impair the rights of any holder without his or her consent.

9. UNFUNDED STATUS OF PLAN.

The Plan is intended to constitute an "unfunded" plan for incentive compensation. With respect to any payments not yet made to a Participant by the Company, nothing contained herein shall give any such Participant any rights that are greater than those of a general creditor of the Company.

10. GENERAL PROVISIONS.

1. The Administrator may require each person purchasing shares pursuant to a Stock Option to represent to and agree with the Company in writing that such person is acquiring the shares without a view to distribution thereof. The certificates for such shares may include any legend which the Administrator deems appropriate to reflect any restrictions on transfer.

All certificates for shares of Stock delivered under the Plan shall be subject to such stock- transfer orders and other restrictions as the Administrator may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Stock is then listed, and any applicable Federal or state securities law, and the Administrator may cause a legend or legends to be placed on any such certificates to make appropriate reference to such restrictions.

2. Nothing contained in the Plan shall prevent the Board from adopting other or additional compensation arrangements, subject to stockholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases. The adoption of the Plan shall not confer upon any officer, director, employee, consultant or advisor of the Company any right to continued employment or service with the Company, as the case may be, nor shall it interfere in any way with the right of the Company to terminate the employment or service of any of its officers, directors, employees, consultants or advisors at any time.
3. Each Participant shall, no later than the date as of which the value of an award first becomes includible in the gross income of the Participant for Federal income tax purposes, pay to the Company, or make arrangements satisfactory to the Administrator regarding payment of, any Federal, state, or local taxes of any kind required by law to be withheld with respect to the award. The obligations of the Company under the Plan shall be conditional on the making of such payments or arrangements, and the Company shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the Participant.
4. No member of the Board or the Administrator, nor any officer or employee of the Company acting on behalf of the Board or the Administrator, shall be personally liable for any action, determination, or interpretation taken or made in good faith with respect to the Plan, and all members of the Board or the Administrator and each and any officer or employee of the Company acting on their behalf shall, to the extent permitted by law, be fully indemnified and protected by the Company in respect of any such action, determination or interpretation.

11. EFFECTIVE DATE OF PLAN.

The Plan became effective (the "Effective Date") on August 5, 1997, the date the Company's stockholders formally approved the Plan.

12. TERM OF PLAN.

No Stock Option, Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit award shall be granted pursuant to the Plan on or after the tenth anniversary of the Effective Date, but awards theretofore granted may extend beyond that date.

**LAM RESEARCH CORPORATION
1999 STOCK OPTION PLAN**

Amended and restated effective as of November 7, 2002

1. Purpose Of Plan

This Amended and Restated 1999 Stock Option Plan (the "**Plan**") is adopted as of November 5, 1998 (the "**Effective Date**") and amended and restated as of October 16 and November 7, 2002. The purpose of the Plan is to enable Lam Research Corporation, a Delaware corporation (the "**Company**"), to attract and retain highly qualified personnel who will contribute to the Company's success by their ability, ingenuity and industry by allowing eligible individuals to acquire or increase proprietary interests in the Company as an incentive to remain in the service of the Company.

2. Definitions

For purposes of the Plan, the following terms shall be defined as set forth below:

- a. "**Administrator**" means the Board, or if and to the extent the Board does not administer the Plan, the Committee appointed by the Board to administer the Plan.
- b. "**Award**" means Stock Options, Restricted Stock awards, Deferred Stock awards, Performance Shares, Restricted Stock Units, or any combination of the foregoing awarded under this Plan.
- c. "**Board**" means the Board of Directors of the Company.
- d. "**Code**" means the Internal Revenue Code of 1986, as amended from time to time, or any successor thereto.
- e. "**Committee**" means the Stock Committee of the Board or any Committee the Board may subsequently appoint to administer the Plan. If at any time or to any extent the Board shall not administer the Plan, then the functions of the Board or Administrator specified in the Plan shall be exercised by the Committee.
- f. "**Designated Subsidiaries**" means the Subsidiaries that have been designated by the Board or Administrator from time to time in its sole discretion, whose officers, Employees and Directors are thereon eligible to participate in this Plan.
- g. "**Date of Grant**" means the date on which the grant of an Award is effective.
- h. "**Deferred Stock**" means an award made pursuant to Section 7 below of the right to receive Stock at the end of a specified deferral period.
- i. "**Disability**" means the inability of a Participant to perform substantially his or her duties and responsibilities to the Company by reason of a physical or mental disability or infirmity (i) for a continuous period of six months, or (ii) at such earlier time as the Participant submits medical evidence satisfactory to the Administrator that he or she has a physical or mental disability or infirmity which will likely prevent him or her from returning to the performance of his or her work duties for six months or longer. The date of such Disability shall be the date of interruption of or separation from employment with the Company due to such Disability or the day on which the Participant submits such satisfactory medical evidence establishing such Disability, as the case may be.
- j. "**Employee**" means any person who is customarily and continuously employed for at least 20 hours per week by the Company or one of its Designated Subsidiaries. Unless the Administrator makes a contrary determination, the Employees of the Company shall, for all purposes of this Plan, be those individuals who satisfy the customary employment criteria set forth above and are carried as employees by the Company or a Designated Subsidiary for regular payroll purposes; provided however, that an Employee's continuous employment shall not be considered interrupted in the case of a leave of absence agreed to in writing by the Company, where such leave is for a period of not more than 90 days or where re-employment upon the expiration of any such leave is guaranteed by contract or statute.
- k. "**Fair Market Value**" means, as of any given date, with respect to any Award granted hereunder, and at the discretion of the Administrator, any of the following: (i) if the Stock is publicly traded, the closing sale price of the Stock on such date as reported in the Wall Street Journal, or the average of the closing price of the Stock on each day on which the Stock was traded over a period of up to twenty trading days immediately prior to such date, (ii) the fair market value of the Stock as determined in accordance with a method prescribed in the agreement evidencing any award hereunder, or (iii) the fair market value of the Stock as otherwise determined by the Administrator in the good faith exercise of its discretion.
- l. "**Parent Corporation**" means any corporation (other than the Company) in an unbroken chain of corporations ending with the Company, if each of the corporations in the chain (other than the Company) owns stock possessing 50% or more of the combined voting power of all classes of stock in one of the other corporations in the chain.
- m. "**Participant**" means any officer, Employee or Director determined by the Administrator to be eligible to be granted Awards under this Plan.
- n. "**Performance Share**" means an award of shares of Stock pursuant to Section 7 that is subject to restrictions based upon the attainment of specified performance objectives.

- o. "**Restricted Stock**" means an award granted pursuant to Section 7 of shares of Stock subject to certain restrictions.
- p. "**Restricted Stock Unit**" means an award granted pursuant to Section 7 which may be settled in whole or in part in cash or shares of Stock upon satisfaction of certain vesting conditions.
- q. "**Stock**" means the common stock, par value \$0.001 per share (the "Common Stock"), of the Company.
- r. "**Stock Option**" means any option to purchase shares of Stock granted pursuant to this Plan. Each Stock Option shall be a non-qualified stock option which, as of the time such Stock Option is granted, shall not be treated as an Incentive Stock Option within the meaning of Section 422 of the Code.
- s. "**Subsidiary**" means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company, if each of the corporations (other than the last corporation) in the unbroken chain owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.

3. Administration Of Plan

The Plan shall be administered in accordance with the requirements of NASD Rule 4350(i)(1)(A) (the "**Rule**") as the Rule applies to equity incentive plans adopted as of the Effective Date so that the Plan shall qualify as a "broadly based" stock option plan under the Rule, unless and until such time as either the Rule or the "broadly-based" standard set forth therein becomes no longer applicable to the Plan.

The Administrator shall have full authority (subject to the provisions of this Plan) to establish such rules and regulations as it deems appropriate for the proper administration of this Plan, and to make such determinations and interpretations concerning this Plan and the Awards granted under this Plan as it deems necessary or advisable.

In particular, the Administrator shall have the authority, consistent with the terms of the Plan:

- a. to select those officers, Employees and Directors who shall be Participants;
- b. to determine whether and to what extent Awards are to be granted hereunder to Participants;
- c. to determine the number of shares of Stock to be covered by each such Awards granted hereunder, including the maximum term for which an Award is to be outstanding;
- d. to determine the terms and conditions of any Award granted hereunder (including, but not limited to, (i) the restrictions applicable to Restricted or Deferred Stock awards and the conditions under which restrictions applicable to such Restricted or Deferred Stock shall lapse, (ii) the performance goals and periods applicable to an award of Performance Shares, and (iii) the vesting conditions applicable to Restricted Stock Units); and
- e. to determine the terms and conditions which shall govern all written instruments evidencing the Awards awarded to Participants.

