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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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*(Mark One)*

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

**For the quarterly period ended December 26, 2004 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**

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*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**94-2634797**

*(I.R.S. Employer Identification Number)*

**4650 Cushing Parkway  
Fremont, California 94538**

*(Address of principal executive offices including zip code)*

**(510) 572-0200**

*(Registrant's telephone number, including area code)*

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES  NO

As of January 27, 2005, there were 139,658,906 shares of Registrant's Common Stock outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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

	December 26, 2004 (unaudited)	June 27, 2004 (1)
<b>ASSETS</b>		
Cash and cash equivalents	\$ 326,173	\$ 163,403
Short-term investments	323,227	266,069
Accounts receivable, net	248,498	245,508
Inventories	129,302	108,249
Deferred income taxes	59,725	102,731
Prepaid expenses and other current assets	10,300	10,428
Total current assets	1,097,225	896,388
Property and equipment, net	45,154	42,444
Restricted cash	112,468	112,468
Deferred income taxes	97,933	106,505
Other assets	41,221	40,821
Total assets	<u>\$ 1,394,001</u>	<u>\$ 1,198,626</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Trade accounts payable	\$ 62,373	\$ 93,394
Accrued expenses and other current liabilities	220,325	172,343
Deferred profit	73,886	108,369
Current portion of long-term liabilities	—	2,500
Total current liabilities	356,584	376,606
Long-term liabilities less current portion	7,268	9,554
Total liabilities	363,852	386,160
Commitments and contingencies		
Preferred stock, at par value of \$0.001 per share; authorized - 5,000 shares, none outstanding	—	—
Common stock, at par value of \$0.001 per share; authorized - 400,000 shares; issued and outstanding — 138,844 shares at December 26, 2004 and 134,988 shares at June 27, 2004	139	135
Additional paid-in capital	669,913	628,076
Deferred stock-based compensation	(1,461)	(1,839)
Treasury stock, at cost, 1,385 shares at December 26, 2004 and June 27, 2004	(19,742)	(19,742)
Accumulated other comprehensive loss	(13,183)	(15,283)
Retained earnings	394,483	221,119
Total stockholders' equity	1,030,149	812,466
Total liabilities and stockholders' equity	<u>\$ 1,394,001</u>	<u>\$ 1,198,626</u>

(1) Derived from June 27, 2004 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)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 26, 2004</b>	<b>December 28, 2003</b>	<b>December 26, 2004</b>	<b>December 28, 2003</b>
Total revenue	\$ 379,800	\$ 191,508	\$ 799,349	\$ 375,246
Cost of goods sold	180,898	105,372	385,686	210,842
Cost of goods sold - restructuring recoveries	—	(1,079)	—	(1,329)
Total cost of goods sold	<u>180,898</u>	<u>104,293</u>	<u>385,686</u>	<u>209,513</u>
Gross margin	<u>198,902</u>	<u>87,215</u>	<u>413,663</u>	<u>165,733</u>
Research and development	47,057	39,078	97,415	77,604
Selling, general and administrative	43,275	34,141	86,402	68,134
Restructuring charges, net	—	5,948	—	7,010
Total operating expenses	<u>90,332</u>	<u>79,167</u>	<u>183,817</u>	<u>152,748</u>
Operating income	108,570	8,048	229,846	12,985
Other income, net	<u>1,298</u>	<u>473</u>	<u>1,306</u>	<u>1,917</u>
Income before income taxes	109,868	8,521	231,152	14,902
Income tax expense	<u>26,254</u>	<u>2,130</u>	<u>57,788</u>	<u>3,725</u>
Net income	<u>\$ 83,614</u>	<u>\$ 6,391</u>	<u>\$ 173,364</u>	<u>\$ 11,177</u>
Net income per share:				
Basic net income per share	<u>\$ 0.61</u>	<u>\$ 0.05</u>	<u>\$ 1.27</u>	<u>\$ 0.09</u>
Diluted net income per share	<u>\$ 0.59</u>	<u>\$ 0.05</u>	<u>\$ 1.23</u>	<u>\$ 0.08</u>
Number of shares used in per share calculations:				
Basic	<u>137,255</u>	<u>131,020</u>	<u>136,366</u>	<u>129,688</u>
Diluted	<u>142,268</u>	<u>139,658</u>	<u>141,108</u>	<u>137,502</u>

See Notes to Condensed Consolidated Financial Statements

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

	<b>Six Months Ended</b>	
	<b>December 26, 2004</b>	<b>December 28, 2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 173,364	\$ 11,177
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	11,878	12,825
Amortization	1,010	3,115
Deferred income taxes	51,578	776
Restructuring charges, net	—	5,681
Amortization of premiums on securities	1,853	1,973
Amortization of deferred stock-based compensation	293	2,769
Other, net	(530)	804
Change in working capital accounts	(48,699)	(4,954)
Net cash provided by operating activities	<u>190,747</u>	<u>34,166</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(13,983)	(6,212)
Purchases of available-for-sale securities	(133,892)	(310,785)
Sales and maturities of available-for-sale securities	75,172	191,317
Other, net	—	(232)
Net cash used for investing activities	<u>(72,703)</u>	<u>(125,912)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments and redemptions on long-term debt and capital lease obligations	—	(12)
Reissuances of treasury stock	—	4,426
Proceeds from issuance of common stock	41,925	48,204
Net cash provided by financing activities	<u>41,925</u>	<u>52,618</u>
Effect of exchange rate changes on cash	2,801	996
Net increase (decrease) in cash and cash equivalents	162,770	(38,132)
Cash and cash equivalents at beginning of period	163,403	167,343
Cash and cash equivalents at end of period	<u>\$ 326,173</u>	<u>\$ 129,211</u>

See Notes to Condensed Consolidated Financial Statements

LAM RESEARCH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 26, 2004

(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 for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Lam Research Corporation (the Company or Lam) for the fiscal year ended June 27, 2004, which are included in the Annual Report on Form 10-K, File Number 0-12933. The Company's Form 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 <http://www.sec.gov>. The Company also posts the Form 10-K, Forms 10-Q and Forms 8-K on the corporate website at <http://www.lamrc.com>.

The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 26, 2005 and includes 52 weeks. The quarter ended December 26, 2004 and the quarter ended December 28, 2003 both included 13 weeks.

*Reclassifications:* Certain amounts presented in the comparative financial statements for prior years have been reclassified to conform to the fiscal 2005 presentation.

**NOTE 2 — RECENT ACCOUNTING PRONOUNCEMENTS**

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under Statement of Financial Accounting Standards (SFAS) 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method or the equity method. In September 2004, the Financial Accounting Standards Board (FASB) issued a final FASB Staff Position, (FSP) EITF Issue 03-01-1, which indefinitely delays the effective date for the measurement and recognition guidance of EITF 03-01. The Company is currently evaluating the impact, if any, of adopting EITF 03-01.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs — An Amendment of ARB No. 43, Chapter 4," which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). The Company is required to adopt SFAS No. 151 in fiscal year 2006 and its adoption is not expected to have a significant impact on the Company's results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment." This Statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation", and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees", and its related implementation guidance. SFAS No. 123(R) requires that compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. This statement is effective beginning with the first interim or annual period after June 15, 2005, with early adoption permitted. The Company has no plans for early adoption.

The effects of the adoption of SFAS No. 123(R) on the Company's results of operations and financial position are dependent upon a number of factors, including the number of employee stock options outstanding and unvested, the number of employee stock options which may be granted in the future, the future market value and volatility of the Company's stock price, movements in the risk free rate of interest, stock option exercise and forfeiture patterns, and the stock option valuation model used to estimate the fair value of each option. As a result of these variables it is not yet possible to reliably estimate the effect of the adoption of SFAS No. 123(R) on the Company's results of operations and financial position. Note 3 herein provides an indication of the effects of adoption assuming the use of the Black Scholes option pricing model and the assumptions detailed therein to estimate the fair value of employee stock options and employee stock purchase plan awards upon the results of operations for the three and six months ended December 26, 2004 and December 28, 2003.

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In December 2004, the FASB issued SFAS No. 153, “Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29.” The amendments made by SFAS No. 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. SFAS No. 153 also eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company will apply its provisions prospectively upon adoption and its adoption is not expected to have a significant impact on the Company’s results of operations or financial position.

**NOTE 3 — STOCK-BASED COMPENSATION PLANS**

The Company has adopted stock option plans that provide for the grant to employees of various equity incentive awards, including options to purchase shares of Lam common stock. In addition, the plans permit the grant of nonstatutory stock options to paid consultants and provide for the automatic grant of nonstatutory stock options to outside directors. The Company also has an employee stock purchase plan (ESPP) that allows employees to purchase its common stock.

