

**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 25, 2011

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 0-12933

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 No.)

4650 Cushing Parkway
Fremont, California
(Address of principal executive offices)

94538
(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 such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

| | | | |
|-------------------------|--|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |

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

As of January 30, 2012 there were 119,883,889 shares of registrant's common stock outstanding.

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LAM RESEARCH CORPORATION

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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LAM RESEARCH CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

| | December 25, 2011 (unaudited) | June 26, 2011 (1) |
|--|-------------------------------------|-------------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 1,506,928 | \$ 1,492,132 |
| Short-term investments | 712,856 | 630,115 |
| Accounts receivable, less allowance for doubtful accounts of \$4,690 as of December 25, 2011 and \$4,720 as of June 26, 2011 | 462,243 | 590,568 |
| Inventories | 373,130 | 396,607 |
| Deferred income taxes | 78,479 | 78,435 |
| Prepaid expenses and other current assets | 79,215 | 85,408 |
| Total current assets | 3,212,851 | 3,273,265 |
| Property and equipment, net | 272,409 | 270,458 |
| Restricted cash and investments | 165,217 | 165,256 |
| Deferred income taxes | 4,184 | 3,892 |
| Goodwill | 169,182 | 169,182 |
| Intangible assets, net | 38,386 | 47,434 |
| Other assets | 115,918 | 124,380 |
| Total assets | <u>\$ 3,978,147</u> | <u>\$ 4,053,867</u> |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Trade accounts payable | \$ 108,118 | \$ 163,541 |
| Accrued expenses and other current liabilities | 365,405 | 358,756 |
| Deferred profit | 117,265 | 153,680 |
| Current portion of long-term debt, convertible notes, and capital leases | 2,817 | 4,782 |
| Total current liabilities | 593,605 | 680,759 |
| Long-term debt, convertible notes, and capital leases | 749,078 | 738,488 |
| Income taxes payable | 115,616 | 113,582 |
| Other long-term liabilities | 57,104 | 51,193 |
| Total liabilities | 1,515,403 | 1,584,022 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| 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 - 119,540 shares as of December 25, 2011 and 123,579 shares as of June 26, 2011 | 120 | 124 |
| Additional paid-in capital | 1,651,015 | 1,531,465 |
| Treasury stock, at cost; 45,728 shares as of December 25, 2011 and 40,995 shares as of June 26, 2011 | (1,950,397) | (1,761,591) |
| Accumulated other comprehensive income (loss) | (33,130) | 9,761 |
| Retained earnings | 2,795,136 | 2,690,086 |
| Total stockholders' equity | 2,462,744 | 2,469,845 |
| Total liabilities and stockholders' equity | <u>\$ 3,978,147</u> | <u>\$ 4,053,867</u> |

(1) Derived from 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 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| Revenue | \$ 583,981 | \$ 870,714 | \$1,264,417 | \$1,676,588 |
| Cost of goods sold | 350,014 | 463,281 | 746,567 | 891,829 |
| Cost of goods sold - restructuring and impairments | (859) | — | (859) | — |
| Total costs of goods sold | 349,155 | 463,281 | 745,708 | 891,829 |
| Gross margin | 234,826 | 407,433 | 518,709 | 784,759 |
| Research and development | 104,024 | 90,477 | 206,583 | 176,830 |
| Selling, general and administrative | 83,256 | 75,852 | 163,456 | 147,994 |
| Restructuring and impairments | — | — | 1,725 | (5,163) |
| Total operating expenses | 187,280 | 166,329 | 371,764 | 319,661 |
| Operating income | 47,546 | 241,104 | 146,945 | 465,098 |
| Other income (expense), net | (7,785) | 1,038 | (19,858) | 59 |
| Income before income taxes | 39,761 | 242,142 | 127,087 | 465,157 |
| Income tax expense | 6,549 | 20,286 | 22,037 | 49,577 |
| Net income | \$ 33,212 | \$ 221,856 | \$ 105,050 | \$ 415,580 |
| Net income per share: | | | | |
| Basic net income per share | \$ 0.28 | \$ 1.80 | \$ 0.87 | \$ 3.37 |
| Diluted net income per share | \$ 0.27 | \$ 1.78 | \$ 0.86 | \$ 3.32 |
| Number of shares used in per share calculations: | | | | |
| Basic | 119,739 | 123,101 | 121,435 | 123,384 |
| Diluted | 120,873 | 124,786 | 122,382 | 124,999 |

See Notes to Condensed Consolidated Financial Statements

LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

| | Six Months Ended | |
|---|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 105,050 | \$ 415,580 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 43,732 | 36,611 |
| Deferred income taxes | (633) | (3,822) |
| Restructuring and impairment charges | 866 | (5,163) |
| Impairment of investment | 1,724 | — |
| Equity-based compensation expense | 35,968 | 25,768 |
| Income tax benefit on equity-based compensation plans | 1,129 | 4,165 |
| Excess tax benefit on equity-based compensation plans | (2,155) | (3,228) |
| Amortization of convertible note discount | 13,264 | — |
| Loss on equity method investment | 202 | — |
| Other, net | 2,304 | (3,564) |
| Changes in operating assets and liabilities | 54,465 | (25,020) |
| Net cash provided by operating activities | <u>255,916</u> | <u>441,327</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures and intangible assets | (42,414) | (57,155) |
| Purchases of available-for-sale securities | (234,576) | (80,916) |
| Sales and maturities of available-for-sale securities | 145,123 | 55,250 |
| Purchase of equity method investment | (10,740) | — |
| Receipt of loan payments | 8,375 | — |
| Proceeds from sale of assets | 2,677 | 1,544 |
| Transfer of restricted cash and investments | 20 | (10) |
| Net cash used for investing activities | <u>(131,535)</u> | <u>(81,287)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Principal payments on long-term debt and capital lease obligations | (3,140) | (3,411) |
| Excess tax benefit on equity-based compensation plans | 2,155 | 3,228 |
| Net cash received in settlement (paid in advance for) stock repurchase contracts | (23,995) | (50,000) |
| Treasury stock purchases | (92,695) | (148,946) |
| Reissuances of treasury stock related to employee stock purchase plan | 8,858 | 7,155 |
| Proceeds from issuance of common stock | 1,475 | 4,242 |
| Net cash used for financing activities | <u>(107,342)</u> | <u>(187,732)</u> |
| Effect of exchange rate changes on cash | (2,243) | 10,985 |
| Net increase (decrease) in cash and cash equivalents | 14,796 | 183,293 |
| Cash and cash equivalents at beginning of period | <u>1,492,132</u> | <u>545,767</u> |
| Cash and cash equivalents at end of period | <u>\$ 1,506,928</u> | <u>\$ 729,060</u> |

See Notes to Condensed Consolidated Financial Statements

LAM RESEARCH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
December 25, 2011
(Unaudited)

NOTE 1 — BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP 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 (“Lam Research” or the “Company”) for the fiscal year ended June 26, 2011, which are included in the Annual Report on Form 10-K as of and for the year ended June 26, 2011 (the “2011 Form 10-K”). The Company’s Forms 10-K, Forms 10-Q and Forms 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is www.sec.gov. The Company also posts its Forms 10-K, Forms 10-Q and Forms 8-K on its corporate website at <http://investor.lamresearch.com>.

The consolidated financial statements include the accounts of Lam Research Corporation and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. We use the equity method to account for equity investments in instances in which we own common stock or similar interests and have the ability to exercise significant influence, but not control, over the investee. The Company’s reporting period is a 52/53-week fiscal year. The Company’s current fiscal year will end June 24, 2012 and includes 52 weeks. The quarters ended December 25, 2011 (the “December 2011 quarter”) and December 26, 2010 (the “December 2010 quarter”) each included 13 weeks.

Certain amounts presented in the comparative financial statements for prior years have been reclassified to conform to the fiscal year 2012 presentation.

NOTE 2 — RECENT ACCOUNTING PRONOUNCEMENTS

In June 2011, the Financial Accounting Standards Board (“FASB”) issued new authoritative guidance that increases the prominence of items reported in other comprehensive income (“OCI”) by eliminating the option to present components of OCI as part of the statement of changes in stockholders’ equity. The amendments in this standard require that all non-owner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance does not affect the underlying accounting for components of OCI, but will change the presentation of the Company’s financial statements. The Company will adopt this authoritative guidance retrospectively in the first quarter of its fiscal year 2013.

In September 2011, the FASB issued revised guidance intended to simplify how an entity tests goodwill for impairment. The amendment will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2013 and early adoption is permitted. The Company is currently evaluating this accounting standard update and does not expect it to have an impact on its Consolidated Financial Statements.

NOTE 3 — EQUITY-BASED COMPENSATION PLANS

The Company has stock plans that provide for grants of equity-based awards to eligible participants, including stock options and restricted stock units (“RSUs”), of Lam Research common stock (“Common Stock”). An option is a right to purchase the Company’s stock at a set price. An RSU award is an agreement to issue shares of the Company’s stock at the time of vesting. The Company’s options and RSU awards typically vest over a period of two years or less. The Company also has an employee stock purchase plan (“ESPP”) that allows employees to purchase its Common Stock at a discount through payroll deductions.

The Company recognized the following equity-based compensation expense and related income tax benefit in the Condensed Consolidated Statements of Operations:

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in millions) | | | |
| Equity-based compensation expense | \$ 18.2 | \$ 12.8 | \$ 36.0 | \$ 25.8 |
| Income tax benefit related to equity-based compensation expense | \$ 2.1 | \$ 2.2 | \$ 4.8 | \$ 4.3 |

The estimated fair value of the Company’s stock-based awards, less expected forfeitures, is amortized over the awards’ vesting term on a straight-line basis.

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Stock Options and RSUs

The 2007 Stock Incentive Plan provides for grants of equity-based awards to eligible participants. Additional shares are reserved for issuance under the Company's 1997 Stock Incentive Plan and its 1999 Stock Option Plan pursuant to awards previously granted under those plans (together with the 2007 Stock Incentive Plan, the "Plans"). As of December 25, 2011, there were a total of 2,787,348 shares reserved to cover options and RSUs issued and outstanding under the Plans. As of December 25, 2011, there were an additional 7,910,788 shares reserved and available for future equity-based awards under the 2007 Stock Incentive Plan.

A summary of stock option activity under the Plans as of December 25, 2011 and changes during the six months then ended is presented below:

| Options | Shares (in thousands) | Weighted- Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | Aggregate Intrinsic Value as of December 25, 2011 (in thousands) |
|----------------------------------|--------------------------------------|---|--|---|
| Outstanding at June 26, 2011 | 310 | \$ 21.50 | 2.26 | |
| Exercised | (64) | \$ 22.87 | | |
| Forfeited or expired | (3) | \$ 20.00 | | |
| Outstanding at December 25, 2011 | 243 | \$ 21.15 | 2.03 | \$ 3,838 |
| Exercisable at December 25, 2011 | 243 | \$ 21.15 | 2.03 | \$ 3,838 |

The total intrinsic value of options exercised during the three months ended December 25, 2011 and December 26, 2010 was \$0.9 million and \$4.0 million, respectively. The total intrinsic value of options exercised during the six months ended December 25, 2011 and December 26, 2010 was \$1.1 million and \$4.8 million, respectively.

As of December 25, 2011, all stock options outstanding were fully vested and all related compensation expense has been recognized.

A summary of the Company's RSUs as of December 25, 2011 and changes during the six months then ended is presented below:

| Unvested Restricted Stock Units | Shares (in thousands) | Average Grant- Date Fair Value |
|--|----------------------------------|---|
| Unvested at June 26, 2011 | 2,331 | \$ 39.90 |
| Granted | 887 | \$ 39.60 |
| Vested | (630) | \$ 42.82 |
| Forfeited | (44) | \$ 39.18 |
| Unvested at December 25, 2011 | 2,544 | \$ 41.66 |

The fair value of the Company's RSUs was calculated based upon the fair market value of the Company's stock at the date of grant. As of December 25, 2011, there was \$60.3 million of total unrecognized compensation expense related to unvested RSUs granted; that expense is expected to be recognized over a weighted average remaining period of 1.3 years.

ESPP

The 1999 Employee Stock Purchase Plan (as amended and restated, the "1999 ESPP") allows employees to designate a portion of their base compensation to be withheld through payroll deductions and used to purchase the Company's Common Stock at a purchase price per share equal to the lower of 85% of the fair market value of the Company's Common Stock on the first or last day of the applicable purchase period. Each offering period generally lasts up to 12 months and includes up to three interim purchase dates. As of December 25, 2011, there were a total of 9,389,557 shares available for issuance under the 1999 ESPP.

Purchase rights under the 1999 ESPP were valued using the Black-Scholes model assuming no expected dividends and the following weighted-average assumptions for the three and six months ended December 25, 2011:

| | Three Months Ended December 25, 2011 | Six Months Ended December 25, 2011 |
|---------------------------------|---|---|
| Expected term (years) | 0.68 | 0.73 |
| Expected stock price volatility | 44.45% | 44.37% |
| Risk-free interest rate | 0.10% | 0.11% |

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As of December 25, 2011, there was \$6.3 million of unrecognized compensation expense related to the 1999 ESPP, which is expected to be recognized over the next 0.7 years.

NOTE 4 — FINANCIAL INSTRUMENTS

The Company maintains an investment portfolio of various holdings, types, and maturities. The Company's mutual funds, which are correlated to the Company's obligations under the deferred compensation plan, are classified as trading securities. Investments classified as trading securities are recorded at fair value based upon quoted market prices. Differences between the cost and fair value of trading securities are recognized as "Other income (expense)" in the Consolidated Statements of Operations. All of the Company's other short-term investments are classified as available-for-sale and consequently are recorded in the Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax.

Fair Value

The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact, and it considers assumptions that market participants would use when pricing the asset or liability.

A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. The level of an asset or liability in the hierarchy is based on the lowest level of input that is significant to the fair value measurement. Assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities with sufficient volume and frequency of transactions.

Level 2: Valuations based on observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or model-derived valuations techniques for which all significant inputs are observable in the market or can be corroborated by, observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuations based on unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities and based on non-binding, broker-provided price quotes and may not have been corroborated by observable market data.

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis:

| | Fair Value Measurement at December 25, 2011 | | | Significant Unobservable Inputs (Level 3) |
|--|---|--|---|---|
| | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | |
| (In thousands) | | | | |
| Assets | | | | |
| Short-Term Investments | | | | |
| Money Market Funds | \$1,364,760 | \$ 1,364,760 | \$ — | \$ — |
| Municipal Notes and Bonds | 400,290 | — | 400,290 | — |
| US Treasury and Agencies | 6,064 | 6,064 | — | — |
| Government-Sponsored Enterprises | 37,851 | — | 37,851 | — |
| Foreign Government Bonds | 1,002 | — | 1,002 | — |
| Corporate Notes and Bonds | 378,264 | 164,885 | 213,379 | — |
| Mortgage Backed Securities - Residential | 1,343 | — | 1,343 | — |
| Mortgage Backed Securities - Commercial | 53,684 | — | 53,684 | — |
| Total Short-Term Investments | \$2,243,258 | \$ 1,535,709 | \$ 707,549 | \$ — |
| Equities | 7,945 | 7,945 | — | — |
| Mutual Funds | 18,164 | 18,164 | — | — |
| Derivatives Assets | 1,002 | — | 1,002 | — |
| Total | \$2,270,369 | \$ 1,561,818 | \$ 708,551 | \$ — |
| Liabilities | | | | |
| Derivative Liabilities | \$ 5,785 | \$ — | \$ 5,785 | \$ — |

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The amounts in the table above are reported in the Consolidated Balance Sheet as of December 25, 2011 as follows:

| Reported As: | Total | (Level 1) | (Level 2) | (Level 3) |
|--|--------------------|--------------------|------------------|-------------|
| | (In thousands) | | | |
| Cash Equivalents | \$1,365,517 | \$1,364,760 | \$ 757 | \$ — |
| Short-Term Investments | 712,856 | 6,064 | 706,792 | — |
| Restricted Cash and Investments | 164,885 | 164,885 | — | — |
| Prepaid Expenses and Other Current Assets | 26,109 | 26,109 | — | — |
| Other Assets | 1,002 | — | 1,002 | — |
| Total | \$2,270,369 | \$1,561,818 | \$708,551 | \$ — |
| Accrued Expenses and Other Current Liabilities | \$ 5,785 | \$ — | \$ 5,785 | \$ — |

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis:

| Total | Fair Value Measurement at June 26, 2011 | | |
|--|---|---|--|
| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| | (In thousands) | | |
| Assets | | | |
| Short-Term Investments | | | |
| Money Market Funds | \$1,300,098 | \$ 1,300,098 | \$ — |
| Municipal Notes and Bonds | 321,339 | — | 321,339 |
| US Treasury and Agencies | 8,496 | 8,496 | — |
| Government-Sponsored Enterprises | 19,868 | — | 19,868 |
| Foreign Government Bond | 1,005 | — | 1,005 |
| Corporate Notes and Bonds | 382,432 | 164,885 | 217,547 |
| Mortgage Backed Securities - Residential | 2,633 | — | 2,633 |
| Mortgage Backed Securities - Commercial | 60,729 | — | 60,729 |
| Total Short-Term Investments | \$2,096,600 | \$ 1,473,479 | \$ 623,121 |
| Equities | 7,443 | 7,443 | — |
| Mutual Funds | 19,467 | 19,467 | — |
| Derivatives Assets | 1,994 | — | 1,994 |
| Total | \$2,125,504 | \$ 1,500,389 | \$ 625,115 |
| Liabilities | | | |
| Derivative Liabilities | \$ 1,924 | \$ — | \$ 1,924 |

The amounts in the table above are reported in the Consolidated Balance Sheet as of June 26, 2011 as follows:

| Reported As: | Total | (Level 1) | (Level 2) | (Level 3) |
|--|--------------------|--------------------|------------------|-------------|
| | (In thousands) | | | |
| Cash Equivalents | \$1,301,600 | \$1,300,098 | \$ 1,502 | \$ — |
| Short-Term Investments | 630,115 | 8,496 | 621,619 | — |
| Restricted Cash and Investments | 164,885 | 164,885 | — | — |
| Prepaid Expenses and Other Current Assets | 26,910 | 26,910 | — | — |
| Other Assets | 1,994 | — | 1,994 | — |
| Total | \$2,125,504 | \$1,500,389 | \$625,115 | \$ — |
| Accrued Expenses and Other Current Liabilities | \$ 1,924 | \$ — | \$ 1,924 | \$ — |

The Company's primary financial instruments include its cash, cash equivalents, short-term investments, restricted cash and investments, long-term investments, accounts receivable, accounts payable, long-term debt and capital leases, and foreign currency related derivatives. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to the short period of time to their maturities. The estimated fair values of long-term debt, excluding convertible notes, and capital lease obligations approximate their carrying value as the substantial majority of these obligations have interest rates that adjust to market rates on a periodic basis. Refer to Note 13 of the Notes to the Condensed Consolidated Financial Statements for additional information regarding the fair value of the Company's convertible notes.

