



---

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

---

**FORM 10-Q**

---

(Mark One)

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

For the quarterly period ended December 25, 2005 or

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

For the transition period from \_\_\_ to \_\_\_

Commission file number 0-12933

**LAM RESEARCH CORPORATION**

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

**Delaware**

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

**94-2634797**

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

**4650 Cushing Parkway  
Fremont, California 94538**

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

**(510) 572-0200**

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

---

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file 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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of January 23, 2006, there were 139,869,936 shares of Registrant's Common Stock outstanding.

---

---

**LAM RESEARCH CORPORATION**  
**TABLE OF CONTENTS**

	<u>Page No.</u>
<b><u>PART I. Financial Information</u></b>	
<u>Item 1. Financial Statements (unaudited):</u>	
<u>Condensed Consolidated Balance Sheets as of December 25, 2005 and June 26, 2005</u>	3
<u>Condensed Consolidated Statements of Operations for the three and six months ended December 25, 2005 and December 26, 2004</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the six months ended December 25, 2005 and December 26, 2004</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	32
<u>Item 4. Controls and Procedures</u>	32
<b><u>PART II. Other Information</u></b>	
<u>Item 1. Legal Proceedings</u>	33
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	33
<u>Item 4. Submission of Matters to a Vote of Security Holders</u>	33
<u>Item 5. Other Information</u>	34
<u>Item 6. Exhibits and Reports on Form 8-K</u>	34
<u>Signatures</u>	35
<u>Exhibit Index</u>	36
<u>EXHIBIT 31.1</u>	
<u>EXHIBIT 31.2</u>	
<u>EXHIBIT 32.1</u>	
<u>EXHIBIT 32.2</u>	

**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(in thousands, except per share data)**

	<u>December 25, 2005</u>	<u>June 26, 2005</u>
	<u>(unaudited)</u>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 633,782	\$ 482,250
Short-term investments	258,463	327,003
Accounts receivable, less allowance for doubtful accounts of \$3,867 as of December 25, 2005 and \$3,865 as of June 26, 2005	279,185	232,005
Inventories	114,051	110,051
Deferred income taxes	64,724	76,660
Prepaid expenses and other current assets	30,288	16,867
Total current assets	<u>1,380,493</u>	<u>1,244,836</u>
Property and equipment, net	41,652	41,082
Restricted cash	85,038	85,038
Deferred income taxes	40,433	43,224
Other assets	34,655	34,635
Total assets	<u>\$ 1,582,271</u>	<u>\$ 1,448,815</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Trade accounts payable	\$ 73,363	\$ 60,218
Accrued expenses and other current liabilities	267,869	229,207
Deferred profit	97,959	89,708
Total current liabilities	<u>439,191</u>	<u>379,133</u>
Long-term liabilities less current portion	1,279	2,786
Total liabilities	<u>440,470</u>	<u>381,919</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, at par value of \$0.001 per share; authorized - 5,000 shares, none outstanding	—	—
Common stock, at par value of \$0.001 per share; authorized - 400,000 shares; issued and outstanding - 138,231 shares at December 25, 2005 and 137,313 shares at June 26, 2005	138	137
Additional paid-in capital	828,836	744,672
Deferred stock-based compensation	—	(1,225)
Treasury stock, at cost, 11,430 shares at December 25, 2005 and 7,215 shares at June 26, 2005	(317,883)	(186,064)
Accumulated other comprehensive loss	(14,067)	(10,789)
Retained earnings	644,777	520,165
Total stockholders' equity	<u>1,141,801</u>	<u>1,066,896</u>
Total liabilities and stockholders' equity	<u>\$ 1,582,271</u>	<u>\$ 1,448,815</u>

See Notes to Condensed Consolidated Financial Statements

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(in thousands, except per share data)**  
**(unaudited)**

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
Total revenue	\$ 358,245	\$ 379,800	\$ 679,152	\$ 799,349
Cost of goods sold	180,735	180,898	345,563	385,686
Gross margin	177,510	198,902	333,589	413,663
Research and development	55,742	47,057	106,984	97,415
Selling, general and administrative	44,859	43,275	90,014	86,402
Total operating expenses	100,601	90,332	196,998	183,817
Operating income	76,909	108,570	136,591	229,846
Other income, net	9,308	1,298	17,796	1,306
Income before income taxes	86,217	109,868	154,387	231,152
Income tax expense	8,439	26,254	27,118	57,788
Net income	<u>\$ 77,778</u>	<u>\$ 83,614</u>	<u>\$ 127,269</u>	<u>\$ 173,364</u>
Net income per share:				
Basic net income per share	<u>\$ 0.57</u>	<u>\$ 0.61</u>	<u>\$ 0.93</u>	<u>\$ 1.27</u>
Diluted net income per share	<u>\$ 0.55</u>	<u>\$ 0.59</u>	<u>\$ 0.89</u>	<u>\$ 1.23</u>
Number of shares used in per share calculations:				
Basic	<u>136,572</u>	<u>137,255</u>	<u>136,499</u>	<u>136,366</u>
Diluted	<u>142,525</u>	<u>142,268</u>	<u>142,209</u>	<u>141,108</u>

See Notes to Condensed Consolidated Financial Statements

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

	<b>Six Months Ended</b>	
	<b>December 25, 2005</b>	<b>December 26, 2004</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 127,269	\$ 173,364
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,996	11,878
Amortization	31	1,010
Deferred income taxes	14,727	51,578
Amortization of premiums on securities	1,599	1,853
Stock-based compensation	11,290	293
Other, net	352	(530)
Change in working capital accounts	(7,478)	(48,699)
Net cash provided by operating activities	<u>158,786</u>	<u>190,747</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(9,694)	(13,983)
Purchases of available-for-sale securities	(28,715)	(133,892)
Sales and maturities of available-for-sale securities	94,504	75,172
Net cash provided by / (used for) investing activities	<u>56,095</u>	<u>(72,703)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Treasury stock purchases	(140,607)	—
Reissuances of treasury stock	5,137	—
Proceeds from issuance of common stock	74,100	41,925
Net cash provided by / (used for) financing activities	<u>(61,370)</u>	<u>41,925</u>
Effect of exchange rate changes on cash	(1,979)	2,801
Net increase in cash and cash equivalents	151,532	162,770
Cash and cash equivalents at beginning of year	482,250	163,403
Cash and cash equivalents at end of year	<u>\$ 633,782</u>	<u>\$ 326,173</u>

See Notes to Condensed Consolidated Financial Statements

**LAM RESEARCH CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**December 25, 2005**  
**(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 26, 2005, which are included in the Annual Report on Form 10-K, File Number 0-12933. The Company's Forms 10-K, Forms 10-Q and Forms 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is <http://www.sec.gov>. The Company also posts the Forms 10-K, Forms 10-Q and Forms 8-K on the corporate website at <http://www.lamresearch.com>.