The Company accounts for its stock option plans and stock purchase plan under the provisions of APB Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25) and FASB Interpretation (FIN) 44, “Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB Opinion No. 25” (FIN 44). Pro forma information regarding net income (loss) and net income (loss) per share is required by SFAS No. 123, “Accounting for Stock-Based Compensation”, as amended by SFAS No. 148, “Accounting for Stock-Based Compensation-Transition and Disclosure” as if the Company had accounted for its stock option and stock purchase plans under the fair value method of SFAS No. 123 and SFAS No. 148. The following table illustrates the effect on net income and net income per share if the Company had accounted for its stock option and stock purchase plans under the fair value method of accounting under SFAS No. 123 and SFAS No. 148:

	Three Months Ended		Six Months Ended	
	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003
	(in thousands, except per share data)			
Net income - as reported	\$ 83,614	\$ 6,391	\$ 173,364	\$ 11,177
Add: compensation expense recorded under APB 25, net of tax	202	—	222	2,077
Deduct: SFAS No. 123 compensation expense, net of tax	4,180	5,283	10,199	14,390
Net income (loss) - pro forma	\$ 79,636	\$ 1,108	\$ 163,387	\$ (1,136)
Basic net income per share - as reported	\$ 0.61	\$ 0.05	\$ 1.27	\$ 0.09
Basic net income (loss) per share - pro forma	0.58	0.01	1.20	(0.01)
Diluted net income per share - as reported	0.59	0.05	1.23	0.08
Diluted net income (loss) per share - pro forma	\$ 0.56	\$ 0.01	\$ 1.16	\$ (0.01)

For pro forma purposes, the estimated fair value of the Company’s stock-based awards is amortized over the options’ vesting period (for options) and the respective four, eight, twelve, or sixteen-month purchase periods (for stock purchases under the employee stock purchase plan). The fair value of the Company’s stock options and stock purchase plan awards were estimated using a Black-Scholes option valuation model, which was developed for use in estimating the fair value of traded options which have no vesting restrictions and which are fully transferable. The model requires the input of highly subjective assumptions, including expected stock price volatility and the estimated life of each option. The fair value of all of the Company’s stock-based awards was estimated assuming no expected dividends and estimates of expected life, volatility and risk-free interest rate at the time of grant. The fair value of the Company’s stock-based awards granted in the three and six-month periods of fiscal 2005 and fiscal 2004 was estimated using the following weighted-average assumptions:

	Options				ESPP			
	Three Months Ended		Six Months Ended		Three Months Ended		Six Months Ended	
	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003
Expected life (years)	4.6	3.5	3.6	3.4	0.7	0.7	0.6	0.5
Expected stock price volatility	74%	74%	74%	74%	74%	74%	74%	74%
Risk-free interest rate	3.4%	2.1%	2.9%	2.0%	3.4%	2.1%	2.9%	2.0%

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**NOTE 4 — INVENTORIES**

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

	December 26, 2004	June 27, 2004
	(in thousands)	
Raw materials	\$ 55,192	\$ 45,070
Work-in-process	36,160	41,353
Finished goods	37,950	21,826
	<u>\$ 129,302</u>	<u>\$ 108,249</u>

**NOTE 5 — PROPERTY AND EQUIPMENT**

Property and equipment, net, consist of the following:

	December 26, 2004	June 27, 2004
	(in thousands)	
Manufacturing, engineering and office equipment	\$ 102,212	\$ 98,046
Computer equipment and software	61,698	59,062
Leasehold improvements	39,579	41,256
Furniture and fixtures	4,633	3,204
	208,122	201,568
Less: accumulated depreciation and amortization	(162,968)	(159,124)
	<u>\$ 45,154</u>	<u>\$ 42,444</u>

**NOTE 6 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

	December 26, 2004	June 27, 2004
	(in thousands)	
Accrued compensation	\$ 102,975	\$ 76,896
Warranty reserves	38,352	28,401
Income and other taxes payable	35,050	33,972
Restructuring reserves	4,885	5,093
Other	39,063	27,981
	<u>\$ 220,325</u>	<u>\$ 172,343</u>

**NOTE 7 — OTHER INCOME, NET**

The significant components of other income, net, are as follow:

	Three Months Ended		Six Months Ended	
	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003
	(in thousands)			
Interest income	\$ 3,189	\$ 2,238	\$ 5,582	\$ 4,950
Interest expense	(444)	(783)	(987)	(1,369)
Foreign exchange gain (loss)	(117)	(185)	306	(307)
Debt issue cost amortization	—	(425)	—	(850)
Charitable contributions	(1,250)	—	(3,250)	—
Other, net	(80)	(372)	(345)	(507)
	<u>\$ 1,298</u>	<u>\$ 473</u>	<u>\$ 1,306</u>	<u>\$ 1,917</u>

**NOTE 8 — 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, as though all potential common shares that are dilutive were outstanding during the period. The following table provides a reconciliation of the numerators and denominators of the basic and diluted computations for net income per share.

	Three Months Ended		Six Months Ended	
	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003
	(in thousands, except per share data)			
<b>Numerator:</b>				
Net income	\$ 83,614	\$ 6,391	\$ 173,364	\$ 11,177
<b>Denominator:</b>				
Basic average shares outstanding	137,255	131,020	136,366	129,688
Effect of potential dilutive securities:				
Employee stock plans and warrant	5,013	8,638	4,742	7,814
Diluted average shares outstanding	142,268	139,658	141,108	137,502
Net income per share — Basic	\$ 0.61	\$ 0.05	\$ 1.27	\$ 0.09
Net income per share — Diluted	\$ 0.59	\$ 0.05	\$ 1.23	\$ 0.08

For purposes of computing diluted net income per share, weighted-average common shares do not include potential dilutive securities whose exercise prices exceed the average market value of the Company's common stock for the period. The following potential dilutive securities were excluded:

	Three Months Ended		Six Months Ended	
	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003
	(in thousands)			
Number of potential dilutive securities excluded	3,800	946	4,319	3,423

In addition, during the three and six months ended December 28, 2003, 6.7 million potential dilutive securities related to the Company's convertible subordinated 4% notes (4% Notes) were excluded for purposes of computing diluted net income per share because the effect would have been antidilutive. The Company's 4% Notes were repaid in June, 2004, two years prior to maturity.

**NOTE 9 — COMPREHENSIVE INCOME**

The components of comprehensive income are as follows:

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>December 26, 2004</u>	<u>December 28, 2003</u>	<u>December 26, 2004</u>	<u>December 28, 2003</u>
	(in thousands)			
Net income	\$ 83,614	\$ 6,391	\$ 173,364	\$ 11,177
Foreign currency translation adjustment	1,808	1,788	1,809	1,473
Unrealized gain (loss) on fair value of derivative financial instruments, net	(82)	38	(82)	(110)
Unrealized gain (loss) on financial instruments, net	(1,212)	(200)	116	(560)
Reclassification adjustment for loss (gain) on financial instruments included in earnings	93	(10)	257	(207)
Comprehensive income	<u>\$ 84,221</u>	<u>\$ 8,007</u>	<u>\$ 175,464</u>	<u>\$ 11,773</u>

The balance of accumulated other comprehensive loss is as follows:

	<u>December 26, 2004</u>	<u>June 27, 2004</u>
	(in thousands)	
Accumulated foreign currency translation adjustment	\$ (11,536)	\$(13,345)
Accumulated unrealized loss on fair value of derivative financial instruments, net	(82)	—
Accumulated unrealized loss on financial instruments	(1,565)	(1,938)
Accumulated other comprehensive loss	<u>\$ (13,183)</u>	<u>\$(15,283)</u>

**NOTE 10 — GUARANTEES**

The Company accounts for its guarantees in accordance with FASB Interpretation 45 “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others” (FIN 45). FIN 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN 45 also requires a company (the Guarantor) to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee.

In March and June of 2003, the Company transferred certain lease agreements relating to various properties at its Fremont, California campus to a new lessor. These agreements require the Company to guarantee residual values of the leased properties to the lessor at the end of the lease terms in fiscal 2008 (in the case that the leases are not renewed, the Company does not exercise the purchase options, the lessor sells the properties and the sale price is less than the lessor’s costs) of up to \$98.7 million (\$48.4 million for March 2003 and \$50.3 million for June 2003). The terms of the guarantees are equal to the remaining terms of the related lease agreements. Under the accounting provisions of FIN 45, the Company recognized a liability of approximately \$1.0 million (\$0.5 million in March 2003 and \$0.5 million in June 2003) for the related residual value guarantees under the leases. The value of these guarantees was determined by computing the estimated present value of the respective probability-weighted cash flows that might be expended under the guarantees over the respective leases’ terms, and was discounted using the Company’s risk adjusted borrowing rate of approximately 2%. The values of these respective guarantees have been recorded as prepaid rent, with the offset recorded as a liability, and the amounts are being amortized to income (for the liability) and to expense (for the prepaid rent) on a ratable basis over the five-year period of the leases. The total value of these guarantees as of December 26, 2004 was \$0.7 million.

The Company has issued certain indemnifications to its lessors under some of its operating lease agreements, such as, indemnification for various environmental matters. The Company has entered into certain insurance contracts to minimize its exposure related to such indemnifications. As of December 26, 2004, the Company has not recorded any liability on its financial statements in connection with these indemnifications, as the Company does not believe, based on information available, that it is probable that any

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amounts will be paid under these guarantees.

The Company has an agreement with a financial institution that guarantees payment of its Japanese subsidiary's overdraft protection obligation. The maximum potential amount of future payments the Company could be required to make under this agreement at December 26, 2004, is approximately \$2.9 million. As of December 26, 2004, the Company's Japanese subsidiary did not owe any amounts under this agreement. The Company has not recorded any liability in connection with this guarantee, as the Company does not believe, based on information available, that it is probable that any amounts will be paid under this guarantee.

The Company has an agreement enabling it to sell to a financial institution certain U.S. Dollar-denominated receivables generated from the sale of its systems, subject to recourse provisions. The Company insures these sold receivables for approximately 90% of their value and guarantees payment of the remaining uninsured receivable value in the event that the payment obligation is not satisfied. Based on historical payment patterns, the Company has experienced negligible default on payment obligations and therefore, believes the risk of loss from default is minimal. The terms of these guarantees are from 90 days past the due date of the receivable, until collected. At December 26, 2004 the maximum potential amount of future payments the Company could be required to make under this agreement is approximately \$4.6 million. As of December 26, 2004, the Company has not recorded any liability in connection with these guarantees, as the Company does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

Generally, the Company indemnifies, under pre-determined conditions and limitations, its customers for infringement of third-party intellectual property rights by its 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 the Company's 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.