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Investments

The following tables summarize the Company's investments (in thousands):

| | December 25, 2011 | | | | June 26, 2011 | | | |
|--|--------------------|-----------------|-------------------|--------------------|--------------------|-----------------|-------------------|--------------------|
| | Cost | Unrealized Gain | Unrealized (Loss) | Fair Value | Cost | Unrealized Gain | Unrealized (Loss) | Fair Value |
| Cash | \$ 141,743 | \$ — | \$ — | \$ 141,743 | \$ 190,903 | \$ — | \$ — | \$ 190,903 |
| Fixed Income Money Market Funds | 1,364,760 | — | — | 1,364,760 | 1,300,098 | — | — | 1,300,098 |
| Municipal Notes and Bonds | 398,723 | 1,591 | (24) | 400,290 | 319,913 | 1,510 | (84) | 321,339 |
| US Treasury and Agencies | 6,036 | 28 | — | 6,064 | 8,462 | 34 | — | 8,496 |
| Government-Sponsored Enterprises | 37,846 | 39 | (34) | 37,851 | 19,864 | 6 | (2) | 19,868 |
| Foreign Government Bonds | 1,002 | — | — | 1,002 | 1,004 | 1 | — | 1,005 |
| Corporate Notes and Bonds | 378,021 | 827 | (584) | 378,264 | 380,992 | 1,498 | (58) | 382,432 |
| Mortgage Backed Securities - Residential | 1,257 | 86 | — | 1,343 | 2,521 | 144 | (32) | 2,633 |
| Mortgage Backed Securities - Commercial | 53,598 | 348 | (262) | 53,684 | 60,639 | 277 | (187) | 60,729 |
| Total Cash and Short-Term Investments | \$2,382,986 | \$ 2,919 | \$ (904) | \$2,385,001 | \$2,284,396 | \$ 3,470 | \$ (363) | \$2,287,503 |
| Publicly Traded Equity Securities | \$ 9,320 | \$ — | \$ (1,375) | \$ 7,945 | \$ 9,320 | \$ — | \$ (1,877) | \$ 7,443 |
| Mutual Funds | 18,051 | 277 | (164) | 18,164 | 17,975 | 1,492 | — | 19,467 |
| Total Financial Instruments | \$2,410,357 | \$ 3,196 | \$ (2,443) | \$2,411,110 | \$2,311,691 | \$ 4,962 | \$ (2,240) | \$2,314,413 |
| As Reported | | | | | | | | |
| Cash and Cash Equivalents | \$1,506,927 | \$ 1 | \$ — | \$1,506,928 | \$1,492,132 | \$ — | \$ — | \$1,492,132 |
| Short-Term Investments | 710,842 | 2,918 | (904) | 712,856 | 627,008 | 3,470 | (363) | 630,115 |
| Restricted Cash and Investments | 165,217 | — | — | 165,217 | 165,256 | — | — | 165,256 |
| Other assets | 27,371 | 277 | (1,539) | 26,109 | 27,295 | 1,492 | (1,877) | 26,910 |
| Total | \$2,410,357 | \$ 3,196 | \$ (2,443) | \$2,411,110 | \$2,311,691 | \$ 4,962 | \$ (2,240) | \$2,314,413 |

The Company accounts for its investment portfolio at fair value. Realized gains (losses) for investment sales and pay-downs are specifically identified. Management assesses the fair value of investments in debt securities that are not actively traded through consideration of interest rates and their impact on the present value of the cash flows to be received from the investments. The Company also considers whether changes in the credit ratings of the issuer could impact the assessment of fair value. The Company recognized a \$1.7 million other-than-temporary impairment of a strategic private equity investment during the six months ended December 25, 2011. The Company did not recognize any losses on investments due to other-than-temporary impairments during the three months ended December 25, 2011 or the three or six months ended December 26, 2010. Additionally, gross realized gains and losses from sales of investments were both less than \$0.4 million during the three and six months ended December 25, 2011 and December 26, 2010.

The following is an analysis of the Company's fixed income securities in unrealized loss positions (in thousands):

| | December 25, 2011 | | | | | |
|---|--|-----------------------|---|-----------------------|------------------|-----------------------|
| | Unrealized Losses Less Than 12 Months | | Unrealized Losses 12 Months or Greater | | Total | |
| | Fair Value | Gross Unrealized Loss | Fair Value | Gross Unrealized Loss | Fair Value | Gross Unrealized Loss |
| Short-Term Investments | | | | | | |
| Municipal Notes and Bonds | \$ 26,581 | \$ (24) | \$ — | \$ — | \$ 26,581 | \$ (24) |
| Government-Sponsored Enterprises | 19,449 | (34) | — | — | 19,449 | (34) |
| Corporate Notes and Bonds | 86,980 | (584) | — | — | 86,980 | (584) |
| Mortgage Backed Securities - Commercial | 25,307 | (216) | 966 | (46) | 26,273 | (262) |
| Total Short-Term Investments | \$158,317 | \$ (858) | \$ 966 | \$ (46) | \$159,283 | \$ (904) |

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The amortized cost and fair value of cash equivalents, short-term investments, and restricted cash and investments with contractual maturities are as follows:

| | December 25, 2011 | | June 26, 2011 | |
|---------------------------|--------------------|----------------------|--------------------|----------------------|
| | Cost | Estimated Fair Value | Cost | Estimated Fair Value |
| | (in thousands) | | | |
| Due in less than one year | \$1,726,678 | \$1,727,063 | \$1,606,390 | \$1,606,925 |
| Due in more than one year | 514,565 | 516,195 | 487,103 | 489,675 |
| | <u>\$2,241,243</u> | <u>\$2,243,258</u> | <u>\$2,093,493</u> | <u>\$2,096,600</u> |

Management has the ability, if necessary, to liquidate any of its cash equivalents and short-term investments in order to meet the Company's liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase nonetheless are classified as short-term on the accompanying Consolidated Balance Sheets.

Derivative Instruments and Hedging

The Company carries derivative financial instruments ("derivatives") on its Consolidated Balance Sheets at their fair values. The Company enters into foreign exchange forward contracts with financial institutions with the primary objective of reducing volatility of earnings and cash flows related to foreign currency exchange rate fluctuations. The counterparties to these foreign exchange forward contracts are large international financial institutions that the Company believes are creditworthy, and therefore, we do not consider the risk of counterparty nonperformance to be material.

Cash Flow Hedges

In the normal course of business, the Company's financial position is routinely subjected to market risk associated with foreign currency exchange rate fluctuations on non-US dollar transactions or cash flows, primarily from Japanese yen-denominated revenues and Euro-denominated expenses. The Company's policy is to mitigate the foreign exchange risk arising from the fluctuations in the value of these non-US dollar denominated transactions or cash flows through a foreign currency cash flow hedging program, using foreign exchange forward contracts that generally expire within 12 months and no later than 24 months. These foreign exchange forward contracts are designated as cash flow hedges and 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 revenue in the same period the hedged revenue is recognized.

At inception and at each quarter end, hedges are tested prospectively and retrospectively for effectiveness using regression analysis. Changes in the fair value of foreign exchange forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in revenue in the current period. The change in time value related to these contracts was not material for all reported periods. To qualify for hedge accounting, the hedge relationship must meet criteria relating both to the derivative instrument and the hedged item. These criteria 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. There were no gains or losses during the three or six months ended December 25, 2011 or December 26, 2010 associated with ineffectiveness or forecasted transactions that failed to occur.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be tested to demonstrate an expectation of providing highly effective offsetting changes to future cash flows on hedged transactions. When derivative instruments are designated and qualify as effective cash flow hedges, the Company is able to defer effective 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 excluded time value and hedge ineffectiveness recognized, the Company's 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 the Company does not believe that the underlying hedged forecasted transactions will occur, the Company may not be able to account for its derivative instruments as cash flow hedges. If this were to occur, future changes in the fair values of the Company's derivative instruments would be recognized in earnings. Additionally, related amounts previously recorded in "Other comprehensive income" would be reclassified to income immediately. At December 25, 2011, the Company had losses of \$5.7 million accumulated in Other Comprehensive Income, which it expects to reclassify from Other Comprehensive Income into earnings over the next 12 months.

Balance Sheet Hedges

The Company also enters into foreign exchange forward contracts to hedge the effects of foreign currency fluctuations associated with foreign currency denominated monetary assets and liabilities, primarily intercompany receivables and payables. These foreign exchange forward contracts are not designated for hedge accounting treatment. Therefore, the change in fair value of these derivatives is recorded as a component of other income (expense) and offsets the change in fair value of the foreign currency denominated assets and liabilities, recorded in other income (expense).

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As of December 25, 2011, the Company had the following outstanding foreign currency forward contracts that were entered into under its cash flow and balance sheet hedge program:

| | <u>Derivatives Designated as</u> <u>Hedging Instruments:</u> | <u>Derivatives Not Designated as</u> <u>Hedging Instruments:</u> |
|---|---|---|
| | <u>(in thousands)</u> | |
| Foreign Currency Forward Contracts | | |
| Sell JPY | \$ 51,278 | \$ 37,179 |
| Buy CHF | — | 236,471 |
| Buy TWD | — | 69,394 |
| Buy EUR | 78,774 | 36,395 |
| | <u>\$ 130,052</u> | <u>\$ 379,439</u> |

The fair value of derivatives instruments in the Company's Condensed Consolidated Balance Sheets as of December 25, 2011 was as follows:

| | <u>Fair Value of Derivative Instruments</u> | | | |
|---|---|--|---|-------------------|
| | <u>Asset Derivatives</u> | | <u>Liability Derivatives</u> | |
| | <u>Balance Sheet</u> <u>Location</u> | <u>Fair Value</u> <u>(in thousands)</u> | <u>Balance Sheet</u> <u>Location</u> | <u>Fair Value</u> |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | Prepaid expense and other assets | \$ 88 | Accrued liabilities | \$ (5,236) |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | Prepaid expense and other assets | \$ 914 | Accrued liabilities | \$ (549) |
| Total derivatives | | <u>\$ 1,002</u> | | <u>\$ (5,785)</u> |

The fair value of derivatives instruments in the Company's Condensed Consolidated Balance Sheets as of June 26, 2011 was as follows:

| | <u>Fair Value of Derivative Instruments</u> | | | |
|---|---|--|---|-------------------|
| | <u>Asset Derivatives</u> | | <u>Liability Derivatives</u> | |
| | <u>Balance Sheet</u> <u>Location</u> | <u>Fair Value</u> <u>(in thousands)</u> | <u>Balance Sheet</u> <u>Location</u> | <u>Fair Value</u> |
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | Prepaid expense and other assets | \$ 1,881 | Accrued liabilities | \$ (1,142) |
| Derivatives not designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | Prepaid expense and other assets | \$ 113 | Accrued liabilities | \$ (782) |
| Total derivatives | | <u>\$ 1,994</u> | | <u>\$ (1,924)</u> |

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The effect of derivative instruments designated as cash flow hedges on the Company's Condensed Consolidated Statements of Operations was as follows:

| | Three Months Ended December 25, 2011 | | | | Six Months Ended December 25, 2011 | | | |
|---|--|--|--|--|--|--|--|--|
| | Gain (Loss) Recognized (Effective Portion) (1) | Gain (Loss) Recognized (Effective Portion) (2) | Gain (Loss) Recognized (Ineffective Portion) (3) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) (4) | Gain (Loss) Recognized (Effective Portion) (1) | Gain (Loss) Recognized (Effective Portion) (2) | Gain (Loss) Recognized (Ineffective Portion) (3) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) (4) |
| Derivatives Designated as Hedging Instruments: | | | | | | | | |
| | | | | (in thousands) | | | | |
| Foreign exchange forward contracts | \$ (3,581) | \$ (2,906) | \$ (1) | \$ 223 | \$ (11,793) | \$ (5,512) | \$ (2) | \$ 754 |

| | Three Months Ended December 26, 2010 | | | | Six Months Ended December 26, 2010 | | | |
|---|--|--|--|--|--|--|--|--|
| | Gain (Loss) Recognized (Effective Portion) (1) | Gain (Loss) Recognized (Effective Portion) (2) | Gain (Loss) Recognized (Ineffective Portion) (3) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) (4) | Gain (Loss) Recognized (Effective Portion) (1) | Gain (Loss) Recognized (Effective Portion) (2) | Gain (Loss) Recognized (Ineffective Portion) (3) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) (4) |
| Derivatives Designated as Hedging Instruments: | | | | | | | | |
| | | | | (in thousands) | | | | |
| Foreign exchange forward contracts | \$ 317 | \$ (2,192) | \$ — | \$ 73 | \$ (4,777) | \$ (5,802) | \$ — | \$ 187 |

- (1) Amount recognized in other comprehensive income (effective portion).
- (2) Amount of gain (loss) reclassified from accumulated other comprehensive income into income (effective portion) located in revenue and operating expenses.
- (3) Amount of gain (loss) recognized in income on derivative (ineffective portion) located in other income (expense), net.
- (4) Amount of gain (loss) recognized in income on derivative (amount excluded from effectiveness testing) located in other income (expense), net.

The effect of derivative instruments not designated as cash flow hedges on the Company's Condensed Consolidated Statement of Operations was as follows:

| | Three Months Ended | | Six Months Ended | |
|---|----------------------------|----------------------------|----------------------------|----------------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| Derivatives Not Designated as Hedging Instruments: | Gain (Loss) Recognized (5) | Gain (Loss) Recognized (5) | Gain (Loss) Recognized (5) | Gain (Loss) Recognized (5) |
| | (in thousands) | | | |
| Foreign exchange forward contracts | \$ (20,411) | \$ 5,798 | \$ (42,823) | \$ 14,177 |

- (5) Amount of gain (loss) recognized in income located in other income (expense), net.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short term investments, restricted cash and investments, trade accounts receivable, and derivative financial instruments used in hedging activities. Cash is placed on deposit in large international financial institutions. Such deposits may be in excess of insured limits. Management believes that the financial institutions that hold the Company's cash are credit worthy and, accordingly, minimal credit risk exists with respect to these balances.

The Company's available-for-sale securities must have a minimum rating of A2 / A at the time of purchase, as rated by two of the following three rating agencies: Moody's, Standard & Poor's (S&P), or Fitch. To ensure diversification and minimize concentration, the Company's policy limits the amount of credit exposure with any one financial institution or commercial issuer.

