

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 March 28, 2004 or

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

For the transition period from _____ to _____

Commission file number 0-12933

LAM RESEARCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

94-2634797

(State or other jurisdiction of incorporation or organization)

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

As of April 27, 2004, there were 134,011,598 shares of Registrant's Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	March 28, 2004	June 29, 2003
	(unaudited)	(1)
ASSETS		
Cash and cash equivalents	\$ 309,079	\$ 167,343
Short-term investments	323,991	340,070
Accounts receivable, net	179,606	107,602
Inventories	110,746	112,016
Prepaid expenses and other current assets	17,819	12,679
Deferred income taxes	129,621	133,066
Total current assets	1,070,862	872,776
Property and equipment, net	37,477	48,771
Restricted cash	118,468	118,468
Deferred income taxes	87,032	87,032
Other assets	56,855	71,228
Total assets	<u>\$1,370,694</u>	<u>\$1,198,275</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Trade accounts payable	\$ 82,241	\$ 35,518
Accrued expenses and other current liabilities	157,479	131,144
Deferred profit	56,599	45,309
Current portion of long-term debt and other long-term liabilities	3,750	5,011
Total current liabilities	300,069	216,982
Long-term debt and other long-term liabilities less current portion	322,944	332,209
Total liabilities	623,013	549,191
Commitments and contingencies		
Preferred stock, at par value of \$0.001 per share; authorized - 5,000 shares, none outstanding	—	—
Common stock, at par value of \$0.001 per share; authorized - 400,000 shares; issued and outstanding - 133,513 shares at March 28, 2004 and 127,435 shares at June 29, 2003	134	127
Additional paid-in capital	615,412	560,273
Deferred stock-based compensation	—	(2,769)
Treasury stock, at cost, 1,808 shares at March 28, 2004 and 2,712 shares at June 29, 2003	(25,769)	(38,670)
Accumulated other comprehensive loss	(12,402)	(13,694)
Retained earnings	170,306	143,817
Total stockholders' equity	747,681	649,084
Total liabilities and stockholders' equity	<u>\$1,370,694</u>	<u>\$1,198,275</u>

(1) Derived from June 29, 2003 audited financial statements.

See Notes to Condensed Consolidated Financial Statements

LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Total revenue	\$231,128	\$187,059	\$606,374	\$569,148
Cost of goods sold	125,337	111,838	336,179	342,744
Cost of goods sold - restructuring recoveries	(322)	—	(1,651)	(301)
Total cost of goods sold	<u>125,015</u>	<u>111,838</u>	<u>334,528</u>	<u>342,443</u>
Gross margin	<u>106,113</u>	<u>75,221</u>	<u>271,846</u>	<u>226,705</u>
Research and development	42,914	38,981	120,518	120,102
Selling, general and administrative	37,218	33,245	105,352	98,319
Restructuring charges, net	1,317	4,043	8,327	6,096
Total operating expenses	<u>81,449</u>	<u>76,269</u>	<u>234,197</u>	<u>224,517</u>
Operating income (loss)	24,664	(1,048)	37,649	2,188
Loss on equity derivative contacts in Company stock	—	—	—	(16,407)
Other income, net	877	2,110	2,794	4,437
Income (loss) before income taxes	25,541	1,062	40,443	(9,782)
Income tax expense	6,385	265	10,110	1,656
Net income (loss)	<u>\$ 19,156</u>	<u>\$ 797</u>	<u>\$ 30,333</u>	<u>\$ (11,438)</u>
Net income (loss) per share:				
Basic net income (loss) per share	<u>\$ 0.14</u>	<u>\$ 0.01</u>	<u>\$ 0.23</u>	<u>\$ (0.09)</u>
Diluted net income (loss) per share	<u>\$ 0.13</u>	<u>\$ 0.01</u>	<u>\$ 0.22</u>	<u>\$ (0.09)</u>
Number of shares used in per share calculations:				
Basic	<u>133,251</u>	<u>125,988</u>	<u>130,893</u>	<u>126,110</u>
Diluted	<u>147,365</u>	<u>129,550</u>	<u>138,527</u>	<u>126,110</u>

See Notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended	
	March 28, 2004	March 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 30,333	\$ (11,438)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Loss on equity derivative contracts in Company stock	—	16,407
Amortization of premiums on securities	2,958	4,641
Depreciation and amortization	21,971	30,504
Deferred income taxes	3,445	(5,426)
Amortization of deferred stock-based compensation	3,051	383
Restructuring charges, net	6,676	5,795
Other, net	722	354
Change in working capital accounts	5,589	(3,676)
Net cash provided by operating activities	<u>74,745</u>	<u>37,544</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(11,011)	(9,528)
Purchases of available-for-sale securities	(418,475)	(360,339)
Sales of available-for-sale securities	431,456	688,012
Restricted cash released upon settlement of equity derivatives in Company stock	—	(48,455)
Other, net	(200)	1,333
Net cash provided by investing activities	<u>1,770</u>	<u>271,023</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments and redemptions on long-term debt and capital lease obligations	(12)	(361,259)
Treasury stock purchases	—	(39,122)
Reissuances of treasury stock	9,057	8,448
Proceeds from issuance of common stock	54,862	6,160
Net cash provided by/(used for) financing activities	<u>63,907</u>	<u>(385,773)</u>
Effect of exchange rate changes on cash	1,314	1,181
Net increase (decrease) in cash and cash equivalents	141,736	(76,025)
Cash and cash equivalents at beginning of period	167,343	172,431
Cash and cash equivalents at end of period	<u>\$ 309,079</u>	<u>\$ 96,406</u>

See Notes to Condensed Consolidated Financial Statements.

LAM RESEARCH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 28, 2004

(Unaudited)

NOTE 1 — BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Lam Research Corporation (the Company or Lam) for the fiscal year ended June 29, 2003, which are included in the Annual Report on Form 10-K, File Number 0-12933. The Company's Form 10-K, Forms 10-Q and Forms 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is <http://www.sec.gov>. The Company also posts the Form 10-K, Forms 10-Q and Forms 8-K on the corporate website at <http://www.lamrc.com>.

The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 27, 2004 and includes 52 weeks. The quarter ended March 28, 2004 and the quarter ended March 30, 2003 both included 13 weeks.

Reclassifications: Certain amounts presented in the comparative financial statements for prior years have been reclassified to conform to the fiscal 2004 presentation.

NOTE 2 — RECENT ACCOUNTING PRONOUNCEMENTS

Accounting for Revenue Arrangements with Multiple Deliverables: In November 2002, the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" (EITF 00-21). EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple deliverables (products, services, and/or rights to use assets). The provisions of EITF 00-21 are applicable for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 did not have a material impact on the Company's financial position or results of operations.

Amendment of Statement 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), on Derivative Instruments and Hedging Activities: In April 2003, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", (SFAS 149). SFAS 149 amends SFAS 133 for decisions made as part of the Derivatives Implementation Group (DIG) and changes financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. Specifically, SFAS 149 (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS 133, (2) clarifies when a derivative contains a financing component that requires reporting as cash flows from financing activities in the statement of cash flows and (3) amends the definition of an "underlying" to correspond to the language in FASB Interpretation (FIN) Number 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including

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Indirect Indebtedness of Others.” These changes will result in more consistent reporting of contracts that are derivatives in their entirety or that contain embedded derivatives that require separate accounting. SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. However, the provisions of SFAS 149 that codify the previous decisions made by the DIG are already effective and should continue to be applied in accordance with their prior respective effective dates. The adoption of SFAS 149 did not have a material impact on the Company’s financial position or results of operations.

Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity: In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”, (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS 150 represents a significant change in practice in the accounting for a number of financial instruments including mandatorily redeemable equity instruments and certain equity derivatives that frequently are used in connection with share repurchase programs. SFAS 150 generally requires liability classification for two broad classes of financial instruments: (1) instruments that represent, or are indexed to, an obligation to buy back the issuer’s shares, regardless of whether the instrument is settled on a net-cash or gross physical basis, (2) obligations that can be settled in shares but meet one of the following conditions: (a) derive their value predominately from some other underlying, or (b) have a fixed value, or have a value to the counterparty that moves in the opposite direction as the issuer’s shares. Many of the instruments within the scope of SFAS 150 were previously classified by the issuer as equity or temporary equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective the first quarter of fiscal 2004. The adoption of SFAS 150 did not have a material impact on the Company’s financial position or results of operations.

Revenue Recognition: In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, “Revenue Recognition” (SAB 104). SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of the Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The Company believes it is following the guidance of SAB 104, and the issuance of SAB 104 did not have a material impact on the Company’s financial position or results of operations.

NOTE 3 — STOCK-BASED COMPENSATION PLANS

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

The Company accounts for its stock option plans and stock purchase plan under the provisions of Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25) and Financial Accounting Standards Board Interpretation (FIN) 44, “Accounting for Certain Transactions Involving Stock Compensation — an Interpretation of APB Opinion No. 25” (FIN 44). Pro forma information regarding net income (loss) and net income (loss) per share is required by SFAS No. 123, “Accounting for Stock-Based

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Compensation” (SFAS 123), as amended by SFAS No. 148, “Accounting for Stock-Based Compensation-Transition and Disclosure” (SFAS 148) as if the Company had accounted for its stock option and stock purchase plans under the fair value method of SFAS 123 and SFAS 148. The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had accounted for its stock option and stock purchase plans under the fair value method of accounting under SFAS 123 and SFAS 148:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
	(in thousands, except per share data)			
Net income (loss) - as reported	\$ 19,156	\$ 797	\$ 30,333	\$(11,438)
Add: compensation expense recorded under APB 25, net of tax	212	329	2,288	458
Deduct: SFAS 123 compensation expense, net of tax	6,297	10,297	20,881	33,537
Net income (loss) - pro forma	\$ 13,071	\$ (9,171)	\$ 11,740	\$(44,517)
Basic net income (loss) per share - as reported	\$ 0.14	\$ 0.01	\$ 0.23	\$ (0.09)
Basic net income (loss) per share - pro forma	0.10	(0.07)	0.09	(0.35)
Diluted net income (loss) per share - as reported	0.13	0.01	0.22	(0.09)
Diluted net income (loss) per share - pro forma	\$ 0.09	\$ (0.07)	\$ 0.08	\$ (0.35)

For pro forma purposes, the estimated fair value of the Company’s stock-based awards is amortized over the options’ vesting period (for options) and the respective four, six, twelve, or fifteen-month purchase periods (for stock purchases under the employee stock purchase plan). The fair value of the Company’s stock options and stock purchase plans was estimated using a Black-Scholes option valuation model, which was developed for use in estimating the fair value of traded options which have no vesting restrictions and which are fully transferable. The model requires the input of highly subjective assumptions, including expected stock price volatility and the estimated life of each option. The fair value of the Company’s stock-based awards granted in the three and nine-month periods of fiscal 2004 and fiscal 2003 was estimated assuming no expected dividends and the following weighted-average assumptions:

	Options				ESPP			
	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Expected life(years)	3.4	3.0	3.2	2.4	0.8	0.7	0.5	0.7
Expected stock price volatility	74%	74%	74%	74%	74%	74%	74%	74%
Risk-free interest rate	2.1%	2.2%	2.0%	1.5%	2.0%	2.2%	2.0%	1.5%

NOTE 4 — INVENTORIES

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

	March 28, 2004	June 29, 2003
	(in thousands)	
Raw materials	\$ 52,397	\$ 67,259
Work-in-process	34,131	27,034
Finished goods	24,218	17,723
	<u>\$110,746</u>	<u>\$112,016</u>

NOTE 5 — PROPERTY AND EQUIPMENT

Property and equipment, net, consist of the following:

	<u>March 28, 2004</u>	<u>June 29, 2003</u>
	(in thousands)	
Manufacturing and office equipment	\$ 100,928	\$ 114,609
Leasehold improvements	46,464	57,497
Furniture and fixtures	3,813	5,031
Computer equipment and software	60,007	67,624
	<u>211,212</u>	<u>244,761</u>
Less: accumulated depreciation and amortization	(173,735)	(195,990)
	<u>\$ 37,477</u>	<u>\$ 48,771</u>

NOTE 6 — LONG-TERM DEBT AND OTHER LONG-TERM LIABILITIES

Long-term debt and other long-term liabilities consist of the following:

	<u>March 28, 2004</u>	<u>June 29, 2003</u>
	(in thousands)	
4% convertible subordinated notes, interest payable semi-annually, principal due June, 2006	\$312,807	\$319,322
Restructuring, long-term portion	9,292	9,396
Patent settlement obligation, long-term portion	—	2,500
Other	845	991
	<u>\$322,944</u>	<u>\$332,209</u>

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At March 28, 2004, obligations under debt financing consist of the Company's 4% convertible subordinated notes (4% Notes). Details of the 4% Notes are:

Offering Date	May 2001
Offering Amount	\$300.0 million
Maturity Date	June 1, 2006
Offering Expenses	\$8.5 million at the time of offering, ratably amortized to other expense over the term of the 4% Notes. Remaining unamortized balance of \$3.7 million and \$5.0 million at March 28, 2004 and June 29, 2003, respectively.
Interest Rate Terms	4% payable on June 1 and December 1 of each year, commencing December 1, 2001; payable in arrears.
Conversion Rights	Convertible into Company Common Stock at any time prior to close of business on the maturity date, unless previously redeemed, at a conversion price of \$44.93 per share subject to anti-dilution adjustments.
Redemption Terms	Redeemable at the Company's option, beginning June 5, 2004 with at least 20 days and no more than 60 days notice, at redemption prices starting at 101.0% and at diminishing prices thereafter, plus accrued interest.
Security	4% Notes are unsecured and subordinated in right of payment in full to all existing and future senior indebtedness of the Company.

The carrying value of the 4% Notes has been adjusted to reflect changes in fair value attributable to changes in the benchmark interest rate in connection with the Company's fair value hedge accomplished through the interest rate swap agreement (the swap) discussed in Note 12. At March 28, 2004, the carrying value of the 4% Notes was \$312.8 million as compared to \$319.3 million at June 29, 2003. The corresponding gain of \$6.5 million was recorded in other income (expense), offset by a recorded loss of \$6.6 million on the carrying value of the swap during the nine months ended March 28, 2004.

Under the terms of the agreement, the Company must provide a minimum of \$6.0 million of collateral plus an amount equal to the unfavorable mark-to-market exposure (fair value) on the swap. Therefore, the amount of cash collateral the Company will have to post in the future will fluctuate from quarter to quarter commensurate with the unfavorable mark-to-market exposure on the swap instrument. Generally, the required collateral will rise as interest rates rise. The Company had \$6.0 million of collateral (reflected as restricted cash) recorded on the consolidated balance sheet related to this agreement as of March 28, 2004 and June 29, 2003.

In April, 2004, the Company settled its interest rate swap agreement and announced plans to repay in full its 4% Notes in June 2004, two years prior to their maturity. Please see Note 16 for additional information.

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

NOTE 7 — DEFERRED STOCK-BASED COMPENSATION

During the quarter ended December 29, 2002, the Company recorded \$3.4 million of deferred stock-based compensation in stockholders' equity, which was offset by a corresponding entry to additional paid-in capital in stockholders' equity, in connection with the modification of terms of a fixed stock option award previously issued to the Company's Chairman and Chief Executive Officer. The modification extended the contractual life of the stock option for a period of three years and modified the vesting requirements. However, no changes were made to either the number of shares of the Company's stock subject to the option, or the option's exercise price. Accordingly, the modification resulted in the remeasurement of compensation expense based on the option's intrinsic value on the date of modification in accordance with the provisions of APB 25 and FIN 44. The deferred stock-based compensation balance of \$3.4 million was being amortized ratably over the vesting period of the modified options, or 16 quarters. Under the terms of this modification, if the Nasdaq National Market closing price of the Company's common stock reached or exceeded \$20.00 per share, all unvested shares would immediately vest and become exercisable. In the event of such accelerated vesting, all remaining deferred compensation would immediately be recognized as compensation expense.

During the quarter ended September 28, 2003, the Company added a second condition to the accelerated vesting provision contained in this stock option award. The second condition required the Company's fiscal quarter net income, based on U.S. generally accepted accounting principles, to exceed \$2.5 million after deducting any incremental amortization expense that resulted from acceleration of these same options. The two conditions needed not to be met simultaneously nor in a specific order. Both conditions were met during the quarter ended September 28, 2003 and, as a result, all options under this arrangement were immediately vested in full. Accordingly, the Company recognized the remaining deferred stock-based compensation balance of \$2.8 million as compensation expense within selling, general and administrative expenses in the Company's condensed consolidated statement of operations for the three months ended September 28, 2003.

NOTE 8 — OTHER INCOME (EXPENSE), NET

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

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
	(in thousands)		(in thousands)	
Interest income	\$ 2,437	\$ 3,296	\$ 7,387	\$ 13,126
Loss on equity derivative contracts	—	—	—	(16,407)
Interest expense	(627)	(718)	(1,996)	(5,322)
Foreign exchange gain (loss)	258	378	(49)	(503)
Debt issue cost amortization	(425)	(785)	(1,275)	(2,111)
Interest rate swap hedge ineffectiveness	(214)	(7)	(92)	(179)
Equity method investment losses	(254)	(109)	(415)	(606)
Other, net	(298)	55	(766)	32
	<u>\$ 877</u>	<u>\$ 2,110</u>	<u>\$ 2,794</u>	<u>\$ (11,970)</u>

NOTE 9 — NET INCOME (LOSS) PER SHARE

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

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
(in thousands, except per share data)				
Numerator:				
Numerator for basic net income (loss) per share	\$ 19,156	\$ 797	\$ 30,333	\$ (11,438)
Add:				
Interest expense on convertible subordinated 4% notes, net of income taxes	434	—	—	—
Numerator for diluted net income (loss) per share	\$ 19,590	\$ 797	\$ 30,333	\$ (11,438)
Denominator:				
Basic average shares outstanding	133,251	125,988	130,893	126,110
Effect of potential dilutive securities:				
Employee stock plans and warrant	7,437	3,562	7,634	—
Assumed conversion of convertible subordinated 4% notes	6,677	—	—	—
Diluted average shares outstanding	147,365	129,550	138,527	126,110
Net income (loss) per share - Basic	\$ 0.14	\$ 0.01	\$ 0.23	\$ (0.09)
Net income (loss) per share - Diluted	\$ 0.13	\$ 0.01	\$ 0.22	\$ (0.09)

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

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
(in thousands)				
Number of potential dilutive securities excluded	1,488	20,139	1,615	19,953

Additionally, the following potential dilutive securities were excluded for purposes of computing diluted net income (loss) per share because the effect would have been antidilutive:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
(in thousands)				
Number of potential dilutive securities excluded - options	—	—	—	3,441
Number of potential dilutive securities excluded - convertible subordinated notes	—	6,677	6,677	6,677
	—	6,677	6,677	10,118

NOTE 10 — COMPREHENSIVE INCOME (LOSS)

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

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
	(in thousands)		(in thousands)	
Net income (loss)	\$19,156	\$ 797	\$30,333	\$(11,438)
Foreign currency translation adjustment	251	39	1,724	(1,036)
Unrealized gain (loss) on fair value of derivative financial instruments, net	(183)	158	(293)	(1,230)
Unrealized gain (loss) on financial instruments, net	628	242	(139)	825
Comprehensive income (loss)	<u>\$19,852</u>	<u>\$ 1,236</u>	<u>\$31,625</u>	<u>\$(12,879)</u>

The balance of accumulated other comprehensive loss is as follows:

	March 28, 2004	June 29, 2003
	(in thousands)	
Accumulated foreign currency translation adjustment	\$(13,429)	\$(15,153)
Accumulated unrealized gain on derivative financial instruments	—	293
Accumulated unrealized gain on financial instruments	1,027	1,166
Accumulated other comprehensive loss	<u>\$(12,402)</u>	<u>\$(13,694)</u>

NOTE 11 — GUARANTEES

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

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

The Company has issued certain indemnifications to its lessors under certain of its operating lease agreements, such as, indemnification for certain environmental matters. The Company has entered into certain insurance contracts to minimize its exposure related to such

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indemnifications. As of March 28, 2004, the Company has not recorded any liability on its financial statements in connection with these indemnifications, as the Company does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

The Company has agreements with two financial institutions that guarantee payment of its Japanese subsidiary's overdraft protection obligation. The maximum potential amount of future payments the Company could be required to make under these agreements at March 28, 2004, is approximately \$5.6 million. As of March 28, 2004, the Company's Japanese subsidiary did not owe any amounts under this agreement. The Company has not recorded any liability in connection with these guarantees, as the Company does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

The Company has an agreement with a financial institution to sell to the institution certain U.S. Dollar-denominated receivables generated from the sale of its systems, subject to recourse provisions. The Company insures these sold receivables for approximately 90% of their value and guarantees payment of the remaining uninsured receivable value in the event that the payment obligation is not satisfied. Based on historical payment patterns, the Company has experienced negligible default on payment obligations and therefore, believes the risk of loss from default is minimal. The terms of these guarantees are from 90 days past the due date of the receivable, until collected. At March 28, 2004 the maximum potential amount of future payments the Company could be required to make under this agreement is approximately \$5.0 million. As of March 28, 2004, the Company has not recorded any liability in connection with these guarantees, as the Company does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

Generally, the Company indemnifies, under pre-determined conditions and limitations, its customers for infringement of third-party intellectual property rights by its products or services. The Company seeks to limit its liability for such indemnity to an amount not to exceed the sales price of the products or services. 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 provides standard warranties on its systems that run generally for a period of 12 months from system acceptance, not to exceed 14 months from the date of shipment of the system to the customer. The liability amount is based on actual historical warranty spending activity by type of system, customer, and geographic region, modified for any known differences such as the impact of system reliability improvements.

Changes in the Company's product warranty reserves during the nine months ended March 28, 2004, were as follows:

	(in thousands)
Balance at June 29, 2003	\$ 16,985
Warranties issued during the period	15,429
Settlements made during the period	(11,405)
Change in liability for pre-existing warranties during the period, including expirations	<u>(2,851)</u>
Balance at March 28, 2004	<u>\$ 18,158</u>

NOTE 12 — DERIVATIVE INSTRUMENTS AND HEDGING

The Company carries derivative financial instruments (derivatives) on the balance sheet at their fair values. The Company has acquired and holds derivative financial instruments to hedge a variety of risks and exposures including interest rate fluctuation risks associated with its long-term debt, foreign currency exchange rate fluctuations on the value of expected cash flows from forecasted revenue transactions denominated in Japanese Yen and foreign currency denominated assets. Changes in the fair value of derivatives that are not designated or that do not qualify as hedges under SFAS 133 are recognized in earnings immediately. The Company does not use derivatives for trading or speculative purposes.