The Administrator shall have the authority, in its discretion, to adopt, alter and repeal such administrative rules, guidelines and practices governing the Plan as it shall from time to time deem advisable; to interpret the terms and provisions of the Plan and any Award granted under the Plan (and any agreements relating thereto); and otherwise to supervise the administration of the Plan. All decisions made by the Administrator pursuant to the administration, interpretation and execution of the Plan shall be final and binding on all persons, including the Company and the Participants.

4. Stock Subject To Plan

The total number of shares of Stock reserved and available for issuance under the Plan shall be twenty-seven million five hundred thousand (27,500,000), subject to adjustment from time to time in accordance with this Section, or as provided by amendment of the Board. The shares may be authorized but unissued shares of Common Stock or reacquired shares of Common Stock, including shares repurchased by the Company on the open market or in private purchases.

To the extent that (i) an Award expires or is otherwise terminated without being exercised, (ii) any shares of Stock awarded hereunder are forfeited, or (iii) any shares subject to Restricted Stock Unit awards are settled in cash rather than in Stock, such shares shall again be available for issuance in connection with future awards under the Plan. If any shares of Stock have been pledged as collateral for indebtedness incurred by a Participant in connection with the exercise of an Award, and such shares are returned to the Company in satisfaction of such indebtedness, such shares shall again be available for issuance in connection with future awards under the Plan.

In the event of any merger, reorganization, consolidation, recapitalization, stock dividend or other change in corporate structure of the Company affecting the Stock, a substitution or adjustment shall be made in (i) the aggregate number of shares reserved for issuance under the Plan, and (ii) the kind, number and class of shares and price of shares subject to outstanding Awards granted under the Plan, as may be determined by the Administrator, in its sole discretion. Such other substitutions or adjustments shall be made as may be determined by the Administrator, in its sole discretion. In connection with any event described in this paragraph, the Administrator may provide, in its discretion, for the cancellation of any outstanding Awards and payment in cash or other property therefor. The adjustments determined by the Administrator shall be final, binding, and conclusive.

5. Eligibility

Unless otherwise designated by the Administrator and subject to Section 3 herein, Participants eligible to be granted Awards under the Plan include officers, Employees or Directors whose services contribute to the management, growth or financial success of the Company (or its parent or subsidiary corporations), or consultants, advisors, or independent contractors who provide valuable services to the Company (or its parent or subsidiary corporations).

6. Discretionary Grants Of Stock Options

Any Stock Option granted under the Plan shall be in such form as the Administrator may from time to time approve, and the provisions of Stock Option awards need not be the same with respect to each optionee. Recipients of Stock Options shall enter into an option agreement with the Company, in such form as the Administrator shall determine, which agreement shall set forth, among other things, the exercise price of the option, the term of the option and provisions regarding exercisability of the option awarded thereunder. More than one option may be awarded to the same optionee and be outstanding concurrently hereunder.

Stock Options awarded under the Plan shall be subject to the following terms and conditions and shall contain such additional terms and conditions, not inconsistent with the terms of the Plan, as the Administrator shall deem desirable:

- a. **Option Price.** The option price per share of Stock purchasable under a Stock Option shall be determined by the Administrator in its sole discretion as of the Date of Grant but shall not be less than 100% of the Fair Market Value of the Stock on such date.
- b. **Option Term.** The term of each Stock Option shall be fixed by the Administrator, but no Stock Option shall be exercisable more than ten years after the date such Stock Option is granted.
- c. **Exercisability.** Stock Options shall be exercisable at such time or times and subject to such terms and conditions as shall be determined by the Administrator at or after grant. The Administrator may provide, in its discretion, that any Stock Option shall be exercisable only in installments, and the Administrator may waive such installment exercise provisions at any time in whole or in part based on such factors as the Administrator may determine, in its sole discretion, including, but not limited to, in connection with any "change in control" of the Company, as defined in any stock option agreement or otherwise.
- d. **Method of Exercise.** Subject to Section 6(c) herein, Stock Options may be exercised in whole or in part at any time during the option period, by giving written notice of exercise to the Company specifying the number of shares to be purchased, accompanied by payment in full of the option exercise price, as provided below or as otherwise determined by the Administrator. As determined by the Administrator, in its sole discretion, payment in whole or in part may also be made by means of any cashless exercise procedure approved by the Administrator. An optionee shall generally have the rights to dividends and any other rights of a stockholder with respect to the Stock subject to the Stock Option, including the right to vote any such Stock, only after the optionee has given written notice of exercise, has paid in full for such shares, and, if requested, has given the representation described in paragraph (a) of Section 9, below. The option exercise price shall be immediately due upon exercise of the Stock Option and shall be payable in one or a combination of the following forms:
 - i. cash or check payable to the Company drawn on good and sufficient funds;
 - ii. shares of Common Stock held by the optionee for the period necessary to avoid a charge to the Company's earnings for financial reporting purposes and valued at Fair Market Value on the exercise date; or
 - iii. a broker-dealer sale-and-remittance procedure pursuant to which the optionee shall provide irrevocable written instructions (x) to a designated brokerage firm to effect the immediate sale of the option shares and remit to the Company, from the sale proceeds available on the settlement date, sufficient funds to cover the aggregate option exercise price, plus all income and employment taxes required to be withheld by the Company in connection with the exercise and (y) to the Company to deliver the certificates for the purchased shares directly to the brokerage firm to complete the transaction.
- e. **Re-Pricing of Stock Options.** The Administrator may require the voluntary surrender of all or a portion of any Stock Option granted under this Plan or any other equity incentive plan of the Company or its Designated Subsidiaries as a condition precedent to the grant of a new Award under this Plan or under any other equity incentive plan of the Company or its Designated Subsidiaries. Subject to the provisions of this Plan, such new Award shall be exercisable at the price, during such period and on such other terms and conditions as are specified by the Administrator at the time the new Award is granted. Upon their surrender, Stock Options shall be canceled and the shares previously subject to such canceled Stock Options shall again be available for grants of Awards hereunder.
- f. **Loans.** The Company may make loans available to Stock Option holders in connection with the exercise of outstanding options granted under the Plan, as the Administrator, in its discretion, may determine. Such loans shall (i) be evidenced by promissory notes entered into by the Stock Option holders in favor of the Company, (ii) be subject to the terms and conditions set forth in this Section and such other terms and conditions, not inconsistent with the Plan, as the Administrator shall determine, (iii) bear interest, if any, at such rate as the Administrator shall determine, and (iv) be subject to Board approval (or to approval by the

Administrator to the extent the Board may delegate such authority). In no event may the principal amount of any such loan exceed the sum of (x) the exercise price less the par value (if any) of the shares of Stock covered by the Stock Option, or portion thereof, exercised by the holder, and (y) any Federal, state, and local income tax attributable to such exercise. The initial term of the loan, the schedule of payments of principal and interest under the loan, the extent to which the loan is to be with or without recourse against the holder with respect to principal or interest and the conditions upon which the loan will become payable in the event of the holder's termination of employment shall be determined by the Administrator. Unless the Administrator determines otherwise, when a loan is made, shares of Stock having a Fair Market Value at least equal to the principal amount of the loan shall be pledged by the holder to the Company as security for payment of the unpaid balance of the loan, and such pledge shall be evidenced by a pledge agreement, the terms of which shall be determined by the Administrator, in its discretion; provided, however, that each loan shall comply with all applicable laws, regulations and rules of the Board of Governors of the Federal Reserve System and any other governmental agency having jurisdiction.

- g. **Non-Transferability of Options.** Unless otherwise provided herein or as otherwise determined by the Administrator, no Stock Option shall be transferable by the optionee, and all Stock Options shall be exercisable, during the optionee's lifetime, only by the optionee.
- h. **Termination of Employment or Service.** If an optionee's employment with or service as an officer, Employee, Director, consultant, advisor or independent contractor to the Company terminates by reason of death, Disability or for any other reason, the Stock Option may thereafter be exercised as provided below, or as otherwise provided in the applicable award agreement or determined by the Administrator.

If an optionee's employment with or service to the Company is terminated:

- i. for or without cause (and whether termination is voluntary or involuntary), each then- outstanding unexercised Stock Option vested and held by the optionee as of the termination date shall expire within ninety [90] days of such termination;
- ii. by reason of Disability, each then-outstanding unexercised Stock Option vested and held by the optionee as of the termination date shall expire within six (6) months of such termination date; and
- iii. by reason of the optionee's death during employment, or if the optionee dies during the three (3) month period after termination of his or her employment (or such other shorter period of time as may be determined by the Administrator), where such termination is other than for cause or by reason of Disability, each then-outstanding unexercised Stock Option vested and held by the optionee as of the termination date shall expire within six (6) months of such termination date. After the optionee's death, the Stock Option may be exercised by the personal representative of the optionee's estate or by the person(s) to whom the option is transferred pursuant to the optionee's will or in accordance with the laws of descent and distribution.