The Company is exposed to credit losses in the event of nonperformance by counterparties on the foreign currency forward contracts that are used to mitigate the effect of exchange rate fluctuations and on contracts related to structured share repurchase agreements. These counterparties are large international financial institutions and to date, no such counterparty has failed to meet its financial obligations to the Company.

Credit risk evaluations, including trade references, bank references and Dun & Bradstreet ratings, are performed on all new customers and the Company monitors its customers' financial statements and payment performance. In general, the Company does not require collateral on sales.

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NOTE 5 — INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market. Shipments to Japanese customers, to whom title does not transfer until customer acceptance, are classified as inventory and carried at cost until title transfers. Inventories consist of the following:

| | December 25, 2011 | June 26, 2011 |
|-----------------|----------------------|------------------|
| | (in thousands) | |
| Raw materials | \$ 221,745 | \$212,979 |
| Work-in-process | 68,407 | 69,013 |
| Finished goods | 82,978 | 114,615 |
| | <u>\$ 373,130</u> | <u>\$396,607</u> |

NOTE 6 — PROPERTY AND EQUIPMENT, NET

Property and equipment, net, consists of the following:

| | December 25, 2011 | June 26, 2011 |
|---|----------------------|-------------------|
| | (in thousands) | |
| Manufacturing, engineering and office equipment | \$ 366,339 | \$ 345,684 |
| Computer equipment and software | 101,191 | 95,770 |
| Land | 14,209 | 14,758 |
| Buildings | 66,524 | 65,429 |
| Leasehold improvements | 60,025 | 55,833 |
| Furniture and fixtures | 15,496 | 15,258 |
| | <u>623,784</u> | <u>592,732</u> |
| Less: accumulated depreciation and amortization | <u>(351,375)</u> | <u>(322,274)</u> |
| | <u>\$ 272,409</u> | <u>\$ 270,458</u> |

NOTE 7 — GOODWILL AND INTANGIBLE ASSETS

Goodwill

The balance of goodwill was \$169.2 million as of December 25, 2011 and June 26, 2011. Goodwill attributable to the SEZ acquisition of \$104.2 million is not tax deductible due to applicable foreign law. The remaining goodwill balance of \$65.0 million is tax deductible.

Intangible Assets

The following table provides details of the Company's intangible assets subject to amortization as of December 25, 2011 (in thousands, except years):

| | Gross | Accumulated Amortization | Net | Weighted- Average Useful Life (years) |
|-------------------------|------------------|-----------------------------|-----------------|--|
| Customer relationships | \$ 35,226 | \$ (25,946) | \$ 9,280 | 6.90 |
| Existing technology | 61,941 | (39,617) | 22,324 | 6.68 |
| Patents | 20,670 | (15,891) | 4,779 | 6.11 |
| Other intangible assets | 35,216 | (33,213) | 2,003 | 4.10 |
| | <u>\$153,053</u> | <u>\$(114,667)</u> | <u>\$38,386</u> | |

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The following table provides details of the Company's intangible assets subject to amortization as of June 26, 2011 (in thousands, except years):

| | <u>Gross</u> | <u>Accumulated Amortization</u> | <u>Net</u> | <u>Weighted- Average Useful Life (years)</u> |
|-------------------------|------------------|-------------------------------------|-----------------|--|
| Customer relationships | \$ 35,226 | \$ (23,468) | \$11,758 | 6.90 |
| Existing technology | 61,941 | (35,409) | 26,532 | 6.68 |
| Patents | 20,670 | (14,323) | 6,347 | 6.11 |
| Other intangible assets | 35,216 | (32,419) | 2,797 | 4.10 |
| | <u>\$153,053</u> | <u>\$(105,619)</u> | <u>\$47,434</u> | 6.06 |

The Company recognized \$4.5 million and \$6.0 million in intangible asset amortization expense during the three months ended December 25, 2011 and December 26, 2010, respectively. The Company recognized \$9.0 million and \$12.0 million in intangible asset amortization expense during the six months ended December 25, 2011 and December 26, 2010, respectively.

The estimated future amortization expense of purchased intangible assets as of December 25, 2011 is as follows (in thousands):

| <u>Fiscal Year</u> | <u>Amount</u> |
|--------------------|-----------------|
| 2012 (6 months) | \$ 8,968 |
| 2013 | 16,350 |
| 2014 | 10,377 |
| 2015 | 2,154 |
| 2016 | 381 |
| Thereafter | 156 |
| | <u>\$38,386</u> |

NOTE 8 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

| | <u>December 25, 2011</u> | <u>June 26, 2011</u> |
|--------------------------------|------------------------------|--------------------------|
| | <u>(in thousands)</u> | |
| Accrued compensation | \$ 212,678 | \$206,313 |
| Warranty reserves | 32,734 | 40,951 |
| Income and other taxes payable | 48,932 | 51,183 |
| Other | 71,061 | 60,309 |
| | <u>\$ 365,405</u> | <u>\$358,756</u> |

[Table of Contents](#)**NOTE 9 — OTHER INCOME (EXPENSE), NET**

The significant components of other income (expense), net, are as follows:

| | Three Months Ended | | Six Months Ended | |
|---------------------------------|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | |
| Interest income | \$ 2,472 | \$ 2,635 | \$ 5,061 | \$ 5,046 |
| Interest expense | (9,346) | (110) | (18,606) | (211) |
| Gains (losses) on mutual funds | (348) | 1,913 | (2,213) | 2,578 |
| Foreign exchange gains (losses) | (142) | (3,108) | (1,232) | (6,287) |
| Other, net | (421) | (292) | (2,868) | (1,067) |
| | <u>\$ (7,785)</u> | <u>\$ 1,038</u> | <u>\$ (19,858)</u> | <u>\$ 59</u> |

NOTE 10 — INCOME TAX EXPENSE

The Company's effective tax rate for the three and six months ended December 25, 2011 was approximately 16.5% and 17.3%, respectively.

The differences between the U.S. federal statutory tax rate of 35% and the Company's effective tax rates for the three and six months ended December 25, 2011 were primarily due to the geographic mix of income and research and development tax credits partially offset by the tax effect of non-deductible stock-based compensation. The effective tax rates recorded during the three and six months ended December 25, 2011 included the tax impact of discrete items, which were recorded during the quarter in which they occurred. During the three and six months ended December 25, 2011, discrete items primarily consisted of: (1) a tax expense of \$2.2 million and \$3.8 million, respectively, related to the filing of prior year foreign tax returns, which resulted in provision to return true-ups, (2) a tax expense of \$0.8 million and \$1.7 million, respectively, of interest related to uncertain tax positions, (3) a tax benefit of \$2.5 million and \$3.7 million, respectively, related to the acquisition, restructuring and asset impairment related expenses, and (4) a tax benefit of \$6.9 million and \$7.1 million, respectively, related to the recognition of previously unrecognized tax benefits and the reversal of the related interest accruals due to finalization of certain foreign uncertain tax positions. The total gross unrecognized tax benefits as of each date noted below were as follows:

| | December 25, 2011 | June 26, 2011 |
|---------------------------------------|----------------------|------------------|
| | (in millions) | |
| Total gross unrecognized tax benefits | \$ 182.0 | \$181.5 |

If the gross unrecognized tax benefits were recognized in a future period, it would result in a net tax benefit of \$119.6 million and a reduction of the effective tax rate.

The Company recognizes interest expense and penalties related to the above unrecognized tax benefits within income tax expense. As of December 25, 2011, the Company had accrued approximately \$17.1 million for the payment of gross interest and penalties, relating to unrecognized tax benefits, compared to \$16.9 million as of June 26, 2011.

The Internal Revenue Service ("IRS") is examining the Company's U.S. income tax return for fiscal years 2008 and 2009. The Company is also under audit by the California Franchise Tax Board ("FTB") for fiscal years 2005 and 2006. As of December 25, 2011, no significant adjustments have been proposed by the IRS or FTB. The Company is unable to make a reasonable estimate as to when cash settlements, if any, with the relevant taxing authorities will occur. In addition, the Company is also subject to audits by foreign tax authorities.

The Company files U.S. federal, U.S. state, and foreign income tax returns. As of December 25, 2011, tax years 2003-2011 remain subject to examination in the jurisdictions where the Company operates.

The Company is in various stages of the examinations in connection with all of its tax audits worldwide and it is difficult to determine when these examinations will be settled. It is reasonably possible that over the next twelve-month period the Company may experience an increase or decrease in its unrecognized tax benefits. It is not possible to determine either the magnitude or the range of any increase or decrease at this time.

Realization of the Company's net deferred tax assets is based upon the weight of available evidence, including such factors as the recent earnings history and expected future taxable income. The Company believes it is more likely than not that such assets will be realized with the exception of \$46.2 million related to certain California and foreign deferred tax assets. However, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. If the valuation allowance related to deferred tax assets were released as of December 25, 2011, approximately \$46.2 million would be credited to the statement of operations.

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NOTE 11 — NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the treasury stock method, for dilutive stock options and RSUs. The following table reconciles the numerators and denominators of the basic and diluted computations for net income per share.

| | Three Months Ended | | Six Months Ended | |
|--|---------------------------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands, except per share data) | | | |
| Numerator: | | | | |
| Net income | \$ 33,212 | \$ 221,856 | \$ 105,050 | \$ 415,580 |
| Denominator: | | | | |
| Basic average shares outstanding | 119,739 | 123,101 | 121,435 | 123,384 |
| Effect of potential dilutive securities: | | | | |
| Employee stock plans | 1,134 | 1,685 | 947 | 1,615 |
| Diluted average shares outstanding | 120,873 | 124,786 | 122,382 | 124,999 |
| Net income per share - basic | \$ 0.28 | \$ 1.80 | \$ 0.87 | \$ 3.37 |
| Net income per share - diluted | \$ 0.27 | \$ 1.78 | \$ 0.86 | \$ 3.32 |

For purposes of computing diluted net income per share, weighted-average common shares do not include potentially dilutive securities that are anti-dilutive under the treasury stock method. The following potentially dilutive securities were excluded:

| | Three Months Ended | | Six Months Ended | |
|--|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | |
| Number of potential dilutive securities excluded | 90 | 54 | 841 | 76 |

Diluted shares outstanding do not include any effect resulting from warrants, assumed conversion of the Notes, or note hedges (as described in Note 13) as their impact would have been anti-dilutive.

NOTE 12 — COMPREHENSIVE INCOME

The components of comprehensive income, on an after-tax basis where applicable, are as follows:

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | |
| Net income | \$ 33,212 | \$ 221,856 | \$ 105,050 | \$ 415,580 |
| Foreign currency translation adjustment | (16,979) | 13,422 | (31,889) | 44,095 |
| Unrealized gain (loss) on fair value of derivative financial instruments, net | 2,068 | 4,700 | (1,463) | 6,861 |
| Unrealized gain (loss) on financial instruments, net | 898 | (485) | 39 | (562) |
| Reclassification adjustment for gain included in earnings | (2,840) | (2,596) | (5,209) | (6,365) |
| Postretirement benefit plan adjustment | 157 | 157 | (4,369) | 1,152 |
| Comprehensive income | \$ 16,516 | \$ 237,054 | \$ 62,159 | \$ 460,761 |

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The balance of accumulated other comprehensive loss, on an after-tax basis where applicable, is as follows:

| | December 25, 2011 | June 26, 2011 |
|--|----------------------|------------------|
| | (in thousands) | |
| Accumulated foreign currency translation adjustment | \$ (17,037) | \$ 14,852 |
| Accumulated unrealized gain (loss) on derivative financial instruments | (5,700) | 581 |
| Accumulated unrealized gain (loss) on financial instruments | 391 | 744 |
| Postretirement benefit plan adjustment | (10,784) | (6,416) |
| Accumulated other comprehensive income (loss) | <u>\$ (33,130)</u> | <u>\$ 9,761</u> |

NOTE 13 — LONG TERM DEBT

The following table reflects the carrying value of the Company's convertible notes and other long-term debt as of December 25, 2011 and June 26, 2011:

| | December 25, 2011 | June 26, 2011 |
|---|----------------------|------------------|
| | (in millions) | |
| 0.50% Notes due 2016 | \$ 450.0 | \$ 450.0 |
| Less: Unamortized interest discount | (67.4) | (74.4) |
| Net carrying amount of 0.50% Notes 2016 | <u>382.6</u> | <u>375.6</u> |
| 1.25% Notes due 2018 | 450.0 | 450.0 |
| Less: Unamortized interest discount | (96.9) | (103.2) |
| Net carrying amount of 1.25% Notes 2018 | <u>353.1</u> | <u>346.8</u> |
| Other long-term debt | 1.3 | 3.9 |
| Total long-term debt | <u>\$ 737.0</u> | <u>\$ 726.3</u> |

Convertible Senior Notes

In May 2011, the Company issued and sold \$450 million in aggregate principal amount of 0.5% Convertible Senior Notes due May 2016 (the "2016 Notes") at par. At the same time, the Company issued and sold \$450 million in aggregate principal amount of 1.25% Convertible Senior Notes due May 2018 (the "2018 Notes", and collectively with the 2016 Notes the "Notes") at par. The Notes may be converted, under certain circumstances, based on an initial conversion rate of 15.8687 shares of common stock per \$1,000 principal amount of notes (which represents an initial conversion price of approximately \$63.02 per share of common stock).

The net proceeds to the Company from the sale of the Notes were \$835.5 million. The Company pays cash interest at an annual rate of 0.5% and 1.25%, respectively, on the 2016 and 2018 Notes, payable semi-annually on May 15 and November 15 of each year, beginning November 15, 2011.

The Company separately accounts for the liability and equity components of the Notes. The initial debt components of the 2016 and 2018 Notes were valued at \$373.8 million and \$345.1 million, respectively, based on the present value of the future cash flows using discount rates of 4.29% and 5.27%, respectively, the Company's borrowing rate at the date of the issuance for similar debt instruments without the conversion feature. The carrying value of the equity components of the 2016 and 2018 Notes were \$76.2 million and \$104.9 million, respectively, as of December 25, 2011. The effective interest rates on the liability components of the 2016 Notes and 2018 Notes for the three months ended December 25, 2011 were 4.29% and 5.27%, respectively. The following table presents the amount of interest cost recognized relating to both the contractual interest coupon and amortization of the discount on the liability component of the Notes during the three and six months ended December 25, 2011.

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| | Three Months Ended December 25, 2011 | Six Months Ended December 25, 2011 |
|-----------------------------------|--|--|
| | (in millions) | |
| Contractual interest coupon | \$ 2.0 | \$ 4.0 |
| Amortization of interest discount | 6.6 | 13.2 |
| Total interest cost recognized | <u>\$ 8.6</u> | <u>\$ 17.2</u> |

The remaining bond discount of the 2016 Notes of \$67.4 million as of December 25, 2011 will be amortized over their remaining life, which is approximately 4.4 years. The remaining bond discount of the 2018 Notes of \$96.9 million as of December 25, 2011 will be amortized over their remaining life, which is approximately 6.4 years.

The 2016 Notes may be converted at any time prior to the close of business on the business day immediately preceding February 15, 2016, at the option of the holder, only under the following circumstances: 1) during the five business-day period after any ten consecutive trading-day period (the "measurement period") in which the trading price per \$1,000 principal amount of 2016 notes for each day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day; 2) during any fiscal quarter commencing after the fiscal quarter ending September 25, 2011, if the last reported sale price of the Company's common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price in effect on the last trading day of the immediately preceding fiscal quarter; or 3) upon the occurrence of specified corporate events. On and after February 15, 2016 until the close of business on the second scheduled trading day immediately preceding the maturity date of May 15, 2016, holders may convert their notes at any time, regardless of the foregoing circumstances.

Upon conversion, a holder will receive the conversion value of the 2016 Notes to be converted equal to the conversion rate multiplied by the volume weighted average price of the Company's common stock during a specified period following the conversion date. The conversion value of each 2016 Note will be paid in: 1) cash equal to the principal amount of the note and 2) to the extent the conversion value exceeds the principal amount of the note, common stock (plus cash in lieu of any fractional shares of common stock). The conversion price will be subject to adjustment in some events but will not be adjusted for accrued interest. Upon a "fundamental change" at any time, as defined, the Company will in some cases increase the conversion rate for a holder who elects to convert its 2016 Notes in connection with such fundamental change. In addition, the holders may require the Company to repurchase for cash all or a portion of their notes upon a "designated event" at a price equal to 100% of the principal amount of the notes being repurchased plus accrued and unpaid interest, if any.