The Company offers standard warranties on its systems that run generally for a period of 12 months from system acceptance, not to exceed 14 months from the date of shipment of the system to the customer. 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 during the six months ended December 26, 2004 and December 28, 2003, were as follows:

	<b>(in thousands)</b>
Balance at June 29, 2003	\$ 16,985
Warranties issued during the period	7,208
Settlements made during the period	(8,716)
Change in liability for pre-existing warranties during the period, including expirations	(1,831)
Balance at December 28, 2003	<u>\$ 13,646</u>
	<b>(in thousands)</b>
Balance at June 27, 2004	\$ 28,401
Warranties issued during the period	22,125
Settlements made during the period	(9,669)
Change in liability for pre-existing warranties during the period, including expirations	(2,505)
Balance at December 26, 2004	<u>\$ 38,352</u>

**NOTE 11 — DERIVATIVE INSTRUMENTS AND HEDGING**

The Company carries derivative financial instruments (derivatives) on the balance sheet at their fair values in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). The Company has a policy of using derivative financial instruments, specifically forward exchange contracts, to hedge foreign currency exchange rate fluctuations on forecasted revenue transactions denominated in Japanese Yen and other foreign currency denominated assets. The Company does not use derivatives for trading or speculative purposes.

The Company's policy is to attempt to minimize short-term business exposure to foreign currency exchange rate risks using an effective and efficient method to eliminate or reduce such exposures. In the normal course of business, the Company's financial position is routinely subjected to market risk associated with foreign currency exchange rate fluctuations. To protect against the reduction in value of forecasted Japanese Yen-denominated sales, the Company has instituted a foreign currency cash flow hedging program. The Company enters into foreign currency forward exchange contracts that generally expire within 12 months, and no later than 24 months. These foreign currency forward exchange 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 earnings in the same period the hedged revenue is recognized. Each period hedges are tested for effectiveness by comparing the change in value of the derivative with the change in the value of the anticipated sales transactions. No gain or loss was recorded in the three and six-month periods ended December 26, 2004 associated with forecasted transactions that failed to occur. A net gain of less than \$0.1 million during the quarter ended December 28, 2003 and a net gain of \$0.3 million for the six months ended December 28, 2003, were recognized in Other Income and Expense associated with cash flow hedges where the original forecasted transactions did not occur within the specified hedge period.

At December 26, 2004, the Company expects to reclassify the entire amount of \$(82,000) accumulated in other comprehensive income to earnings during the next 12 months due to the recognition in earnings of the hedged forecasted transactions.

The Company also enters into foreign currency exchange rate forward contracts to hedge the gains and losses generated by the remeasurement of Japanese Yen-denominated intercompany and trade receivables. Under SFAS No. 133, these forward contracts are not designated hedges. Therefore, the change in fair value of these derivatives is recorded into earnings as a component of other income and offsets the change in fair value of the foreign currency denominated intercompany and trade receivables.

**NOTE 12 — RESTRUCTURING ACTIVITIES**

The Company distinguishes regular operating cost management activities from restructuring activities. Accounting for restructuring 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 Company has historically developed plans and incurred restructuring charges to respond to the high level of volatility and, at times, depressed levels of capital investment by the semiconductor industry. The Company systematically reviews its revenue outlook and forecasts and assesses their impact on required employment levels, facilities utilization, and outsourcing activities scope. Based on these evaluations, the Company's senior management committed to cost reduction and exit activities in the quarters ended March 28, 2004 (the March 2004 Plan), December 28, 2003 (the December 2003 Plan), September 28, 2003 (the September 2003 Plan), June 29, 2003 (the June 2003 Plan), March 30, 2003 (the March 2003 Plan), December 29, 2002 (the December 2002 Plan), December 30, 2001 (the December 2001 Plan), and September 23, 2001 (the September 2001 Plan).

Prior to the end of each quarter noted above, the Company initiated the announced restructuring activities and management with the proper level of authority approved specific actions under the respective Plan. Severance packages to potentially impacted employees were communicated in enough detail such 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 recorded in the restructuring charges include facilities for which a contract was terminated in accordance with its terms and charges for facilities, or a portion of facilities the Company ceased to use, were 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, where these items were determined to have no future economic benefit to the Company and have been abandoned.

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As of December 26, 2004, the overall restructuring reserve balance consisted of the following:

	<b>Severance and Benefits</b>	<b>Facilities</b>	<b>Total</b>
Fiscal 2004 restructurings	\$ —	\$ 1,897	\$ 1,897
Fiscal 2003 restructurings	—	5,754	5,754
Fiscal 2002 restructurings	200	2,764	2,964
Pre-fiscal 2002 restructurings	—	842	842
Balance at December 26, 2004	<u>200</u>	<u>11,257</u>	<u>11,457</u>
Less: portion included in other current liabilities	<u>200</u>	<u>4,685</u>	<u>4,885</u>
Included in long-term liabilities	<u>\$ —</u>	<u>\$ 6,572</u>	<u>\$ 6,572</u>

The severance and benefits-related balance is anticipated to be utilized by the end of calendar year 2005. The facilities balance consists primarily of lease payments on vacated buildings and is expected to be utilized by the end of fiscal year 2010.

### *Fiscal 2004 Restructuring Activities*

The Company's fiscal 2004 restructuring activities included reducing its workforce by less than 40 employees, primarily in North America and Europe and by vacating selected facilities located in North America and Asia deemed to be no longer necessary to its operations. The employees were from a range of functions and at multiple levels of the organization.

The Company recorded net restructuring charges during fiscal year 2004 of approximately \$6.7 million, consisting of severance and benefits for involuntarily terminated employees of \$1.2 million, charges for the present value of remaining lease payments on vacated facilities of \$2.8 million, and the write-off of related leasehold improvements of \$1.6 million. The Company also recorded a charge of approximately \$1.0 million due to the cancellation of a lease agreement related to one of its facilities in Japan and \$2.1 million for the write-off of related leasehold improvements.

The Company recognized \$1.9 million of additional facilities-related expenses due to changes in estimates of restructuring plans initiated prior to fiscal 2004. Charges during the year were partially offset by the recovery of \$1.5 million of previously accrued expenses related to the remaining lease payments on vacated facilities in Japan. Additional offsetting items include recovery of \$0.7 million due to lower than previously estimated employee severance and benefits costs and \$1.7 million of recovered inventory from unanticipated sales to the Company's installed base of certain portions of inventory previously written off as part of its September 2001 restructuring. The inventory recovery was recorded as a credit in cost of goods sold.

The following is a table summarizing restructuring activities relating to the Company's fiscal year 2004 restructuring plans:

	<b>Severance and Benefits</b>	<b>Facilities</b>	<b>Total</b>
Balance at June 27, 2004	\$ 30	\$ 2,077	\$ 2,107
Cash payments	(30)	(180)	(210)
Balance at December 26, 2004	<u>\$ —</u>	<u>\$ 1,897</u>	<u>\$ 1,897</u>

### *Fiscal 2003 Restructuring Activities*

The Company's senior management committed to cost reduction and exit activities during fiscal 2003 through its June 2003, March 2003 and December 2002 Plans and recorded restructuring charges during fiscal 2003 of approximately \$18.1 million. The Company's fiscal 2003 restructuring activities included reducing its workforce in North America, Europe, and Asia by approximately 200 people and vacating selected sales and administrative facilities located in North America, Europe, and Asia deemed to be no longer required for its operations. The employees included in the Plans were from a broad range of functions and at multiple levels of the organization, with the majority of the reductions in North America.

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The \$18.1 million restructuring charges consisted of \$5.7 million of severance and benefits for involuntarily terminated employees and \$12.4 million of facilities-related charges. The facilities-related charges consisted of the present value of remaining lease payments on vacated facilities, a loss on the fair value of a vacated facility and the write-off of related leasehold improvements. In June 2003, a lease covering one of the Company's vacated facilities at its Fremont, California campus was amended, combined, restated, and transferred to a new lessor under a single lease structure. At the time of the amendment, the leased facility's fair value was less than its original cost by approximately \$1 million. Accordingly, this amount was recorded as a loss on the fair value of the vacated facility and included in the \$18.1 million of restructuring charges.

The following is a table summarizing restructuring activities relating to the Company's fiscal year 2003 restructuring plans:

	<b>Severance and Benefits</b>	<b>Facilities</b>	<b>Total</b>
Balance at June 27, 2004	\$ 183	\$ 6,451	\$ 6,634
Cash payments	(183)	(697)	(880)
Balance at December 26, 2004	<u>\$ —</u>	<u>\$ 5,754</u>	<u>\$ 5,754</u>

### *Fiscal 2002 Restructuring Activities*

The Company's senior management committed to cost reduction and exit activities during fiscal 2002 through its December 2001 and September 2001 Plans and recorded restructuring charges during fiscal 2002 of approximately \$54.8 million. The Company's fiscal 2002 restructuring activities included reducing its workforce in North America, Europe, and Asia by approximately 1,020 people and by vacating selected facilities at its Fremont, California campus deemed to be no longer required for its operations, the closure of certain offices in Asia, and discontinuance of the manufacture of specific products within its etch product lines. The employees were from a broad range of functions and at multiple levels of the organization, with approximately 83% from North America and approximately 17% from Europe and Asia Pacific locations.

The restructuring charges included severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, write-off of related leasehold improvements and fixed assets, and inventory write-downs. The inventory charge of approximately \$7.6 million related to the Company's decision to discontinue manufacture of specific systems within its etch product lines. The Company recovered approximately \$1.7 million during fiscal year 2004, \$1.0 million during fiscal year 2003, and \$0.7 million during fiscal year 2002, from unanticipated subsequent sales of these inventories to its installed base. The Company physically disposed of approximately \$1.0 million of this inventory during fiscal 2004 and \$2.7 million during fiscal 2003 and 2002. During fiscal 2002, the Company also recovered approximately \$1.0 million of the \$54.8 million due to lower than estimated employee termination costs of \$0.7 million and lower than planned expenses related to a vacated facility of \$0.3 million. During fiscal 2004, the Company recorded approximately \$0.4 million of additional restructuring charges due to a revision in estimates for one of its vacated facilities and the Company recovered approximately \$1.4 million, net, due to the difference between costs previously accrued and actual costs to terminate a lease agreement for a facility for which it entered into a lease cancellation agreement during fiscal 2004.

