

LATTICE SEMICONDUCTOR CORP  
Form 10-Q  
November 05, 2009  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE QUARTERLY PERIOD ENDED OCTOBER 3, 2009

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission file number 000-18032

**LATTICE SEMICONDUCTOR CORPORATION**

(Exact name of Registrant as specified in its charter)

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

93-0835214  
(I.R.S. Employer Identification No.)

5555 N.E. Moore Court, Hillsboro, Oregon  
(Address of principal executive offices)

97124-6421  
(Zip Code)

(503) 268-8000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

Number of shares of common stock outstanding as of November 2, 2009

115,339,068

The information contained in this Form 10-Q is as of November 5, 2009. This Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended January 3, 2009.

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**Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. We use words or phrases such as anticipates, believes, estimates, expects, intends, plans, projects, may, will, should, continue, ongoing, future, potential, or other similar phrases to identify forward-looking statements.

Forward-looking statements involve estimates, assumptions, risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. The key factors that could cause our actual results to differ materially from the forward-looking statements include global economic conditions and uncertainty, the concentration of our sales in the communications equipment end market, particularly as it relates to the China 3G telecommunications network build-out, the concentration of our sales in the Asia Pacific region, the compromised liquidity of auction rate securities in our long-term marketable securities portfolio, market acceptance and demand for our new products, moving the majority of our inventory to a third party contractor with a logistics facility in Singapore may involve logistical and other challenges and our expectation that this move will improve our shipping times to many or the majority of our customers may not be realized, our reliance on export sales, the effect of the downturn in the economy on capital markets and credit markets, technology and development risks, our efforts to improve our cost structure and to reduce costs out of our supply chain may not occur on a timely basis or achieve the expected results, the risks associated with our transition to new distributors in various regions including Taiwan and China, the risks associated with Fujitsu Limited as a sole source of silicon wafers for all of our new products, the impact of competitive products and pricing, our inability to utilize our remaining advance wafer credits, unanticipated taxation requirements, unexpected impacts of recent accounting guidance and the other risks that are described herein and that are otherwise described from time to time in our filings with the Securities and Exchange Commission (SEC), including but not limited to, the items discussed in Risk Factors in Item 1A of Part II of this Quarterly Report on Form 10-Q. You should not unduly rely on forward-looking statements because our actual results could differ materially from those expressed in any forward-looking statements made by us. In addition, any forward-looking statement applies only as of the date on which it is made. We are not required to, and undertake no obligation to, update any forward-looking statements to reflect events or circumstances that occur after the date on which such statements are made or to reflect the occurrence of unanticipated events.



**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****LATTICE SEMICONDUCTOR CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)****(unaudited)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>October 3, 2009</b>	<b>September 27, 2008</b>	<b>October 3, 2009</b>	<b>September 27, 2008</b>
Revenue	\$ 49,097	\$ 57,610	\$ 139,333	\$ 172,293
Costs and expenses:				
Cost of products sold	22,478	26,493	65,450	77,204
Research and development	14,789	17,534	43,491	53,139
Selling, general and administrative	12,739	14,547	39,255	44,741
Amortization of intangible assets		1,369	228	4,218
Restructuring	2,544	3,882	2,504	6,530
	52,550	63,825	150,928	185,832
Loss from operations	(3,453)	(6,215)	(11,595)	(13,539)
Other expense, net	(536)	(999)	(859)	(10,186)
Loss before provision (benefit) for income taxes	(3,989)	(7,214)	(12,454)	(23,725)
Provision (benefit) for income taxes	125	(236)	129	78
Net loss	\$ (4,114)	\$ (6,978)	\$ (12,583)	\$ (23,803)
Basic and diluted net loss per share	\$ (0.04)	\$ (0.06)	\$ (0.11)	\$ (0.21)
Shares used in per share calculations:				
Basic and diluted	115,321	115,370	115,356	115,240

**See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.**

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**LATTICE SEMICONDUCTOR CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and par value data)