The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 25, 2006 and includes 52 weeks. The quarter ended December 25, 2005 and the quarter ended December 26, 2004 both included 13 weeks.

**NOTE 2 — STOCK-BASED COMPENSATION PLANS**

The Company has adopted stock plans that provide for the grant to employees of stock-based awards, including stock options and restricted stock units, of Lam common stock. In addition, these plans permit the grant of nonstatutory stock-based awards to paid consultants and outside directors. The Company also has an employee stock purchase plan (ESPP) that allows employees to purchase its common stock.

Prior to June 27, 2005, the Company accounted for its stock plans under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25) and FASB Interpretation (FIN) No. 44, "Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB Opinion No. 25" (FIN No. 44). The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R), effective June 27, 2005 using the modified prospective transition method. Under that transition method, stock-based compensation expense recognized during the three and six months ended December 25, 2005 includes: (a) ESPP awards with offering periods commencing, and stock options and restricted stock units granted, prior to, but not yet vested as of June 27, 2005, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) ESPP with offering periods commencing and restricted stock units granted, subsequent to June 27, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. Under the modified prospective transition method, results for prior periods are not restated.

The Company analyzed its stock-based compensation strategies prior to the adoption of SFAS No. 123R and made the decision to grant restricted stock units rather than stock options during the three and six months ended December 25, 2005. The Company recognized stock-based compensation expense of \$6.0 million and \$11.3 million during the three and six months ended December 25, 2005, respectively. Included in these amounts are expenses related to restricted stock units of \$3.0 million and \$4.7 million during the three and six months ended December 25, 2005, respectively, which would have been included in the Company's Condensed Consolidated Statements of Operations under the provisions of APB No. 25. The expense related to restricted stock units is therefore excluded from the following table which presents the impact of the adoption of SFAS No. 123R for the three and six months ended December 25, 2005.

[Table of Contents](#)

	Three Months Ended December 25, 2005		Six Months Ended December 25, 2005	
	As Reported	Excluding impact of adoption of SFAS No. 123R (in thousands, except per share data)	As Reported	Excluding impact of adoption of SFAS No. 123R
Net income before income taxes	\$86,217	\$89,307	\$154,387	\$160,921
Net income	77,778	80,591	127,269	132,869
Earnings per share — basic	0.57	0.59	0.93	0.97
Earnings per share — diluted	\$ 0.55	\$ 0.57	\$ 0.89	\$ 0.93

The income tax benefit recognized in the condensed consolidated statements of operations related to stock-based compensation expense was \$1.0 million and \$1.9 million during the three and six months ended December 25, 2005, respectively. The estimated fair value of the Company's stock-based awards, less expected forfeitures, is amortized over the awards' vesting period on a straight-line basis for awards granted after the adoption of SFAS No. 123R and on a graded vesting basis for awards granted prior to the adoption of SFAS No. 123R.

The modified prospective transition method of SFAS No. 123R requires the presentation of pro forma information, for periods presented prior to the adoption of SFAS No. 123R, regarding net income (loss) and net income (loss) per share as if the Company had accounted for its stock plans under the fair value method of SFAS No. 123R. For pro forma purposes, fair value of stock options and ESPP awards was estimated using the Black-Scholes option valuation model and amortized on a graded vesting basis. 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 following table illustrates the effect on net income and net income per share if the Company had accounted for its stock plans under the fair value method of accounting under SFAS No. 123R:

	Three Months Ended December 26, 2004	Six Months Ended December 26, 2004
	(in thousands, except per share data)	
Net income — as reported	\$ 83,614	\$ 173,364
Add: compensation expense recorded under APB No. 25, net of tax	202	222
Deduct: SFAS No. 123R compensation expense, net of tax	4,180	10,199
Net income — pro forma	\$ 79,636	\$ 163,387
Basic net income per share — as reported	\$ 0.61	\$ 1.27
Basic net income per share — pro forma	0.58	1.20
Diluted net income per share — as reported	0.59	1.23
Diluted net income per share — pro forma	\$ 0.56	\$ 1.16

The fair value of the Company's stock-based awards granted in the three and six-month periods ended December 26, 2004 was estimated using the following weighted-average assumptions:

	Three Months Ended		Six Months Ended	
	Options December 26, 2004	ESPP December 26, 2004	Options December 26, 2004	ESPP December 26, 2004
Expected life (years)	4.6	0.7	3.6	0.60
Expected stock price volatility	74%	74%	74%	74%
Risk-free interest rate	3.4%	3.4%	2.9%	2.9%

## [Table of Contents](#)

### Stock Options and Restricted Stock Units

The 1997 Stock Incentive Plan and the 1999 Stock Option Plan provide for the grant of non-qualified stock-based awards to eligible employees, consultants and advisors, and non-employee directors of the Company and its subsidiaries. As of December 25, 2005, there were a total of 22,458,618 shares reserved for future issuance under these Plans.

The Company did not grant any stock options during the three and six months ended December 25, 2005. The fair value of the Company's stock options issued prior to the adoption of SFAS No. 123R was estimated using a Black-Scholes option valuation model. This model requires the input of highly subjective assumptions, including expected stock price volatility and the estimated life of each award. The fair value of these stock options was estimated assuming no expected dividends and estimates of expected life, volatility and risk-free interest rate at the time of grant. Prior to the adoption of SFAS No. 123R, the Company used historical volatility as a basis for calculating expected volatility.

A summary of stock option activity under the Plans as of December 25, 2005 and changes during the six months then ended is presented below:

<b>Options</b>	<b>Shares (in thousands)</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Remaining Contractual Term (years)</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding at June 26, 2005	15,702	\$ 18.92		
Granted	—	—		
Exercised	(4,246)	17.52		
Forfeited or expired	(247)	25.25		
Outstanding at December 25, 2005	<u>11,209</u>	<u>\$ 19.33</u>	<u>3.74</u>	<u>\$ 192,742</u>
Exercisable at December 25, 2005	<u>7,539</u>	<u>\$ 18.45</u>	<u>3.69</u>	<u>\$ 136,335</u>

The total intrinsic value of options exercised during the three and six months ended December 25, 2005 was \$64.8 million and \$74.2 million, respectively. As of December 25, 2005, there was \$4.8 million of total unrecognized compensation cost related to nonvested stock options granted and outstanding; that cost is expected to be recognized through fiscal year 2009, with a weighted average remaining period of 0.6 years. Cash received from stock option exercises was \$61.9 million and \$74.1 million during the three and six months ended December 25, 2005.