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

Fluctuations in the carrying value of the 4% Notes included in long-term debt and other long-term liabilities were as follows:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
	(in thousands)		(in thousands)	
Increase (decrease)	\$ 2,493	\$ (343)	\$ (6,515)	\$ 13,839

Fluctuations in the fair value of the swap, included in long-term assets, were as follows:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
	(in thousands)		(in thousands)	
Increase (decrease)	\$ 2,279	\$ (349)	\$ (6,607)	\$ 13,661

The corresponding losses, net, resulting from hedge ineffectiveness related to differences in changes in the fair value of the swap and changes in the fair value of the 4% Notes for the three and nine-month periods are recorded in other income (expense), net and were:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
	(in thousands)		(in thousands)	
Losses	\$ (214)	\$ (6)	\$ (92)	\$ (178)

In April, 2004, the Company settled its interest rate swap agreement and announced plans to repay in full its 4% Notes in June 2004, two years prior to their maturity. Please see Note 16 for additional information.

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The Company's policy is to attempt to minimize short-term business exposure to foreign exchange risks using the most effective and efficient methods to eliminate or reduce such exposures. In the normal course of business, the Company's financial position is routinely subjected to market risk associated with foreign currency rate fluctuations. To protect against the reduction in value of forecasted Japanese Yen-denominated cash flows resulting from sales in Japanese Yen, the Company will, at times, institute foreign currency cash flow hedging programs. The Company has previously entered into foreign currency forward exchange contracts that generally expired within 12 months, and no later than 24 months. These foreign currency forward exchange contracts were designated as cash flow hedges and 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 was recognized.

The Company recognized no gains or losses during the quarter ended March 28, 2004 and a net loss of \$0.1 million for the three months ended March 30, 2003, for cash flow hedges that had been discontinued, because the original forecasted transactions did not or were not expected to occur. The Company recognized net gains of \$0.3 million for the nine months ended March 28, 2004 and a net loss of \$0.1 million during the nine months ended March 30, 2003 related to the discontinued cash flow hedges. The losses and gains are recorded in other income (expense) in the condensed consolidated statements of operations.

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

NOTE 13 — RESTRUCTURING ACTIVITIES

The Company has developed plans and incurred restructuring charges to respond to the high level of volatility and, at times, depressed levels of capital investment by the semiconductor industry. The Company systematically reviews its revenue outlook and forecasts and assesses their impact on required employment levels, facilities utilization, and outsourcing activities scope. Based on these evaluations, senior management of the Company committed to cost reduction and exit activities in the quarters ended March 28, 2004 (the March 2004 Plan), December 28, 2003 (the December 2003 Plan), September 28, 2003 (the September 2003 Plan), June 29, 2003 (the June 2003 Plan), March 30, 2003 (the March 2003 Plan), December 29, 2002 (the December 2002 Plan), December 30, 2001 (the December 2001 Plan), and September 23, 2001 (the September 2001 Plan). Prior to the end of each quarter noted above, management with the proper level of authority approved specific actions under the respective Plan and communicated the severance packages to potentially impacted employees in enough detail such that the employees could determine their type and amount of benefit. The termination of the affected employees occurred as soon as practical after the restructuring plans were announced. The amount of remaining future lease payments for facilities the Company ceased to use and included in the restructuring charges is based on management's estimates using known prevailing real estate market conditions at that time based, in part, on the opinions of independent real estate experts. Leasehold improvements relating to the vacated buildings were written off, as these items will have no future economic benefit to the Company and have been abandoned. The Company distinguishes regular operating cost management activities from restructuring activities. Accounting for restructuring activities requires an evaluation of formally committed and approved plans. Restructuring activities have comparatively greater strategic

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significance and materiality and may involve exit activities, whereas regular cost containment activities are more tactical in nature and are rarely characterized by formal and integrated action plans or exiting a particular product, facility, or service.

As of March 28, 2004, the overall restructuring reserve balance consisted of approximately \$2.5 million related to restructurings implemented during fiscal 2004, \$7.6 million related to restructurings implemented during fiscal 2003, \$5.0 million related to restructurings implemented during fiscal 2002, and \$1.4 million related to restructurings implemented prior to fiscal 2002. These same balances consisted of approximately \$0.8 million of severance and benefits-related costs anticipated to be utilized by the end of the 2004 calendar year and \$15.7 million primarily related to lease payments on vacated buildings anticipated to be utilized by the end of fiscal year 2008.

Fiscal 2004 Restructuring Activities

The Company recorded a net restructuring charge during the quarter ended March 28, 2004, of approximately \$1.0 million. Charges for the March 2004 Plan consisted of expenses for the cancellation of a lease agreement related to one of the Company's facilities in Japan of \$1.0 million, and the write-off of related leasehold improvements of \$2.1 million. Charges during the quarter were partially offset by recovery of approximately \$1.5 million, net, of facilities-related expenses primarily due to costs previously accrued for the Japan facility for which the Company entered into a lease cancellation agreement discussed above. Additional offsetting items include recovery of approximately \$0.3 million due to lower than previously estimated employee severance and benefits costs. Recovered inventory from unanticipated sales to the Company's installed base of certain portions of inventory previously written off as part of the Company's September 2001 restructuring resulted in a \$0.3 million credit to cost of goods sold.

The Company recorded a net restructuring charge during the nine months ended March 28, 2004 of approximately \$6.7 million, consisting of severance and benefits for involuntarily terminated employees of \$1.2 million, charges for the present value of remaining lease payments on vacated facilities of \$2.8 million, and the write-off of related leasehold improvements of \$1.6 million. The Company also recorded a charge of approximately \$1.0 million due to the cancellation of a lease agreement related to one of its facilities in Japan and \$2.1 million for the write-off of leasehold improvements associated with this facility. Additionally, the Company recognized \$1.9 million of additional facilities-related expenses due to changes in estimates of restructuring plans initiated prior to fiscal 2004. Charges during the nine-month period were partially offset by recovery of \$1.5 million, net, of facilities-related expenses primarily due to costs previously accrued for the Japan facility for which the Company entered into a lease cancellation agreement during the quarter ended March 28, 2004. Additional offsetting items include recovery of \$0.7 million due to lower than previously estimated employee severance and benefits costs and \$1.7 million of recovered inventory from unanticipated sales to the Company's installed base of certain portions of inventory previously written off as part of the Company's September 2001 restructuring. The inventory recovery was recorded as a credit in cost of goods sold.

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March 2004 Plan

The Company began carrying out the announced restructuring activities prior to March 28, 2004, and recorded a restructuring charge during the quarter ended March, 2004 of approximately \$3.0 million, consisting of charges for the cancellation of a lease agreement related to one of the Company's facilities in Japan, deemed to be no longer useful to the Company's operations, of \$1.0 million, and the write-off of related leasehold improvements of \$2.1 million.

Below is a table summarizing activity relating to the March 2004 Plan:

	Facilities	Abandoned Fixed Assets	Total
			(in thousands)
March 2004 provision	\$ 950	\$ 2,088	\$ 3,038
Cash payments	(780)	—	(780)
Non-cash charges	—	(2,088)	(2,088)
Balance at March 28, 2004	<u>\$ 170</u>	<u>\$ —</u>	<u>\$ 170</u>

December 2003 Plan

The Company began carrying out the announced restructuring activities prior to December 28, 2003, by reducing its workforce by less than 20 employees, primarily in North America and by vacating a facility located also in North America deemed to be no longer useful to the Company's operations. The employees included in the Plan were from a range of functions and at different levels of the organization. The Company recorded a restructuring charge during the quarter ended December 28, 2003 of approximately \$4.2 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, and the write-off of related leasehold improvements.

Below is a table summarizing activity relating to the December 2003 Plan:

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
				(in thousands)
December 2003 provision	\$ 350	\$2,305	\$ 1,514	\$ 4,169
Reversal of restructuring charges	—	(18)	—	(18)
Cash payments	(350)	(58)	—	(408)
Non-cash charges	—	—	(1,514)	(1,514)
Balance at March 28, 2004	<u>\$ —</u>	<u>\$2,229</u>	<u>\$ —</u>	<u>\$ 2,229</u>

September 2003 Plan

The Company began carrying out the announced restructuring activities prior to September 28, 2003, by reducing its workforce primarily in North America and Europe by approximately 20 people and by vacating selected facilities located in North America and Asia deemed to be no longer necessary to the Company's operations. The employees included in the Plan were from a range of functions and at multiple levels of the organization, with the majority of the reductions in North America. The Company recorded a restructuring charge during the quarter ended September 28, 2003 of approximately \$1.2 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities,

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and the write-off of associated leasehold improvements.

Below is a table summarizing activity relating to the September 2003 Plan:

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
	(in thousands)			
September 2003 provision	\$ 713	\$ 394	\$ 123	\$ 1,230
Additional restructuring charges	48	—	—	48
Reversal of restructuring charges	(69)	—	—	(69)
Cash payments	(662)	(345)	—	(1,007)
Non-cash charges	—	—	(123)	(123)
Balance at March 28, 2004	<u>\$ 30</u>	<u>\$ 49</u>	<u>\$ —</u>	<u>\$ 79</u>

Fiscal 2003 Restructuring Activities

June 2003 Plan

The Company began carrying out the announced restructuring activities prior to June 29, 2003, by reducing its workforce in North America, Europe, and Asia by approximately 30 people and by vacating selected sales and administrative facilities located in North America, Europe, and Asia deemed to be no longer required for the Company's operations. The employees included in the Plan were from a broad range of functions and at multiple levels of the organization, with the majority of the reductions in North America. The Company recorded a restructuring charge during the quarter ended June 29, 2003, of approximately \$7.6 million, consisting of severance and benefits for involuntarily terminated employees, charges for the present value of remaining lease payments on vacated facilities, a loss on the fair value of a vacated facility and the write-off of related leasehold improvements. In June 2003, a lease covering one of the Company's vacated facilities at its Fremont, California campus was amended, combined, restated, and transferred to a new lessor under a single lease structure. At the time of the amendment, the leased facility's fair value was less than its original cost by approximately \$1.0 million. Accordingly, this amount was recorded as a loss on the fair value of the vacated facility and included in the \$6.7 million facility-related restructuring charge.

Below is a table summarizing activity relating to the June 2003 Plan:

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
	(in thousands)			
June 2003 provision	\$ 783	\$6,656	\$ 210	\$ 7,649
Cash payments	(366)	(388)	—	(754)
Non-cash charges	—	—	(210)	(210)
Balance at June 29, 2003	<u>417</u>	<u>6,268</u>	<u>—</u>	<u>6,685</u>
Cash payments	(374)	(937)	—	(1,311)
Reversal of restructuring charges	(23)	(2)	—	(25)
Additional restructuring charges	—	84	—	84
Balance at March 28, 2004	<u>\$ 20</u>	<u>\$5,413</u>	<u>\$ —</u>	<u>\$ 5,433</u>

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March 2003 Plan

The Company began carrying out these restructuring activities prior to March 30, 2003, by reducing its workforce in North America and Europe by approximately 50 people and by vacating selected sales and administrative facilities located in North America deemed to be no longer required for the Company's operations. The employees included in the Plan were from a broad range of functions and at multiple levels of the organization, with the majority of the reductions in North America. The Company recorded a restructuring charge during the quarter ended March 30, 2003, of approximately \$4.7 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, and the write-off of related leasehold improvements. \$0.1 million and \$0.2 million were recovered during the three months ended March 28, 2004 and December 28, 2003, respectively, due to a change in estimates related to the Company's facilities. Additionally, during the quarter ended September 28, 2003, \$0.3 million were recovered due to lower than previously estimated employee severance and benefits costs.