During fiscal 2003, the Company recovered approximately \$2.7 million for benefits offered that were not utilized by terminated employees and \$2.0 million was recovered due to revisions to the net amount of lease payments remaining on vacated facilities. The Company also recorded additional restructuring charges during fiscal 2003 of \$3.1 million due to revisions the Company made in sublease assumptions for two of its vacated buildings in Fremont, California, \$0.1 million due to additional facility restoration costs, and \$0.4 million for revisions that the Company made in its estimates for employee termination costs.

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The following is a table summarizing restructuring activities relating to the Company's fiscal year 2002 restructuring plans:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Total</u>
Balance at June 27, 2004	\$ 389	\$ 3,496	\$ 3,885
Cash payments	<u>(189)</u>	<u>(732)</u>	<u>(921)</u>
Balance at December 26, 2004	<u>\$ 200</u>	<u>\$ 2,764</u>	<u>\$ 2,964</u>

*Fiscal 2001 Restructuring Activities*

During the second quarter of fiscal 2003, the Company completed the remaining elements of its restructuring activities under the June 2001 Plan. A final \$1.1 million of restructuring charges was recovered due to lower than estimated employee termination costs. The remaining \$0.8 million facilities balance as of December 26, 2004 is expected to be paid by January, 2006.

**NOTE 13 — SUBSEQUENT EVENT**

On January 25, 2005, the California State Board of Equalization ruled that the Company is entitled to receive a refund of \$8.7 million for previously paid sales and use tax expended for its manufacturing operations. The Company is currently evaluating the impact of this ruling and the pending refund on its financial statements.

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. Such forward-looking statements include, but are not limited to, statements that relate to our future revenue, product development, demand, acceptance and market share, competitiveness, gross margins, levels of research and development (R&D), outsourcing plans and operating expenses, tax expenses, our management's plans and objectives for our current and future operations, management's plans for repurchasing Company stock pursuant to the authorization of our Board, the effects of our restructurings and consolidation of operations and facilities, our ability to complete contemplated restructurings or consolidations on time or within anticipated costs, the levels of customer spending or R&D activities, general economic conditions and the sufficiency of financial resources to support future operations, and capital expenditures. Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value and effect, including those discussed below under the heading "Risk Factors" within the section of this report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other documents we file from time to time with the Securities and Exchange Commission (SEC), such as our last filed Annual Report on Form 10-K for the fiscal year ended June 27, 2004, our quarterly report on Form 10-Q for the quarter ended September 26, 2004, 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 herein and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known 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, which 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 Analysis Of Financial Condition and Results Of Operations**

This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes presented in this Form 10-Q and the financial statements and notes in our last filed Annual Report on Form 10-K as of June 27, 2004 and Form 10-Q for the three months ended September 26, 2004 for a full understanding of our financial position and results of operations for the three and six months ended December 26, 2004.

**RESULTS OF OPERATIONS**

Lam Research Corporation (Lam or the Company) is a major supplier of wafer fabrication equipment and services to the world's semiconductor industry. We actively market and sell product offerings that include single-wafer plasma etch systems with a wide range of applications, wafer cleaning systems, and an array of services designed to optimize the utilization of these systems by our customers.

The semiconductor industry is cyclical in nature and has historically experienced periodic downturns and upturns. Over the past three business cycles, the severity of these fluctuations has increased, and today's leading indicators of changes in customer investment patterns 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, supply, demand, and prices for semiconductors, customer capacity requirements, and our ability to develop and market competitive products. For these and other reasons, our results of operations for the three and six months ended December 26, 2004 may not necessarily be indicative of future operating results.

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New orders recorded into backlog during the three and six months ended December 26, 2004 were approximately \$387 million and \$816 million, respectively. Regional geographic breakdown of new orders is as follows:

	<b>Three Months Ended December 26, 2004</b>	<b>Six Months Ended December 26, 2004</b>
North America	14%	17%
Europe	9%	14%
Asia Pacific	25%	26%
Korea	40%	27%
Japan	12%	16%

Indicators of customer demand for wafer processing equipment improved in the quarter ended September 28, 2003 and continued through the quarter ended September 26, 2004. New orders for the quarter ended December 26, 2004 decreased by approximately 10% compared to the quarter ended September 26, 2004.

The basis for our new orders is defined by our backlog policy. Our policy is to make adjustments to our backlog to reflect, among other things, customer delivery date changes as well as order cancellations. We schedule production of our systems based upon purchase orders in backlog and our customers' delivery requirements. Included in our systems backlog are orders for which written requests have been accepted, prices have been agreed upon, and shipment of systems is expected within one year. The spares and services backlog includes customer orders for products that have not yet shipped and for services that have not yet been provided. Where specific spare parts and customer service purchase contracts do not contain discrete delivery dates, we use volume estimates at the contract price and over the contract period, not exceeding 12 months, in calculating backlog amounts. Unshipped orders in backlog were approximately \$456 million as of December 26, 2004.

**Revenue**

	<b>Three Months Ended</b>		<b>Percent Change</b>	<b>Six Months Ended</b>		<b>Percent Change</b>
	<b>December 26, 2004</b>	<b>December 28, 2003</b>		<b>December 26, 2004</b>	<b>December 28, 2003</b>	
	<b>(in thousands, except percentages)</b>			<b>(in thousands, except percentages)</b>		
Revenue	\$ 379,800	\$ 191,508	98.3%	\$ 799,349	\$ 375,246	113.0%

Revenue increased significantly in both the three and six months ended December 26, 2004 as compared with the same periods in the prior year. These increases reflected an improved market environment which was evidenced by expanded levels of capital investments by semiconductor manufacturers, changes in customer demand, and customer acceptance cycle times. Our deferred revenue balance was \$123.0 million as of December 26, 2004. The value of orders shipped from backlog to Japanese customers that are not recorded as deferred revenue was approximately \$53 million as of December 26, 2004. These shipments are classified as inventory at cost until title transfer.

Our current estimate for revenues for the March 2005 quarter is approximately \$340 million to \$355 million, reflecting our expectations for customer demand and customer acceptance cycle times.

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Regional geographic breakdown of revenue is as follows:

	Three Months Ended		Six Months Ended	
	December 26, 2004	December 28, 2003	December 26, 2004	December 28, 2003
North America	14%	20%	15%	23%
Europe	12%	17%	10%	21%
Asia Pacific	42%	45%	51%	40%
Korea	15%	6%	10%	7%
Japan	17%	12%	14%	9%

**Gross Margin**

	Three Months Ended		Percent Change	Six Months Ended		Percent Change
	December 26, 2004	December 28, 2003		December 26, 2004	December 28, 2003	
	(in thousands, except percentages)			(in thousands, except percentages)		
Gross Margin	\$ 198,902	\$ 87,215	128.1%	\$ 413,663	\$ 165,733	149.6%
Percent of total revenue	52.4%	45.5%		51.7%	44.2%	

Our gross margin as a percent of total revenue has increased in each of the last eight quarters to reach 52.4% in the quarter ended December 26, 2004. The increase during both the quarter and six months ended December 26, 2004 as compared with the same periods in the prior year is primarily due to sales volume growth and improved utilization of factory and field resources. In addition, continued expense control, asset management, focus on installation and warranty and the mix of our business contributed to the improvement.

During the March 2005 quarter, we expect gross margin as a percent of revenue will be from approximately 48% to 49%.

**Research and Development**

	Three Months Ended		Percent Change	Six Months Ended		Percent Change
	December 26, 2004	December 28, 2003		December 26, 2004	December 28, 2003	
	(in thousands, except percentages)			(in thousands, except percentages)		
Research and Development	\$ 47,057	\$ 39,078	20.4%	\$ 97,415	\$ 77,604	25.5%
Percent of total revenue	12.4%	20.4%		12.2%	20.7%	

We continue to invest significantly in research and development while focusing on opportunities to improve the efficiency and effectiveness of our spending. Our investments have been aimed at strengthening our product and services portfolio via the introduction of next-generation products as well as enhancing our existing offerings. The growth in absolute spending levels during the three and six months ended December 26, 2004 as compared to the same periods in the prior year is primarily due to increases in salary and benefits costs of approximately \$1 million and \$4 million, respectively, due to planned increases of employee base compensation and headcount increases as well as roughly \$4 million and \$8 million, respectively, due to incentive-based benefits triggered by higher profits. R&D supplies expense also increased approximately \$2 million during the quarter ended December 26, 2004 and \$6 million during the six-month period ended December 26, 2004, as compared to the same periods in the prior year, in support of the enhancement of our product offerings and development of next-generation products.

[Table of Contents](#)*Selling, General and Administrative*

	Three Months Ended			Six Months Ended		
	December 26, 2004	December 28, 2003	Percent Change	December 26, 2004	December 28, 2003	Percent Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Selling, General & Administrative (SG&A)	\$ 43,275	\$ 34,141	26.8%	\$ 86,402	\$ 68,134	26.8%
Percent of total revenue	11.4%	17.8%		10.8%	18.2%	

Increases in selling, general and administrative (SG&A) expenses during the quarter ended December 26, 2004 as compared with the quarter ended December 28, 2003 were primarily due to increases in salary and benefits costs of approximately \$1 million due to planned increases of employee base compensation and headcount increases as well as roughly \$6 million due to incentive-based benefits triggered by higher profits.

Increases during the six months ended December 26, 2004 as compared with the same period in the prior year were primarily due to increases in salary and benefits costs of approximately \$2 million due to planned increases of employee base compensation and headcount increases as well as roughly \$11 million due to incentive-based benefits triggered by higher profits, offset by approximately \$3 million in compensation expense recorded in the quarter ended September 28, 2003 in connection with the modification of terms of a fixed stock option award previously issued to our Chairman and Chief Executive Officer. Certain discretionary information technology projects also contributed to the increase.