Concurrently with the issuance of the 2016 Notes, the Company purchased a convertible note hedge and sold warrants. The separate convertible note hedge and warrant transactions are collectively structured to reduce the potential future economic dilution associated with the conversion of the 2016 Notes and to increase the effective initial conversion price to \$71.34 per share. Each of these components is discussed separately below:

Convertible Note Hedge. Counterparties agreed to sell to the Company up to approximately 7.1 million shares of the Company's common stock, which is the number of shares initially issuable upon conversion of the 2016 Notes in full, at a price of \$63.02 per share. The convertible note hedge transaction will be settled in net shares and will terminate upon the earlier of the maturity date of the 2016 Notes or the first day none of the 2016 Notes remains outstanding due to conversion or otherwise. Settlement of the convertible note hedge in net shares, based on the number of shares issued upon conversion of the 2016 Notes, on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 2016 Notes. Should there be an early unwind of the convertible note hedge transaction, the number of net shares potentially received by the Company will depend upon 1) the then existing overall market conditions, 2) the Company's stock price, 3) the volatility of the Company's stock, and 4) the amount of time remaining before expiration of the convertible note hedge. The convertible note hedge transaction cost of \$76.2 million has been accounted for as an equity transaction. The Company initially recorded approximately \$28.2 million in stockholders' equity from the net deferred tax liability related to the convertible note hedge at inception of the transaction.

Sold Warrants. The Company received \$57.6 million from the same counterparties from the sale of warrants to purchase up to approximately 7.1 million shares of the Company's common stock at an exercise price of \$71.34 per share. The warrants expire on a series of dates between August 15, 2016 and October 21, 2016. At expiration, the Company may, at its option, elect to settle the warrants on a net share basis. As of December 25, 2011, the warrants had not been exercised and remained outstanding. The value of the warrants was initially recorded in equity and continues to be classified as equity.

The 2018 Notes may be converted at any time prior to the close of business on the business day immediately preceding February 15, 2018, at the option of the holder only under the following circumstances: 1) during the five business-day period after any ten consecutive trading-day period (the "measurement period") in which the trading price per 1,000 principal amount of 2018 notes for each day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the applicable conversion rate on each such trading day; 2) during any fiscal quarter commencing after the fiscal quarter ending September 25, 2011, if the last reported sale price of the Company's common stock for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price in effect on the last trading day of the immediately preceding fiscal quarter; or 3) upon the occurrence of specified corporate events. On and after February 15, 2018 until the close of business on the second scheduled trading day immediately preceding the maturity date of May 15, 2018, holders may convert their notes at any time, regardless of the foregoing circumstances.

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Upon conversion, a holder will receive the conversion value of the 2018 Notes to be converted equal to the conversion rate multiplied by the volume weighted average price of the Company's common stock during a specified period following the conversion date. The conversion value of each 2018 Note will be paid in: 1) cash equal to the principal amount of the note and 2) to the extent the conversion value exceeds the principal amount of the note, common stock (plus cash in lieu of any fractional shares of common stock). The conversion price will be subject to adjustment in some events but will not be adjusted for accrued interest. Upon a "fundamental change" at any time, as defined, the Company will in some cases increase the conversion rate for a holder who elects to convert its 2018 Notes in connection with such fundamental change. In addition, the holders may require the Company to repurchase for cash all or a portion of their notes upon a "designated event" at a price equal to 100% of the principal amount of the notes being repurchased plus accrued and unpaid interest, if any.

Concurrently with the issuance of the 2018 Notes, the Company purchased a convertible note hedge and sold warrants. The separate convertible note hedge and warrant transactions are collectively structured to reduce the potential future economic dilution associated with the conversion of the 2018 Notes and to increase the effective initial conversion price to \$76.10 per share. Each of these components is discussed separately below:

Convertible Note Hedge. Counterparties agreed to sell to the Company up to approximately 7.1 million shares of the Company's common stock, which is the number of shares initially issuable upon conversion of the 2018 Notes in full, at a price of \$63.02 per share. The convertible note hedge transaction will be settled in net shares and will terminate upon the earlier of the maturity date of the 2018 Notes or the first day none of the 2018 Notes remains outstanding due to conversion or otherwise. Settlement of the convertible note hedge in net shares, based on the number of shares issued upon conversion of the 2018 Notes, on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 2018 Notes. Should there be an early unwind of the convertible note hedge transaction, the number of net shares potentially received by the Company will depend upon 1) the then existing overall market conditions, 2) the Company's stock price, 3) the volatility of the Company's stock, and 4) the amount of time remaining before expiration of the convertible note hedge. The convertible note hedge transaction cost of \$104.9 million has been accounted for as an equity transaction. The Company initially recorded approximately \$38.8 million in stockholders' equity from the net deferred tax liability related to the convertible note hedge at inception of the transaction.

Sold Warrants. The Company received \$76.3 million from the same counterparties from the sale of warrants to purchase up to approximately 7.1 million shares of the Company's common stock at an exercise price of \$76.10 per share. The warrants expire on a series of dates between August 15, 2018 and October 23, 2018. At expiration, the Company may, at its option, elect to settle the warrants on a net share basis. As of December 25, 2011, the warrants had not been exercised and remained outstanding. The value of the warrants was initially recorded in equity and continues to be classified as equity.

Fair Value of Notes

As of December 25, 2011, the face values of the 2016 Notes and 2018 Notes were \$450.0 million and \$450.0 million, respectively. As of December 25, 2011, the fair values of the 2016 Notes and 2018 Notes, which includes the debt and equity components, were approximately \$423.8 million and \$426.8 million, respectively, based on quoted market prices.

Other Long-term Debt

The Company's remaining total long-term debt, excluding convertible notes, of \$1.3 million as of December 25, 2011 consists of various bank loans and government subsidized technology loans supporting operating needs.

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Contractual Obligations

The Company's contractual cash obligations relating to its convertible notes and other long-term debt December 25, 2011 were as follows:

| | Long-term Debt |
|-----------------------------------|---------------------------|
| | (in thousands) |
| Payments due by period: | |
| One year | \$ 1,342 |
| Two years | — |
| Three years | — |
| Four years | — |
| Five years | 450,000 |
| Over 5 years | <u>450,000</u> |
| Total | 901,342 |
| Current portion of long-term debt | <u>1,342</u> |
| Long-term debt | <u>\$ 900,000</u> |

NOTE 14 — COMMITMENTS

Capital Leases

Capital leases reflect building and an office equipment leases. The amounts in the table below include the interest portion of payment obligations.

The Company's contractual cash obligations relating to its existing capital leases, including interest, as of December 25, 2011 were as follows:

| | Capital Leases |
|---|---------------------------|
| | (in thousands) |
| Payments due by period: | |
| One year | \$ 1,755 |
| Two years | 1,581 |
| Three years | 1,459 |
| Four years | 1,468 |
| Five years | 9,616 |
| Over 5 years | <u>—</u> |
| Total | 15,879 |
| Less: Interest on capital leases | <u>1,017</u> |
| Less: Current portion of capital leases | <u>1,472</u> |
| Capital leases | <u>\$ 13,390</u> |

Operating Leases and Related Guarantees

The Company leases most of its administrative, R&D and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases. Certain of the Company's facility leases for buildings located at its Fremont, California headquarters and certain other facility leases provide the Company with options to extend the leases for additional periods or to purchase the facilities. Certain of the Company's facility leases provide for periodic rent increases based on the general rate of inflation.

On December 18, 2007, the Company entered into two operating leases regarding certain improved properties in Livermore, California. These leases were amended on April 3, 2008 and July 9, 2008 (as so amended, the "Livermore Leases"). On December 21, 2007, the Company entered into a series of four amended and restated operating leases (the "New Fremont Leases," and collectively with the Livermore Leases, the "Operating Leases") with regard to certain improved properties at the Company's headquarters in Fremont, California.

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The Operating Leases have a term of approximately seven years ending on the first business day in January 2015. The Company may, at its discretion and with 30 days' notice, elect to purchase the property that is the subject of the Operating Lease for an amount approximating the sum required to pay the amount of the lessor's investment in the property and any accrued but unpaid rent.

The Company is required, pursuant to the terms of the Operating Leases, to maintain collateral in an aggregate of approximately \$164.9 million in separate interest-bearing accounts as security for the Company's obligations under the Operating Leases. This amount is recorded as restricted cash in the Company's Consolidated Balance Sheet as of as of December 25, 2011.

When the terms of the Operating Leases expire, the property subject to that Operating Lease may be remarketed. The Company has guaranteed to the lessor that each property will have a certain minimum residual value. The aggregate guarantee made by the Company under the Operating Leases is generally no more than approximately \$141.7 million; however, under certain default circumstances, the guarantee with regard to an Operating Lease may be 100% of the lessor's aggregate investment in the applicable property, which in no case will exceed \$164.9 million, in the aggregate.

The Company recognized at lease inception \$0.6 million in estimated liabilities related to the Operating Leases, which represents the fair value guarantee premium that would be required had the guarantee been issued in a standalone transaction. These liabilities are recorded in other long-term liabilities with the offsetting entry recorded as prepaid rent in other assets. The balances in prepaid rent and the guarantee liability are amortized to the statement of operations on a straight line basis over the life of the leases. If it becomes probable that the Company will be required to make a payment under the residual guarantee, the Company will increase its liability with a corresponding increase to prepaid rent and amortize the increased prepaid rent over the remaining lease term with no corresponding reduction in the liability. As of December 25, 2011, the unamortized portion of the fair value of the residual value guarantees remaining in other long-term liabilities and prepaid rent was \$0.2 million.

Other Guarantees

The Company has issued certain indemnifications to its lessors for taxes and general liability under some of its agreements. The Company has entered into certain insurance contracts that may limit its exposure to such indemnifications. As of December 25, 2011, the Company had not recorded any liability on its Consolidated Financial Statements in connection with these indemnifications, as it does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

Generally, the Company indemnifies, under pre-determined conditions and limitations, its customers for infringement of third-party intellectual property rights by the Company's products or services. The Company seeks to limit its liability for such indemnity to an amount not to exceed the sales price of the products or services subject to its indemnification obligations. The Company does not believe, based on information available, that it is probable that any material amounts will be paid under these guarantees.

Warranties

The Company provides standard warranties on its systems. The liability 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 were as follows:

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | |
| Balance at beginning of period | \$ 36,160 | \$ 35,612 | \$ 40,951 | \$ 31,756 |
| Warranties issued during the period | 8,421 | 14,914 | 16,353 | 26,330 |
| Settlements made during the period | (11,925) | (8,326) | (23,146) | (16,020) |
| Expirations and change in liability for pre-existing warranties during the period | 78 | 8 | (1,424) | (234) |
| Changes in foreign currency exchange rates | — | 312 | — | 688 |
| Balance at end of period | <u>\$ 32,734</u> | <u>\$ 42,520</u> | <u>\$ 32,734</u> | <u>\$ 42,520</u> |

NOTE 15 — RESTRUCTURING AND ASSET IMPAIRMENTS

Prior to incurring charges under the restructuring plans discussed below, management approved and announced the specific actions to be taken under each plan. Severance packages were communicated to affected employees in sufficient detail that the employees could determine their type and amount of benefit. The termination of the affected employees occurred as soon as practical after the restructuring plans were announced. The amount of remaining future lease payments for facilities the Company ceased to use and included in the restructuring charges is based on management's estimates using known prevailing real estate market conditions at that time based, in part, on the opinions of independent real estate experts. Leasehold improvements relating to the vacated buildings were written off, as these items will have no future economic benefit to the Company and have been abandoned.

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Accounting for restructuring activities, as compared to regular operating cost management activities, requires an evaluation of formally committed and approved plans. Restructuring activities have comparatively greater strategic significance and materiality and may involve exit activities, whereas regular cost containment activities are more tactical in nature and are rarely characterized by formal and integrated action plans or exiting a particular product, facility, or service.

The following table summarizes restructuring and asset impairment charges and reversals during the three and six months ended December 25, 2011 and December 26, 2010. In addition to charges incurred under specific restructuring plans, the Company incurred asset impairment charges of \$1.7 million related to a decline in the market value of certain facilities.

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | |
| June 2008 Plan | \$ (859) | \$ — | \$ (859) | \$ — |
| March 2009 Plan | — | — | — | (5,163) |
| Asset impairments outside of specific restructuring plans | — | — | 1,725 | — |
| Total restructuring and asset impairment charges (recoveries) | <u>\$ (859)</u> | <u>\$ —</u> | <u>\$ 866</u> | <u>\$ (5,163)</u> |

The amounts in the table above were recorded in the Consolidated Statements of Operations for the respective periods as follows:

| | Three Months Ended | | Six Months Ended | |
|---|----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | |
| Cost of goods sold | \$ (859) | \$ — | \$ (859) | — |
| Operating expense | — | — | 1,725 | (5,163) |
| Total restructuring and asset impairment charges (recoveries) | <u>\$ (859)</u> | <u>\$ —</u> | <u>\$ 866</u> | <u>\$ (5,163)</u> |

June 2008 Plan

During the June 2008 quarter, the Company incurred restructuring expenses and asset impairment charges related to the integration of SEZ and overall streamlining of the Company's combined Clean Product Group ("June 2008 Plan"). During the three months ended December 25, 2011 the Company released \$0.9 million related to a recorded obligation not realized for a previously restructured product line. There were no restructuring and asset impairment charges (recoveries) under the June 2008 Plan during the three or six months ended December 26, 2010. There are no remaining liabilities related to the June 2008 Plan as of December 25, 2011.

March 2009 Plan

During the March 2009 quarter the Company incurred restructuring expenses and asset impairment charges designed to align the Company's cost structure with its outlook for the current economic environment and future business opportunities ("March 2009 Plan"). There were no charges incurred under the March 2009 Plan during the three or six months ended December 25, 2011 or the three months December 26, 2010. During the six months ended December 26, 2010 the Company reversed \$5.2 million in restructuring and asset impairment charges as a result of a decision to occupy previously restructured facilities.

Below is a table summarizing activity relating to the March 2009 Plan during the six months ended December 25, 2011:

| | Facilities (in thousands) |
|------------------------------|------------------------------|
| Balance at June 26, 2011 | \$ 28,106 |
| Cash payments | (151) |
| Balance at December 25, 2011 | <u>\$ 27,955</u> |

Total charges incurred through December 25, 2011 under the March 2009 Plan were \$61.3 million. The facilities balance consists primarily of lease payments, net of sublease income, on vacated buildings and is expected to be paid by the end of fiscal year 2015.

NOTE 16 – BUSINESS COMBINATIONS

On December 14, 2011, Lam Research entered into and announced an Agreement and Plan of Merger with Novellus Systems, Inc. (“Novellus”), under which Novellus will become a wholly-owned subsidiary of Lam Research. The transaction is structured as an all stock deal that was estimated at the date of announcement to be valued at approximately \$3.3 billion, based on Lam’s closing stock price on the date of announcement. The ultimate transaction value will be based on Lam’s stock price at the close of market on the date of the transaction close. Completion of the transaction is subject to certain closing conditions, including but not limited to approval of the transaction by the stockholders of Lam Research and Novellus, receipt of all required regulatory approvals, and other customary conditions.

In addition, on the date of announcement, the Board of Directors authorized, in conjunction with the transaction, the repurchase of up to \$1.6 billion of Company common stock, which replaces the previous repurchase authorizations under the program.

NOTE 17 — STOCK REPURCHASE PROGRAM

On September 10, 2010, the Board of Directors authorized the repurchase of up to \$250 million of Company common stock and on September 1, 2011 the Board of Directors authorized the repurchase of up to an additional \$500 million of Company common stock. On December 14, 2011, the Board of Directors authorized the repurchase of up to \$1.6 billion of Company common stock, which replaces the previous repurchase authorizations under the program. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance with applicable law. Repurchases will be funded using the Company’s available cash. This repurchase program has no termination date and may be suspended or discontinued at any time.

Repurchases under the repurchase program were as follows during the periods indicated:

| <u>Period</u> | <u>Total Number of Shares Repurchased</u> | <u>Total Cost of Repurchase</u> | <u>Average Price Paid Per Share</u> | <u>Amount Available Under Repurchase Program</u> |
|--|---|--|-------------------------------------|--|
| | | <u>(in thousands, except per share data)</u> | | |
| Available balance as of June 26, 2011 | | | | \$ 249,244 |
| Authorization of additional \$500 million - September 2011 | | | | \$ 749,244 |
| Quarter ended September 25, 2011 | 1,977 | \$ 74,287 | \$ 37.57 | \$ 674,957 |
| Quarter ended December 25, 2011 | 2,860 | \$ 110,637 | \$ 38.69 | \$ 564,320 |
| Authorization of new \$1.6 billion - December 2011 | | | | \$ 1,600,000 |

In addition to shares repurchased under Board authorized repurchase program shown above, the Company acquired 182,000 shares at a total cost of \$7.8 million which the Company withheld through net share settlements to cover tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company’s equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company’s equity compensation plans.