Below is a table summarizing activity relating to the March 2003 Plan:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Abandoned Fixed Assets</u>	<u>Total</u>
			(in thousands)	
March 2003 provision	\$ 1,658	\$2,913	\$ 171	\$ 4,742
Cash payments	(855)	(757)	—	(1,612)
Non-cash charges	(228)	—	(171)	(399)
Balance at June 29, 2003	575	2,156	—	2,731
Cash payments	(264)	(473)	—	(737)
Reversal of restructuring charges	(280)	(295)	—	(575)
Balance at March 28, 2004	<u>\$ 31</u>	<u>\$1,388</u>	<u>\$ —</u>	<u>\$ 1,419</u>

December 2002 Plan

The Company began carrying out these restructuring activities prior to December 29, 2002 by reducing its workforce in North America, Europe, and Asia by approximately 120 employees and by vacating selected sales and administrative facilities located in North America, Europe and Asia deemed to be no longer necessary for the Company's operations. The employees included in the Plan were from a broad range of functions and at multiple levels of the organization, with approximately 65% from North America and approximately 35% from Asia and Europe locations. The Company recorded a restructuring charge of \$5.7 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, and the write-off of related leasehold improvements. During the quarter ended March 28, 2004, the Company recovered \$0.1 million due to the difference between the costs previously accrued and actual costs to terminate a lease agreement related to a facility in Japan.

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

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
	(in thousands)			
December 2002 provision	\$ 3,257	\$ 1,945	\$ 474	\$ 5,676
Cash payments	(3,112)	(487)	—	(3,599)
Non-cash charges	—	(49)	(474)	(523)
Balance at June 29, 2003	145	1,409	—	1,554
Reversal of restructuring charges	—	(90)	—	(90)
Cash payments	(77)	(647)	—	(724)
Balance at March 28, 2004	\$ 68	\$ 672	\$ —	\$ 740

Fiscal 2002 Restructuring Activities

December 2001 Plan

During the second fiscal quarter of 2002, the Company began implementing restructuring activities which included reducing its workforce by approximately 470 employees in North America, Europe, and Asia, vacating selected administrative and warehouse facilities at the Company's Fremont, California campus deemed to be no longer required for the Company's operations, and the closure of certain offices in Asia. The employees included in the Plan were from a broad range of functions and at multiple levels throughout the organization with approximately 80% from North America and approximately 20% from Asia and Europe locations. The Company recorded a restructuring charge of \$33.8 million relating to severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities and the write-off of related leasehold improvements and fixed assets.

During fiscal 2004, the Company recorded approximately \$0.4 million of additional restructuring charges due to revision in estimates for one of its vacated facilities. During fiscal 2004, the Company recovered approximately \$1.4 million, net, due to the difference between the costs previously accrued and actual costs to terminate a lease agreement for a facility in Japan during the quarter ended March 28, 2004. During fiscal 2003, the Company recovered approximately \$3.8 million of restructuring charges originally accrued under the December 2001 Plan, \$2.1 million for benefits offered that were not utilized by the terminated employees and approximately \$1.7 million related to a revision to the net amount of lease payments remaining on the vacated facilities. In addition, during fiscal 2003, the Company recorded approximately \$3.0 million of additional restructuring charges of which \$2.5 million were due to revisions the Company made in sublease assumptions for two of its vacated buildings in Fremont, California and approximately \$0.1 million due to additional facility restoration costs. Additionally, the Company revised its estimates for employee termination costs and recorded \$0.4 million of additional expenses.

September 2001 Plan

During the first quarter of fiscal 2002, the Company began implementing restructuring activities which included a reduction of approximately 550 employees in North America, Europe and Asia, vacating selected facilities at the Company's headquarters in Fremont, California deemed to be no longer required for the Company's operations and discontinuance of the manufacture of specific products within the Company's etch product lines. The employees were from a broad range of functions and at multiple levels of the organization, with approximately

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85% from North America and 15% from Asia and Europe locations. The Company recorded a restructuring charge of \$21.0 million which included severance and benefits for involuntarily terminated employees, charges for remaining lease payments, write-offs of leasehold improvements on vacated facilities, and inventory write-downs. The inventory charge of approximately \$7.6 million related to the Company's decision to discontinue manufacture of specific systems within the Company's etch product lines. The Company recovered approximately \$0.3 million and \$1.7 million during the three and nine months ended March 28, 2004 and \$1.7 million during fiscal years 2003 and 2002, respectively, from unanticipated subsequent sales to the Company's installed base of these items. In addition, the Company physically disposed of approximately \$1.0 million of this inventory during the nine months ended March 28, 2004 and \$2.7 million during fiscal 2003 and 2002.

During fiscal 2003, approximately \$0.9 million was recovered due to lower employee severance and termination costs of \$0.6 million and actual expenses being lower than estimated for vacated facility leases of \$0.3 million. In addition, in the second quarter of fiscal 2003, the Company recorded additional charges for the September 2001 Plan based on a revised estimate of the length of time required to sublease one of its vacated buildings in Fremont, California. Based on prevailing market conditions, the Company extended the accrual for lease payments to the end of the lease in June 2004 and recorded an additional \$0.6 million expense.

During fiscal 2002, the Company recovered approximately \$1.0 million of the September 2001 Plan charge due to lower than estimated employee termination costs of \$0.7 million and lower than planned expenses relating to a vacated facility lease of \$0.3 million.

Fiscal 2001 Restructuring Plans

During the second quarter of fiscal 2003, the Company completed the remaining elements of its restructuring activities under the June 2001 Plan. A final \$1.1 million of restructuring charges was recovered due to lower than estimated employee termination costs.

NOTE 14 — EQUITY DERIVATIVE CONTRACTS IN COMPANY STOCK

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

On August 23, 2002, the Company settled its outstanding equity derivative contracts by purchasing approximately 3.5 million shares of Lam common stock at an average price of \$11.19 per share for a total cash payment of \$39.1 million. By settling the equity derivative contracts, the Company was able to repurchase the shares recording a life-to-date gain of \$8.4 million (\$2.41 per share) from their then market value. As a result of this transaction, the Company recognized an increase in treasury stock of \$47.6 million and a \$16.4 million reduction in the equity derivative contracts' fair value which was recorded as a non-taxable loss in other income (expense), net, during the three months ended September 29, 2002.

NOTE 15 — RELATED PARTY TRANSACTIONS

During fiscal year 2001, the Company's President and Chief Operating Officer (COO) signed a promissory note with the Company entitling him to borrow up to \$1.0 million from the Company at 6.75% simple interest. The Company's President and COO had previously been advanced the \$1.0 million and repaid the entire amount of \$1.0 million, plus accrued interest, during the quarter ended December 28, 2003.

NOTE 16 — SUBSEQUENT EVENTS

On April 1, 2004, the Company settled its interest rate swap agreement (the swap) which had been used to minimize the impact of interest rate exposure associated with the Company's fixed rate convertible subordinated 4% notes (4% Notes) as discussed in Note 12. This settlement resulted in an increase in cash of approximately \$11 million and, in addition, a transfer of \$6 million from restricted cash to cash balances during the quarter ending June 27, 2004.

On April 14, 2004, the Company announced plans to repay in full its 4% Notes in June 2004, two years prior to their maturity. The Company has set June 5, 2004 as the redemption date for the 4% Notes. Noteholders may redeem their 4% Notes for cash including the redemption price and interest accrued from June 1, 2004 through June 4, 2004. Alternatively, prior to 5:00 p.m. Eastern Time, on June 4, 2004, noteholders may convert their 4% Notes into shares of the Company's common stock at a price of approximately \$44.93 per share, or 22.2568 shares of the Company's common stock per \$1,000 principal amount. Any 4% Notes that are not converted will be automatically redeemed on June 5, 2004, and after June 4, 2004, no further interest will accrue on the 4% Notes. The redemption price plus unpaid accrued interest will be payable on June 7, 2004. The repayment of the 4% Notes is expected to result in a cash outlay of approximately \$303 million, including a redemption premium of \$3 million and accrued and unpaid interest as of the redemption date. Additionally, the Company will write off approximately \$3.5 million of unamortized offering expenses as of June 7, 2004.

The Company has a deferred gain of approximately \$11 million recorded on the balance sheet related to the swap. As a result of the settlement of the swap and the redemption of the 4% Notes, the Company expects to record a net gain of approximately \$4 million included in other income, net during the quarter ending June 27, 2004. The net gain is comprised of the deferred gain noted above, less the redemption premium, write-off of unamortized offering expenses, and transaction-related costs.

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

CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

With the exception of historical facts, the statements contained in this discussion are forward-looking statements, which are subject to the Safe Harbor provisions created by the Private Securities Litigation Reform Act of 1995. Such forward-looking statements include, but are not limited to, statements that relate to our future revenue, product development, demand, acceptance and market share, competitiveness, gross margins, levels of research and development (R&D), outsourcing plans and operating expenses, our management's plans and objectives for our current and future operations, the effects of our restructurings and consolidation of operations and facilities, our ability to complete contemplated restructurings or consolidations on time or within anticipated costs, the levels of customer spending or R&D activities, general economic conditions and the sufficiency of financial resources to support future operations, and capital expenditures. Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value and effect, including those discussed below under the heading "Risk Factors" within the section of this report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other documents we file from time to time with the Securities and Exchange Commission, such as our last filed Annual Report on Form 10-K for the fiscal year ended June 29, 2003, our quarterly report on Form 10-Q for the quarter ended December 28, 2003, and our current reports on Form 8-K. Such risks, uncertainties and changes in condition, significance, value and effect could cause our actual results to differ materially from those expressed herein and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known to us. We undertake no obligation to release the results of any revisions to these forward-looking statements, which may be made to reflect events or circumstances, which occur after the date hereof or to reflect the occurrence or effect of anticipated or unanticipated events.

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

This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes presented in this Form 10-Q and the financial statements and notes in our last filed Annual Report on Form 10-K and Form 10-Q for the three and six months ended December 28, 2003 for a full understanding of our financial position and results of operations for the three and nine-month periods ended March 28, 2004.

RESULTS OF OPERATIONS

Lam Research Corporation (Lam or the Company) is a major supplier of semiconductor capital equipment. Our product offerings include single-wafer plasma etch systems with a wide range of applications, Chemical Mechanical Planarization (CMP) and Post-CMP wafer cleaning systems, and an array of services designed to optimize the utilization of these systems by our customers.

The semiconductor industry is cyclical in nature and has historically experienced periodic downturns and upturns. Over the past three business cycles, the severity of these fluctuations has increased, and today's leading indicators of changes in customer investment patterns may not be any more reliable than in prior years. Demand for our equipment can vary significantly from period to period as a result of various factors, including, but not limited to, economic conditions, supply, demand, and price 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 nine months ended March 28, 2004 may not necessarily be indicative of future operating results.

Revenue

	Three Months Ended			Nine Months Ended		
	March 28, 2004	March 30, 2003	Percent Change	March 28, 2004	March 30, 2003	Percent Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Revenue	\$ 231,128	\$ 187,059	23.6%	\$ 606,374	\$ 569,148	6.5%

Revenues for the quarter ended March 28, 2004 increased \$44.1 million, or 23.6% from the same period in the prior year, reflective of the early stages of the current cycle recovery. Revenues during the nine-month period ended March 28, 2004 as compared to the prior year increased by \$37.2 million, or 6.5%. Our market environment has continued to improve through the March 2004 quarter, evidenced by expanded levels of capital investments by semiconductor manufacturers. The overall increase in revenues is influenced by increased demand, shorter system installation cycles and faster customer acceptances.

Regional geographic breakdown of revenue is as follows:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
North America	15%	23%	20%	25%
Europe	19%	25%	20%	20%
Asia Pacific	53%	44%	49%	46%
Japan	13%	8%	11%	9%

We expect revenues for the June 2004 quarter to increase to approximately \$300 million based upon higher shipments combined with customer acceptance patterns similar to the quarter just ended.