A summary of the status of the Company's restricted stock units as of December 25, 2005, and changes during the six months then ended is presented below:

<b>Nonvested Restricted Stock Units</b>	<b>Shares (in thousands)</b>	<b>Weighted- Average Grant- Date Fair Value</b>
Nonvested at June 26, 2005	63	\$ 22.10
Granted	780	29.24
Vested	(7)	22.10
Forfeited	(12)	28.94
Nonvested at December 25, 2005	<u>824</u>	<u>\$ 28.77</u>

## Table of Contents

The fair value of the Company's restricted stock units was calculated based upon the fair market value of the Company's stock at the date of grant. As of December 25, 2005, there was \$16.4 million of total unrecognized compensation cost related to nonvested restricted stock units granted; that cost is expected to be recognized over a remaining period of 1.7 years.

### ESPP

The 1999 Employee Stock Purchase Plan (the 1999 ESPP) allows employees to designate a portion of their base compensation to be used to purchase the Company's Common Stock at a purchase price per share of the lower of 85% of the fair market value of the Company's Common Stock on the first or last day of the applicable offering period. Typically, each offering period lasts 12 months and comprises three interim purchase dates. As of December 25, 2005, there were a total of 10,993,828 shares reserved for issuance and 1,695,788 shares were available for issuance under the 1999 ESPP Plan.

ESPP awards were valued using the Black-Scholes model. ESPP awards for offering periods subsequent to the adoption of SFAS No. 123R were valued using the Black-Scholes model with expected volatility calculated using implied volatility. Prior to the adoption of SFAS No. 123R, the Company used historical volatility in deriving its expected volatility assumption. The Company determined that implied volatility provides a more accurate reflection of market conditions and is a better indicator of expected volatility than historical volatility. During the six months ended December 25, 2005, ESPP was valued assuming no expected dividends and the following weighted-average assumptions:

Expected life (years)	0.68
Expected stock price volatility	34.5%
Risk-free interest rate	3.4%

As of December 25, 2005, there was \$3.1 million of total unrecognized compensation cost related to the ESPP that is expected to be recognized over a remaining period of eight months.

### **NOTE 3 — INVENTORIES**

Inventories are stated at the lower of cost (first-in, first-out method) or market. Shipments to Japanese customers are classified as inventory and carried at cost until title transfers. Inventories consist of the following:

	December 25, 2005	June 26, 2005
	(in thousands)	
Raw materials	\$ 54,693	\$ 51,251
Work-in-process	25,591	24,492
Finished goods	33,767	34,308
	<u>\$ 114,051</u>	<u>\$ 110,051</u>

[Table of Contents](#)

**NOTE 4 — PROPERTY AND EQUIPMENT, NET**

Property and equipment, net, consist of the following:

	December 25, 2005	June 26, 2005
	(in thousands)	
Manufacturing, engineering and office equipment	\$ 98,698	\$ 98,947
Computer equipment and software	61,154	63,839
Leasehold improvements	44,180	41,574
Furniture and fixtures	5,550	5,045
	<u>209,582</u>	<u>209,405</u>
Less: accumulated depreciation and amortization	(167,930)	(168,323)
	<u>\$ 41,652</u>	<u>\$ 41,082</u>

**NOTE 5 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

	December 25, 2005	June 26, 2005
	(in thousands)	
Accrued compensation	\$ 114,678	\$ 96,006
Warranty reserves	30,231	35,802
Income and other taxes payable	56,179	30,518
Restructuring reserves	2,084	3,317
Other	64,697	63,564
	<u>\$ 267,869</u>	<u>\$ 229,207</u>

**NOTE 6 — OTHER INCOME, NET**

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

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands)			
Interest income	\$ 8,383	\$ 3,189	\$ 15,097	\$ 5,582
Interest expense	(88)	(444)	(167)	(987)
Foreign exchange gains (losses)	1,125	(117)	3,152	306
Charitable contributions	—	(1,250)	—	(3,250)
Other, net	(112)	(80)	(286)	(345)
	<u>\$ 9,308</u>	<u>\$ 1,298</u>	<u>\$ 17,796</u>	<u>\$ 1,306</u>

**NOTE 7 — 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 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands, except per share data)			
<b>Numerator:</b>				
Net income	\$ 77,778	\$ 83,614	\$ 127,269	\$ 173,364
<b>Denominator:</b>				
Basic average shares outstanding	136,572	137,255	136,499	136,366
<b>Effect of potential dilutive securities:</b>				
Employee stock plans and warrant	5,953	5,013	5,710	4,742
Diluted average shares outstanding	142,525	142,268	142,209	141,108
Net income per share — Basic	\$ 0.57	\$ 0.61	\$ 0.93	\$ 1.27
Net income per share — Diluted	\$ 0.55	\$ 0.59	\$ 0.89	\$ 1.23

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

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands)			
Number of potential dilutive securities excluded	315	3,800	874	4,319

**NOTE 8 — COMPREHENSIVE INCOME**

The components of comprehensive income are as follows:

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands)			
Net income	\$ 77,778	\$ 83,614	\$ 127,269	\$ 173,364
Foreign currency translation adjustment	(584)	1,808	(2,378)	1,809
Unrealized gain (loss) on fair value of derivative financial instruments, net	2,323	(82)	4,737	(82)
Unrealized gain (loss) on financial instruments, net	(610)	(1,212)	(1,331)	116
Reclassification adjustment for loss (gain) included in earnings	(2,814)	93	(4,306)	257
Comprehensive income	\$ 76,093	\$ 84,221	\$ 123,991	\$ 175,464

## [Table of Contents](#)

The balance of accumulated other comprehensive loss is as follows:

	<u>December 25, 2005</u>	<u>June 26, 2005</u>
	(in thousands)	
Accumulated foreign currency translation adjustment	\$ (12,139)	\$ (9,761)
Accumulated unrealized gain on derivative financial instruments	1,067	815
Accumulated unrealized loss on financial instruments	(2,995)	(1,843)
Accumulated other comprehensive loss	<u>\$ (14,067)</u>	<u>\$ (10,789)</u>

### NOTE 9 — GUARANTEES

The Company accounts for its guarantees in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 45 “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others” (FIN No. 45). FIN No. 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN No. 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.

The Company leases several facilities at its headquarters location in Fremont, California. As part of the lease agreements, the Company has the option to purchase the remaining buildings at any time for a total purchase price for all remaining properties related to these leases of approximately \$85.0 million. The Company is required to guarantee the lessors a residual value on the properties of up to \$75.0 million at the end of the lease terms in fiscal year 2008 (in the event 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). The Company maintains cash collateral of \$85.0 million as part of the lease agreements as of December 25, 2005 in separate, specified interest-bearing accounts which is recorded as restricted cash in the Company’s Condensed 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 No. 46, “Consolidation of Variable Interest Entities” and is therefore not consolidated by Lam.