We expect total operating expenses (R&D and SG&A) to modestly increase during the March 2005 quarter as compared with the quarter ended December 26, 2004.

*Restructuring Activities*

We distinguish regular operating cost management activities from restructuring activities. Accounting for restructuring 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.

We have historically developed plans and incurred restructuring charges to respond to the high level of volatility and, at times, depressed levels of capital investment by the semiconductor industry. The frequency of our restructuring plans has been driven by the unpredictable and substantial changes in the semiconductor industry as a whole and the market for semiconductor processing equipment in particular. These dynamic changes in the semiconductor industry and our business have required multiple integrated responses, including those activities within our restructuring plans, based on the best information and industry-expert forecasts available at that point in time. Although management makes every attempt to consolidate all known restructuring activities into one plan, the extreme nature of our industry's business cycles and the rapidly changing forecasting environment places practical limitations on achieving this objective. The implementation of restructuring activities and recognition of their impact in our financial statements does not preclude similar but unrelated actions from being necessary in future periods.

We systematically review our revenue outlook and forecasts and outsourcing activities and assess their impact on required employment levels, and facilities and infrastructure utilization. Based on these evaluations, our senior management committed to cost reduction and exit activities in the quarters ended March 28, 2004 (the March 2004 Plan), December 28, 2003 (the December 2003 Plan), September 28, 2003 (the September 2003 Plan), June 29, 2003 (the June 2003 Plan), March 30, 2003 (the March 2003 Plan), December 29, 2002 (the December 2002 Plan), December 30, 2001 (the December 2001 Plan), and September 23, 2001 (the September 2001 Plan).

Prior to the end of each quarter noted above, we initiated the announced restructuring activities and management with the proper level of authority approved specific actions under the respective Plan. Severance packages to potentially impacted employees were communicated in enough detail such 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 recorded in the restructuring charges include facilities for which a contract was terminated in accordance with its terms and charges for facilities, or a portion of facilities we ceased to use, were 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, where these items were determined to have no future economic benefit to us and have been abandoned.

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As of December 26, 2004, the overall restructuring reserve balance consisted of the following:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Total</u>
Fiscal 2004 restructurings	\$ —	\$ 1,897	\$ 1,897
Fiscal 2003 restructurings	—	5,754	5,754
Fiscal 2002 restructurings	200	2,764	2,964
Pre-fiscal 2002 restructurings	—	842	842
Balance at December 26, 2004	<u>200</u>	<u>11,257</u>	<u>11,457</u>
Less: portion included in other current liabilities	<u>200</u>	<u>4,685</u>	<u>4,885</u>
Included in long-term liabilities	<u>\$ —</u>	<u>\$ 6,572</u>	<u>\$ 6,572</u>

The severance and benefits-related balance is anticipated to be utilized by the end of calendar year 2005. The facilities balance consists primarily of lease payments on vacated buildings and is expected to be utilized by the end of fiscal year 2010.

### *Fiscal 2004 Restructuring Activities*

Our fiscal 2004 restructuring activities included reducing our workforce by less than 40 employees, primarily in North America and Europe and by vacating selected facilities located in North America and Asia deemed to be no longer necessary to our operations. The employees were from a range of functions and at multiple levels of the organization.

We recorded net restructuring charges during fiscal year 2004 of approximately \$6.7 million, consisting of severance and benefits for involuntarily terminated employees of \$1.2 million, charges for the present value of remaining lease payments on vacated facilities of \$2.8 million, and the write-off of related leasehold improvements of \$1.6 million. We also recorded a charge of approximately \$1.0 million due to the cancellation of a lease agreement related to one of our facilities in Japan and \$2.1 million for the write-off of related leasehold improvements.

We recognized \$1.9 million of additional facilities-related expenses due to changes in estimates of restructuring plans initiated prior to fiscal 2004. Charges during the year were partially offset by the recovery of \$1.5 million of previously accrued expenses related to the remaining lease payments on vacated facilities in Japan. Additional offsetting items include recovery of \$0.7 million due to lower than previously estimated employee severance and benefits costs and \$1.7 million of recovered inventory from unanticipated sales to our installed base of certain portions of inventory previously written off as part of our September 2001 restructuring. The inventory recovery was recorded as a credit in cost of goods sold.

As a result of the fiscal 2004 restructuring activities, we expect quarterly savings, relative to the cost structure immediately preceding the activities, in total expenses of approximately \$0.3 million from the March 2004 Plan, \$0.7 million from the December 2003 Plan and \$0.5 million from the September 2003 Plan. The majority of the savings are expected to be realized within Operating Expenses, mainly Selling, General and Administrative expenses. These estimated savings from the Plans' discrete actions are primarily related to lower employee payroll, facilities, and depreciation expenses. Actual savings may vary from these forecasts, depending upon future events and circumstances, such as differences in actual sublease income versus estimated amounts. Through December 26, 2004, we believe actual savings from these Plans are largely consistent with original estimated quarterly savings.

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The following is a table summarizing restructuring activities relating to our fiscal year 2004 restructuring plans:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Total</u>
Balance at June 27, 2004	\$ 30	\$ 2,077	\$ 2,107
Cash payments	(30)	(180)	(210)
Balance at December 26, 2004	<u>\$ —</u>	<u>\$ 1,897</u>	<u>\$ 1,897</u>

### *Fiscal 2003 Restructuring Activities*

Our senior management committed to cost reduction and exit activities during fiscal 2003 through our June 2003, March 2003 and December 2002 Plans and recorded restructuring charges of approximately \$18.1 million. Our fiscal 2003 restructuring activities included reducing our workforce in North America, Europe, and Asia by approximately 200 people and vacating selected sales and administrative facilities located in North America, Europe, and Asia deemed to be no longer required for our operations. The employees included in the Plans were from a broad range of functions and at multiple levels of the organization, with the majority of the reductions in North America.

The \$18.1 million restructuring charges consisted of \$5.7 million of severance and benefits for involuntarily terminated employees and \$12.4 million of facilities-related charges. The facilities-related charges consisted of the present value of remaining lease payments on vacated facilities, a loss on the fair value of a vacated facility and the write-off of related leasehold improvements. In June 2003, a lease covering one of our vacated facilities at our Fremont, California campus was amended, combined, restated, and transferred to a new lessor under a single lease structure. At the time of the amendment, the leased facility's fair value was less than its original cost by approximately \$1 million. Accordingly, this amount was recorded as a loss on the fair value of the vacated facility and included in the \$18.1 million of restructuring charges.

As a result of the fiscal 2003 restructuring activities, we expect quarterly savings, relative to the cost structure immediately preceding the activities, of approximately \$1.0 million from the June 2003 Plan, \$1.0 million from the March 2003 Plan, and \$3.0 million from the December 2002 Plan. The majority of the savings were expected to be realized within Operating Expenses, mainly Selling, General and Administrative expenses. These estimated savings were primarily from lower payroll, facilities, and depreciation expenses. Through December 26, 2004, we believe realized savings are consistent with original forecasts. However, other factors may significantly influence our future cost structure and, consequently, partially or totally offset savings from these Plans.

The following is a table summarizing restructuring activities relating to our fiscal year 2003 restructuring plans:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Total</u>
Balance at June 27, 2004	\$ 183	\$ 6,451	\$ 6,634
Cash payments	(183)	(697)	(880)
Balance at December 26, 2004	<u>\$ —</u>	<u>\$ 5,754</u>	<u>\$ 5,754</u>

### *Fiscal 2002 Restructuring Activities*

Our senior management committed to cost reduction and exit activities during fiscal 2002 through our December 2001 and September 2001 Plans and recorded restructuring charges during fiscal 2002 of approximately \$54.8 million. Our fiscal 2002 restructuring activities included reducing our workforce in North America, Europe, and Asia by approximately 1,020 people and by vacating selected facilities at its Fremont, California campus deemed to be no longer required for our operations, the closure of certain offices in Asia, and discontinuance of the manufacture of specific products within our etch product lines. The employees were from a broad range of functions and at multiple levels of the organization, with approximately 83% from North America and approximately 17% from Europe and Asia Pacific locations.

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The restructuring charges included severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, write-off of related leasehold improvements and fixed assets, and inventory write-downs. The inventory charge of approximately \$7.6 million related to our decision to discontinue manufacture of specific systems within our etch product lines. We recovered approximately \$1.7 million during fiscal year 2004, \$1.0 million during fiscal year 2003, and \$0.7 million during fiscal year 2002, from unanticipated subsequent sales of these inventories to our installed base. We physically disposed of approximately \$1.0 million of this inventory during fiscal 2004 and \$2.7 million during fiscal 2003 and 2002. During fiscal 2002, we also recovered approximately \$1.0 million of the \$54.8 million due to lower than estimated employee termination costs of \$0.7 million and lower than planned expenses related to a vacated facility of \$0.3 million. During fiscal 2004, we recorded approximately \$0.4 million of additional restructuring charges due to a revision in estimates for one of our vacated facilities and we recovered approximately \$1.4 million, net, due to the difference between costs previously accrued and actual costs to terminate a lease agreement for a facility for which we entered into a lease cancellation agreement during fiscal 2004.

During fiscal 2003, we recovered approximately \$2.7 million for benefits offered that were not utilized by terminated employees and \$2.0 million was recovered due to revisions to the net amount of lease payments remaining on vacated facilities. We also recorded restructuring charges during fiscal 2003 of \$3.1 million due to revisions we made in sublease assumptions for two of our vacated buildings in Fremont, California, \$0.1 million due to additional facility restoration costs, and \$0.4 million for revisions that we made in our estimates for employee termination costs.