Based on the guidance provided by Securities and Exchange Commission Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements", as amended by Securities and Exchange Commission Staff Accounting Bulletin No. 104 (SAB 104), "Revenue Recognition", we generally recognize new systems revenue when we receive customer acceptance or are otherwise released from our customer acceptance obligations. Refer to our discussion of "Critical Accounting Policies" within this document for additional information about our revenue recognition policy. Where customer acceptance provisions exist, the fiscal period in which we are able to recognize systems revenue is typically determined based on the length of time that our customers require to evaluate the performance of our equipment to agreed standards and specifications. On average, revenue recognition for systems normally occurs from two to five months after the date of shipment. Spares and system upgrade revenues are generally recognized on the date of shipment, and service revenues are generally recognized upon performance of the activities requested by the customer, including training and extended warranty support.

Gross Margin

	Three Months Ended			Nine Months Ended		
	March 28, 2004	March 30, 2003	Percent Change	March 28, 2004	March 30, 2003	Percent Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Gross Margin	\$ 106,113	\$ 75,221	41.1%	\$ 271,846	\$ 226,705	19.9%
Percent of total revenue	45.9%	40.2%		44.8%	39.8%	

We have maintained focus on designing our systems to achieve more efficient purchasing and installation processes, and supporting the latest achievement of gross margin as a percent of revenue of 45.9%. This performance represents the fifth successive quarter of positive gross margin progression. The improved outcome for the three and nine months ended March 28, 2004 as compared to the prior year is additionally due to better utilization of factory and field resources combined with expense management programs. These cost reductions were partially offset by increases in employment expenses due to salary adjustments and the triggering of profit-related variable incentive-based compensation. During the three and nine months ended March 28, 2004, we recovered and recorded in cost of goods sold \$0.3 million and \$1.7 million, respectively, from unanticipated sales of certain inventories previously written off as part of our September 2001 restructuring.

During the June 2004 quarter, we expect gross margin as a percent of revenues to continue to improve, reaching approximately 47%.

Research and Development

	Three Months Ended			Nine Months Ended		
	March 28, 2004	March 30, 2003	Percent Change	March 28, 2004	March 30, 2003	Percent Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Research and Development	\$ 42,914	\$ 38,981	10.1%	\$ 120,518	\$ 120,102	0.3%
Percent of total revenue	18.6%	20.8%		19.9%	21.1%	

To remain competitive, we have continued to invest significantly in research and development aiming at strengthening of our product and services portfolio. The increase in absolute dollars for the three months ended March 28, 2004 as compared to the same period in the prior fiscal year is due primarily to salary adjustments and benefits increases triggered by profit-related incentive-based compensation. Expense levels remained relatively flat for the nine-month period ended March 28, 2004 as compared to the prior year as increases in payroll costs were largely offset by lowered costs of supplies and reductions in facilities-related expenses due to infrastructure rationalization. The decrease in expenses as a percent of revenues for both periods is reflective of continued focus on improving our productivity, as expenses increased by less than half of our revenue growth rate.

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	Three Months Ended			Nine Months Ended		
	March 28, 2004	March 30, 2003	Percent Change	March 28, 2004	March 30, 2003	Percent Change
	(in thousands, except percentages)			(in thousands, except percentages)		
Selling, General & Administrative (SG&A)	\$ 37,218	\$ 33,245	12.0%	\$ 105,352	\$ 98,319	7.2%
Percent of total revenue	16.1%	17.8%		17.4%	17.3%	

The primary reasons for the dollar uptick in SG&A expenses for the quarter ending March 28, 2004 as compared with the prior year are increased compensation costs as discussed above, partially offset by reduced facilities expenditures. The growth in the nine-month period of fiscal 2004 over fiscal 2003 is the result of increased compensation costs, selective investments in customer support efforts, and the charges related to the accelerated vesting of a stock option award as discussed in Note 7 to the Condensed Consolidated Financial Statements. Reductions in facilities costs resulting from a smaller infrastructure, partially offset the higher level of expenses described above. The decrease in expenses as a percent of revenues for the quarter ended March, 2004 is reflective of the leverage in our business model as expenses increased by approximately half that of our revenue growth rate. The slight increase in expenses as a percent of revenues during the nine months ended March 28, 2004 is primarily a result of the charge related to the stock option award accelerated vesting discussed above.

We expect total operating expenses to increase during the June 2004 quarter as we plan to undertake the implementation of various information technology and research and development-related projects designed to improve productivity across the Company.

Restructuring Activities

We have developed plans and incurred restructuring charges to respond to the high level of volatility and, at times, depressed levels of capital investment by the semiconductor industry. We systematically review our revenue outlook and forecasts and assess their impact on required employment levels, facilities utilization, and outsourcing activities scope. Based on these evaluations, our senior management committed to cost reduction and exit activities in the quarters ended March 28, 2004 (the March 2004 Plan), December 28, 2003 (the December 2003 Plan), September 28, 2003 (the September 2003 Plan), June 29, 2003 (the June 2003 Plan), March 30, 2003 (the March 2003 Plan), December 29, 2002 (the December 2002 Plan), December 30, 2001 (the December 2001 Plan), and September 23, 2001 (the September 2001 Plan). Prior to the end of each quarter noted above, management with the proper level of authority approved specific actions under the respective Plan and communicated the severance packages to potentially impacted employees in enough detail such that the employees could determine their type and amount of benefit. The termination of the affected employees occurred as soon as practical after the restructuring plans were announced. The amount of remaining future lease payments for facilities we ceased to use and included in the restructuring charges is based on management's estimates using known prevailing real estate market conditions at that time based, in part, on the opinions of independent real estate experts. Leasehold improvements relating to the vacated buildings were written off, as these items will have no future economic benefit to us and have been abandoned. We distinguish regular operating cost management activities from restructuring activities. Accounting for restructuring activities requires an evaluation of formally committed and approved plans. Restructuring activities have comparatively greater strategic significance and materiality and may involve exit activities, whereas regular cost containment activities are more tactical in nature and are rarely characterized by formal and integrated action plans or exiting a particular product, facility, or

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service.

As of March 28, 2004, the overall restructuring reserve balance consisted of approximately \$2.5 million related to restructurings implemented during fiscal 2004, \$7.6 million related to restructurings implemented during fiscal 2003, \$5.0 million related to restructurings implemented during fiscal 2002, and \$1.4 million related to restructurings implemented prior to fiscal 2002. These same balances consisted of approximately \$0.8 million of severance and benefits-related costs anticipated to be utilized by the end of the 2004 calendar year and \$15.7 million primarily related to lease payments on vacated buildings anticipated to be utilized by the end of fiscal year 2008.

Fiscal 2004 Restructuring Activities

We recorded a net restructuring charge during the quarter ended March 28, 2004, of approximately \$1.0 million. Charges for the March 2004 Plan consisted of expenses for the cancellation of a lease agreement related to one of our facilities in Japan of \$1.0 million, and the write-off of related leasehold improvements of \$2.1 million. Charges during the quarter were partially offset by recovery of approximately \$1.5 million, net, of facilities-related expenses primarily due to costs previously accrued for the Japan facility for which we entered into a lease cancellation agreement discussed above. Additional offsetting items include recovery of approximately \$0.3 million due to lower than previously estimated employee severance and benefits costs. Recovered inventory from unanticipated sales to our installed base of certain portions of inventory previously written off as part of our September 2001 restructuring resulted in a \$0.3 million credit to cost of goods sold.

We recorded a net restructuring charge during the nine months ended March 28, 2004 of approximately \$6.7 million, consisting of severance and benefits for involuntarily terminated employees of \$1.2 million, charges for the present value of remaining lease payments on vacated facilities of \$2.8 million, and the write-off of related leasehold improvements of \$1.6 million. We also recorded a charge of approximately \$1.0 million due to the cancellation of a lease agreement related to one of our facilities in Japan and \$2.1 million for the write-off of related leasehold improvements. Additionally, we recognized \$1.9 million of additional facilities-related expenses due to changes in estimates of restructuring plans initiated prior to fiscal 2004. Charges during the nine-month period were partially offset by recovery of \$1.5 million, net, of facilities-related expenses primarily due to costs previously accrued for the Japan facility for which we entered into a lease cancellation agreement during the quarter ended March 28, 2004. Additional offsetting items include recovery of \$0.7 million due to lower than previously estimated employee severance and benefits costs and \$1.7 million of recovered inventory from unanticipated sales to our installed base of certain portions of inventory previously written off as part of our September 2001 restructuring. The inventory recovery was recorded as a credit in cost of goods sold.

As a result of the fiscal 2004 restructuring activities, we expect quarterly savings in total expenses of approximately \$0.1 million from the March 2004 Plan, \$0.7 million from the December 2003 Plan and \$0.5 million from the September 2003 Plan. The majority of the savings are expected to be realized within Operating Expenses, mainly Selling, General and Administrative expenses. These estimated savings from the Plans' discrete actions are primarily related to lower employee payroll, facilities, and depreciation expenses. Actual savings may vary from these forecasts, depending upon future events and circumstances, such as differences in actual sublease income versus estimated amounts. Through March 28, 2004, we believe actual savings from the December 2003 and September 2003 Plans are largely consistent with original

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estimated quarterly savings.

March 2004 Plan

We began carrying out the announced restructuring activities prior to March 28, 2004, and recorded a restructuring charge during the quarter ended March, 2004 of approximately \$3.0 million, consisting of charges for the cancellation of a lease agreement related to one of our facilities in Japan, deemed to be no longer useful to the Company's operations, of \$1.0 million, and the write-off of related leasehold improvements of \$2.1 million.

Below is a table summarizing activity relating to the March 2004 Plan:

	<u>Facilities</u>	<u>Abandoned Fixed Assets</u>	<u>Total</u>
		(in thousands)	
March 2004 provision	\$ 950	\$ 2,088	\$ 3,038
Cash payments	(780)	—	(780)
Non-cash charges	—	(2,088)	(2,088)
Balance at March 28, 2004	<u>\$ 170</u>	<u>\$ —</u>	<u>\$ 170</u>

December 2003 Plan

We began carrying out the announced restructuring activities prior to December 28, 2003, by reducing our workforce by less than 20 employees, primarily in North America and by vacating a facility located also in North America deemed to be no longer useful to our operations. The employees included in the Plan were from a range of functions and at different levels of the organization. We recorded a restructuring charge during the quarter ended December 28, 2003 of approximately \$4.2 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, and the write-off of related leasehold improvements.

Below is a table summarizing activity relating to the December 2003 Plan:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Abandoned Fixed Assets</u>	<u>Total</u>
			(in thousands)	
December 2003 provision	\$ 350	\$2,305	\$ 1,514	\$ 4,169
Reversal of restructuring charges	—	(18)	—	(18)
Cash payments	(350)	(58)	—	(408)
Non-cash charges	—	—	(1,514)	(1,514)
Balance at March 28, 2004	<u>\$ —</u>	<u>\$2,229</u>	<u>\$ —</u>	<u>\$ 2,229</u>

September 2003 Plan

We began carrying out the announced restructuring activities prior to September 28, 2003, by reducing our workforce primarily in North America and Europe by approximately 20 people and by vacating selected facilities located in North America and Asia deemed to be no longer necessary to our operations. The employees included in the Plan were from a range of functions and at multiple levels of the organization, with the majority of the reductions in North America. We recorded a restructuring charge during the quarter ended September 28, 2003 of approximately \$1.2 million, consisting of severance and benefits for involuntarily terminated

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employees, charges for remaining lease payments on vacated facilities, and the write-off of associated leasehold improvements.