The Company has issued certain indemnifications to its lessors and vendors under some of its agreements. The Company has entered into certain insurance contracts to minimize its exposure related to such indemnifications. As of December 25, 2005, 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 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. At December 25, 2005, the maximum potential amount of future payments the Company could be required to make under this agreement was approximately \$2.6 million, although the Company’s Japanese subsidiary did not owe any amounts under this agreement.

Generally, the Company indemnifies, under pre-determined conditions and limitations, its customers for infringement of third-party intellectual property rights by the Company’s products or services. The Company seeks to limit its liability for such indemnity to an amount not to exceed the sales price of the products or services subject to 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.

## Table of Contents

Changes in the Company's product warranty reserves were as follows:

	(in thousands)
Balance at June 27, 2004	\$ 28,401
Warranties issued during the period	22,125
Settlements made during the period	(9,669)
Expirations and change in liability for pre-existing warranties during the period	(2,505)
Balance at December 26, 2004	<u>\$ 38,352</u>
	(in thousands)
Balance at June 26, 2005	\$ 35,802
Warranties issued during the period	16,355
Settlements made during the period	(10,732)
Expirations and change in liability for pre-existing warranties during the period	(11,194)
Balance at December 25, 2005	<u>\$ 30,231</u>

### **NOTE 10 — 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 that allows the use of derivative financial instruments, specifically foreign currency forward exchange rate 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 revenues, the Company has instituted a foreign currency cash flow hedging program. The Company enters into foreign currency forward exchange rate 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. There were no gains or losses during the three and six months ended December 25, 2005 and December 26, 2004 associated with forecasted transactions that failed to occur. To qualify for hedge accounting, the hedge relationship must meet criteria relating both to the derivative instrument and the hedged item. These include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows will be measured.

When derivative instruments are designated and qualify as effective cash flow hedges, the Company is able to defer changes in the fair value of the hedging instrument within accumulated other comprehensive income (loss) until the hedged exposure is realized. Consequently, with the exception of hedge ineffectiveness recognized, the Company's results of operations are not subject to fluctuation as a result of changes in the fair value of the derivative instruments. If hedges are not highly effective or if the Company does not believe that forecasted transactions would occur, the Company may not be able to account for its investments in derivative instruments as hedges. If this were to occur in a future period, changes in the fair values of the Company's derivative instruments would be recognized in operations without the benefits of offsets or deferrals of changes in fair value arising from hedge accounting treatment. At December 25, 2005, the Company expects to reclassify the entire amount of \$1.1 million 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 forward exchange rate contracts to hedge the gains and losses generated by the remeasurement of Japanese Yen-denominated receivable balances. Under SFAS No. 133, these forward contracts are not designated

[Table of Contents](#)

accounting hedges. Therefore, the change in fair value of these derivatives is recorded into earnings as a component of other income and expense and offsets the change in fair value of the foreign currency denominated intercompany and trade receivables assuming the hedge contract fully covers the intercompany and trade receivable balances.

**NOTE 11 – STOCK REPURCHASE PROGRAM**

In October, 2004, the Company announced that its Board of Directors had authorized the repurchase of up to \$250 million of Company common stock from the public market or in private purchases. The terms of the repurchase program permit the Company to repurchase shares through September 30, 2007. In August, 2005, the Company announced that its Board of Directors had authorized the repurchase of an additional \$500 million of the Company's common stock from the public market or private purchase. The terms of the repurchase program permit the Company to repurchase shares through September 30, 2008. The Company plans to continue to execute the authorized repurchases. Share repurchases under the authorizations were as follows:

<u>Period</u>	<u>Total Number of Shares Repurchased</u>	<u>Total Cost of Repurchase</u> <u>(in thousands, except per share data)</u>	<u>Average Price Paid per share</u>	<u>Amount Available For Repurchase Under the Plan</u>
As of June 26, 2005	5,855	\$ 167,081	\$ 28.54	\$ 82,919
Additional authorization of \$500 million				\$ 582,919
Quarter Ending September 25, 2005	2,644	78,690	29.76	\$ 504,229
Quarter Ending December 25, 2005	1,848	61,917	33.50	\$ 442,312
Total	<u>10,347</u>	<u>\$ 307,688</u>	<u>\$ 29.74</u>	

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

**CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS**

*With the exception of historical facts, the statements contained in this discussion are forward-looking statements, which are subject to the safe harbor provisions created by the Private Securities Litigation Reform Act of 1995. Certain, but not all, of the forward-looking statements in this report are specifically identified. The identification of certain statements as "forward-looking" is not intended to mean that other statements not specifically identified are not forward-looking. Forward-looking statements include, but are not limited to, statements that relate to 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 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 26, 2005, our quarterly reports on Form 10-Q, 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**

For a full understanding of our financial position and results of operations for the three and six months ended December 25, 2005, 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 26, 2005 and Form 10-Q for the three months ended September 25, 2005.

**RESULTS OF OPERATIONS**

Lam Research Corporation (Lam or the Company) is a major provider 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. 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 25, 2005 may not necessarily be indicative of future operating results.

[Table of Contents](#)

**New Orders and Backlog**

New orders recorded into backlog over the past six quarters were approximately:

December 25, 2005	September 25, 2005	Three Months Ended				September 26, 2004
		June 26, 2005	March 27, 2005	December 26, 2004	December 26, 2004	
		(in millions)				
\$ 403	\$ 326	\$ 315	\$ 315	\$ 387	\$ 429	

The balance of unshipped orders in backlog as of December 25, 2005 was approximately \$404 million. The basis for recording new orders is defined in our backlog policy. Our unshipped orders backlog includes orders for systems, spares, and services where written customer requests have been accepted and the delivery of products or provision of services is anticipated within the next 12 months. Our policy is to make adjustments to our backlog to reflect, among other things, customer delivery date changes as well as order cancellations. Please refer to "Backlog" in Part I Item 1, "Business" of our Annual Report on Form 10-K for the fiscal year ended June 26, 2005 for additional information on our backlog policy.

The regional geographic breakdown of new orders is as follows:

	Three Months Ended					
	December 25, 2005	September 25, 2005	June 26, 2005	March 27, 2005	December 26, 2004	September 26, 2004
North America	13%	17%	9%	16%	14%	20%
Europe	12%	15%	12%	19%	9%	19%
Asia Pacific	29%	33%	35%	29%	25%	26%
Korea	23%	13%	16%	14%	40%	15%
Japan	23%	22%	28%	22%	12%	20%

Our business continues to be cyclical in nature. Customer demand for our products began to improve in the September 2003 quarter after a prolonged two and one half year downturn. This positive trend in new orders continued through the September 2004 quarter, then declined and stabilized over the course of the March 2005 and June 2005 quarters. New orders in the quarter ended September 25, 2005 represented a positive inflection point with 3% growth sequentially. This trend has continued with 24% sequential growth in the quarter ended December 25, 2005. We expect new orders to increase sequentially in the March 2006 quarter by 25% to 30%. This expectation is a forward-looking statement and actual results could differ materially as a result of factors such as those referred to on page 15 of this Quarterly Report on Form 10-Q.