Following termination of the optionee's employment or service, a Stock Option shall not be exercisable to any greater extent than on the termination date; provided, however, that the Administrator shall have complete discretion, at any time while the Stock Option remains outstanding, to permit the Stock Option to be exercised, not only with respect to the number of shares for which the Stock Option is exercisable at the time of the termination, but also with respect to one or more subsequent installments of purchasable shares for which the Stock Option would otherwise have become exercisable had termination not occurred.

7. Restricted Stock, Deferred Stock, Performance Shares and Restricted Stock Units.

(a) **General.** Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards may be issued either alone or in addition to other awards granted under the Plan. The Administrator shall determine the Participants to whom, and the time or times at which, grants of Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards shall be made; the number of shares to be awarded; the price, if any, to be paid by the recipient of Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards; the Restricted Period (as defined in paragraph (c) hereof) applicable to Restricted Stock or Deferred Stock awards; the performance objectives applicable to Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards; the date or dates on which restrictions applicable to such Restricted Stock or Deferred Stock awards shall lapse during such Restricted Period; the date or dates on which the Participant's rights in the Restricted Stock Units shall vest; and all other conditions of the Restricted Stock, Deferred Stock, Performance Share and Restricted Stock Unit awards. The Administrator may also condition the grant of Restricted Stock, Deferred Stock awards, Performance Shares or Restricted Stock Units upon the exercise of Stock Options, or upon such other criteria as the Administrator may determine, in its sole discretion. The provisions of Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit awards need not be the same with respect to each recipient. In the discretion of the Administrator, loans may be made to Participants in connection with the purchase of Restricted Stock under substantially the same terms and conditions as provided in Section 6(f) herein with respect to the exercise of Stock Options.

(b) **Awards and Certificates.** The prospective recipient of a Restricted Stock, Deferred Stock, Performance Share or Restricted Stock Unit award shall not have any rights with respect to such Award, unless and until such recipient has executed an agreement evidencing the Award (a "Restricted Stock Award Agreement," "Deferred Stock Award Agreement," "Performance Share Award Agreement," or Restricted Stock Unit Award Agreement,"

as appropriate) and delivered a fully executed copy thereof to the Company, within a period of sixty days (or such other period as the Administrator may specify) after the Date of Grant. Except as otherwise provided below in this Section 7(b), (i) each Participant who is awarded Restricted Stock or Performance Shares shall be issued a stock certificate in respect of such shares of Restricted Stock or Performance Shares; and (ii) such certificate shall be registered in the name of the Participant, and shall bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Award.

The Company may require that the stock certificates evidencing Restricted Stock or Performance Share awards hereunder be held in the custody of the Company until the restrictions thereon shall have lapsed, and that, as a condition of any Restricted Stock award or Performance Share award, the Participant shall have delivered a stock power, endorsed in blank, relating to the Stock covered by such award.

With respect to Deferred Stock and Restricted Stock Unit awards (to the extent, if any, that Restricted Stock Unit awards shall be settled in shares of Stock), at the expiration of the Restricted Period or upon the vesting and settlement of the Restricted Stock Units, stock certificates in respect of such shares of Deferred Stock or Stock issuable pursuant to the vesting of a Restricted Stock Unit shall be delivered to the Participant, or his or her legal representative, or the shares of Stock issued pursuant to a Deferred Stock or Restricted Stock Unit award shall be otherwise distributed to the Participant, in a number equal to the number of shares of Stock covered by the Deferred Stock or Restricted Stock Unit award. As appropriate, applicable legends may be placed on stock certificates issued pursuant to a Deferred Stock or Restricted Stock Unit award.

(c) **Restrictions and Conditions.** The Restricted Stock, Deferred Stock, Performance Share and Restricted Stock Unit awards granted pursuant to this Section 7 shall be subject to the following restrictions and conditions:

(i) Subject to the provisions of the Plan and the Restricted Stock Award Agreement, Deferred Stock Award Agreement, Performance Share Award Agreement, or Restricted Stock Unit Award Agreement, as appropriate, governing such Award, during such period as may be set by the Administrator commencing on the Date of Grant (the "Restricted Period"), the Participant shall not be permitted to sell, transfer, pledge or assign shares of Restricted Stock, Deferred Stock or Performance Shares or shall not be vested in the rights to the Restricted Stock Units awarded under this Plan; provided that the Administrator may, in its sole discretion, provide for the lapse of such restrictions or the vesting in such rights in installments and may accelerate or waive such restrictions or vesting in whole or in part based on the attainment of certain performance related goals, the Participant's termination of employment or service, death or Disability or the occurrence of a "Change of Control" as defined in the agreement evidencing such award or otherwise.