Below is a table summarizing activity relating to the September 2003 Plan:

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
	(in thousands)			
September 2003 provision	\$ 713	\$ 394	\$ 123	\$ 1,230
Additional restructuring charges	48	—	—	48
Reversal of restructuring charges	(69)	—	—	(69)
Cash payments	(662)	(345)	—	(1,007)
Non-cash charges	—	—	(123)	(123)
Balance at March 28, 2004	<u>\$ 30</u>	<u>\$ 49</u>	<u>\$ —</u>	<u>\$ 79</u>

Fiscal 2003 Restructuring Activities

As a result of the fiscal 2003 restructuring activities, we expect quarterly savings of approximately \$1.0 million from the June 2003 Plan, \$1.0 million from the March 2003 Plan, and \$3.0 million from the December 2002 Plan. The majority of the savings are expected to be realized within Operating Expenses, mainly Selling, General and Administrative expenses. These estimated savings are primarily from lower payroll, facilities, and depreciation expenses. Actual results may vary from those anticipated, depending upon future events and circumstances, such as differences in actual sublease income versus estimated amounts. Through March 28, 2004, we believe realized savings are consistent with original forecasts. However, other factors may significantly influence our future cost structure and, consequently, partially or totally offset savings from the Plans.

June 2003 Plan

We began carrying out the announced restructuring activities prior to June 29, 2003, by reducing our workforce in North America, Europe, and Asia by approximately 30 people and by vacating selected sales and administrative facilities located in North America, Europe, and Asia deemed to be no longer required for our operations. The employees included in the Plan were from a broad range of functions and at multiple levels of the organization, with the majority of the reductions in North America. We recorded a restructuring charge during the quarter ended June 29, 2003, of approximately \$7.6 million, consisting of severance and benefits for involuntarily terminated employees, charges for the present value of remaining lease payments on vacated facilities, a loss on the fair value of a vacated facility and the write-off of related leasehold improvements. In June 2003, a lease covering one of our vacated facilities at our Fremont, California campus was amended, combined, restated, and transferred to a new lessor under a single lease structure. At the time of the amendment, the leased facility's fair value was less than its original cost by approximately \$1.0 million. Accordingly, this amount was recorded as a loss on the fair value of the vacated facility and included in the \$6.7 million facility-related restructuring charge.

Below is a table summarizing activity relating to the June 2003 Plan:

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
	(in thousands)			
June 2003 provision	\$ 783	\$6,656	\$ 210	\$ 7,649
Cash payments	(366)	(388)	—	(754)
Non-cash charges	—	—	(210)	(210)
Balance at June 29, 2003	<u>417</u>	<u>6,268</u>	<u>—</u>	<u>6,685</u>
Cash payments	(374)	(937)	—	(1,311)
Reversal of restructuring charges	(23)	(2)	—	(25)
Additional restructuring charges	—	84	—	84
Balance at March 28, 2004	<u>\$ 20</u>	<u>\$5,413</u>	<u>\$ —</u>	<u>\$ 5,433</u>

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March 2003 Plan

We began carrying out these restructuring activities prior to March 30, 2003, by reducing our workforce in North America and Europe by approximately 50 people and by vacating selected sales and administrative facilities located in North America deemed to be no longer required for our operations. The employees included in the Plan were from a broad range of functions and at multiple levels of the organization, with the majority of the reductions in North America. We recorded a restructuring charge during the quarter ended March 30, 2003, of approximately \$4.7 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, and the write-off of related leasehold improvements. \$0.1 million and \$0.2 million were recovered during the three months ended March 28, 2004 and December 28, 2003, respectively, due to a change in estimates related to our facilities. Additionally, during the quarter ended September 28, 2003, \$0.3 million were recovered due to lower than previously estimated employee severance and benefits costs.

Below is a table summarizing activity relating to the March 2003 Plan:

	<u>Severance and Benefits</u>	<u>Facilities</u>	<u>Abandoned Fixed Assets</u>	<u>Total</u>
	(in thousands)			
March 2003 provision	\$ 1,658	\$2,913	\$ 171	\$ 4,742
Cash payments	(855)	(757)	—	(1,612)
Non-cash charges	(228)	—	(171)	(399)
Balance at June 29, 2003	575	2,156	—	2,731
Cash payments	(264)	(473)	—	(737)
Reversal of restructuring charges	(280)	(295)	—	(575)
Balance at March 28, 2004	<u>\$ 31</u>	<u>\$1,388</u>	<u>\$ —</u>	<u>\$ 1,419</u>

December 2002 Plan

We began carrying out these restructuring activities prior to December 29, 2002 by reducing our workforce in North America, Europe, and Asia by approximately 120 employees and by vacating selected sales and administrative facilities located in North America, Europe and Asia deemed to be no longer necessary for our operations. The employees included in the Plan were from a broad range of functions and at multiple levels of the organization, with approximately 65% from North America and approximately 35% from Asia and Europe locations. We recorded a restructuring charge of \$5.7 million, consisting of severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities, and the write-off of related leasehold improvements. During the quarter ended March 28, 2004, we recovered \$0.1 million due to the difference between the costs previously accrued and actual costs to terminate a lease agreement related to a facility in Japan.

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

	Severance and Benefits	Facilities	Abandoned Fixed Assets	Total
	(in thousands)			
December 2002 provision	\$ 3,257	\$ 1,945	\$ 474	\$ 5,676
Cash payments	(3,112)	(487)	—	(3,599)
Non-cash charges	—	(49)	(474)	(523)
Balance at June 29, 2003	145	1,409	—	1,554
Reversal of restructuring charges	—	(90)	—	(90)
Cash payments	(77)	(647)	—	(724)
Balance at March 28, 2004	\$ 68	\$ 672	\$ —	\$ 740

Fiscal 2002 Restructuring Activities

December 2001 Plan

During the second fiscal quarter of 2002, we began implementing restructuring activities which included reducing our workforce by approximately 470 employees in North America, Europe, and Asia, vacating selected administrative and warehouse facilities at our Fremont, California campus deemed to be no longer required for our operations, and the closure of certain offices in Asia. The employees included in the Plan were from a broad range of functions and at multiple levels throughout the organization with approximately 80% from North America and approximately 20% from Asia and Europe locations. We recorded a restructuring charge of \$33.8 million relating to severance and benefits for involuntarily terminated employees, charges for remaining lease payments on vacated facilities and the write-off of related leasehold improvements and fixed assets.

During fiscal 2004, we recorded approximately \$0.4 million of additional restructuring charges due to revision in estimates for one of our vacated facilities. During fiscal 2004, we recovered approximately \$1.4 million, net, due to the difference between the costs previously accrued and actual costs to terminate a lease agreement for a facility for which we entered into a lease cancellation agreement during the quarter ended March 28, 2004. During fiscal 2003, we recovered approximately \$3.8 million of restructuring charges originally accrued under the December 2001 Plan, \$2.1 million for benefits offered that were not utilized by the terminated employees and approximately \$1.7 million related to a revision to the net amount of lease payments remaining on the vacated facilities. In addition, during fiscal 2003, we recorded approximately \$3.0 million of additional restructuring charges of which \$2.5 million were due to revisions we made in sublease assumptions for two of our vacated buildings in Fremont, California and approximately \$0.1 million due to additional facility restoration costs. Additionally, we revised our estimates for employee termination costs and recorded \$0.4 million of additional expenses.

September 2001 Plan

During the first quarter of fiscal 2002, we began implementing restructuring activities which included a reduction of approximately 550 employees in North America, Europe and Asia, vacating selected facilities at our headquarters in Fremont, California deemed to be no longer required for our operations and discontinuance of the manufacture of specific products within our etch product lines. The employees were from a broad range of functions and at multiple levels of the organization, with approximately 85% from North America and 15% from Asia and

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Europe locations. We recorded a restructuring charge of \$21.0 million which included severance and benefits for involuntarily terminated employees, charges for remaining lease payments, write-offs of leasehold improvements on vacated facilities, and inventory write-downs. The inventory charge of approximately \$7.6 million related to our decision to discontinue manufacture of specific systems within our etch product lines. We recovered approximately \$0.3 million and \$1.7 million during the three and nine months ended March 28, 2004 and \$1.7 million during fiscal years 2003 and 2002, respectively, from unanticipated subsequent sales to our installed base of these items. In addition, we physically disposed of approximately \$1.0 million of this inventory during the nine months ended March 28, 2004 and \$2.7 million during fiscal 2003 and 2002.

During fiscal 2003, approximately \$0.9 million was recovered due to lower employee severance and termination costs of \$0.6 million and actual expenses being lower than estimated for vacated facility leases of \$0.3 million. In addition, in the second quarter of fiscal 2003, we recorded additional charges for the September 2001 Plan based on a revised estimate of the length of time required to sublease one of our vacated buildings in Fremont, California. Based on prevailing market conditions, we extended the accrual for lease payments to the end of the lease in June 2004 and recorded an additional \$0.6 million expense.

During fiscal 2002, we recovered approximately \$1.0 million of the September 2001 Plan charge due to lower than estimated employee termination costs of \$0.7 million and lower than planned expenses relating to a vacated facility lease of \$0.3 million.

Fiscal 2001 Restructuring Plans

During the second quarter of fiscal 2003, we completed the remaining elements of our restructuring activities under the June 2001 Plan. A final \$1.1 million of restructuring charges was recovered due to lower than estimated employee termination costs.

Other Income (Expense), net

Other income, net for the three-month period ended March 28, 2004 was \$0.9 million compared to \$2.1 million in the corresponding period of fiscal 2003. The primary reason for the change was a decrease in interest income of approximately \$0.9 million. Although total cash and cash equivalents, short-term investments and restricted cash balances increased by \$166.2 million at March 28, 2004 as compared to the prior year, lower market rates yielded less interest income for the most recent quarter.

Other income (expense), net for the nine-month period ended March 28, 2004 was income of \$2.8 million compared to expense of \$12.0 million in the corresponding period of fiscal 2003. The change from fiscal 2003 to fiscal 2004 was primarily due to the settlement, in August 2002, of certain equity derivative instruments indexed to Lam stock. We settled those instruments, and recorded a \$16.4 million loss in the quarter ended September 29, 2002, resulting in the instruments' life-to-date gain of \$8.4 million. The majority of the remainder of the change included lower interest expense of \$3.3 million and decreased debt issuance cost amortization of \$0.8 million as a result of the repayment of our 5% convertible subordinated notes on September 2, 2002. These items were partially offset by lower interest income of \$5.7 million primarily due to reduced interest rate yields.

Income Tax Expense

Income tax expense for the three and nine months ended March 28, 2004 and March 30, 2003 was recorded using a 25% estimated effective tax rate in each period. The loss on the settlement of our equity derivative instruments of \$16.4 million recorded in the quarter ended September 29, 2002, was not deductible for tax reporting purposes. Our fiscal 2004 tax rate estimate is based on our current profitability outlook, including our continued and substantial investments in research and development programs qualifying for R&D tax benefits. We have implemented strategies to, in the longer-term, limit our tax liability on the sale of our products worldwide. These tax strategies are structured to align the asset ownership and functions of our various legal entities around the world, with our expectations of the level, timing, and sources of future revenues and profits.

Deferred Income Taxes

We had gross deferred tax assets arising from temporary differences, net operating losses, and tax credit carryforwards of \$284.1 million and \$287.5 million as of March 28, 2004 and June 29, 2003, respectively. The gross deferred tax assets were offset by a valuation allowance of \$36.7 million as of March 28, 2004 and June 29, 2003. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more likely than not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. We evaluate the realizability of the deferred tax assets quarterly and will continue to assess the need for additional or less valuation allowances, if any, in subsequent quarters.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, 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 subjective judgments, often as a result of the need to make estimates about matters that are inherently uncertain. We believe that the following critical accounting policies reflect the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

Revenue Recognition: We recognize all revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, collectibility is reasonably assured, and we have completed our system installation obligations, received customer acceptance or are otherwise released from our installation or customer acceptance obligations. In the event that terms of the sale provide for a lapsing customer acceptance period, we recognize revenue upon the expiration of the lapsing acceptance period or customer acceptance, whichever occurs first. In circumstances where the practices of a customer do not provide for a written acceptance and in addition, the terms of sale do not include

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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. Revenue related to sales of spare parts, system upgrade kits, and remanufactured systems is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of performance of the services requested by a customer order. Revenue for extended maintenance service contracts with a fixed payment amount and a term more than one month is recognized on a straight-line basis over the term of the contract.