**Revenue**

	Three Months Ended			Six Months Ended	
	December 25, 2005	September 25, 2005 (in thousands)	December 26, 2004	December 25, 2005 (in thousands)	December 26, 2004
Revenue	\$ 358,245	\$ 320,907	\$ 379,800	\$ 679,152	\$ 799,349

Revenue for the December 2005 quarter essentially met our expectations. The sequential increase in revenues in the December 2005 quarter reflects the recent growth trend in new orders as well as customer acceptance cycle times. The decrease in the three and six months ended December 25, 2005 as compared with the same periods in the prior year was primarily due to the decline in new orders and shipments over that time period. Our deferred revenue balance was \$161.4 million as of December 25, 2005. The anticipated future revenue value of orders shipped from backlog to Japanese customers that are not recorded as deferred revenue was approximately \$46 million as of December 25, 2005. These shipments are classified as inventory, until title transfers, and carried at cost.

## [Table of Contents](#)

The regional geographic breakdown of revenue is as follows:

	Three Months Ended			Six Months Ended	
	December 25, 2005	September 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
North America	13%	16%	14%	14%	15%
Europe	13%	12%	12%	12%	10%
Asia Pacific	29%	29%	42%	29%	51%
Korea	20%	17%	15%	19%	10%
Japan	25%	26%	17%	26%	14%

The overall Asia region continues to represent a significant portion of our revenues as a substantial amount of the investment in worldwide capacity for semiconductor manufacturing occurs in this region.

Our current estimate for revenues for the March 2006 quarter ranges from \$410 million to \$430 million. This expectation is a forward-looking statement and actual results could differ materially as a result of factors such as those referred to on page 15 of this Quarterly Report on Form 10-Q.

### **Gross Margin**

	Three Months Ended			Six Months Ended	
	December 25, 2005	September 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands, except percentages)				
Gross Margin	\$ 177,510	\$ 156,079	\$ 198,902	\$ 333,589	\$ 413,663
Percent of total revenue	49.5%	48.6%	52.4%	49.1%	51.7%

Gross margin as a percent of revenue during the three months ended December 25, 2005 as compared to the same period in the prior year decreased on lower revenues and a return to a more normal mix of customer configuration choices and material content. These decreases were partially offset by improvements in installation and warranty performance. Gross margin as a percent of revenue during the six months ended December 25, 2005 decreased due to the factors noted above as well as a decrease in production volumes.

We expect gross margin as a percent of revenue will be 50.5% in the March 2006 quarter. This expectation is a forward-looking statement and actual results could differ materially as a result of factors such as those referred to on page 15 of this Quarterly Report on Form 10-Q.

### **Research and Development**

	Three Months Ended			Six Months Ended	
	December 25, 2005	September 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands, except percentages)				
Research & Development (R&D)	\$ 55,742	\$ 51,242	\$ 47,057	\$ 106,984	\$ 97,415
Percent of total revenue	15.6%	16.0%	12.4%	15.8%	12.2%

We continue to invest significantly in research and development in business cycle upturns and downturns. We continue to target and incur expenses related to discretionary and headcount-related investments focused on leading-edge plasma etch, strip and clean applications. The increase in R&D expenses during the December 2005 quarter compared to the September 2005 quarter reflects our planned investment and included an increase of \$2 million in R&D supplies and outside services related to the construction and testing of new equipment prototypes supplemented with approximately \$2 million in increased incentive-based cash compensation from higher profitability, and stock-based compensation. The growth in R&D expenses during the quarter ended December 25, 2005 compared with the same period in the prior year is primarily due to \$3 million of stock-based compensation expense and

## Table of Contents

approximately \$5 million in increased R&D supplies and outside services expense, partially offset by a reduction in incentive-based cash compensation of approximately \$1 million due to lower quarterly operating performance. The growth in R&D expenses during the six months ended December 25, 2005 compared with the same period in the prior year is primarily due to \$4 million of stock-based compensation expense and approximately \$7 million in increased R&D supplies and outside services expense, partially offset by a reduction in incentive-based cash compensation of approximately \$3 million due to lower operating performance.

### *Selling, General and Administrative*

	Three Months Ended			Six Months Ended	
	December 25, 2005	September 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands, except percentages)				
Selling, General & Administrative (SG&A)	\$ 44,859	\$ 45,155	\$ 43,275	\$ 90,014	\$ 86,402
Percent of total revenue	12.5%	14.1%	11.4%	13.3%	10.8%

Notable items within the \$1.6 million net increase in SG&A expenses for the quarter ended December 25, 2005 compared with the same period in the prior year included \$2 million of stock-based compensation expense partially offset by a decrease of approximately \$1 million in incentive-based cash compensation due to lower quarterly operating performance. The increase in expenses for the six months ended December 25, 2005 compared with the same period in the prior year is primarily due to increased salaries and stock-based compensation expense of \$6 million partially offset by a reduction of \$3 million in incentive-based cash compensation due to lower operating performance levels.

We expect total operating expenses (R&D and SG&A) in the March 2006 quarter to be approximately \$110 million. This expectation is a forward-looking statement and actual results could differ materially as a result of factors such as those referred to on page 15 of this Quarterly Report on Form 10-Q.

### *Other Income, net*

Other income, net consisted of the following:

	Three Months Ended			Six Months Ended	
	December 25, 2005	September 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands)				
Interest income	\$ 8,383	\$ 6,714	\$ 3,189	\$ 15,097	\$ 5,582
Interest expense	(88)	(79)	(444)	(167)	(987)
Foreign exchange gains (losses)	1,125	2,027	(117)	3,152	306
Charitable contributions	—	—	(1,250)	—	(3,250)
Other, net	(112)	(174)	(80)	(286)	(345)
	<u>\$ 9,308</u>	<u>\$ 8,488</u>	<u>\$ 1,298</u>	<u>\$ 17,796</u>	<u>\$ 1,306</u>

The increase in interest income during the quarter ended December 25, 2005 as compared with the quarter ended September 25, 2005 was due to an increase in our investment portfolio's yield. The increases in interest income during the three and six months ended December 25, 2005 as compared with the same periods in the prior year were due to increases in our investment portfolio's yield as well as increases in average cash balances. The foreign exchange gains during the December 2005 and September 2005 quarters were primarily due to our intercompany balances with non-U.S. dollar functional subsidiaries where the dollar strengthened against certain foreign currencies, primarily the Taiwan dollar. The foreign exchange loss during the three months ended December 26, 2004 and the gain during the six months ended December 26, 2004 were comparatively less as the exchange rate for the foreign currencies to which our intercompany balances are exposed did not change significantly. A description of our exposure to foreign currency exchange rates can be found in the Risk Factors section of this Form 10-Q under the heading "Our Future Success Depends on International Sales and the Management of Global Operations."