The following is a table summarizing restructuring activities relating to our fiscal year 2002 restructuring plans:

	<b>Severance and Benefits</b>	<b>Facilities</b>	<b>Total</b>
Balance at June 27, 2004	\$ 389	\$ 3,496	\$ 3,885
Cash payments	(189)	(732)	(921)
Balance at December 26, 2004	<u>\$ 200</u>	<u>\$ 2,764</u>	<u>\$ 2,964</u>

*Fiscal 2001 Restructuring Activities*

During the second quarter of fiscal 2003, we completed the remaining elements of our restructuring activities under the June 2001 Plan. A final \$1.1 million of restructuring charges was recovered due to lower than estimated employee termination costs. The remaining \$0.8 million facilities balance as of December 26, 2004 is expected to be paid by January, 2006.

**Other Income, net**

Other income, net consisted of the following:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 26, 2004</b>	<b>December 28, 2003</b>	<b>December 26, 2004</b>	<b>December 28, 2003</b>
	(in thousands)			
Interest income	\$ 3,189	\$ 2,238	\$ 5,582	\$ 4,950
Interest expense	(444)	(783)	(987)	(1,369)
Foreign exchange gain (loss)	(117)	(185)	306	(307)
Debt issue cost amortization	—	(425)	—	(850)
Charitable contributions	(1,250)	—	(3,250)	—
Other, net	(80)	(372)	(345)	(507)
	<u>\$ 1,298</u>	<u>\$ 473</u>	<u>\$ 1,306</u>	<u>\$ 1,917</u>

Interest income increased during both the three and six months ended December 26, 2004 primarily due to an increase in interest rate yields as compared to the same periods in the prior year. Interest expense and debt issue cost amortization decreased as a result of the early retirement of our convertible subordinated 4% notes in June 2004. We elected to make charitable contributions of \$1.3 million and \$3.3 million during the three and six months ended December 26, 2004, respectively and announced in January 2005 a

matching gift program for employees who wish to support the global relief efforts to assist tsunami victims.

### ***Income Tax Expense***

Our effective tax rate was 25% for the six months ended December 26, 2004 and December 28, 2003. The effective tax rate for the quarter ended December 26, 2004 of 24% reflects the impact of a reduction in the estimated effective tax rate for the year from 26% to 25%. The decrease in the effective tax rate primarily resulted from the research and development tax credit extension signed into law on October 4, 2004. Our effective tax rate reflects the underlying profitability of the Company, the source of profits and the respective U.S. and non-U.S. tax rates imposed. Our fiscal 2005 tax rate estimate is based on our current profitability outlook, including our continued and substantial investments in research and development programs qualifying for R&D tax benefits. We have implemented strategies to, in the longer-term, limit our tax liability on the sale of our products worldwide. These tax strategies are structured to align the asset ownership and functions of our various legal entities around the world, with our expectations of the level, timing, and sources of future revenues and profits.

On October 22, 2004 the American Jobs Creation Act (AJCA) was signed into law. The AJCA provides for a deduction of 85% of certain non-U.S. earnings that are repatriated, as defined in the AJCA. We may elect to apply this provision to qualifying earnings repatriations in either fiscal 2005 or 2006. On January 13, 2005 the U.S. Treasury published Notice 2005-10 providing guidance on the implementation of the repatriation deduction. Based on our current understanding of the AJCA, we believe the range of possible amounts that we may consider for repatriation under this provision is between zero and \$500 million. The potential range of related income tax that may be incurred as a result of the repatriation is between zero and \$51.25 million.

### ***Deferred Income Taxes***

We had gross deferred tax assets arising from temporary differences, net operating losses, and tax credit carryforwards of \$251.7 million and \$303.3 million as of December 26, 2004 and June 27, 2004, respectively. The gross deferred tax assets were offset by deferred tax liabilities of \$26.3 million and a valuation allowance of \$67.8 million as of December 26, 2004 and June 27, 2004. Total deferred tax assets net of valuation allowance decreased by \$51.6 million from June 27, 2004 to December 26, 2004 due to the utilization of net operating loss tax assets against our tax profits. 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. We evaluate the realizability of the deferred tax assets quarterly and will continue to assess the need for additional or less valuation allowances, if any, in subsequent quarters.

### ***Critical Accounting Policies and Estimates***

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 based our estimates and assumptions on historical experience and on various other assumptions believed to be applicable, and evaluated them on an on-going basis to ensure they remained reasonable under current conditions. Actual results could differ significantly from those 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. We believe that the following critical accounting policies reflect the more significant judgments and estimates used in the preparation of our condensed 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 completed our system installation obligations, received customer acceptance or are otherwise released from our installation or customer acceptance obligations. In the event that terms of the sale provide for a lapsing customer acceptance period, we recognize revenue upon the expiration of the lapsing acceptance period or customer acceptance, whichever occurs first. In circumstances where the practices of a customer do not provide for a written acceptance or the terms of sale do not include a lapsing acceptance provision, we recognize revenue where it can be reliably demonstrated that the delivered system meets all of the agreed to customer specifications. In situations with multiple deliverables, revenue is recognized 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. Consideration from multiple element arrangements is allocated among the separate elements based on their relative fair values,

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provided the elements have value on a stand alone basis, there is objective and reliable evidence of fair value, the arrangement does not include a general right of return relative to the delivered item and delivery or performance of the undelivered item(s) is considered probable and substantially in our control. The maximum revenue recognized on a delivered element is limited to the amount that is not contingent upon the delivery of additional items. Revenue related to sales of spare parts and system upgrade kits is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services requested by a customer order. Revenue for extended maintenance service contracts with a fixed payment amount is recognized on a straight-line basis over the term of the contract.

*Inventory Valuation* : Inventories are stated at the lower of cost or market using standard costs, which 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. When the terms of sale do not specify, we assume title transfers when we complete physical transfer of the products to the freight carrier unless other customer practices prevail.

Standard costs are re-assessed at least annually and reflect achievable acquisition costs, generally the most recent vendor contract prices for purchased parts, currently obtainable assembly and test labor performance levels, and overhead for internally manufactured products. Manufacturing labor and overhead costs are attributed to individual product standard costs at a level planned to absorb spending at average utilization volumes. All intercompany profits related to the sales and purchases of inventory between our legal entities are eliminated from our condensed 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. Inherent in the estimates of market value are management's forecasts related to our future manufacturing schedules, customer demand, technological and/or market obsolescence, general semiconductor market conditions, possible alternative uses and ultimate realization of excess inventory. If future customer demand or market conditions are less favorable than our projections, additional inventory write-downs may be required, and would be reflected in cost of sales in the period the revision is made.

*Warranty*: Typically, marketing and selling semiconductor capital equipment includes providing parts and service warranty to customers as part of the overall price of the system. We offer standard warranties for our systems that run generally for a period of 12 months from system acceptance, not to exceed 14 months from shipment of the system to the customer. When appropriate, we record a provision for estimated warranty expenses to cost of sales for each system upon revenue recognition. The amount recorded is based on an analysis of historical activity, which uses factors such as type of system, customer, geographic region, and any known factors such as tool reliability trends. All actual parts and labor costs incurred in subsequent periods are charged to those established reserves through the application of detailed project record keeping.

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

We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. Historically, including the three and six months ended December 26, 2004, all warranty obligations have been determined with reasonable estimates.

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 either as incurred or when related liabilities are determined to be probable and estimable.

*Employee Stock Purchase Plan and Employee Stock Option Plans*: We account for our employee stock purchase plan (ESPP) and stock option plans under the provisions of Accounting Principles Board (APB) Opinion No. 25 "Accounting For Stock Issued to Employees" (APB 25) and Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB Opinion No. 25" and make pro forma footnote disclosures as required by Statement of Financial Accounting Standards (SFAS) No. 148, "Accounting For Stock-Based Compensation — Transition and Disclosure", which amends SFAS No. 123, "Accounting For Stock-Based Compensation". Our ESPP is a non-compensatory plan, and our stock option plans are

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accounted for using the intrinsic value method under the provisions of APB 25. Please see Recent Accounting Pronouncements below regarding the provisions of Statement of Financial Accounting Standards No. 123(R) which will become effective during our quarter ending September 25, 2005.

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

*Deferred Income Taxes:* Deferred income taxes reflect the net effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. 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. Our current valuation allowance of \$67.8 million relates to the tax benefit from the exercise of employee stock options and foreign tax credits. When stock option tax benefits are realized, the related deferred tax asset will reverse and a portion of the valuation allowance will also be reversed and credited to capital in excess of par value.

### *Recent Accounting Pronouncements*

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and investments accounted for under the cost method or the equity method. In September 2004, the Financial Accounting Standards Board (FASB) issued a final FASB Staff Position, (FSP) EITF Issue 03-01-1, which indefinitely delays the effective date for the measurement and recognition guidance of EITF 03-01. We are currently evaluating the impact, if any, of adopting EITF 03-01.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs — An Amendment of ARB No. 43, Chapter 4," which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). We are required to adopt SFAS No. 151 in fiscal year 2006 and its adoption is not expected to have a significant impact on our results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment." This Statement is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation", and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees", and its related implementation guidance. SFAS No. 123(R) requires that compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. This statement is effective beginning with the first interim or annual period after June 15, 2005, with early adoption permitted. We have no plans for early adoption.

The effects of the adoption of SFAS No. 123(R) on our results of operations and financial position are dependent upon a number of factors, including the number of employee stock options outstanding and unvested, the number of employee stock options which may be granted in the future, the future market value and volatility of our stock price, movements in the risk free rate of interest, stock option exercise and forfeiture patterns, and the stock option valuation model used to estimate the fair value of each option. As a result of these variables it is not yet possible to reliably estimate the effect of the adoption of SFAS No. 123(R) on our results of operations and financial position. Note 3 herein provides an indication of the effects of adoption assuming the use of the Black Scholes option pricing model and the assumptions detailed therein to estimate the fair value of employee stock options and employee stock purchase plan awards upon the results of operations for the three and six months ended December 26, 2004 and December 28, 2003.