(ii) Except as provided in paragraph (c)(i) of this Section 7 or in the Award agreement, the Participant shall generally have, with respect to the shares of Restricted Stock or Performance Shares, all of the rights of a stockholder with respect to such stock during the Restricted Period. The Participant shall generally not have the rights of a stockholder with respect to stock subject to Deferred Stock awards during the Restricted Period or with respect to unissued Stock subject to Restricted Stock Unit awards; provided, however, that dividends declared during the Restricted Period with respect to the number of shares covered by a Deferred Stock award shall be paid to the Participant. With respect to Restricted Stock Unit awards, prior to settlement or forfeiture, any Restricted Stock Unit award may, at the Administrator's discretion, carry with it a right to dividend equivalents. Such right entitles the Participant to be credited with an amount equal to all cash dividends paid on one share of Stock while the Restricted Stock Unit is outstanding. Dividend equivalents may be converted into additional Restricted Stock Units. Settlement of dividend equivalents may be made in the form of cash, in the form of shares of Stock, or in a combination of both. Prior to distribution, any dividend equivalents that are not paid shall be subject to the same conditions and restrictions as the Restricted Stock Units to which they attach. Certificates for shares of unrestricted Stock shall be delivered to the Participant promptly after, and only after, the Restricted Period shall expire without forfeiture in respect of such shares of Restricted Stock, Performance Shares or Deferred Stock, or upon vesting, without forfeiture, in Restricted Stock Units, except as the Administrator, in its sole discretion, shall otherwise determine.

(iii) The rights of holders of Restricted Stock, Deferred Stock, Performance Share and Restricted Stock Unit awards upon termination of employment or service for any reason during the Restricted Period or prior to completion of vesting in the Restricted Stock Units shall be set forth in the Restricted Stock Award Agreement, Deferred Stock Award Agreement, Performance Share Award Agreement or Restricted Stock Unit Award, as appropriate, governing such awards.

(iv) Settlement of vested Restricted Stock Units may be made in the form of (a) cash, (b) shares of Stock, or (c) any combination of both, as determined by the Administrator. The actual number of Restricted Stock Units eligible for settlement may be larger or smaller than the number included in the original Award, based on predetermined performance factors. Methods of converting Restricted Stock Units into cash may include (without limitation) a method based on the average Fair Market Value of a share of Stock over a series of trading days. Vested Restricted Stock Units may be settled in a lump sum or in installments. The distribution may occur or commence when all vesting conditions applicable to the Restricted Stock Units have been satisfied or lapsed, or it may be deferred to any later date. The amount of a deferred distribution may be increased by an interest factor or by

dividend equivalents. Until a Restricted Stock Unit award is settled, the number of such Restricted Stock Units shall be subject to adjustment pursuant to Sections 4 and 12.

8. Amendment And Termination Of Plan

The Board may amend, alter or discontinue the Plan, but no amendment, alteration, or discontinuation shall be made that would impair the rights of a Participant under any Award theretofore awarded without such Participant's consent. The Administrator may amend the terms of any Award theretofore awarded, prospectively or retroactively, but, as herein provided, no such amendment shall impair the rights of any Participant without his or her consent.

9. General Provisions

- a. The Administrator may require each person purchasing shares pursuant to the exercise of an Award to represent to and agree with the Company in writing that such person is acquiring the shares without a view to distribution thereof. The certificates for such shares may include any legend which the Administrator deems appropriate to reflect any restrictions on transfer.
- b. All certificates for shares of Stock delivered under the Plan shall be subject to such stock-transfer orders and other restrictions as the Administrator may deem advisable under the rules, regulations, and other requirements of the Securities and Exchange Commission, any stock exchange upon which the Stock is then listed, and any applicable Federal or state securities law, and the Administrator may cause a legend or legends to be placed on any such certificates to make appropriate reference to such restrictions.
- c. Nothing contained in the Plan shall prevent the Board from adopting other or additional compensation arrangements, subject to stockholder approval if such approval is required; and such arrangements may be either generally applicable or applicable only in specific cases.
- d. Each Participant shall, no later than the date as of which the value of an award first becomes includable in the gross income of the Participant for Federal income tax purposes, pay to the Company, or make arrangements satisfactory to the Administrator regarding payment of, any Federal, state, or local taxes of any kind required by law (as determined by the Administrator, in its sole discretion) to be withheld with respect to the Award. The obligations of the Company under the Plan shall be conditional on the making of such payments or arrangements, and the Company shall, to the extent permitted by law, have the right to deduct any such taxes from any payment of any kind otherwise due to the Participant.
- e. The Plan is intended to constitute an "unfunded" plan for incentive compensation. With respect to any payments not yet made to a Participant by the Company, nothing contained herein shall give any such Participant any rights that are greater than those of a general creditor of the Company.