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

During the quarter ended December 25, 2005, we revised our annual estimated effective tax rate for fiscal year 2006 to 21.5%. The effective tax rate for the three and six months ended December 25, 2005 of 9.8% and 17.6%, respectively, reflects the impact of this reduction from 27.4% to 21.5% as well as a one time adjustment of \$6.1 million related to foreign tax rulings on prior year tax returns. Our current estimated annual effective tax rate has decreased due to the positive impact of changes in the international jurisdiction of income and the foreign tax ruling noted above. Our fiscal year 2006 estimated effective annual tax rate was lower compared to fiscal year 2005 due to these factors noted above, partially offset by the impact of the accounting for stock-based awards in accordance with SFAS No. 123R and the deductibility of those awards in some jurisdictions and by the expiration of the research tax credit on December 31, 2005. Congress is currently discussing the extension and/or revision of the research credit, but to date no law has been passed. Our effective tax rate is based on our current profitability outlook, including our continued and substantial investments in research and development programs qualifying for R&D tax benefits (through the expiration in December 2005), and our expectations of earnings from operations in lower-tax jurisdictions throughout the world. 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 forecasts of the level, timing, and sources of future revenues and profits.

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

We had gross deferred tax assets, related primarily to reserves and accruals that are not currently deductible, net operating losses, and tax credit carryforwards of \$233.3 million and \$248.0 million as of December 25, 2005 and June 26, 2005, respectively. The gross deferred tax assets were offset by deferred tax liabilities of \$22.2 million and a valuation allowance of \$106.0 million, both as of December 25, 2005 and June 26, 2005, respectively.

Total deferred tax assets, net of deferred tax liabilities and valuation allowance, decreased by \$14.7 million from June 26, 2005 to December 25, 2005 primarily due to the expected utilization of net operating loss tax assets against our 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 valuation allowances, if any, in subsequent quarters.

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 to the U.S., as defined in the AJCA. 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 \$26 million. The Company must repatriate cash before the current fiscal year end to qualify for the provisions under the AJCA.

### ***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 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

## Table of Contents

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. Revenue from multiple element arrangements is allocated among the separate elements based on their relative fair values, 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. Transfer of title for shipments to Japanese customers generally occurs at time of customer acceptance.

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 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, the sale of 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.

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.

*Stock-Based Compensation — Employee Stock Purchase Plan and Employee Stock Plans :* Beginning on June 27, 2005 we account for our employee stock purchase plan (ESPP) and stock plans under the provisions of SFAS No. 123R. SFAS No. 123R

## Table of Contents

requires the recognition of the fair value of stock-based compensation in net income. The fair value of our restricted stock units was calculated based upon the fair market value of our stock at the date of grant. The fair value of our stock options and ESPP awards was estimated using a Black-Scholes option valuation model. This model requires the input of highly subjective assumptions and elections in adopting and implementing SFAS No. 123R, including expected stock price volatility and the estimated life of each award. The fair value of stock-based awards is amortized over the vesting period of the award and we have elected to use the straight-line method for awards granted after the adoption of SFAS No. 123R and continue to use a graded vesting method for awards granted prior to the adoption of SFAS No. 123R. We make quarterly assessments of the adequacy of our tax credit pool to determine if there are any deficiencies which require recognition in our condensed consolidated statements of operations. Prior to the adoption of SFAS No. 123R, we accounted for our ESPP and stock option plans under the provisions of Accounting Principles Board (APB) Opinion No. 25 “Accounting For Stock Issued to Employees” (APB No. 25) and Financial Accounting Standards Board (FASB) Interpretation No. 44, “Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB Opinion No. 25” and made 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”. Pro forma net income (loss) and pro forma net income (loss) per share disclosed in the footnotes to our condensed consolidated financial statements were estimated using a Black-Scholes option valuation model.

*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.

We calculate our current and deferred tax provision based on estimates and assumptions that can differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are recorded when identified.

We provide for income taxes on the basis of annual estimated effective income tax rates. Our estimated effective income tax rate reflects the underlying profitability of the Company, the level of R&D spending, the regions where profits are recorded and the respective tax rates imposed. We carefully monitor these factors and adjust the effective income tax rate, if necessary. If actual results differ from estimates, we could be required to record an additional valuation allowance on deferred tax assets or adjust our effective income tax rate, which could have a material impact on our business, results of operations, and financial condition.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws. Our estimate for the potential outcome of any uncertain tax issue is highly judgmental. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial condition. We account for income tax contingencies in accordance with SFAS No. 5, “Accounting for Contingencies.”

**LIQUIDITY AND CAPITAL RESOURCES**

As of December 25, 2005, we had \$977.3 million in cash, cash equivalents, short-term investments, and restricted cash compared with \$894.3 million at June 26, 2005. This increase was primarily due to \$158.8 million of cash flows from operating activities. Our continued commitment to our share repurchase program resulted in \$140.6 million of repurchases during the six months ended December 25, 2005 which was partially offset by \$79.2 million of net proceeds from issuance of common stock related to employee stock-based plans.

*Cash Flows From Operating Activities*

Net cash provided by operating activities of \$158.8 million during the six months ended December 25, 2005, consisted of (in millions):

Net income	\$ 127.3
Non-cash charges:	
Depreciation and amortization	11.0
Stock-based compensation	11.3
Other, net	2.0
Decrease in deferred tax assets	14.7
Change in other working capital accounts	(7.5)
	<u>\$ 158.8</u>

Significant changes in assets and liabilities during the six months ended December 25, 2005, and included in the \$(7.5) million change in other working capital accounts above, include an increase in accounts receivable of \$47.7 million due to an increased volume of shipments, partially offset by an increase in accrued liabilities of \$38.7 million due primarily due to an increase in VAT taxes payable as well as an increase in incentive-based compensation balances.

*Cash Flows from Investing Activities*

Net cash provided by investing activities during the six months ended December 25, 2005 was \$56.1 million and consisted of net sales of \$65.8 million of short-term investments to support our stock repurchase program, partially offset by capital expenditures of \$9.7 million which consisted primarily of engineering equipment.

*Cash Flows from Financing Activities*

Net cash used for financing activities during the six months ended December 25, 2005 was \$61.4 million including stock repurchases of \$140.6 million partially offset by net proceeds of \$79.2 million from the issuance of our common stock related to employee stock-based plans.