We changed our revenue recognition policy in the fourth quarter of fiscal 2001, effective June 26, 2000, based on guidance provided in SAB 101, as amended by SAB 104.

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 delivery of the products unless other customer practices prevail.

Standard costs are generally 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, 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 sale and purchase 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, marketing and selling semiconductor capital equipment includes providing parts and service warranty to customers as part of the overall price of the system. We provide standard warranties for our systems 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. 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 differences such as tool reliability improvements. All actual parts and labor costs incurred in subsequent periods are charged to those established reserves through the application of detailed project record keeping.

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

We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. Historically, including the most recent three months ended March 28, 2004, all warranty obligations have been determined with reasonable estimates.

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

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

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

Deferred Income Taxes: We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more likely than not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more likely than not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed. Our current valuation allowance of \$36.7 million covers the tax benefit from the exercise of employee stock options and foreign tax credits. When the stock option tax benefits are realized, a portion of the valuation allowance will

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be reversed and credited to capital in excess of par value. When the foreign tax credits are realized, the remaining portion of the valuation allowance will be reversed through the tax provision (benefit) in the statement of operations as a reduction of income tax expense.

Recent Accounting Pronouncements

Accounting for Revenue Arrangements with Multiple Deliverables: In November 2002, the Financial Accounting Standards Board's (FASB) Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" (EITF 00-21). EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple deliverables (products, services, and/or rights to use assets). The provisions of EITF 00-21 are applicable for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF 00-21 did not have a material impact on our financial position or results of operations.

Amendment of Statement 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133), on Derivative Instruments and Hedging Activities: In April 2003, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", (SFAS 149). SFAS 149 amends SFAS 133 for decisions made as part of the Derivatives Implementation Group (DIG) and changes financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. Specifically, SFAS 149 (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS 133, (2) clarifies when a derivative contains a financing component that requires reporting as cash flows from financing activities in the statement of cash flows and (3) amends the definition of an "underlying" to correspond to the language in FASB Interpretation (FIN) Number 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Indebtedness of Others." These changes will result in more consistent reporting of contracts that are derivatives in their entirety or that contain embedded derivatives that require separate accounting. SFAS 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. However, the provisions of SFAS 149 that codify the previous decisions made by the DIG are already effective and should continue to be applied in accordance with their prior respective effective dates. The adoption of SFAS 149 did not have a material impact on our financial position or results of operations.

Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity: In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity", (SFAS 150). SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS 150 represents a significant change in practice in the accounting for a number of financial instruments including mandatorily redeemable equity instruments and certain equity derivatives that frequently are used in connection with share repurchase programs. SFAS 150 generally requires liability classification for two broad classes of financial instruments: (1) instruments that represent, or are indexed to, an obligation to buy back the issuer's shares, regardless of whether the instrument is settled on a net-cash or gross physical basis, (2) obligations that can be settled in shares but meet one of the following conditions: (a) derive their value predominately from some other underlying, or (b) have a fixed value, or have a value to the counterparty that moves in the opposite direction as the issuer's shares. Many of the instruments within the scope of SFAS 150 were previously classified by the issuer as equity or temporary equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is

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effective the first quarter of fiscal 2004. The adoption of SFAS 150 did not have a material impact on our financial position or results of operations.

Revenue Recognition: In December 2003, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 104, "Revenue Recognition" (SAB 104). SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of the Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. We believe we are following the guidance of SAB 104, and the adoption of SAB 104 did not have a material impact on our financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents, short-term investments, and restricted cash increased by \$125.7 million to \$751.5 million at March 28, 2004 as compared to June 29, 2003 primarily due to net cash provided by operating and financing activities for the nine months ended March 28, 2004.

Net cash provided by operations for the nine-month period ended March 28, 2004, was \$74.7 million. Net income of \$30.3 million, adjusted for non-cash charges including depreciation and amortization, amortization of deferred stock-based compensation, deferred taxes and certain restructuring charges, resulted in positive cash flow of \$69.2 million. Inventory turns increased from 3.9 as of June 29, 2003 to 4.5 as of March 28, 2004 as net inventories decreased by \$3.6 million reflecting continued asset management efforts while accounts payable increased by \$46.8 million primarily due to increased manufacturing volume. As shipments outstripped acceptances, deferred profit and net accounts receivable increased by \$11.4 million and \$72.2 million, respectively. We have an agreement to sell certain U.S. Dollar-denominated receivables, subject to certain recourse provisions to a financial institution. During the three and nine months ended March 28, 2004, we sold \$49.9 million and \$98.7 million, respectively, of accounts receivable. At March 28, 2004, \$49.9 million of these receivables, approximately 90% of which are insured, remained uncollected, of which \$5.0 million were subject to recourse provisions. Accrued expenses and other liabilities rose by approximately \$15.7 million, with higher accrued compensation and timing of payments.

Net cash provided by investing activities in the nine-month period ended March 28, 2004 was \$1.8 million. We sold \$13.0 million, net, of short-term investments. Net capital expenditures were \$11.0 million, consisting primarily of equipment to update our research and development labs and computer equipment and software to enhance administrative efficiencies.

Net cash provided by financing activities for the nine-month period ended March 28, 2004, was \$63.9 million and consisted primarily of the issuance of common stock as a result of employee exercises of stock options of \$54.9 million and reissuance of \$9.1 million from treasury stock through our employee stock purchase program.

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

	<u>Debt and Other Long-term Liabilities</u>	<u>Restructuring Liabilities</u>	<u>Operating Leases</u>	<u>Purchase Obligations</u>	<u>Total</u>
	(in thousands)				
Payments due by period:					
Less than 1 year	\$ 3,922	\$ 7,220	\$ 9,375	\$114,465	\$134,982
1-3 years	313,195	7,827	10,339	49,980	\$381,341
4-5 years	301	1,450	101,290	43,980	\$147,021
Over 5 years	—	15	538	871	\$ 1,424
Total	<u>\$ 317,418</u>	<u>\$ 16,512</u>	<u>\$121,542</u>	<u>\$209,296</u>	<u>\$664,768</u>

Debt and Other Long-Term Liabilities

During the second quarter of fiscal 2002 we signed a final settlement agreement with Varian Semiconductor Equipment Associates, Inc. (Varian) in connection with the patent infringement litigation filed by Varian in October 1993. Under the terms of the settlement agreement, Varian granted us a non-exclusive license to the patents involved in the litigation. We agreed to pay Varian \$20.0 million in cash, \$5.0 million in December 2001 and the remainder to be paid in equal quarterly installments of \$1.25 million over a three-year period. As of March 28, 2004, a total amount of \$16.3 million has been paid to Varian and the total obligation remaining is \$3.8 million through December 2004.

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At March 28, 2004, obligations under debt financing consist of our 4% Convertible Subordinated Notes (4% Notes). Details of the 4% Notes are:

Offering Date	May 2001
Offering Amount	\$300.0 million
Maturity Date	June 1, 2006
Offering Expenses	\$8.5 million at the time of offering, ratably amortized to other expense over the term of the 4% Notes. Remaining unamortized balance of \$3.7 million and \$5.0 million at March 28, 2004 and June 29, 2003, respectively.
Interest Rate Terms	4% payable on June 1 and December 1 of each year, commencing December 1, 2001; payable in arrears.
Conversion Rights	Convertible into Lam Common Stock at any time prior to close of business on the maturity date, unless previously redeemed, at a conversion price of \$44.93 per share subject to anti-dilution adjustments.
Redemption Terms	Redeemable at Lam's option, beginning June 5, 2004 with at least 20 days and no more than 60 days notice, at redemption prices starting at 101.0% and at diminishing prices thereafter, plus accrued interest.
Security	4% Notes are unsecured and subordinated in right of payment in full to all existing and future senior indebtedness of Lam.

During the third quarter of fiscal 2002, we entered into an interest rate swap agreement (the swap) with a notional amount of \$300 million in order to hedge changes in the fair value of our 4% Notes, attributable to changes in the benchmark interest rate. The transaction swapped 4% fixed interest payments for variable interest payments based on the London Interbank Offered Rate (LIBOR), resulting in interest expense savings of approximately \$2.8 million and \$8.0 million for the three and nine months ended March 28, 2004. Under the terms of the transaction, we must provide collateral to match any unfavorable mark-to-market exposure (fair value) on the swap. The amount of collateral required totals a minimum of \$6.0 million plus an amount equal to the unfavorable mark-to-market exposure on the swap. Generally, the required collateral will rise as interest rates rise. As of March 28, 2004 and June 29, 2003, we have posted \$6.0 million of collateral under this swap agreement which is included in restricted cash on our balance sheet. We have designated this swap as a fair value hedge under the provisions of SFAS 133.

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On April 1, 2004, we settled our interest rate swap agreement (the swap) which had been used to minimize the impact of interest rate exposure associated with our fixed rate convertible subordinated 4% notes (4% Notes) as discussed in Note 12. This settlement resulted in an increase in cash of approximately \$11 million and, in addition, a transfer of \$6 million from restricted cash to cash balances during the quarter ending June 27, 2004.

On April 14, 2004, we announced plans to repay in full our 4% Notes in June 2004, two years prior to their maturity. We have set June 5, 2004 as the redemption date for the 4% Notes. Noteholders may redeem their 4% Notes for cash including the redemption price and interest accrued from June 1, 2004 through June 4, 2004. Alternatively, prior to 5:00 p.m. Eastern Time, on June 4, 2004, noteholders may convert their 4% Notes into shares of our common stock at a price of approximately \$44.93 per share, or 22.2568 shares of our common stock per \$1,000 principal amount. Any 4% Notes that are not converted will be automatically redeemed on June 5, 2004, and after June 4, 2004, no further interest will accrue on the 4% Notes. The redemption price plus unpaid accrued interest will be payable on June 7, 2004. The repayment of the 4% Notes is expected to result in a cash outlay of approximately \$303 million, including a redemption premium of \$3 million and accrued and unpaid interest as of the redemption date. Additionally, we will write off approximately \$3.5 million of unamortized offering expenses as of June 7, 2004.

We have a deferred gain of approximately \$11 million recorded on the balance sheet related to the swap. As a result of the settlement of the swap and the redemption of the 4% Notes, we expect to record a net gain of approximately \$4 million included in other income, net during the quarter ending June 27, 2004. The net gain is comprised of the deferred gain noted above, less the redemption premium, write-off of unamortized offering expenses, and transaction-related costs.