As part of its share repurchase program, the Company may from time-to-time enter into structured share repurchase arrangements with financial institutions using general corporate funds. Historically, these arrangements have required the Company to make an up-front cash payment in exchange for the right to receive shares of its common stock or cash at the expiration of the agreement, dependent upon the closing price of the Corporation’s common stock at the settlement date. During the quarter ended December 25, 2011 two of these arrangements settled, resulting in the receipt of 2.6 million shares at an aggregate price of \$100.0 million under the first arrangement and \$51.0 million under the second arrangement. As of December 25, 2011, a prepayment of \$75.0 million was outstanding under one such arrangement. This arrangement settled in January 2012, resulting in the receipt of \$79.2 million. Under these arrangements, any prepayments or cash payments at settlement are recorded as a component of additional paid in capital in the Company’s Consolidated Balance Sheet as of December 25, 2011.

NOTE 18 — LEGAL PROCEEDINGS

From time to time, the Company has received notices from third parties alleging infringement of such parties’ patent or other intellectual property rights by the Company’s products. In such cases, it is the Company’s policy to defend the claims, or if considered appropriate, negotiate licenses on commercially reasonable terms. The Company does not believe any of these matters will have a material adverse effect on its consolidated financial condition or results of operations. However, no assurance can be given that the Company 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 the Company’s consolidated financial position or operating results.

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

CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

With the exception of historical facts, the statements contained in this discussion are forward-looking statements, which are subject to the safe harbor provisions created by the Private Securities Litigation Reform Act of 1995. Certain, but not all, of the forward-looking statements in this report are specifically identified as forward-looking, by use of phrases and words such as "we believe," "we anticipate," "we expect," "may," "should," "could" and other future-oriented terms. The identification of certain statements as "forward-looking" is not intended to mean that other statements not specifically identified are not forward-looking. Forward-looking statements include, but are not limited to, statements that relate to: trends in the global economic environment and the semiconductor industry; the anticipated levels of, and rates of change in, future shipments, margins, market share, capital expenditures, revenue and operating expenses generally; volatility in our quarterly results; customer requirements and our ability to satisfy those requirements; customer capital spending and their demand for our products; our ability to defend our market share and to gain new market share; anticipated growth in the industry and the total market for wafer-fabrication equipment and our growth relative to such growth; levels of research and development ("R&D") expenditures; the estimates we make, and the accruals we record, in order to implement our critical accounting policies (including but not limited to the adequacy of prior tax payments, future tax liabilities and the adequacy of our accruals relating to them); our access to capital markets; our ability to manage and grow our cash position; and the sufficiency of our financial resources to support future business activities (including but not limited to operations, investments, debt service requirements 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 without limitation those discussed below under the heading "Risk Factors" within Part II Item 1A and elsewhere in this report and other documents we file from time to time with the Securities and Exchange Commission ("SEC"), such as our annual report on Form 10-K for the year ended June 26, 2011, our quarterly report on Form 10-Q for the quarter ended September 25, 2011, and our current reports on Form 8-K. Such risks, uncertainties and changes in condition, significance, value, and effect could cause our actual results to differ materially from those expressed in this report 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 to us. We undertake no obligation to release the results of any revisions to these forward-looking statements, which may be made to reflect events or circumstances that occur after the date hereof or to reflect the occurrence or effect of anticipated or unanticipated events.

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

For a full understanding of our financial position and results of operations for the three and six months ended December 25, 2011, and the related Management's Discussion and Analysis of Financial Condition and Results of Operations below, you should also read the Condensed Consolidated Financial Statements and notes presented in this Form 10-Q and the financial statements and notes in our 2011 Form 10-K.

Overview

Management's Discussion and Analysis of Financial Condition and Results of Operations consists of the following sections:

Executive Summary provides an overview of the Company's operations and a summary of certain highlights of our results of operations

Results of Operations provides an analysis of operating results

Critical Accounting Policies and Estimates discusses accounting policies that reflect the more significant judgments and estimates we use to prepare our Condensed Consolidated Financial Statements

Liquidity and Capital Resources provides an analysis of cash flows, contractual obligations and financial position

EXECUTIVE SUMMARY

We design, manufacture, market, refurbish, and service semiconductor processing equipment used in the fabrication of integrated circuits and are recognized as a major provider of such equipment to the worldwide semiconductor industry. Our customers include semiconductor manufacturers that make DRAM, flash memory, and logic integrated circuits for a wide range of consumer and industrial electronics. Semiconductor wafers are subjected to a complex series of process and preparation steps that result in the simultaneous creation of many individual integrated circuits. We leverage our expertise in the areas of etch and single-wafer clean processing to develop technology and productivity solutions that typically benefit our customers through lower defect rates, enhanced yields, faster processing time, and/or reduced cost as well as by facilitating their ability to meet more stringent performance and design standards.

The semiconductor capital equipment industry is cyclical in nature and has historically experienced periodic and pronounced changes in customer demand resulting in industry downturns and upturns. Today's leading indicators of change in customer investment patterns, such as electronics demand, memory pricing, and foundry utilization rates, may not be any more reliable than in prior years. Demand for our equipment can vary significantly from period to period as a result of various factors, including, but not limited to, economic conditions (both general and in the semiconductor and electronics industries), supply, demand, prices for semiconductors, customer capacity requirements, and our ability to develop, acquire, and market competitive products. For these and other reasons, our results of operations during any particular fiscal period are not necessarily indicative of future operating results.

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Demand for our products declined in the second half of calendar year 2011 as semiconductor device manufacturers slowed the pace of their capacity expansions in response to continued macroeconomic conditions. In spite of the slowing pace of capacity expansion, our customers continued to invest in leading edge technologies over this period. Our financial results in the December quarter were consistent with communicated expectations, supported by these leading edge capacity shipments across all market segments. Throughout calendar year 2011, we continued to execute on our long-term growth strategy by investing in the technology and productivity solutions that address our customers' most critical needs. In addition, as announced in December, we plan to extend our product and services portfolio and leadership in wafer fabrication equipment via the acquisition of Novellus Systems, Inc. We believe that the complementary market positions, technologies, product capabilities and leadership of both companies will provide more comprehensive and faster solutions to our customers and provide improved financial performance for our shareholders.

Historically, any change in demand for semiconductor manufacturing equipment occurs at an uneven pace and forecasts about demand for wafer fabrication equipment in the near term are subject to uncertainty. Additionally, today's macroeconomic environment adds further overall levels of uncertainty. As a result, we could experience significant volatility in our quarterly results of operations during the next several quarters.

The following table summarizes certain key financial information for the periods indicated below (in thousands, except percentage and per share data):

| | Three Months Ended | | |
|--------------------------------------|----------------------|-----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 |
| Revenue | \$ 583,981 | \$ 680,436 | \$ 870,714 |
| Gross margin | \$ 234,826 | \$ 283,883 | \$ 407,433 |
| Gross margin as a percent of revenue | 40.2% | 41.7% | 46.8% |
| Total operating expenses | \$ 187,280 | \$ 184,484 | \$ 166,329 |
| Net income | \$ 33,212 | \$ 71,838 | \$ 221,856 |
| Diluted net income per share | \$ 0.27 | \$ 0.58 | \$ 1.78 |

In the quarter ended December 25, 2011, revenue decreased as compared to the quarter ended September 25, 2011, primarily reflecting the timing of customers' investments for capacity. Gross margin as a percent of revenues decreased in the December 2011 quarter as compared to the September 2011 quarter due to lower factory and field utilization rates correlated to the lower revenue levels and product mix. Operating expenses in the December 2011 quarter increased as compared to the quarter ended September 2011. This change in operating expenses is related to outside service costs associated with the Novellus acquisition and R&D related activities and reflects our ongoing commitment to long-term R&D in existing businesses.

Our cash and cash equivalents, short-term investments, and restricted cash and investments balances totaled approximately \$2.4 billion as of December 25, 2011 compared to \$2.2 billion as of September 25, 2011. Cash generated by operations was approximately \$169 million during the December 2011 quarter. We used cash during the December 2011 quarter to purchase \$27 million of property and equipment and repurchase \$21 million of our shares including net share settlements, and we received cash of \$51 million as the result of the cash settlement under a structured stock repurchase program. Employee headcount increased to approximately 3,850 as of December 25, 2011, from approximately 3,750 as of September 25, 2011.

RESULTS OF OPERATIONS

Shipments

| | Three Months Ended | | |
|-------------------------|----------------------|-----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 |
| Shipments (in millions) | \$ 563 | \$ 580 | \$ 892 |
| North America | 19% | 22% | 11% |
| Europe | 8% | 10% | 13% |
| Japan | 10% | 16% | 10% |
| Korea | 37% | 27% | 18% |
| Taiwan | 18% | 10% | 29% |
| Asia Pacific | 8% | 15% | 19% |

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Shipments for the December 2011 quarter decreased 3% compared to the September 2011 quarter and 37% year over year. During the December 2011 quarter, applications at or below the 45 nanometer technology node were 90% of total systems shipments. The system shipments in the memory, foundry, and logic/integrated device manufacturing markets were approximately 42%, 46% and 12%, respectively. Starting with the December 2011 quarter we have modified the foundry category to include manufacturers that have a majority of their logic capacity available for the foundry business. These shipments were previously reported in the logic/integrated device manufacturing category.

Revenue

| | Three Months Ended | | | Six Months Ended | |
|-----------------------|----------------------|-----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| Revenue (in millions) | \$ 584 | \$ 680 | \$ 871 | \$ 1,264 | \$ 1,677 |
| North America | 18% | 19% | 6% | 19% | 6% |
| Europe | 9% | 11% | 13% | 10% | 12% |
| Japan | 14% | 18% | 11% | 16% | 11% |
| Korea | 34% | 25% | 18% | 29% | 27% |
| Taiwan | 17% | 13% | 38% | 15% | 30% |
| Asia Pacific | 8% | 14% | 14% | 11% | 14% |

Revenue for the December 2011 quarter decreased 14% compared to the September 2011 quarter and 33% year over year. This decrease is related to the pace and timing of customer investments. The overall Asia region continues to account for a majority of our revenues as a substantial amount of the worldwide capacity additions for semiconductor manufacturing continues to occur in this region. Our deferred revenue balance increased to \$192 million as of December 25, 2011 compared to \$181 million as of September 25, 2011. Our deferred revenue balance does not include shipments to Japanese customers, to whom title does not transfer until customer acceptance. Shipments to Japanese customers are classified as inventory at cost until the time of acceptance. The anticipated future revenue value from shipments to Japanese customers was approximately \$16 million as of December 25, 2011 compared to \$43 million as of September 25, 2011.

Gross Margin

| | Three Months Ended | | | Six Months Ended | |
|--------------------|------------------------------------|-----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands, except percentages) | | | | |
| Gross margin | \$ 234,826 | \$ 283,883 | \$ 407,433 | \$ 518,709 | \$ 784,759 |
| Percent of revenue | 40.2% | 41.7% | 46.8% | 41.0% | 46.8% |

The decrease in gross margin as a percentage of revenue during the three and six months ended December 2011 quarter as compared to the September 2011 quarter and same periods in the prior year is attributable to reduced factory and field utilization as a result of the decline in business volume and product mix.

Research and Development

| | Three Months Ended | | | Six Months Ended | |
|----------------------------------|------------------------------------|-----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands, except percentages) | | | | |
| Research and development ("R&D") | \$ 104,024 | \$ 102,559 | \$ 90,477 | \$ 206,583 | \$ 176,830 |
| Percent of revenue | 17.8% | 15.1% | 10.4% | 16.3% | 10.5% |

We continue to make significant R&D investments focused on leading-edge plasma etch, single-wafer clean and other semiconductor manufacturing requirements. The increase in R&D expenses during the December 2011 quarter compared to the September 2011 quarter was primarily due to added headcount and increased outside services related to new product development, offset by a reduction in variable compensation due to a lower operating income level.

The increase in R&D expenses during the December 2011 quarter compared to the same period in the prior year was primarily due to \$9 million of higher outside services and supplies related to new product development and \$5 million of increased salary and benefit costs related to higher headcount.

The increase in R&D expense during the six months ended December 25, 2011 as compared to the same period prior year was due to approximately \$20 million of higher outside services and supplies related to new product development. There was also \$15 million of increased salary, benefit, and equity compensation costs related to higher headcount, offset by a \$7 million reduction in variable compensation expense as a result of lower operating income levels.

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Selling, General and Administrative

| | Three Months Ended | | | Six Months Ended | |
|--|------------------------------------|-----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands, except percentages) | | | | |
| Selling, general and administrative ("SG&A") | \$ 83,256 | \$ 80,200 | \$ 75,852 | \$ 163,456 | \$ 147,994 |
| Percent of revenue | 14.3% | 11.8% | 8.7% | 12.9% | 8.8% |

The increase in SG&A expense during the December 2011 quarter as compared to the September 2011 quarter was due to \$7 million of outside services related to the Novellus acquisition offset by \$4 million of decreased variable compensation expense, resulting from a lower level of operating income.

The increase in SG&A expenses in the December 2011 quarter compared to the same period in the prior year was primarily due to a \$7 million of increases in salary, benefits, and equity compensation related to higher headcount, \$7 million of Novellus-related acquisition costs, and a \$2 million increase in insurance and taxes, offset by \$10 million lower variable compensation expense associated with lower company profitability.

The increase in SG&A expense during the six months ended December 25, 2011 as compared to the same period prior year was due to higher headcount and increased marketing investments, offset by a lower level of variable compensation in the 2012 fiscal year.

Restructuring and Asset Impairments

During the three months ended December 25, 2011 the Company released \$0.9 million related to a recorded obligation not realized for a previously restructured product line. During the three months ended September 25, 2011, the Company incurred asset impairment charges of \$1.7 million related to a decline in the market value of certain facilities. During the six months ended December 26, 2010 the Company reversed \$5.2 million in restructuring and asset impairment charges under the March 2009 Plan as a result of a decision to occupy previously restructured facilities.

The following table summarizes charges and reversals under each of the plans described below for the three-month periods indicated:

| | Three Months Ended | | | Six Months Ended | |
|---|----------------------|-----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands) | | | | |
| June 2008 Plan | \$ (859) | \$ — | \$ — | \$ (859) | \$ — |
| March 2009 Plan | — | — | — | — | (5,163) |
| Asset impairments outside of specific restructuring plans | — | 1,725 | — | 1,725 | — |
| Total restructuring and asset impairment charges | \$ (859) | \$ 1,725 | \$ — | \$ 866 | \$ (5,163) |

For further details related to restructuring and asset impairment, see Note 15 of the Notes to Consolidated Financial Statements.

Other Income (Expense), Net

Other income (expense), net consisted of the following:

| | Three Months Ended | | | Six Months Ended | |
|--------------------------------|------------------------------------|-----------------------|----------------------|----------------------|----------------------|
| | December 25, 2011 | September 25, 2011 | December 26, 2010 | December 25, 2011 | December 26, 2010 |
| | (in thousands, except percentages) | | | | |
| Interest income | \$ 2,472 | \$ 2,589 | \$ 2,635 | \$ 5,061 | \$ 5,046 |
| Interest expense | (9,346) | (9,260) | (110) | (18,606) | (211) |
| Gains (losses) on mutual funds | (348) | (1,865) | 1,913 | (2,213) | 2,578 |
| Foreign exchange gain (loss) | (142) | (1,090) | (3,108) | (1,232) | (6,287) |
| Other, net | (421) | (2,447) | (292) | (2,868) | (1,067) |
| | \$ (7,785) | \$ (12,073) | \$ 1,038 | \$ (19,858) | \$ 59 |

Interest expense increased in the three and six months ended December 25, 2011 as compared to the same periods in the prior year due interest expense related to the \$900 million convertible notes issued May 2011.

We recognized losses on our mutual funds, which are correlated to obligations under our deferred compensation plan, in the three and six months ended December 25, 2011 as compared to gains recognized in the three and six months ended December 26, 2010 due to changes in the market value of securities in this portfolio.

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We recognized smaller losses as a result of changes in the value of our foreign currency denominated assets and liabilities net of hedging activities in the three and six months ended December 25, 2011 as compared to the three and six months ended December 26, 2010.

Other expenses, net was higher during the three months ended September 25, 2011 as compared to the three months ended December 25, 2011 and December 26, 2010 primarily due to a \$1.7 million other-than-temporary impairment of a strategic private equity investment recognized during the September 2011 quarter. The same impairment resulted in higher other expenses, net during the six months ended December 25, 2011 and compared to the same period prior year.