In October, 2004, we announced that our Board of Directors had authorized the repurchase of up to \$250 million of our common stock from the public market or in private purchases. The terms of the repurchase program permit us to repurchase shares through September 30, 2007. In August, 2005, we announced that our Board of Directors had authorized the repurchase of an additional \$500 million of our common stock from the public market or private purchases. The terms of the repurchase program permit us to repurchase shares through September 30, 2008. During the six months ended December 25, 2005, we repurchased approximately 4.5 million shares of common stock at a total price of \$140.6 million. As of December 25, 2005 the total amount available for repurchase under these authorizations was \$442.3 million. We expect to continue to repurchase shares consistent with the Board authorizations, the level of which will be determined by, including but not limited to, the needs of the business and the stock price and daily trading volumes of our stock.

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 25, 2005 are expected to be sufficient to support our presently anticipated levels of operations, investments, and capital expenditures, through at least the next 12 months.

## Table of Contents

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.

### *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>Operating Leases</u>	<u>Purchase Obligations</u>	<u>Restructuring Liabilities</u>	<u>Total</u>
	(in thousands)			
Payments due by period:				
Less than 1 year	\$ 12,449	\$ 105,057	\$ 2,084	\$ 119,590
1-3 years	88,412	54,422	693	143,527
4-5 years	1,486	6,842	16	8,344
Over 5 years	849	—	—	849
Total	<u>\$ 103,196</u>	<u>\$ 166,321</u>	<u>\$ 2,793</u>	<u>\$ 272,310</u>

### *Operating Leases*

We lease most of our administrative, R&D and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases, 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 or to purchase the facilities. Certain of our facility leases provide for periodic rent increases based on the general rate of inflation.

Included in the operating leases 1-3 years section of the table above is \$75.0 million in guaranteed residual values for lease agreements relating to certain properties at our Fremont, California campus. As part of the lease agreements, we have the option to purchase the remaining buildings at any time for a total purchase price for all remaining properties related to these leases of approximately \$85.0 million. We are required to guarantee the lessors a residual value on the properties of up to \$75.0 million at the end of the lease terms in fiscal year 2008 (in the event 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). We maintain cash collateral of \$85.0 million as part of the lease agreements as of December 25, 2005 in separate, specified interest-bearing accounts which is recorded as restricted cash in our Condensed 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 No. 46, "Consolidation of Variable Interest Entities" and is therefore not consolidated by us.

The remaining balances primarily relate to non-cancelable facility-related operating leases expiring at various dates through 2021.

### *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

## Table of Contents

25, 2005 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 storage locations and warehouses, are not reported as our inventory until title is transferred to us or our purchase obligation is determined. At December 25, 2005, vendor-owned inventories held at our locations and not reported as our inventory were approximately \$13.5 million.

### *Restructuring Liabilities*

Our total restructuring reserves as of December 25, 2005 were \$2.8 million, which consists primarily of lease payments on vacated buildings. Through cash generated from operations, we expect \$2.1 million to be paid over the next twelve months and \$0.7 million to be paid between fiscal year 2007 and fiscal year 2011.

### **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;

## Table of Contents

- procurement shortages;
- manufacturing difficulties;
- the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;
- changes in our estimated effective tax rate;
- 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 \$5.7 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 is typically 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.

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.

## [Table of Contents](#)

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. Moreover, future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both.

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

We derive a substantial percentage of our revenues from a limited number of products, and we expect 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;
- export restrictions or other regulatory or legislative actions which limit our ability to sell those products to key customer or market segments;
- an improved version of products being offered by a competitor in the market we participate in;
- increased pressure from competitors that offer broader product lines;
- 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.

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

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

Sales to a limited number of large customers constitute a significant portion of our overall revenue, new orders and profitability. 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.

### ***Strategic Alliances May Have Negative Effects on our Business***

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

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

***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 relatively 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, such as information technology, facilities management, and certain elements of our finance organization. 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 accounted for approximately 84% in fiscal year 2005, 82% in fiscal year 2004 and 72% in fiscal year 2003 of our total revenue. 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;
- economic and political conditions;
- changes in currency controls;
- differences in the enforcement of intellectual property and contract rights in varying jurisdictions;
- our 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;
- the need for technical support resources in different locations; and
- our ability to secure and retain qualified people for the operation of our business.

Certain international sales depend on our ability to obtain export licenses from the U.S. Government. Our failure or inability to obtain such licenses would substantially limit our markets and severely restrict our revenues. Many of the challenges noted above are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships between China, Taiwan, Japan, 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 region. A significant trade disruption in these areas could have a material, adverse impact on our future revenue and profits.

We are potentially exposed to adverse as well as beneficial movements in foreign currency exchange rates. The majority of our sales and expenses are denominated in U.S. dollars except for certain of our revenues in Japan that are denominated in Japanese Yen, certain of our spares and service contracts which are denominated in other currencies, and expenses related to our non-U.S. sales and support offices which are denominated in these countries' local currency.

We currently enter into foreign currency forward contracts to minimize the short-term impact of the exchange rate fluctuations on Japanese Yen-denominated assets and forecasted Japanese Yen-denominated revenue where we currently believe our primary exposure to currency rate fluctuation lies and will continue to enter into hedging transactions, for the purposes outlined, in the foreseeable future. However, these hedging transactions may not achieve their desired effect because differences between the actual timing of customer acceptances and our forecasts of those acceptances may leave us either over- or under-hedged on any given transaction. Moreover, by hedging our Yen-denominated assets with currency forward contracts, we may miss favorable currency trends, that would have been advantageous to us but for the hedges. Additionally, we currently do not enter into such forward contracts for currencies other than the Yen, and we therefore are subject to both favorable and unfavorable exchange rate fluctuations to the extent that we transact business (including intercompany transactions) in other currencies.

***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 predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. In addition, the amount of income taxes we pay is subject to ongoing audits in various jurisdictions, and a material assessment by a governing tax authority could affect our profitability. 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. Our decision whether or not to repatriate cash to take advantage of the Jobs Creation Act must be made by the end of our current fiscal year which ends on June 25, 2006.

***Changes in Accounting Standards for Stock-Based Compensation May Adversely Affect our Operating Results, Our Stock Price, and Our Competitiveness in the Employee Marketplace***

The adoption of SFAS No. 123(R) required us to expense all stock-based compensation provided to employees and directors beginning with our quarter ending September 25, 2005. The environment for skilled employees that are knowledgeable about our products and services is a competitive one, and we believe that stock-based compensation is an important part of the overall compensation that we offer to attract and retain such employees. SFAS No. 123(R) will decrease our earnings based on its measure of the value of stock-based compensation. There is some risk that the design of our compensation plans is ineffective at balancing our profitability and employee retention objectives. Moreover, as we have adopted these rules before certain other companies in our industry, there may be, for some period of time, an appearance that our earnings are lower than those of comparable companies that have not yet adopted SFAS No. 123(R), which could have a negative effect on our stock price.