Restructuring Liabilities

Our total restructuring reserves as of March 28, 2004 were \$16.5 million. The \$16.5 million consists of \$0.8 million of severance and benefits-related costs and \$15.7 million primarily related to lease payments on vacated buildings. \$7.3 million is expected to be paid out over the next twelve months while the long-term amount of \$9.2 million includes payments extending out to various dates beyond the next twelve months, that we expect to utilize in total by the end of fiscal 2008 and fund through cash generated from operations. Please see the related discussion in "Restructuring Charges" within "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Operating Leases

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

In March and June of 2003, lease agreements relating to properties at our Fremont, California campus were transferred to a new lessor, amended, combined and restated. As part of the lease agreements, we have the option to purchase the buildings at any time for a total purchase price for all properties related to these leases of approximately \$112.4 million. In addition, we are required to guarantee the lessors a residual value on the properties of up to \$98.7 million at the end of the lease terms in fiscal 2008 (in the case that the leases are not renewed, we do not exercise the purchase options, and the lessor sells the properties and the sale price is less than the

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lessor's costs). At the time of the June amendment, one of the leased property's current fair value was less than its original cost by approximately \$1.0 million. The leased property was a building that had been part of our past restructuring activities, and the non-cash loss was recorded as a restructuring charge during fiscal 2003. As a result, we recorded a \$1.0 million liability for the loss on the leased property. We maintain cash collateral of \$112.4 million as part of the lease agreements as of March 28, 2004 in separate, specified interest-bearing accounts. 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 FIN 46, "Consolidation of Variable Interest Entities", and is therefore not consolidated by us. The \$98.7 million is included in the table above. The remaining \$22.8 million primarily relates to non-cancelable facility-related operating leases expiring at various dates through 2021.

Purchase Obligations

Purchase obligations consist of material contractual purchase 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 elements of our transactional general and administrative functions, elements of our manufacturing, warehousing, logistics, facilities maintenance and information technology functions. These outsourced services should provide us with more flexibility to scale our operations in a more timely manner to respond to the cyclical nature of our business. The contractual cash obligations and commitments table presented above contains our minimum outsourcing obligations at March 28, 2004 under these arrangements and others. Actual expenditures will vary based on the volume of transactions and length of contractual service provided. In addition to minimum spending commitments, certain of these agreements provide for potential cancellation charges.

Consignment inventories, which are owned by vendors but located in our discrete storage locations and warehouses, are not reported as inventory until title is transferred to us or our purchase obligation is determined. At March 28, 2004, vendor owned inventories held at Lam and not reported as inventory were approximately \$11.1 million.

Given the cyclical nature of the semiconductor equipment industry, we believe that maintaining sufficient liquidity reserves is important to ensure our ability to invest in R&D and capital infrastructure through ensuing business cycles. Based upon our current business outlook, our levels of cash, cash equivalents, and short-term investments at March 28, 2004, combined with asset management activities, are expected to be sufficient to support our anticipated levels of operations, investments, capital expenditures, and planned repayment of our 4% Notes, through at least the next twelve months. In the longer-term, liquidity will depend to a great extent on our future revenues and our ability to appropriately size our business based on demand for our products.

Risk Factors

Our Quarterly Revenues and Operating Results are Unpredictable

Our revenues and operating results may fluctuate significantly from quarter to quarter due to a number of factors, not all of which are in our control. 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, or regulatory changes or changes in their interpretation;
- procurement shortages;
- manufacturing difficulties;
- the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;
- new or modified accounting regulations; and
- exchange rate fluctuations.

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

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 \$4.8 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 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. The semiconductor equipment industry began a prolonged downturn in calendar year 2001. During the latter part of calendar year 2003, business conditions began to improve. While indications are that business conditions remain positive, they can change, and 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 have new products manufactured successfully, or new products that we introduce may fail in the marketplace. Our

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failure to complete commercialization of these new products in a timely manner could result in unanticipated costs and inventory obsolescence, which would adversely affect our financial results.

In order to develop new products and processes, we expect to continue to make significant investments in R&D and to pursue joint development relationships with customers or other members of the industry. We must manage product transitions and joint development relationships successfully, as introduction of new products could adversely affect our sales of existing products. Future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both.

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

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

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

We Have a Limited Number of Key Customers

Sales to a limited number of large customers constitute a significant portion of our overall revenue. As a result, the actions of even one customer may subject us to revenue swings that are difficult to predict. Similarly, significant portions of our credit risk may, at any given time, be concentrated among a limited number of customers, so that the failure of even one of these key customers to pay its obligations to us could significantly impact our financial results.

We Are Dependent Upon a Limited Number of Key Suppliers

We obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. We have established long-term contracts with many of these suppliers. These long-term contracts can take a variety of forms. We may renew these contracts periodically. In some cases, these component suppliers sold us products during at least the last four years, and we expect that we will continue to renew these contracts in the future or that we will otherwise replace them with competent alternative source suppliers. However, several of our outsourced assembly suppliers are new providers to us so that our experience with them and their performance is limited. Where practical, our intent is to establish alternative sources to mitigate the risk that the failure of any single supplier will adversely affect our business. Nevertheless, a prolonged inability to obtain certain components could impair our ability to ship products, lower our revenues and thus adversely affect our operating results and

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result in damage to our customer relationships.

Our Outsource Providers May Fail to Perform as We Expect

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

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

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

We 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

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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 72% of our total revenue in fiscal 2003, 71% in fiscal 2002, and 70% in fiscal 2001. We expect that international sales will continue to account for a significant portion of our total revenue in future years. We are subject to various challenges related to the management of global operations, and international sales are subject to risks including, but not limited to:

- trade balance issues;
- regional economic and political conditions;
- changes in currency controls;
- differences in the enforcement of intellectual property and contract rights in varying jurisdictions;
- ability to develop relationships with local suppliers;
- changes in U.S. and international laws and regulations, including U.S. export restrictions;
- fluctuations in interest and currency exchange rates; and
- the need for technical support resources in different locations.

Many of these challenges are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships between China, Taiwan and the United States, that political and diplomatic influences might lead to trade disruptions which would adversely affect our business with China and/or Taiwan and perhaps the entire Asia-Pacific region. A significant trade disruption in these areas could have a material, adverse impact on our future revenue and profits.

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

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

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regulations could result in fines being imposed on us, suspension of production, cessation of our operations or reduction in our customers' acceptance of our products. These regulations could require us to alter our current operations, to acquire significant equipment or to incur substantial other expenses to comply with environmental regulations. Our failure to control the use, sale, transport or disposal of hazardous substances could subject us to future liabilities.

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

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

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

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

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

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

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

In addition, the stock market experiences significant price and volume fluctuations. Historically, we have witnessed significant volatility in the price of our Common Stock due in part to the actual or anticipated movement in interest rates and the price of and markets for semiconductors. These broad market and industry factors have and may again adversely affect the price of our Common Stock, regardless of our actual operating performance. In the past, following volatile periods in the price of stock, many companies became the object of securities class action litigation. If we are sued in a securities class action, we could incur substantial costs, and it could divert management's attention and resources and have an unfavorable impact on the price for our Common Stock.

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

We maintain and rely upon certain critical Information Systems for the effective operation of our business. These Information Systems include telecommunications, the internet, our corporate intranet, various computer hardware and software applications, network communications, and e-mail. These Information Systems may be owned by us or by our outsource providers or even third parties such as vendors and contractors and may be maintained by us or by such providers and third parties. These Information Systems are subject to attacks, failures, and access denials from a number of potential sources including viruses, destructive or inadequate code, power failures, and physical damage to computers, hard drives, communication lines, and networking equipment. To the extent that these Information Systems are under our control, we have implemented security procedures, such as virus protection software and emergency recovery processes, to address the outlined risks; however, security procedures for Information Systems cannot be guaranteed to be fail-safe 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.

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

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

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

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

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

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

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

Our success depends in part on our proprietary technology. While we attempt to protect our proprietary technology through patents, copyrights and trade secret protection, we believe that our success also depends on increasing our technological expertise, continuing our development of new systems, increasing market penetration and growth of our installed base, and providing comprehensive support and service to our customers. However, we may be unable to protect our technology in all instances, or our competitors may develop similar or more competitive technology independently. We currently hold a number of United States and foreign patents and pending patent applications. However, other parties may challenge or attempt to invalidate or

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circumvent any patents the United States or foreign governments issue to us or these governments may fail to issue pending applications. In addition, the rights granted or anticipated under any of these patents or pending patent applications may be narrower than we expect or, in fact provide no competitive advantages.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

For financial market risks related to changes in interest rates and foreign currency exchange rates, refer to Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk", in our Annual Report on Form 10-K for the year ended June 29, 2003.

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio, synthetic leases and long-term debt obligations. 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. We have no foreign exchange cash flow exposure related to our fixed rate \$300.0 million convertible subordinated notes.

During the third quarter of fiscal 2002, we entered into an interest rate swap agreement with a notional amount of \$300 million in order to hedge changes in the fair value of our 4% Convertible Subordinated Notes, attributable to changes in the benchmark interest rate. The transaction exchanged 4% fixed interest payments for variable interest payments based on the LIBOR-based interest rate, resulting in interest expense savings of approximately \$2.8 million and \$8.0 million for the three and nine-month periods ended March 28, 2004. In April, 2004, we settled our interest rate swap agreement. This settlement resulted in an increase in cash of approximately \$11 million and, in addition, a transfer of \$6 million from restricted cash to cash balances during the quarter ending June 27, 2004.

ITEM 4. Controls and Procedures

As of the close of our quarter ended March 28, 2004, we carried out an evaluation, under the supervision and with the participation of our management, including our Chairman and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-14 and 13a-15. Based upon that evaluation, our Chairman and Chief Executive Officer along with our Chief Financial Officer concluded that our disclosure controls and procedures are reasonably effective in timely alerting them to material information relating to the Company (including our consolidated subsidiaries) required to be included in our periodic SEC filings.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to correct any material deficiencies that we may discover. Our goal is to ensure that our senior management has timely access to material information that could affect our business. While we believe the present design of our disclosure controls and procedures is reasonably effective to achieve our goal, future events affecting our business may cause us to modify our disclosure controls and procedures. The effectiveness of controls cannot be absolute because the cost to design and implement a control to identify errors or mitigate the risk of errors occurring should not outweigh the potential loss caused by the errors that would likely be detected by the control. Moreover, we believe that disclosure controls and procedures cannot be guaranteed to be 100% effective all of the time. Accordingly, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

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

Not applicable.

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 Certification Pursuant to 18 U.S.C. 1350 (section 906 of the Sarbanes-Oxley Act of 2002) – Chief Executive Officer
- 32.2 Certification Pursuant to 18 U.S.C. 1350 (section 906 of the Sarbanes-Oxley Act of 2002) – Chief Financial Officer

(b) Reports on Form 8-K

None.

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: May 4, 2004

LAM RESEARCH CORPORATION

(Registrant)

/s/ Mercedes Johnson

Mercedes Johnson

Senior Vice President, Finance and

Chief Financial Officer(Chief Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description
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	Certification Pursuant to 18 U.S.C. 1350 (section 906 of the Sarbanes-Oxley Act of 2002) – Chief Executive Officer
32.2	Certification Pursuant to 18 U.S.C. 1350 (section 906 of the Sarbanes-Oxley Act of 2002) – Chief Financial Officer

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

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

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 4, 2004

/s/ James W. Bagley

James W. Bagley

Chairman and Chief Executive Officer

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

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

1. I have reviewed this quarterly report on Form 10-Q of Lam Research Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - c) disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 4, 2004

/s/ Mercedes Johnson

Mercedes Johnson

Senior Vice President, Finance,

Chief Financial Officer and

Chief Accounting Officer

LAM RESEARCH CORPORATION
CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Lam Research Corporation (the "Company") on Form 10-Q for the fiscal period ending March 28, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James W. Bagley, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

May 4, 2004

/s/ James W. Bagley

James W. Bagley

Chairman and Chief Executive Officer

LAM RESEARCH CORPORATION
CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Lam Research Corporation (the "Company") on Form 10-Q for the fiscal period ending March 28, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mercedes Johnson, Senior Vice President, Finance, Chief Financial Officer and Chief Accounting Officer of the Company, certify, pursuant to 18 U.S.C. 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.

May 4, 2004

/s/ Mercedes Johnson

Mercedes Johnson

Senior Vice President, Finance,

Chief Financial Officer and

Chief Accounting Officer