Income Tax Expense

Our effective tax rates for the three and six months ended December 25, 2011 were 16.5% and 17.3%, respectively. Our effective tax rate for the three and six months ended December 26, 2010 were approximately 8.4% and 10.7%, respectively. The increase in the effective tax rate for the three months ended December 25, 2011 compared to the three months ended December 26, 2010 was primarily due to the level of income, a decrease in the percentage of profits in jurisdictions with lower tax rates, and an increase in the non-deductible stock-based compensation. The increase in the effective tax rate for the six months ended December 25, 2011 compared to the six months ended December 26, 2010 was primarily due to the level of income, geographical mix of income, and an increase in the non-deductible stock-based compensation.

The effective tax rate of 16.5% and 17.3% for the three and six months ended December 25, 2011 includes the tax impact of the following discrete items which are recorded in the period in which they occur: (1) a tax expense of \$2.2 million and \$3.8 million, respectively, related to the filing of prior year foreign tax returns, which resulted in provision to return true-ups, (2) a tax expense of \$0.8 million and \$1.7 million, respectively, of interest related to uncertain tax positions, (3) a tax benefit of \$2.5 million and \$3.7 million, respectively, related to the acquisition, restructuring and asset impairment related expenses, and (4) a tax benefit of \$6.9 million and \$7.1 million, respectively, related to the recognition of previously unrecognized tax benefits and the reversal of the related interest accruals due to finalization of certain foreign uncertain tax positions. The effective tax rates of 8.4% and 10.7% for the three and six months ended December 26, 2010, respectively, included the tax impact of the following discrete items which are recorded in the period in which they occur: (1) a tax expense of \$1.0 million and \$2.0 million, respectively, of interest related to uncertain tax positions, (2) a tax benefit of \$4.8 million in both periods related to the retroactive extension of the U.S. federal research and development credit for part of fiscal year 2010, (3) a tax benefit of \$3.0 million and \$3.2 million, respectively, due to the recognition of previously unrecognized tax benefits and the reversal of the related interest accruals due to finalization of certain foreign tax positions, and (4) a tax expense of zero and \$2.1 million, respectively, related to the reversal of accrued restructuring expenses.

Deferred Income Taxes

We had gross deferred tax assets, related primarily to reserves and accruals that are not currently deductible and tax credit carryforwards, of \$147.6 million and \$147.2 million as of December 25, 2011 and June 26, 2011, respectively. The gross deferred tax assets were offset by deferred tax liabilities of \$31.7 million and a valuation allowance of \$46.2 million as of December 25, 2011 and June 26, 2011.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more-likely-than-not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more likely than not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. 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 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.

We evaluate the realizability of the deferred tax assets quarterly and will continue to assess the need for changes in valuation allowances, if any.

Uncertain Tax Positions

We reevaluate uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

A critical accounting policy is defined as one that has both a material impact on our financial condition and results of operations and requires us to make difficult, complex and/or subjective judgments, often as a result of the need to make estimates about matters that are inherently uncertain. The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make certain judgments, 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. We base our estimates and assumptions on historical experience and on various other assumptions we believe to be applicable and evaluate them on an ongoing basis to ensure they remain reasonable under current conditions. Actual results could differ significantly from those estimates, which could have a material impact on our business, results of operations, and financial condition.

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We believe that the following critical accounting policies reflect the more significant judgments and estimates we use in preparing our Consolidated Financial Statements.

Revenue Recognition: We recognize all revenue when persuasive evidence of an arrangement exists, delivery has occurred and title has passed or services have been rendered, the selling price is fixed or determinable, collection of the receivable is reasonably assured, and we have received customer acceptance, completed our system installation obligations, or are otherwise released from our installation or customer acceptance obligations. If 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. If the practices of a customer do not provide for a written acceptance or the terms of sale do not include a lapsing acceptance provision, we recognize revenue when it can be reliably demonstrated that the delivered system meets all of the agreed-to customer specifications. In situations with multiple deliverables, we recognize revenue upon the delivery of the separate elements to the customer and when we receive customer acceptance or are otherwise released from our customer acceptance obligations. We allocate revenue from multiple-element arrangements among the separate elements based on their relative selling prices, provided the elements have value on a stand-alone basis. Our sales arrangements do not include a general right of return. The maximum revenue we recognize on a delivered element is limited to the amount that is not contingent upon the delivery of additional items. We generally recognize revenue related to sales of spare parts and system upgrade kits upon shipment. We generally recognize revenue related to services as services are performed. We recognize revenue for extended maintenance service contracts with a fixed payment amount on a straight-line basis over the term of the contract. When goods or services have been delivered to the customer but all conditions for revenue recognition have not been met, we record deferred revenue and/or deferred costs of sales in deferred profit on our Consolidated Balance Sheet.

Inventory Valuation: Inventories are stated at the lower of cost or market using standard costs that generally approximate actual costs on a first-in, first-out basis. 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. Unless specified in the terms of sale, title generally transfers when we complete physical transfer of the products to the freight carrier. Transfer of title for shipments to Japanese customers generally occurs at the time of customer acceptance. We eliminate all intercompany profits related to the sales and purchases of inventory between our legal entities from our Consolidated Financial Statements.

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 is written down to its estimated market value if less than cost. Estimates of market value include, but are not limited to, management's forecasts related to our future manufacturing schedules, customer demand, technological and/or market obsolescence, general semiconductor market conditions, and possible alternative uses. 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 goods sold in the period in which we make the revision.

Warranty: Typically, the sale of semiconductor capital equipment includes providing parts and service warranty to customers as part of the overall price of the system. We provide standard warranties for our systems. When appropriate, we record a provision for estimated warranty expenses to cost of sales for each system when we recognize revenue. We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. The amount recorded is based on an analysis of historical activity that uses factors such as type of system, customer, geographic region, and any known factors such as tool reliability trends. All actual or estimated parts and labor costs incurred in subsequent periods are charged to those established reserves on a system-by-system basis.

Actual warranty expenses are accounted for on a system-by-system basis and 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. In addition to the provision of standard warranties, we offer customer-paid extended warranty services. Revenues for extended maintenance and warranty services with a fixed payment amount are recognized on a straight-line basis over the term of the contract. Related costs are recorded as incurred.

Equity-based Compensation — Employee Stock Purchase Plan ("ESPP") and Employee Stock Plans: GAAP requires us to recognize the fair value of equity-based compensation in net income. We determine the fair value of our restricted stock units ("RSUs") based upon the fair market value of Company stock at the date of grant. We estimate the fair value of our stock options and ESPP awards using the Black-Scholes option valuation model. This model requires us to input highly subjective assumptions, including expected stock price volatility and the estimated life of each award. We amortize the fair value of equity-based awards over the vesting periods of the awards, and we have elected to use the straight-line method of amortization.

We make quarterly assessments of the adequacy of our tax credit pool related to equity-based compensation to determine if there are any deficiencies that we are required to recognize in our Consolidated Statements of Operations. We will only recognize a benefit from stock-based compensation in paid-in-capital if we realize an incremental tax benefit after all other tax attributes currently available to us have been utilized. In addition, we have elected to account for the indirect benefits of stock-based compensation on the research tax credit through the income

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statement (continuing operations) rather than through paid-in-capital. We have also elected to net deferred tax assets and the associated valuation allowance related to net operating loss and tax credit carryforwards for the accumulated stock award tax benefits for income tax footnote disclosure purposes. We will track these stock award attributes separately and will only recognize these attributes through paid-in-capital.

Income Taxes: Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as the tax effect of carryforwards. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more-likely-than-not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at the time. 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 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.

We calculate our current and deferred tax provision based on estimates and assumptions that can differ from the actual results reflected in income tax returns filed during the subsequent year. These estimates and assumptions occur in the calculation of tax credits, benefits, and deductions, and in the calculation and valuation of certain tax assets and liabilities, which arise from temporary differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as the interest and penalties related to uncertain tax positions. Adjustments based on filed returns are recorded when identified.

We recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. Our policy is to include interest and penalties related to unrecognized tax benefits as a component of income tax expense. Please refer to Note 10 of the Notes to the Consolidated Financial Statements for additional information.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for uncertain tax positions based on the two-step process prescribed within the interpretation. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more-likely-than-not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires us to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period such determination is made.

Goodwill and Intangible Assets: Goodwill represents the amount by which the purchase price in each business combination exceeds the fair value of the net tangible and identifiable intangible assets acquired. We allocate the carrying value of goodwill to our reporting units. We test goodwill and identifiable intangible assets with indefinite useful lives for impairment at least annually. We amortize intangible assets with estimable useful lives over their respective estimated useful lives, and we review for impairment whenever events or changes in circumstances indicate that the carrying amount of the intangible asset may not be recoverable and the carrying amount exceeds its fair value.

We review goodwill at least annually for impairment. If certain events or indicators of impairment occur between annual impairment tests, we would perform an impairment test of goodwill at that date. In testing for a potential impairment of goodwill, we: (1) allocate goodwill to our reporting units to which the acquired goodwill relates; (2) estimate the fair value of our reporting units; and (3) determine the carrying value (book value) of those reporting units, as some of the assets and liabilities related to those reporting units are not held by those reporting units but by a corporate function. Prior to this allocation of the assets to the reporting units, we are required to assess long-lived assets for impairment. Furthermore, if the estimated fair value of a reporting unit is less than the carrying value, we must estimate the fair value of all identifiable assets and liabilities of that reporting unit, in a manner similar to a purchase price allocation for an acquired business. This can require independent valuations of certain internally generated and unrecognized intangible assets such as in-process R&D and developed technology. Only after this process is completed can the amount of goodwill impairment, if any, be determined.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. We determine the fair value of our reporting units by using a weighted combination of both a market and an income approach, as this combination is deemed to be the most indicative of fair value in an orderly transaction between market participants.

Under the market approach, we use information regarding the reporting unit as well as publicly available industry information to determine various financial multiples to value our reporting units. Under the income approach, we determine fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn.

In estimating the fair value of a reporting unit for the purposes of our annual or periodic analyses, we make estimates and judgments about the future cash flows of our reporting units, including estimated growth rates and assumptions about the economic environment. Although our cash flow forecasts are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying businesses, there is significant judgment involved in determining the cash flows attributable to a reporting unit. In addition, we make certain judgments about allocating shared assets to the estimated balance sheets of our reporting units. We also consider our market capitalization and that of our competitors on the date we perform the analysis. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge.

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As a result, several factors could result in impairment of a material amount of our goodwill balance in future periods, including, but not limited to: (1) weakening of the global economy, weakness in the semiconductor equipment industry, or failure of the Company to reach its internal forecasts, which could impact our ability to achieve our forecasted levels of cash flows and reduce the estimated discounted cash flow value of our reporting units; and (2) a decline in our stock price and resulting market capitalization, if we determine that the decline is sustained and indicates a reduction in the fair value of our reporting units below their carrying value. In addition, the value we assign to intangible assets, other than goodwill, is based on our estimates and judgments regarding expectations such as the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from our estimates, we may be required to record an impairment charge to write down the asset to its realizable value.

Recent Accounting Pronouncements

In June 2011, the FASB issued new authoritative guidance that increases the prominence of items reported in other comprehensive income (OCI) by eliminating the option to present components of OCI as part of the statement of changes in stockholders' equity. The amendments in this standard require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from OCI to net income in the financial statements where the components of net income and the components of OCI are presented. This guidance does not affect the underlying accounting for components of OCI, but will change the presentation of our financial statements. We will adopt this authoritative guidance retrospectively in the first quarter of our fiscal year 2013.

In September 2011, the FASB issued revised guidance intended to simplify how an entity tests goodwill for impairment. The amendment will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This accounting standard update will be effective for us beginning in the first quarter of fiscal 2013 and early adoption is permitted. We are currently evaluating this accounting standard update and do not expect it to have an impact on our Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

As of December 25, 2011, we had \$2.4 billion in cash and cash equivalents, short-term investments, and restricted cash and investments (total cash and investments) compared to \$2.3 billion as of June 26, 2011.

Cash Flows from Operating Activities

Net cash provided by operating activities of \$255.9 million during the six months ended December 25, 2011 consisted of (in millions):

| | |
|--|----------------|
| Net income | \$105.1 |
| Non-cash charges: | |
| Depreciation and amortization | 43.7 |
| Equity-based compensation | 36.0 |
| Restructuring and impairment charges | 0.9 |
| Amortization of convertible note discount | 13.3 |
| Impairment of investment | 1.7 |
| Loss on equity method investment | 0.2 |
| Net tax benefit on equity-based compensation plans | (1.0) |
| Deferred income taxes | (0.6) |
| Changes in operating asset and liability accounts | 54.5 |
| Other | 2.1 |
| | <u>\$255.9</u> |

Changes in operating asset and liability accounts, net of foreign exchange impact, included the following sources of cash: decreases in accounts receivable of \$127.7 million, inventories of \$23.3 million, and prepaid and other assets of \$12.9 million, partially offset by the following uses of cash: decreases in accounts payable of \$55.4 million, deferred profit of \$36.4 million, and accrued liabilities of \$17.6 million. These changes in overall cash were all consistent with decreased business volumes.

Cash Flows from Investing Activities

Net cash used for investing activities during the six months ended December 25, 2011 was \$131.5 million, primarily consisting of net purchases of available-for-sale securities of \$89.5 million, capital expenditures of \$42.4 million, and the purchase of other investments of \$10.7 million, partially offset by the receipt of an \$8.4 million loan payment.

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Cash Flows from Financing Activities

Net cash used for financing activities during the six months ended December 25, 2011 was \$107.3 million, primarily consisting of \$92.7 million in treasury stock repurchases and \$24.0 million net prepayments for the potential purchase of treasury stock under the structured stock repurchase arrangement (see Note 17 of Notes to Condensed Consolidated Financial Statements), partially offset by net proceeds from issuance of common stock related to employee equity-based plans of \$10.0 million.

Liquidity

Given the cyclical nature of the semiconductor equipment industry, we believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in R&D and capital infrastructure. Based upon our current business outlook, we expect that our levels of cash, cash equivalents, and short-term investments at December 25, 2011 will be sufficient to support our anticipated levels of operations, investments, debt service requirements, and capital expenditures, through at least the next 12 months.

In the longer term, liquidity will depend to a great extent on our future revenues and our ability to appropriately manage our costs based on demand for our products and services. While the company has substantial cash balances in the United States and offshore, we may require additional funding and need to raise the required funds through borrowings or public or private sales of debt or equity securities. We believe that, if necessary, we will be able to access the capital markets on terms and in amounts adequate to meet our objectives. However, given the possibility of changes in market conditions or other occurrences, there can be no certainty that such funding will be available in needed quantities or on terms favorable to us.

Off-Balance Sheet Arrangements and Contractual Obligations

We have certain obligations to make future payments under various contracts, some of which are recorded on our balance sheet and some of which are not. Obligations are recorded on our balance sheet in accordance with GAAP and include our long-term debt and capital leases which are outlined in the following table and noted below. Our off-balance sheet arrangements include contractual relationships and are presented as operating leases and purchase obligations in the table below. Our contractual cash obligations and commitments as of December 25, 2011, relating to these agreements are included in the following table. The amounts in the table below exclude \$115.6 million of liabilities related to uncertain tax benefits as we are unable to reasonably estimate the ultimate amount or time of settlement.

| | <u>Operating Leases</u> | <u>Capital Leases</u> | <u>Purchase Obligations</u> | <u>Long-term Debt and Interest Expense</u> | <u>Total</u> |
|-------------------------|-----------------------------|---------------------------|---------------------------------|--|--------------------|
| | | | (in thousands) | | |
| Payments due by period: | | | | | |
| Less than 1 year | \$11,035 | \$ 1,755 | \$170,735 | \$ 9,226 | \$ 192,751 |
| 1-3 years | 14,415 | 3,040 | 59,690 | 15,750 | 92,895 |
| 3-5 years | 3,420 | 11,083 | 28,840 | 464,906 | 508,249 |
| Over 5 years | 26 | — | 700 | 459,141 | 459,867 |
| Total | <u>\$28,896</u> | <u>\$15,878</u> | <u>\$259,965</u> | <u>\$ 949,023</u> | <u>\$1,253,762</u> |

Operating Leases

We lease most of our administrative, R&D and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases. Certain of our facility leases for buildings located at our Fremont, California headquarters, Livermore facilities, and certain other facility leases provide us with an option to extend the leases for additional periods or to purchase the facilities. Certain of our facility leases provide for periodic rent increases based on the general rate of inflation. In addition to amounts included in the table above, we have guaranteed residual values for certain of our Fremont and Livermore facility leases of up to \$164.9 million. See Note 14 of Notes to the Condensed Consolidated Financial Statements for further discussion.