10. Non-Liability

No member of the Board or the Administrator, nor any officer or employee of the Company acting on behalf of the Board or the Administrator, shall be personally liable for any action, determination, or interpretation taken or made in good faith with respect to the Plan, and all members of the Board or the Administrator and each and any officer or employee of the Company acting on their behalf shall, to the extent permitted by law, be fully indemnified and protected by the Company in respect of any such action, determination or interpretation.

11. Term Of Plan

No Award shall be awarded pursuant to the Plan on or after the tenth anniversary of the Effective Date, but Awards theretofore awarded may extend and be exercisable beyond that date.

12. Corporate Transactions/Changes Of Control

- a. In the event of any of the following stockholder-approved transactions (a "**Corporate Transaction**"):
 - i. a merger or consolidation in which the Company is not the surviving entity, except for a transaction whose principal purpose is to change the State of the Company's incorporation,
 - ii. the sale, transfer, or other disposition of all or substantially all of the assets of the Company in liquidation or dissolution, or
 - iii. any "reverse" merger in which the Company is the surviving entity but in which securities possessing more than 50% of the total combined voting power of the Company's outstanding securities are transferred to holders other than those who owned such voting power immediately before the merger,

then immediately before the effective date of the Corporate Transaction, each Award granted under this Plan shall become fully exercisable ("**accelerate**") with respect to the total number of shares of Common Stock then subject to the Stock Option. However, an Award shall not accelerate if and to the extent: (i) the Award is, in connection with the Corporate Transaction, either to be assumed by the successor corporation or parent thereof or to be replaced by an option on equivalent terms to purchase shares of the capital stock of the successor corporation or parent thereof, or (ii) acceleration of the Award is subject to other limitations imposed by the Administrator at the Date of Grant. The determination of equivalence under clause (i) above shall be made by the Administrator and shall be final, binding, and conclusive as to all parties.

- b. Upon consummation of the Corporate Transaction, all Awards granted under this Plan shall terminate and cease to be outstanding, except to the extent assumed by the successor (or surviving) corporation or its parent company.

- c. Each Award granted under this Plan that is replaced by an equivalent award in a Corporate Transaction or that otherwise continues in effect shall be appropriately adjusted, immediately after the Corporate Transaction, to apply to the number and class of securities that would have been issued in the Corporate Transaction to an actual holder of the number of shares of Common Stock that were subject to the Award immediately before the Corporate Transaction. Appropriate adjustment shall also be made to the price payable per share; provided that the aggregate price payable for such securities shall remain the same. In addition, the class and number of securities available for issuance under this Plan following the consummation of the Corporate Transaction shall be appropriately adjusted.
- d. The Administrator shall have full discretionary authority, exercisable either in advance of, or at the time of, a Change in Control, to provide for the automatic acceleration of Awards granted under this Plan upon the occurrence of the Change in Control. The Administrator shall also have full discretionary authority to condition any such acceleration upon the subsequent termination of the Participant's service to the Company (or a parent or subsidiary) within a specified period after the Change in Control. Any Award accelerated in connection with the Change in Control shall remain fully exercisable until the expiration of the option term. For all purposes of this Plan, a Change in Control shall mean a change in control of the Company of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), whether or not the Company is then subject to such reporting requirement, other than a Corporate Transaction; provided that, without limitation, a Change in Control shall be deemed to have occurred if:
 - i. any individual, partnership, firm, corporation, association, trust, unincorporated organization or other entity, or any syndicate or group deemed to be a "person" under Section 14(d) (2) of the Exchange Act, is or becomes the "beneficial owner" (as defined in Rule 13d-3 of the General Rules and Regulations under the Exchange Act), directly or indirectly, of securities of the Company representing 40% or more of the combined voting power of the Company's then-outstanding securities entitled to vote in the election of Directors of the Company, pursuant to a tender or exchange offer that the Board does not recommend that the Company's stockholders accept; or
 - ii. during any period of two consecutive years, individuals who at the beginning of such period constituted the Board and any new members of the Board, whose election by the Board or nomination for election by the Company's stockholders was approved by a vote of at least three-quarters of the Directors then in office who either were Directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof.
- e. The grant of Award under this Plan shall not affect the right of the Company to adjust, reclassify, reorganize, or otherwise change its capital or business structure or to merge, consolidate, dissolve, liquidate, or sell or transfer all or any part of its business or assets.