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In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." The amendments made by SFAS No. 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. SFAS No. 153 also eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. We will apply its provisions prospectively upon adoption and its adoption is not expected to have a significant impact on our results of operations or financial position.

## **LIQUIDITY AND CAPITAL RESOURCES**

As of December 26, 2004, we had \$761.9 million in cash, cash equivalents, short-term investments, and restricted cash compared with \$541.9 million at June 27, 2004 as a result of our profitability and continued focus on working capital management. During the six months ended December 26, 2004, cash and cash equivalents increased by \$162.8 million as a result of cash provided by operating activities of \$190.7 million and cash provided by financing activities of \$41.9 million, partially offset by cash used for investing activities of \$72.7 million.

### *Cash Flows From Operating Activities*

Net cash provided by operating activities was \$190.7 million during the six months ended December 26, 2004, which consisted of net income for the period of \$173.4 million, adjusted for non-cash charges of \$66.1 million and uses of working capital of \$48.7 million. Non-cash charges include items such as the decrease in deferred income taxes of \$51.6 million and \$12.9 million of depreciation and amortization.

Significant changes in assets and liabilities during the six months ended December 26, 2004 include an increase of \$99.9 million in accounts receivable due to increased sales volumes. We have an agreement with a financial institution that enables us to sell certain U.S. dollar-denominated accounts receivable. These sales of accounts receivable are intended to accelerate the collection of cash. The amount of these accounts receivable that were sold and remained uncollected as of December 26, 2004 was \$45.8 million. Trade payables decreased by \$29.3 million due to a decline in purchasing activity during the period as well as the timing of payments. Accrued liabilities increased by \$40.7 million primarily due to increased warranty reserves on higher sales volumes, increased variable-based compensation accruals, and an increase in charitable contributions.

### *Cash Flows from Investing Activities*

Net cash used for investing activities during the six months ended December 26, 2004 was \$72.7 million and consisted of net purchases of \$58.7 million of short-term investments in addition to net capital expenditures of \$14.0 million which consisted primarily of engineering and manufacturing equipment.

### *Cash Flows from Financing Activities*

Net cash provided by financing activities during the six months ended December 26, 2004 was \$41.9 million due to net proceeds from the issuance of our common stock from stock option exercises and employee stock purchase plan (ESPP) purchases.

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, our levels of cash, cash equivalents, and short-term investments at December 26, 2004 are expected to be sufficient to support our presently anticipated levels of operations, investments, 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. Should additional funding be required, we may need to raise the required funds through borrowings or public or private sales of debt or equity securities. We believe that, in the event of such requirements, 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.

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### *Commitments*

We have certain obligations, some of which are recorded on our balance sheet and some which are not, to make future payments under various contracts. Obligations are recorded on our balance sheet in accordance with U.S. generally accepted accounting principles. The obligations recorded on our consolidated balance sheet include restructuring liabilities which are outlined in the following table and are discussed 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 relating to these agreements, and our guarantees are included in the following table:

	<u>Restructuring Liabilities</u>	<u>Operating Leases</u>	<u>Purchase Obligations</u>	<u>Total</u>
	(in thousands)			
Payments due by period:				
Less than 1 year	\$ 4,885	\$ 13,697	\$ 122,355	\$ 140,937
1-3 years	5,104	17,247	58,938	\$ 81,289
4-5 years	1,439	102,746	34,348	\$ 138,533
Over 5 years	29	855	1,098	\$ 1,982
Total	<u>\$ 11,457</u>	<u>\$ 134,545</u>	<u>\$ 216,739</u>	<u>\$ 362,741</u>

### *Restructuring Liabilities*

Our total restructuring reserves as of December 26, 2004 were \$11.5 million, including \$0.2 million of severance and benefits-related costs and \$11.3 million related to lease payments on vacated buildings. Through cash generated from operations, we expect \$4.9 million to be paid over the next twelve months and \$6.6 million to be paid between fiscal 2006 and fiscal 2010. Please see the related discussion in "Restructuring Activities" within "Management's Discussion and Analysis of Financial Condition and Results of Operations."

### *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, which expire at various dates through 2021. Certain of our facility leases for buildings located at our Fremont, California headquarters and certain other facility leases provide us with an option to extend the leases for additional periods. Certain of our facility leases provide for periodic rent increases based on the general rate of inflation.

In March and June of 2003, lease agreements relating to certain properties at our Fremont, California campus were transferred to a new lessor, amended, combined and restated. As part of the lease agreements, we have the option to purchase the buildings at any time for a total purchase price for all properties related to these leases of approximately \$112.5 million. In addition, we are required to guarantee the lessors a residual value on the properties of up to \$98.7 million at the end of the lease terms in fiscal 2008 (in the case that the leases are not renewed, we do not exercise the purchase options, the lessor sells the properties and the sale price is less than the lessor's costs). At the time of the June amendment, one of the leased property's current fair value was less than its original cost by approximately \$1.0 million. The leased property was a building that had been part of our past restructuring activities, and the non-cash loss was recorded as a restructuring charge during fiscal 2003. As a result, we recorded a \$1.0 million liability for the loss on the leased property. We maintain cash collateral of \$112.5 million as part of the lease agreements as of December 26, 2004 in separate, specified interest-bearing accounts which is recorded as restricted cash in our consolidated balance sheet. The lessor under the lease agreements is a substantive independent leasing company that does not have the characteristics of a variable interest entity (VIE) as defined by FASB Interpretation 46, "Consolidation of Variable Interest Entities", and is therefore not consolidated by us. The \$98.7 million residual value guarantee is included in the table above.

The remaining \$35.8 million primarily relates to non-cancelable facility-related operating leases expiring at various dates through 2021.

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*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 minimum obligations at December 26, 2004 under these arrangements and others. Actual expenditures will vary based on the volume of transactions and length of contractual service provided. In addition to minimum spending commitments, certain of these agreements provide for potential cancellation charges.

Consignment inventories, which are owned by vendors but located in our discrete storage locations and warehouses, are not reported as Lam inventory until title is transferred to us or our purchase obligation is determined. At December 26, 2004, vendor owned inventories held at our locations and not reported as Lam inventory were approximately \$16.1 million.

## **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, or should be attached, to the order in which the risk factors appear.

### ***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. If revenue levels in a particular quarter do not meet our expectations, our operating results may be adversely affected. 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 single transaction 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 industry generally and the equipment industry specifically;
- the extent that customers use our products and services in their business;
- timing of customer acceptances of equipment;
- the size and timing of orders from customers;
- customer cancellations or delays in our shipments, installations, and/or acceptances;
- changes in average selling prices 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;
- changes in import/export regulations;
- transportation, communication, demand, information technology or supply disruptions based on factors outside our control such as acts of God, wars, terrorist activities and natural disasters;
- legislative, tax, accounting, or regulatory changes or changes in their interpretation;
- procurement shortages;
- manufacturing difficulties;
- the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;
- new or modified accounting regulations; and
- exchange rate fluctuations.

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

### ***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 can typically range in price from approximately \$0.4 million to \$5.0 million per unit, and our revenues in any given quarter are dependent upon the acceptance of a rather limited number of such systems. As a result, the inability to declare revenue on even a few systems can cause a significant adverse impact on our revenues for that quarter.

### ***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 may be subject to the length of time that our customers require to evaluate the performance of our equipment after shipment and installation, which could cause our quarterly operating results to fluctuate.

### ***The Semiconductor Equipment Industry Is Volatile and Reduced Product Demand Has a Negative Impact on Shipments***

Our business depends on the capital equipment expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits and products using integrated circuits. The semiconductor industry is cyclical in nature and historically experiences periodic downturns. Business conditions historically have changed rapidly and unpredictably.



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Fluctuating levels of investment by semiconductor manufacturers could continue to materially affect our aggregate shipments, revenues and operating results. We will attempt to respond to these fluctuations with cost management programs aimed at 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 and maintain extensive ongoing worldwide customer service and support capabilities to remain competitive, which may temporarily harm our financial results.

### ***We Depend on New Products and Processes for Our Success. 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 enabling such 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 or quality problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may be unable to develop and manufacture new products successfully, or new products that we introduce may fail in the marketplace. Our failure to complete commercialization of 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 introduction of new products could adversely affect our sales of existing products. Future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both.

### ***We Are Subject to Risks Relating to Product Concentration and Lack of Product Revenue Diversification***

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

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

### ***We Have a Limited Number of Key Customers***

Sales to a limited number of large customers constitute a significant portion of our overall revenue. As a result, the actions of even one customer may subject us to revenue swings that are difficult to predict. 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.

### ***We Are Dependent Upon a Limited Number of Key Suppliers***

We obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. 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 sold us products during at least the last four years, and we expect that we will continue to renew these contracts in the future or that we will otherwise replace them with competent alternative suppliers. However, several of our outsourced assembly suppliers are new providers to us so that our experience with them and their performance is limited. Where practical, our intent is 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, lower our revenues and thus adversely affect our operating results and result in damage to our customer relationships.

***Our Outsource Providers May Fail to Perform as We Expect***

Outsource providers have played and will play key roles in our manufacturing operations and in many of our transactional and administrative functions. Although we aim at selecting reputable providers and secure their performance on terms documented in written contracts, it is possible that one or more of these providers could fail to perform as we expect and such failure could have an adverse impact on our business. In addition, the expansive role of outsource providers has required and will 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 relationships and/or have a negative effect on our operating results.

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

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

***We Are Subject to Risks Associated with Our Competitors' Strategic Relationships and Their Introduction of New Products and We May Lack the Financial Resources or Technological Capabilities of Certain of Our Competitors Needed to Capture Increased Market Share***

We expect to face significant competition from multiple current and future competitors. We believe that other companies are developing systems and products that are competitive to ours and are planning to introduce new products, which may affect our ability to sell our 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 will require significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide, and to invest in product and process R&D. Certain of our competitors have substantially greater financial resources and more extensive engineering, manufacturing, marketing, and customer service and support resources than we do and therefore have the potential to increasingly dominate the semiconductor equipment industry. 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. For these reasons, we may fail to continue to compete successfully worldwide.