***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 has historically been characterized by frequent periods of rapid change in demand that challenge our management to adjust spending and resources allocated to operating activities. During periods of rapid growth or decline in demand for our products and services, we face significant challenges in maintaining adequate financial and business controls, management processes, information systems and procedures and in training, managing, and appropriately sizing our supply chain, 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

## Table of Contents

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 inabilities or inadequacies could have a material adverse effect on our business, operating results, financial condition, and cash flows.

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

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

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

- general market, semiconductor, or semiconductor equipment industry conditions;
- global economic fluctuations;
- variations in our quarterly operating results;
- variations in our revenues or earnings from levels experienced by other companies in our industry or forecasts by securities analysts;
- 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;
- liquidity of Lam;
- 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

## Table of Contents

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.

### ***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. Moreover, although we seek to obtain insurance to protect us from claims and cover losses to our property, there is no guarantee that such insurance will fully indemnify us for any losses that we may incur.

### ***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.

### ***We Are Subject to the Internal Control Evaluation and Attestation Requirements of Section 404 of the Sarbanes-Oxley Act of 2002***

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we were required, beginning with our fiscal year ended 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 each fiscal year. Furthermore, our independent registered public accounting firm (Firm) is 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 the end of each fiscal year. We have successfully completed our assessment and obtained our Firm's attestation as to the effectiveness of our internal control over financial reporting as of June 26, 2005. In future years, if we fail to timely complete this assessment, or if our 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 Must Confirm Its Independence in Order for Us to Meet Our Regulatory Reporting Obligations on a Timely Basis***

Our independent registered public accounting firm communicates with us at least annually regarding any relationships between the Firm and Lam that, in the Firm's professional judgment, might have a bearing on the Firm's independence with respect to us. If, for whatever reason, our independent registered public accounting firm finds that it cannot confirm that it is independent of Lam 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 26, 2005.

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**

#### *Disclosure Controls and Procedures*

As required by Exchange Act Rule 13a-15(b), as of December 25, 2005, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer along with our Chief Financial Officer, concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to correct any material deficiencies that we may discover. Our goal is to ensure that our senior management has timely access to material information that could affect our business.

#### *Changes in Internal Control over Financial Reporting*

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

#### *Effectiveness of Controls*

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

**PART II. OTHER INFORMATION****ITEM 1. Legal Proceedings**

From time to time, we have received notices from third parties alleging infringement of such parties' patent or other intellectual property rights by our products. In such cases it is our policy to defend the claims, or if considered appropriate, negotiate licenses on commercially reasonable terms. 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**

(a) Effective as of December 7, 2005, the Company issued 878,829 shares of its common stock to Highbridge International, LLC ("Highbridge") upon receipt of a warrant exercise notice from Highbridge. The shares were issued pursuant to a cashless, net exercise provision in the warrant and accordingly, were issued as securities exempt from registration pursuant to Section 3(a)(9) of the Securities Act of 1933 as amended.

As previously disclosed by the Company, the warrant was originally issued on December 19, 2001 to Varian Semiconductor Equipment Associates, Inc. ("Varian") in connection with the settlement of a patent infringement litigation filed by Varian in October 1993. Effective with the December 7 exercise, the warrant has been fully exercised and no additional shares are issuable.

(c) In October, 2004, we announced that our Board of Directors had authorized the repurchase of up to \$250 million of our common stock from the public market or in private purchases. The terms of the repurchase program permit us to repurchase shares through September 30, 2007. In August, 2005, we announced that our Board of Directors had authorized the repurchase of an additional \$500 million of our common stock from the public market or private purchase. The terms of the repurchase program permit us to repurchase shares through September 30, 2008. We plan to continue to execute the authorized repurchases. Share repurchases under the authorizations were as follows:

<u>Period</u>	<u>Total Number of Shares Repurchased</u>	<u>Average Price Paid per Share</u> (in thousands, except per share data)	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Amount Available For Repurchase Under the Plan</u>
As of September 25, 2005	8,499	\$ 28.92	8,499	\$ 504,229
September 26, 2005 - October 23, 2005	957	30.93	957	\$ 474,631
October 24, 2005 - November 20, 2005	498	35.17	498	\$ 457,115
November 21, 2005 - December 25, 2005	393	37.67	393	\$ 442,312
<b>Total</b>	<b>10,347</b>	<b>\$ 29.74</b>	<b>10,347</b>	

**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 3, 2005.

Out of 135,993,802 shares of Common Stock (as of the record date of September 9, 2005) entitled to vote at the meeting, 126,315,318 shares were present in person or by proxy.

## Table of Contents

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	122,195,740	4,119,577
David G. Arscott	122,170,540	4,144,777
Robert M. Berdahl	122,485,479	3,829,838
Richard J. Elkus, Jr.	122,473,401	3,841,916
Jack R. Harris	122,174,874	4,140,443
Grant M. Inman	122,185,041	4,130,276
Stephen G. Newberry	125,423,166	892,151
Seiichi Watanabe	125,727,481	587,836

Amendment of the Lam 2004 Executive Incentive Plan:

	<u>IN FAVOR</u>	<u>AGAINST</u>	<u>ABSTAIN</u>
Total Shares Voted:	107,113,721	1,986,330	212,709
% of Voted Shares:	97.98%	1.81%	0.19%
% of Outstanding Shares:	78.76%	1.46%	0.15%

Ratification of Appointment of Ernst and Young LLP as Independent Registered Public Accounting Firm for the Company for the fiscal year ending June 25, 2006:

	<u>IN FAVOR</u>	<u>AGAINST</u>	<u>ABSTAIN</u>
Total Shares Voted:	125,586,580	682,301	46,437
% of Voted Shares:	99.42%	0.54%	0.03%
% of Outstanding Shares:	92.34%	0.50%	0.03%

### **ITEM 5. Other Information**

### **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)

**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: January 27, 2006

LAM RESEARCH CORPORATION

(Registrant)

/s/ Martin B. Anstice

Martin B. Anstice

*Group 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, Stephen G. Newberry, President 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this 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
  - d) 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.

January 27, 2006

/s/ Stephen G. Newberry  
Stephen G. Newberry  
*President and Chief Executive Officer*

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

I, Martin B. Anstice, Group 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this 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
  - d) 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.

January 27, 2006

/s/ Martin B. Anstice  
Martin B. Anstice  
*Group 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 25, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stephen G. Newberry, President 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.

January 27, 2006

/s/ Stephen G. Newberry  
Stephen G. Newberry  
*President 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 25, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Martin B. Anstice, Group 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.

January 27, 2006

/s/ Martin B. Anstice  
Martin B. Anstice  
*Group Vice President, Finance,  
Chief Financial Officer and  
Chief Accounting Officer*