Capital Leases

Capital leases reflect building and office equipment lease obligations. The amounts in the table above include the interest portion of payment obligations.

Purchase Obligations

Purchase obligations consist of significant contractual obligations either on an annual basis or over multi-year periods related to our outsourcing activities or other material commitments, including vendor-consigned inventories. We continue to enter into new agreements and maintain existing agreements to outsource certain activities, including elements of our manufacturing, warehousing, logistics, facilities maintenance, certain information technology functions, and certain transactional general and administrative functions. The contractual cash obligations and commitments table presented above contains our obligations at December 25, 2011 under these arrangements and others. Actual expenditures will vary based on the volume of transactions and length of contractual service provided. In addition to these obligations, certain of these agreements include early termination provisions and/or cancellation penalties which could increase or decrease amounts actually paid.

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Long-Term Debt

On May 11, 2011, we issued and sold \$450.0 million in aggregate principal amount of 0.5% convertible notes due 2016 (the “2016 Notes”) and \$450.0 million in aggregate principal amount of 1.25% convertible notes due 2018 (the “2018 Notes,” and collectively with the “2016 Notes”, the “Notes”). The 2016 Notes were issued at par and pay interest at a rate of 0.5% per annum and the 2018 Notes were issued at par and pay interest at rate of 1.25% per annum. The Notes may be converted into our common stock, under certain circumstances, based on an initial conversion rate of 15.8687 shares of our common stock per \$1,000 principal amount of Notes, which is equal to a conversion price of approximately \$63.02 per share of our common stock. The conversion price will be subject to adjustment in some events but will not be adjusted for accrued interest. Concurrently with the issuance of the Notes, we purchased convertible note hedges for \$181.1 million and sold warrants for \$133.8 million. The separate convertible note hedges and warrant transactions are structured to reduce the potential future economic dilution associated with the conversion of the Notes.

In addition to the convertible notes, our remaining total long-term debt, excluding interest, of \$1.3 million as of December 25, 2011 consists of various bank loans and government subsidized technology loans supporting operating needs.

Other Guarantees

We have issued certain indemnifications to our lessors for taxes and general liability under some of our agreements. We have entered into certain insurance contracts that may limit our exposure to such indemnifications. As of December 25, 2011, we had not recorded any liability on our Consolidated Financial Statements in connection with these indemnifications, as we do not believe, based on information available, that it is probable that we will pay any amounts under these guarantees.

Generally, we indemnify, under pre-determined conditions and limitations, our customers for infringement of third-party intellectual property rights by our products or services. We seek to limit our liability for such indemnity to an amount not to exceed the sales price of the products or services subject to its indemnification obligations. We do not believe, based on information available, that it is probable that we will pay any material amounts under these guarantees.

Warranties

We offer standard warranties on our systems. The liability 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.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

For financial market risks related to changes in interest rates, marketable equity security prices, and foreign currency exchange rates, refer to Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”, in our 2011 Form 10-K. Other than noted below, our exposure related to market risk has not changed materially since June 26, 2011. All of the potential changes noted below are based on sensitivity analyses performed on our financial position as of December 25, 2011. Actual results may differ materially.

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio, long-term debt, and operating leases. We maintain a conservative investment policy, which focuses on the safety and preservation of our invested funds by limiting default risk, market risk, and reinvestment risk. We mitigate default risk by investing in high credit quality securities and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to achieve portfolio liquidity and maintain a prudent amount of diversification.

To mitigate the impact of fluctuations in the value of forecasted Japanese yen-denominated revenue and Euro-denominated expenses, we enter into foreign currency forward exchange rate contracts. These foreign currency forward exchange rate contracts are designated as cash flow hedges and are carried on our 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 and/or expense is recognized. The notional amount and unrealized gain of our outstanding forward contracts that are designated as cash flow hedges, as of December 25, 2011 are shown in the table below. This table also shows the change in fair value of these cash flow hedges assuming a hypothetical foreign currency exchange rate movement of plus-or-minus 10 percent and plus-or-minus 15 percent.

| | Notional Amount | Unrealized FX Gain / (Loss) December 25, 2011 | Valuation of Fx Contracts Given an X% Increase (+)/Decrease(-) in Each Fx Rate | | |
|------------------------|-----------------|--|--|------------|---------|
| | | | + /- (10%) | + /- (15%) | |
| | | | (in \$ Millions) | | |
| Cash Flow Hedge | | | | | |
| Sell | JPY | \$ 51.9 | (\$0.8) | \$ 5.2 | \$ 7.8 |
| Buy | EUR | \$ 74.2 | (\$4.9) | \$ 7.4 | \$ 11.1 |
| | | \$126.1 | (\$5.7) | \$ 12.6 | \$ 18.9 |

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We believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in our business activities. Anticipated cash flows from operations based on our current business outlook, combined with our current levels of cash, cash equivalents, and short-term investments at December 25, 2011 are expected to be sufficient to support our anticipated levels of operations, investments, debt service requirements, and capital expenditures, through at least the next 12 months. However, uncertainty in the global economy and the semiconductor industry, as well as disruptions in credit markets have in the past, and could in the future, impact customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers, and creditors.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Exchange Act Rule 13a-15(b), as of December 25, 2011, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer, along with our Chief Financial Officer, concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

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.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Effectiveness of Controls

While we believe the present design of our disclosure controls and procedures and internal control over financial reporting is effective, future events affecting our business may cause us to modify our disclosure controls and procedures or internal control over financial reporting. The effectiveness of controls cannot be absolute because the cost to design and implement a control to identify errors or mitigate the risk of errors occurring should not outweigh the potential loss caused by the errors that would likely be detected by the control. Moreover, we believe that a control system cannot be guaranteed to be 100% effective all of the time. Accordingly, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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. The Company does not believe that any of these matters will have a material adverse effect on its consolidated financial condition or results of operations. 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 1A. Risk Factors

In addition to the other information in this Form 10-Q, the following risk factors should be carefully considered in evaluating the Company and its business because such factors may significantly impact our business, operating results, and financial condition. As a result of these risk factors, as well as other risks discussed in our other SEC filings, our actual results could differ materially from those projected in any forward-looking statements. No priority or significance is intended, nor should be attached, to the order in which the risk factors appear.

The Semiconductor Equipment Industry is Subject to Major Fluctuations and, as a Result, We Face Risks Related to Our Strategic Resource Allocation Decisions

The business cycle in the semiconductor equipment industry has historically been characterized by frequent periods of rapid change in demand that challenge our management to adjust spending and other resources allocated to 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, procedures for training and managing our work force, and in appropriately sizing our supply chain infrastructure, work force, and other components of our business on a timely basis. If we do not adequately meet these challenges during periods of demand decline, our gross margins and earnings may be negatively impacted. In late 2008 and throughout 2009, the semiconductor industry experienced a general decline in demand, leading to a steep decline in demand for our products and services. In response to that industry demand decline and in an effort to minimize the disruptive effects of the deteriorating economic conditions on our business operating results, we made difficult resource allocation decisions, including layoffs and restructurings.

We continuously reassess our strategic resource allocation choices in response to the changing business environment. If we do not adequately adapt to the changing business environment, we may lack the infrastructure and resources to scale up our business to meet customer expectations and compete successfully during this period of growth, or we may expand our capacity too rapidly and/or beyond what is appropriate for the actual demand environment.

Especially during transitional periods, resource allocation decisions can have a significant impact on our future performance, particularly if we have not accurately anticipated industry changes. 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.

Future Declines in the Semiconductor Industry, and the Overall World Economic Conditions on Which it is Significantly Dependent, Could Have a Material Adverse Impact on Our Results of Operations and Financial Condition

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. The semiconductor industry is cyclical in nature and historically experiences periodic downturns. Global economic and business conditions, which are often unpredictable, have historically impacted customer demand for our products and normal commercial relationships with our customers, suppliers, and creditors. Additionally, in times of economic uncertainty our customers' budgets for our products, or their ability to access credit to purchase them, could be adversely affected. This would limit their ability to purchase our products and services. As a result, economic downturns can cause material adverse changes to our results of operations and financial condition including, but not limited to:

- a decline in demand for our products;
- an increase in reserves on accounts receivable due to our customers' inability to pay us;
- an increase in reserves on inventory balances due to excess or obsolete inventory as a result of our inability to sell such inventory;
- valuation allowances on deferred tax assets;
- restructuring charges;
- asset impairments including the potential impairment of goodwill and other intangible assets;
- a decline in the value of our investments;
- exposure to claims from our suppliers for payment on inventory that is ordered in anticipation of customer purchases that do not come to fruition;
- a decline in the value of certain facilities we lease to less than our residual value guarantee with the lessor; and
- challenges maintaining reliable and uninterrupted sources of supply.

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Fluctuating levels of investment by semiconductor manufacturers may materially affect our aggregate shipments, revenues and operating results. Where appropriate, we will attempt to respond to these fluctuations with cost management programs aimed at aligning our expenditures with anticipated revenue streams, which sometimes result in restructuring charges. Even during periods of reduced revenues, we must continue to invest in research and development (“R&D”) and maintain extensive ongoing worldwide customer service and support capabilities to remain competitive, which may temporarily harm our profitability and other financial results.

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. We manage our expense levels based in part on our expectations of future revenues. Because our operating expenses are based in part on anticipated future revenues, and a certain amount of those expenses are relatively fixed, a change in the timing of recognition of revenue and/or the level of gross profit from a small number of transactions can unfavorably affect operating results in a particular quarter. Factors that may cause our financial results to fluctuate unpredictably include, but are not limited to:

- economic conditions in the electronics and semiconductor industries in general and specifically the semiconductor equipment industry;
- the size and timing of orders from customers;
- procurement shortages;
- the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;
- manufacturing difficulties;
- customer cancellations or delays in shipments, installations, and/or customer acceptances;
- the extent that customers continue to purchase and use our products and services in their business;
- changes in average selling prices, customer mix, and product mix;
- 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;
- transportation, communication, demand, information technology or supply disruptions based on factors outside our control such as strikes, acts of God, wars, terrorist activities, and natural disasters;
- legal, tax, accounting, or regulatory changes (including but not limited to change in import/export regulations) or changes in the interpretation or enforcement of existing requirements;
- changes in our estimated effective tax rate;
- foreign currency exchange rate fluctuations; and
- the dilutive impact of our convertible notes and related warrants on our earnings per share.

Our Leverage and Debt Service Obligations and Potential Note Conversion or Related Hedging Activities May Adversely Affect Our Financial Condition, Results of Operations and Earnings Per Share

As a result of the sale of our convertible notes (“Notes”), we have a greater amount of debt than we have maintained in the past. Our maintenance of higher levels of indebtedness could have adverse consequences including:

- impacting our ability to satisfy our obligations;
- increasing the portion of our cash flows that may have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes; and
- impairing our ability to obtain additional financing in the future.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. Furthermore, our operations may not generate sufficient cash flows to enable us to meet our expenses and service our debt. As a result, we may need to enter into new financing arrangements to obtain the necessary funds. If we determine it is necessary to seek additional funding for any reason, we may not be able to obtain such funding or, if funding is available, obtain it on acceptable terms. If we fail to make a payment on our debt, we could be in default on such debt, and this default could cause us to be in default on our other outstanding indebtedness.

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Conversion of our Notes may cause dilution to our shareholders and to our earnings per share. Upon conversion of any Notes, we will deliver cash in the amount of the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock, which would result in dilution to our shareholders. This dilution may be mitigated to some extent by the hedging transactions we entered into in connection with the sale of the Notes. Prior to the maturity of the Notes, if the price of our common stock exceeds the conversion price, U.S. GAAP requires that we report an increase in diluted share count, which would result in lower reported earnings per share. The price of our common stock could also be affected by sales of our common stock by investors who view the Notes as a more attractive means of equity participation in our company and by hedging activity that may develop involving our common stock by holders of the Notes.

We Derive Our Revenues Primarily from a Relatively Small Number of High-Priced Systems

System sales constitute a significant portion of our total revenue. Our systems are priced up to approximately \$6 million per unit, and our revenues in any given quarter are dependent upon the acceptance of a limited number of systems. As a result, the inability to recognize revenue on even a few systems can cause a significantly adverse impact on our revenues for a given quarter.

We Have a Limited Number of Key Customers

Sales to a limited number of large customers constitute a significant portion of our overall revenue, shipments and profitability. As a result, the actions of even one customer may subject us to variability in those areas that are difficult to predict. In addition, large customers may be able to negotiate requirements that result in increased costs and/or lower margins for us. Similarly, significant portions of our credit risk may, at any given time, be concentrated among a limited number of customers, so that the failure of even one of these key customers to pay its obligations to us could significantly impact our financial results.

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 system sales 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 typically subject to the length of time that our customers require to evaluate the performance of our equipment after shipment and installation, which may vary from customer to customer and tool to tool. Such variations could cause our quarterly operating results to fluctuate.

We Depend on New Products and Processes for Our Success. Consequently, 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 that enable those processes. We believe that our future success depends in part upon our ability to develop and offer new products with improved capabilities and to continue to enhance our existing products. If new products have reliability, quality, or design 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. Our failure to commercialize these new products in a timely manner could result in unanticipated costs and inventory obsolescence, which would adversely affect our financial results.

In order to develop new products and processes, we expect to continue to make significant investments in R&D and to pursue joint development relationships with customers, suppliers or other members of the industry. We must manage product transitions and joint development relationships successfully, as the introduction of new products could adversely affect our sales of existing products. Moreover, 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 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 our etch and clean products to continue to account for a large percentage of our revenues in the near term. Continued market acceptance of these 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 even a limited number of our products;
- a failure to achieve continued market acceptance of our key products;
- export restrictions or other regulatory or legislative actions that could limit our ability to sell those products to key customer or market segments;
- an improved version of products being offered by a competitor in the market in which we participate;
- increased pressure from competitors that offer broader product lines;
- technological changes that we are unable to address with our products; or
- a failure to release new or enhanced versions of our products on a timely basis.

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In addition, the fact that we offer limited product lines creates the risk that our customers may view us as less important to their business than our competitors that offer additional products as well. This may impact our ability to maintain or expand our business with certain customers. Such product concentration may also subject us to additional risks associated with technology changes. Since we are a provider of etch and clean equipment, our business is affected by our customers' use of etching and clean steps in their processes. Should technologies change so that the manufacture of semiconductor chips requires fewer etching or clean steps, this could have a larger impact on our business than it would on the business of our less concentrated competitors.

Strategic Alliances May Have Negative Effects on Our Business

Increasingly, semiconductor manufacturing companies are entering into strategic alliances with one another to expedite the development of processes and other manufacturing technologies. Often, one of the outcomes of such an alliance is the definition of a particular tool set for a certain function or a series of process steps that use a specific set of manufacturing equipment. While this could work to our advantage if our equipment becomes the basis for the function or process, it could work to our disadvantage if a competitor's tools or equipment become the standard equipment for such function or process. In the latter case, even if our equipment was previously used by a customer, that equipment may be displaced in current and future applications by the tools standardized by the alliance.

Similarly, our customers may team with, or follow the lead of, educational or research institutions that establish processes for accomplishing various tasks or manufacturing steps. If those institutions utilize a competitor's equipment when they establish those processes, it is likely that customers will tend to use the same equipment in setting up their own manufacturing lines. These actions could adversely impact our market share and financial results.

We Depend On 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. We have established long-term contracts with many of these suppliers. These long-term contracts can take a variety of forms. We may renew these contracts periodically. In some cases, these suppliers have sold us products for a substantial period of time, and we expect that we and they will continue to renew these contracts in the future or that we will otherwise replace them with competent alternative suppliers. However, certain of our suppliers are relatively new providers to us so that our experience with them and their performance is limited. Where practical, we intend to establish alternative sources to mitigate the risk that the failure of any single supplier will adversely affect our business. Nevertheless, a prolonged inability to obtain certain components could impair our ability to ship products and generate revenues, which could adversely affect our operating results and damage our customer relationships.

Our Outsource Providers May Fail to Perform as We Expect

Outsource providers have played and will continue to play a key role in our manufacturing operations and in many of our transactional and administrative functions, such as information technology, facilities management, and certain elements of our finance organization. Although we attempt to select reputable providers and secure their performance on terms documented in written contracts, it is possible that one or more of these providers could fail to perform as we expect and such failure could have an adverse impact on our business.

In addition, the expansive role of our outsource providers has required and may continue to 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 and/or employee relationships, which could 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 for an extended period of time. Accordingly, we expect it to be more difficult to sell our products to a given customer if that customer initially selects a competitor's equipment for the same product line application.