13. Miscellaneous

- a. **Use of Proceeds.** Any cash proceeds received by the Company from the sale of shares pursuant to Award granted under this Plan may be used for general corporate purposes.
- b. **Regulatory Approvals.** The implementation of this Plan, the awarding of any Awards hereunder, and the issuance of Stock upon the exercise or surrender of any such Award shall be subject to and conditional upon the procurement by the Company of all approvals and permits required by regulatory authorities having jurisdiction over this Plan, Awards granted under it, and Stock issued pursuant to it.
- c. **Securities Laws.** No shares of Common Stock or other assets shall be issued or delivered under this Plan unless and until there shall have been compliance with all applicable requirements of federal and state securities laws, including the filing and effectiveness of a Form S-8 registration statement for the shares of Common Stock issuable under this Plan, and all applicable listing requirements of any securities exchange on which stock of the same class is then listed.
- d. **No Employment Rights.** Neither the action of the Company in establishing this Plan, nor any action taken by the Administrator hereunder, nor any provision of this Plan, shall be construed so as to grant or offer any individual the right to remain in the employ or service of the Company (or any parent or subsidiary corporation) for any period, and the Company (or any parent or subsidiary corporation retaining the services of such individual) may terminate such individual's employment or service at any time and for any reason, with or without cause.
- e. **Assignment.** Except as otherwise provided in this Plan, the right to acquire Common Stock or other assets under this Plan may not be assigned, encumbered, or otherwise transferred by any recipient of an Award.
- f. **Governing Law.** The provisions of this Plan shall be governed by the laws of the State of California, as such laws are applied to contracts entered into and performed in that State. The provisions of this Plan shall inure to the benefit of, and be binding upon, the Company and its successors or assigns, and the Participants, the legal representatives of their respective estates, their respective heirs or legatees, and their permitted assignees.

Lam Research Corporation
Amendment to Stock Option Grant

Effective October 16, 2002 (the "Effective Date") the parties agree to amend Stock Option Grant No. 9700467, dated November 21, 1996, to James W. Bagley (the "Original Grant"). The Stock Option incorporates the following amendments to the Original Grant:

1. Right to Exercise. All shares of the Original Grant shall become unexercisable until vested under the following schedule. The right to exercise those shares shall vest as follows:
 - a. The first one-sixteenth (1/16) of the shares (119,250 shares) shall vest and become exercisable on January 17, 2003;
 - b. An additional one-sixteenth of the shares (119,250 shares) shall vest and become exercisable on April 17, 2003;
 - c. An additional one-sixteenth of the shares (119,250 shares) shall vest and become exercisable on July 17, 2003;
 - d. An additional one-sixteenth of the shares (119,250 shares) shall vest and become exercisable on October 17, 2003; and
 - e. An additional one-sixteenth of the shares (119,250 shares) shall vest and become exercisable each January 17, April 17, July 17 and October 17, during the years 2004 through 2006, until all shares are fully vested and exercisable;
 - f. Provided that should the closing price of Lam's Common Stock ever reach \$20.00 per share all unvested shares shall immediately accelerate and become exercisable.
1. Term of Option. This Stock Option shall expire on November 21, 2006, unless earlier terminated by virtue of a change in the optionee's employment status or the optionee's death or disability.
2. Change of Control and other events. This Stock Option incorporates by reference any terms regarding Change of Control and other events affecting the optionee's stock options as provided in the employment agreement between Lam Research Corporation and the optionee.
3. All terms of the Original Grant remain the same except as amended above. Only where amended do the amended terms supersede those of the Original Grant.

Optionee

/s/ James W. Bagley_____

James W. Bagley

LAM RESEARCH CORPORATION

By /s/ Terry Bean_____

Terry Bean

Its Vice-President of Human Resources

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Lam Research Corporation (the "Company") on Form 10-Q for the fiscal period ending December 29, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James W. Bagley, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 7, 2003

/s/ James W. Bagley
James W. Bagley
Chairman and Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Lam Research Corporation (the "Company") on Form 10-Q for the fiscal period ending December 29, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mercedes Johnson, Senior Vice President, Finance, Chief Financial Officer and Chief Accounting Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

February 7, 2003

/s/ Mercedes Johnson
Mercedes Johnson
Senior Vice President, Finance, Chief Financial
Officer and Chief Accounting Officer