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

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

Non-U.S. sales, as a percentage of total revenue, accounted for approximately 82% in fiscal 2004, 72% in fiscal 2003 and 71% in fiscal 2002. We expect that international sales will continue to account for a significant portion of our total revenue in future years. We are subject to various challenges related to the management of global operations, and international sales are subject to risks including, but not limited to:

- trade balance issues;
- regional economic and political conditions;
- changes in currency controls;
- differences in the enforcement of intellectual property and contract rights in varying jurisdictions;

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- ability to develop relationships with local suppliers;
- compliance with U.S. and international laws and regulations, including U.S. export restrictions;
- fluctuations in interest and currency exchange rates; and
- the need for technical support resources in different locations.

Our international sales depend, in large part, 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 between China, Taiwan and the United States, that political and diplomatic influences might lead to trade disruptions which would adversely affect our business with China and/or Taiwan and perhaps the entire Asia-Pacific region. A significant trade disruption in these areas could have a material, adverse impact on our future revenue and profits.

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

### ***Our financial results may be adversely impacted by higher than expected tax rates or exposure to additional income 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 both 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 or by material audit assessments, which could affect our profitability. In particular, the carrying value of deferred tax assets, which are predominately 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. Further, if we elect to repatriate cash held outside the United States pursuant to the American Jobs Creation Act of 2004, our tax rate may increase even if by a lesser amount than without such legislation.

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

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

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

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

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

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

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

### ***The Market for Our Common Stock is Extremely Volatile, Which May Affect Our Ability to Raise Capital or Make Acquisitions***

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

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

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

### ***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 by us or by our outsource providers or even third parties such as vendors and contractors and may be maintained by us or by such providers and third parties. 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. 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 address 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 could unfavorably impact the timely and efficient operation of our business.

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

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

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

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

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

Third parties may assert infringement, unfair competition or other claims against us. From time to time, other parties send us notices alleging that our products infringe their patent or other intellectual property rights. In addition, our Bylaws and indemnity obligations provide that we will indemnify officers and directors against losses that they may incur in legal proceedings resulting from their service to Lam. In such cases, it is our policy either to defend the claims or to negotiate licenses 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.

### ***We May Fail to Protect Our Proprietary Technology Rights, Which Would Affect Our Business***

Our success depends in part on our proprietary technology. While we attempt to protect our proprietary technology through patents, copyrights and trade secret protection, we believe that our success also depends on increasing our technological expertise, continuing our development of new systems, increasing market penetration and growth of our installed base, and providing comprehensive support and service to our customers. However, we may be unable to protect our technology in all instances, or our competitors may develop similar or more competitive technology independently. We currently hold a number of United States and foreign patents and pending patent applications. However, other parties may challenge or attempt to invalidate or circumvent any patents the United States or foreign governments issue to us or these governments may fail to issue patents for pending applications. In addition, the rights granted or anticipated under any of these patents or pending patent applications may be narrower than we expect or, in fact provide no competitive advantages.

### ***Compliance with Internal Control Attestation and Independent Registered Public Accounting Firm Independence***

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we will be required, beginning with our fiscal year ending June 26, 2005, to include in our annual report our assessment of the effectiveness of our internal control over financial reporting and our audited financial statements as of the end of fiscal 2005. Furthermore, our independent registered public accounting firm (Firm) will be required to attest to whether our assessment of the effectiveness of our internal control over financial reporting is fairly stated in all material respects and separately report on whether it believes we maintained, in all material respects, effective internal control over financial reporting as of June 26, 2005. We have not yet completed our assessment of the effectiveness of our internal control. If we fail to timely complete this assessment, or if our independent registered public accounting firm cannot timely attest to our assessment, we could be subject to regulatory sanctions and a loss of public confidence in our internal control. In addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to timely meet our regulatory reporting obligations.

Our independent registered public accounting firm communicates with us at least annually regarding any relationships between the Firm and the Company that, in the Firm’s professional judgment, might have a bearing on the Firm’s independence with respect to the Company. If, for whatever reason, our independent registered public accounting firm finds that it cannot confirm that it is independent of the Company based on existing securities laws and registered public accounting firm independence standards, we could experience delays or other failures to meet our regulatory reporting obligations.

### **ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

For financial market risks related to changes in interest rates and foreign currency exchange rates, refer to Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk", in our Annual Report on Form 10-K for the year ended June 27, 2004.

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and synthetic 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 constantly 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.

### **ITEM 4. Controls and Procedures**

As of the close of our quarter ended December 26, 2004, we carried out an evaluation, under the supervision and with the participation of our management, including our Chairman and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-14 and 13a-15. Based upon that evaluation, our Chairman and Chief Executive Officer along with our Chief Financial Officer concluded that our disclosure controls and procedures are effective in providing reasonable assurance in timely alerting them to material information relating to the Company (including its consolidated subsidiaries) required to be included in its periodic SEC filings.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to correct any material deficiencies that we may discover. Our goal is to ensure that our senior management has timely access to material information that could affect our business. While we believe the present design of our disclosure controls and procedures is effective to achieve our goal, future events affecting our business may cause us to modify our disclosure controls and procedures. 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 disclosure controls and procedures 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. 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 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The Company made no share repurchases during the quarter ended December 26, 2004. The dollar value of shares that may yet be purchased under our currently authorized share repurchase program is \$250 million.

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

The Annual Meeting of Stockholders of Lam Research Corporation was held at the principal office of the Company at 4650 Cushing Parkway, Fremont, California 94538 on November 4, 2004.

Out of 135,779,483 shares of Common Stock (as of the record date of September 10, 2004) entitled to vote at the meeting, 125,246,423 shares were present in person or by proxy.

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

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

<u>NOMINEE</u>	<u>IN FAVOR</u>	<u>WITHHELD</u>
James W. Bagley	107,040,738	18,205,685
David G. Arscott	102,764,910	22,481,513
Robert M. Berdahl	107,040,972	18,205,451
Richard J. Elkus, Jr.	107,048,279	18,198,144
Jack R. Harris	102,777,770	22,468,653
Grant M. Inman	102,769,181	22,477,242

Ratification of appointment of Ernst & Young LLP as independent registered public accounting firm for the Company for the fiscal year ending June 26, 2005:

	<u>IN FAVOR</u>	<u>AGAINST</u>	<u>ABSTAIN</u>
Beneficial Vote:	124,884,940	202,472	33,468
Registered Vote:	115,190	10,353	0
Total Shares Voted:	125,000,130	212,825	33,468
% of Voted Shares:	99.89%	0.16%	0.02%
% of Outstanding Shares:	92.06%	0.15%	0.02%

**ITEM 5. Other Information**

a) The following disclosure would otherwise have been filed on Form 8-K under the heading "Item 1.01. Entry into a Material Definitive Agreement."

**Adoption of Executive Incentive Plan Performance Goals for the first Half of Calendar Year 2005**

Pursuant to the Company's 2004 Executive Incentive Plan (the "Incentive Plan"), the independent members of Lam's Board of Directors met on January 31, 2005 and established target incentive amounts and a scale of performance goals for the first half of calendar year 2005 for James W. Bagley, and the Compensation Committee met on the same day and established target incentive amounts and a scale of performance goals for the first half of calendar year 2005 for Stephen G. Newberry. Each was assigned a target incentive amount of 100% of his salary for the period. Actual incentive awards may range from zero to 2.25 times the target amounts based on both corporate and individual performance. To the extent that the actual performance (whether corporate or individual) falls below median performance targets, incentive awards are determined as a declining percentage of the target incentive amounts. No incentive awards are paid under the Incentive Plan if predetermined minimum financial performance targets are not met. The performance goals included financial, operating and marketing objectives. Financial goals included revenue, gross margin, operating profit, and cash generation targets. Non-financial targets included certain market position objectives and Sarbanes-Oxley Section 404 certification.

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**ITEM 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

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)

(b) Reports on Form 8-K

On November 9, 2004, Lam Research Corporation (the Company) filed a current report on Form 8-K announcing that, effective June 27, 2005, the Company's current chairman and chief executive officer, James W. Bagley, will transition from the role of chief executive officer. Mr. Bagley will continue his duties as chairman of the Board of Directors and remain an executive officer of the Company. Effective June 27, 2005, the Company's current president and chief operating officer, Stephen G. Newberry, will become chief executive officer and president of the Company. The position of chief operating officer will not be filled.

**LAM RESEARCH CORPORATION**

**SIGNATURES**

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

Date: February 3, 2005

LAM RESEARCH CORPORATION

*(Registrant)*

*/s/ Martin B. Anstice*

*Martin B. Anstice*

*Vice President, Finance,*

*Chief Financial Officer and Chief Accounting Officer*

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
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)

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

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

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we 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 quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - c) disclosed in this quarterly 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.
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, 2005

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

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

I, Martin B. Anstice, Vice President, Finance, Chief Financial Officer and Chief Accounting Officer of Lam Research Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we 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 quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - c) disclosed in this quarterly 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.
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, 2005

/s/ Martin B. Anstice

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Martin B. Anstice  
Vice President, Finance,  
Chief Financial Officer and  
Chief 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 26, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James W. Bagley, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. 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, 2005

/s/ James W. Bagley

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James W. Bagley  
Chairman and Chief Executive Officer

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 26, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Martin B. Anstice, Vice President, Finance, Chief Financial Officer and Chief Accounting Officer of the Company, 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, 2005

/s/ Martin B. Anstice

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Martin B. Anstice  
Vice President, Finance,  
Chief Financial Officer and  
Chief Accounting Officer