We Face a Challenging and Complex Competitive Environment

We face significant competition from multiple competitors. Other companies continue to develop systems and products that are competitive to ours and may introduce new products, which may affect our ability to sell our existing products. We face a greater risk if our competitors enter into strategic relationships with leading semiconductor manufacturers covering products similar to those we sell or may develop, as this could adversely affect our ability to sell products to those manufacturers.

We believe that to remain competitive we must devote 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 R&D. Certain of our competitors, especially those that are created and financially backed by foreign governments, 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. These competitors may deeply discount or give away products similar to those that we sell, challenging or even exceeding our ability to make similar accommodations and threatening our ability to sell those products. We also face competition from our own customers, who in some instances have established affiliated entities that manufacture equipment similar to ours. For these reasons, we may fail to continue to compete successfully worldwide.

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In addition, our 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 continue to develop 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, competition may intensify, and we may be unable to continue to compete successfully in our markets, which could have a material adverse effect on our revenues, operating results, financial condition, and/or cash flows.

Our Future Success Depends Heavily on International Sales and the Management of Global Operations

Non-U.S. sales accounted for approximately 81% of total revenue during the six months ended December 25, 2011, 88% of total revenue in fiscal year 2011, 91% of total revenue in fiscal year 2010, and 85% of total revenue in fiscal year 2009. We expect that international sales will continue to account for a substantial portion of our total revenue in future years.

We are subject to various challenges related to international sales and the management of global operations including, but not limited to:

- trade balance issues;
- global economic and political conditions, including the ongoing macroeconomic challenges associated with debt levels in certain Euro-zone countries and the financial contagion to global markets;
- changes in currency controls;
- differences in the enforcement of intellectual property and contract rights in varying jurisdictions;
- our ability to respond to customer and foreign government demands for locally sourced systems, spare parts and services and develop the necessary relationships with local suppliers;
- compliance with U.S. and international laws and regulations affecting foreign operations, including U.S. export restrictions;
- fluctuations in interest and foreign currency exchange rates;
- the need for technical support resources in different locations; and
- our ability to secure and retain qualified people in all necessary locations for the successful operation of our business.

Certain international sales depend on our ability to obtain export licenses from the U.S. government. Our failure or inability to obtain such licenses would substantially limit our markets and severely restrict our revenues. Many of the challenges noted above are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships among China, Taiwan, Japan, South Korea, and the United States, that political and diplomatic influences might lead to trade disruptions. This would adversely affect our business with China, Taiwan, Japan, and/or South Korea and perhaps the entire Asia Pacific region. A significant trade disruption in these areas could have a materially adverse impact on our future revenue and profits.

We are potentially exposed to adverse as well as beneficial movements in foreign currency exchange rates. The majority of our sales and expenses are denominated in U.S. dollars. However, we are exposed to foreign currency exchange rate fluctuations related to certain of our revenues denominated in Japanese yen and Euros, as well as certain of our spares and service contracts, Euro denominated expenses, and expenses related to our non-U.S. sales and support offices that are denominated in the related countries' local currency.

We currently enter into foreign exchange forward contracts to minimize the short-term impact of the foreign currency exchange rate fluctuations on Japanese yen-denominated ("JPY") revenue and monetary assets and liabilities, Euro-denominated ("EUR") expenses and monetary assets and liabilities, as well as monetary assets and liabilities denominated in Swiss francs ("CHF") and Taiwanese dollars ("TWD"). We believe these are our primary exposures to currency rate fluctuation. We expect to continue to enter into hedging transactions, for the purposes outlined, for the foreseeable future. However, these hedging transactions may not achieve their desired effect because differences between the actual timing of the underlying exposures and our forecasts of those exposures may leave us either over- or under-hedged on any given transaction. Moreover, by hedging these foreign currency denominated revenues, expenses, monetary assets and liabilities with foreign exchange forward contracts, we may miss favorable currency trends that would have been advantageous to us but for the hedges. Additionally, we are exposed to short-term foreign currency exchange rate fluctuations on non-U.S. dollar-denominated ("USD") assets and liabilities (other than those currency exposures previously discussed) and currently we do not enter into foreign exchange forward contracts to hedge these other foreign currency exposures. Therefore, we are subject to both favorable and unfavorable foreign currency exchange rate fluctuations to the extent that we transact business (including intercompany transactions) in other currencies.

Our Ability To Attract, Retain and Motivate Key Employees Is Critical To Our Success.

Our ability to compete successfully depends in large part on our ability to attract, retain and motivate key employees. This is an ongoing challenge due to intense competition for top talent, as well as fluctuations in industry economic conditions that may require cycles of hiring activity and workforce reductions. Our success in hiring depends on a variety of factors, including the attractiveness of our compensation and benefit programs and our ability to offer a challenging and rewarding work environment. We periodically evaluate our overall compensation

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programs and make adjustments, as appropriate, to maintain or enhance their competitiveness. If we are not able to successfully attract, retain and motivate key employees, we may be unable to capitalize on market opportunities and our operating results may be materially and adversely affected.

We Rely Upon Certain Critical Information Systems for the Operation of Our Business

We maintain and rely upon certain critical information systems for the effective operation of our business. These information systems include telecommunications, the internet, our corporate intranet, various computer hardware and software applications, network communications, and e-mail. These information systems may be owned and maintained by us, our outsource providers or third parties such as vendors and contractors. These information systems are subject to attacks, failures, and access denials from a number of potential sources including viruses, destructive or inadequate code, power failures, and physical damage to computers, hard drives, communication lines, and networking equipment. Confidential information stored on these information systems could be compromised. To the extent that these information systems are under our control, we have implemented security procedures, such as virus protection software and emergency recovery processes, to mitigate the outlined risks. However, security procedures for information systems cannot be guaranteed to be failsafe and our inability to use or access these information systems at critical points in time, or unauthorized releases of confidential information, could unfavorably impact the timely and efficient operation of our business.

Our Financial Results May be Adversely Impacted by Higher than Expected Tax Rates or Exposure to Additional Tax Liabilities

As a global company, our effective tax rate is highly dependent upon the geographic composition of worldwide earnings and tax regulations governing each region. We are subject to income taxes in the United States and various foreign jurisdictions, and significant judgment is required to determine worldwide tax liabilities. Our effective tax rate could be adversely affected by changes in the split of earnings between countries with differing statutory tax rates, in the valuation of deferred tax assets, in tax laws, by material audit assessments, or changes in or expirations of agreements with tax authorities. These factors could affect our profitability. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. In addition, the amount of income taxes we pay is subject to ongoing audits in various jurisdictions, and a material assessment by a governing tax authority could affect our profitability.

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 handling, discharge, and disposal of toxic, volatile or otherwise hazardous chemicals. We believe that we are generally in compliance with these regulations and that we have obtained (or will obtain or are otherwise addressing the need for) all environmental permits necessary to conduct our business. These permits generally relate to the handling and disposal of hazardous wastes. Nevertheless, the failure to comply with present or future regulations could result in fines being imposed on us, require us to suspend production, or cease operations or cause our customers to not accept our products. These regulations could require us to alter our current operations, to acquire significant additional equipment or to incur substantial other expenses to comply with environmental regulations. Any failure to comply with regulations governing the use, handling, sale, transport or disposal of hazardous substances could subject us to future liabilities.

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 that 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. 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 acquisition 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 Volatile, Which May Affect Our Ability to Raise Capital, Make Acquisitions, or Subject Our Business to Additional Costs

The market price for our Common Stock is 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 a variety of factors, many of which are not within our control or influence. These factors include but are not limited to the following:

- general market, semiconductor, or semiconductor equipment industry conditions;

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- economic or political events and trends occurring globally or in any of our key sales regions;
- variations in our quarterly operating results and financial condition, including our liquidity;
- variations in our revenues, earnings or other business and financial metrics from forecasts by us or securities analysts, or from those experienced by other companies in our industry;
- announcements of restructurings, reductions in force, departure of key employees, and/or consolidations of operations;
- government regulations;
- developments in, or claims relating to, patent or other proprietary rights;
- technological innovations and the introduction of new products by us or our competitors;
- commercial success or failure of our new and existing products;
- disruptions of relationships with key customers or suppliers; or
- dilutive impacts of our Notes and related warrants.

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 their stock, many companies became 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 our financial performance and the price for our Common Stock.

Intellectual Property, Indemnity and Other Claims Against Us Can be Costly and We Could Lose Significant Rights That are Necessary to Our Continued Business and Profitability

Third parties may assert infringement, unfair competition, product liability, breach of contract, 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, law enforcement authorities may seek criminal charges relating to intellectual property or other issues. We also face risks of claims arising from commercial and other relationships. In addition, our Bylaws and indemnity obligations provide that we will indemnify officers and directors against losses that they may incur in legal proceedings resulting from their service to Lam Research. In such cases, it is our policy either to defend the claims or to negotiate licenses or other settlements on commercially reasonable terms. However, we may be unable in the future to negotiate necessary licenses or reach agreement on other settlements 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, and we may be subject to substantial damage awards and penalties. Moreover, although we have insurance to protect us from certain claims and cover certain losses to our property, such insurance may not cover us for the full amount of any losses, or at all, and may be subject to substantial exclusions and deductibles.

We May Fail to Protect Our Critical Proprietary Technology Rights, Which Could Affect Our Business

Our success depends in part on our proprietary technology and our ability to protect key components of that technology through patents, copyrights and trade secret protection. Protecting our key proprietary technology helps us to achieve our goals of developing technological expertise and new products and systems that give us a competitive advantage; increasing market penetration and growth of our installed base; and providing comprehensive support and service to our customers. As part of our strategy to protect our technology 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 patents for pending applications. Additionally, even when patents are issued, the legal systems in certain of the countries in which we do business do not enforce patents and other intellectual property rights as rigorously as the United States. The rights granted or anticipated under any of our patents or pending patent applications may be narrower than we expect or, in fact, provide no competitive advantages. Any of these circumstances could have a material adverse impact on our business.

Risks Related to the Acquisition of Novellus Systems, Inc.

Our proposed acquisition of Novellus Systems, Inc. ("Novellus") is subject to a number of risks, including those described in the section entitled "Risk Factors Relating to the Merger" in our Form S-4 filed with the SEC on January 31, 2012 (the "S-4"). Further, if the acquisition is completed, in addition to the risks described below, we may be subject to the risks and uncertainties associated with Novellus' business, including those described in the section entitled "Risk Factors Relating to the Combined Company" in the S-4.

If We are Unable to Complete Our Contemplated Acquisition of Novellus, Our Expected Financial Results Could Be Adversely Affected

On December 14, 2011, we entered into an Agreement and Plan of Merger (the “merger agreement”) with Novellus to acquire all of Novellus’ issued and outstanding stock through a merger of Novellus with our subsidiary, BLMS Inc. (the “merger”). Consummation of the merger is subject to customary conditions to closing, including the receipt of required regulatory approvals, the approval of the issuance of our common stock to Novellus’ shareholders in the merger by our stockholders, and the approval of the merger by Novellus’ shareholders. If any condition to the merger is not satisfied or waived, the merger will not be completed. We and Novellus also may terminate the merger agreement under certain circumstances. Any or all of the preceding could jeopardize our ability to consummate the merger on the already negotiated terms. To the extent the merger is not completed for any reason, we would have devoted substantial resources and management attention to the transaction without realizing the accompanying benefits expected by our management, and our financial condition and results of operations and the market value of our stock may be adversely affected.

Even if the Novellus Merger is Consummated, We May Experience Difficulties Integrating Novellus’ Businesses, Which Could Cause Us to Fail to Realize the Anticipated Benefits of the Merger

If the merger is consummated, achieving the anticipated benefits of the merger will depend in part upon whether we and Novellus integrate our businesses in an effective and efficient manner. We may not be able to accomplish this integration process smoothly or successfully. The integration of certain operations following the merger will take time and will require the dedication of significant management resources, which may temporarily distract our management’s attention from the routine business of the combined company. Any delay or inability of our management to successfully integrate the operations of the two companies could compromise the combined entity’s potential to achieve the anticipated long-term strategic benefits of the merger and could have a material adverse effect on the business, financial condition and results of operations of the combined company and the market value of our stock after the merger.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases of Company Shares

On September 10, 2010, the Board of Directors authorized the repurchase of up to \$250 million of Company common stock and on September 1, 2011 the Board of Directors authorized the repurchase of up to an additional \$500 million of Company common stock. On December 14, 2011, the Board of Directors authorized the repurchase of up to \$1.6 billion of Company common stock in conjunction with the planned merger with Novellus, which replaces the previous repurchase authorizations under the program. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance with applicable law. Repurchases will be funded using the Company’s available cash. This repurchase program has no termination date and may be suspended or discontinued at any time.

As part of its share repurchase program, the Company may from time-to-time enter into structured share repurchase arrangements with financial institutions using general corporate funds. Historically, these arrangements have required the Company to make an up-front cash payment in exchange for the right to receive shares of its common stock or cash at the expiration of the agreement, dependent upon the closing

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price of the Corporation's common stock at the settlement date. During the quarter ended December 25, 2011 two of these arrangements settled, resulting in the receipt of 2.6 million shares at an aggregate price of \$100.0 million under the first arrangement and \$51.0 million under the second arrangement. As of December 25, 2011, a prepayment of \$75.0 million was outstanding under one such arrangement. This arrangement settled in January 2012, resulting in the receipt of \$79.2 million. Under these arrangements, any prepayments or cash payments at settlement are recorded as a component of additional paid in capital in the Company's Consolidated Balance Sheet as of December 25, 2011.

Share repurchases, including those under the repurchase program, were as follows:

| <u>Period</u> | <u>Total Number of Shares Repurchased (1)</u> | <u>Average Price Paid Per Share</u> | <u>Total Number of Shares Purchased as Part of Publicly Announced Plan or Program</u> | <u>Amount Available Under Repurchase Program</u> |
|--|---|---|---|--|
| | | (in thousands, except per share data) | | |
| Amount available at June 26, 2011 | | | | \$ 249,244 |
| Authorization of additional \$500 million - September 2011 | | | | \$ 749,244 |
| Quarter ending September 25, 2011 | 2,063 | \$ 37.83 | 1,977 | \$ 674,957 |
| September 26, 2011 - October 25, 2011 | 2,838 | \$ 38.66 | 2,834 | \$ 565,405 |
| October 26, 2011 - November 25, 2011 | 112 | \$ 42.10 | 26 | \$ 564,320 |
| November 26, 2011 - December 25, 2011 | 5 | \$ 41.30 | — | \$ 564,320 |
| Authorization of new \$1.6 billion - December 2011 | | | | \$1,600,000 |
| Total | <u>5,018</u> | \$ 38.40 | <u>4,837</u> | |

- (1) In addition to shares repurchased under Board authorized repurchase program (as described above), included in this column are 182,000 shares acquired at a total cost of \$7.8 million which the Company withheld through net share settlements to cover tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company's equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company's equity compensation plans.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. (Removed and Reserved)**ITEM 5. Other Information**

None.

ITEM 6. Exhibits

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

EXHIBIT INDEX

| <u>Exhibit Number</u> | <u>Description</u> |
|----------------------------------|--|
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer) |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer) |
| 32.1 | Section 1350 Certification (Principal Executive Officer) |
| 32.2 | Section 1350 Certification (Principal Financial Officer) |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

RULE 13a-14(a)/15d-14(a) CERTIFICATION (PRINCIPAL EXECUTIVE OFFICER)

I, Martin B. Anstice, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 3, 2012

/s/ Martin B. Anstice

Martin B. Anstice

President and Chief Executive Officer

RULE 13a-14(a)/15d-14(a) CERTIFICATION (PRINCIPAL FINANCIAL OFFICER)

I, Ernest E. Maddock, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 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-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

February 3, 2012

/s/ Ernest E. Maddock

Ernest E. Maddock
Senior Vice President, Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

SECTION 1350 CERTIFICATION (PRINCIPAL EXECUTIVE OFFICER)

In connection with the Quarterly Report of Lam Research Corporation (the "Company") on Form 10-Q for the fiscal period ending December 25, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Martin B. Anstice, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 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 3, 2012

/s/ Martin B. Anstice

Martin B. Anstice

President and Chief Executive Officer

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and will not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") or otherwise subject to the liability of that section. Such certification will not be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

SECTION 1350 CERTIFICATION (PRINCIPAL FINANCIAL OFFICER)

In connection with the Quarterly Report of Lam Research Corporation (the "Company") on Form 10-Q for the fiscal period ending December 25, 2011 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ernest E. Maddock, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 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 3, 2012

/s/ Ernest E. Maddock

Ernest E. Maddock

Senior Vice President, Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and will not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act") or otherwise subject to the liability of that section. Such certification will not be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the Company specifically incorporates it by reference.