(unaudited)

	October 3, 2009	January 3, 2009
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 115,064	\$ 53,668
Short-term marketable securities		12,241
Accounts receivable, net	28,243	26,404
Other receivable	30,000	60,000
Inventories	27,064	32,703
Current portion of foundry advances	17,956	19,157
Prepaid expenses and other current assets	8,387	7,663
<b>Total current assets</b>	<b>226,714</b>	<b>211,836</b>
Foundry advances and other assets	4,450	20,080
Property and equipment, less accumulated depreciation	36,283	40,307
Long-term marketable securities	17,656	19,485
Intangible assets, less accumulated amortization		228
<b>Total assets</b>	<b>\$ 285,103</b>	<b>\$ 291,936</b>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 21,665	\$ 16,947
Accrued payroll obligations	5,873	6,693
Deferred income and allowances on sales to distributors	5,532	5,741
<b>Total current liabilities</b>	<b>33,070</b>	<b>29,381</b>
Other long-term liabilities	5,298	7,616
<b>Total liabilities</b>	<b>38,368</b>	<b>36,997</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 10,000,000 shares authorized, none issued and outstanding		
Common stock, \$.01 par value, 300,000,000 shares authorized, 115,339,000 and 115,469,000 shares issued and outstanding	1,156	1,155
Paid-in capital	621,019	617,572
Treasury stock, at cost, 263,000 shares	(329)	
Accumulated other comprehensive income (loss)	727	(533)
Accumulated deficit	(375,838)	(363,255)
<b>Total stockholders' equity</b>	<b>246,735</b>	<b>254,939</b>

Total liabilities and stockholders' equity	\$ 285,103	\$ 291,936
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**See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.**

**Table of Contents****LATTICE SEMICONDUCTOR CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(unaudited)**

	<b>Nine months ended</b>	
	<b>October 3, 2009</b>	<b>September 27, 2008</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (12,583)	\$ (23,803)
<b>Adjustments to reconcile net loss to net cash provided by operating activities:</b>		
Depreciation and amortization	10,928	16,139
Impairment of Long-term marketable securities	2,267	12,756
Gain on sale of marketable securities	(163)	
Loss on sale of UMC common stock		233
Stock-based compensation	3,363	4,157
<b>Changes in assets and liabilities:</b>		
Accounts receivable, net	(1,839)	(586)
Inventories	5,639	4,249
Prepaid expenses and other current assets	392	(351)
Foundry advances (includes advance credits and other receivable)	43,147	12,704
Accounts payable and accrued expenses (includes restructuring)	6,168	1,896
Accrued payroll obligations	(820)	(1,933)
Deferred income and allowances on sales to distributors	(209)	(1,333)
Other liabilities	(2,546)	440
<b>Net cash provided by operating activities</b>	<b>53,744</b>	<b>24,568</b>
<b>Cash flows from investing activities:</b>		
Proceeds from sales or maturities of marketable securities	13,262	74,232
Purchase of marketable securities		(37,841)
Proceeds from sale of UMC common stock		1,658
Capital expenditures	(4,323)	(8,530)
<b>Net cash provided by investing activities</b>	<b>8,939</b>	<b>29,519</b>
<b>Cash flows from financing activities:</b>		
Extinguishment of Zero Coupon Convertible Subordinated Notes		(40,000)
Advances in yen line of credit		1,414
Payment on yen line of credit	(805)	(1,136)
Net share settlement	(161)	(133)
Purchase of treasury stock	(329)	
Net proceeds from issuance of common stock	8	5
<b>Net cash used in financing activities</b>	<b>(1,287)</b>	<b>(39,850)</b>
<b>Net increase in cash and cash equivalents</b>	<b>61,396</b>	<b>14,237</b>
Beginning cash and cash equivalents	53,668	37,332
<b>Ending cash and cash equivalents</b>	<b>\$ 115,064</b>	<b>\$ 51,569</b>



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Supplemental disclosures of non-cash investing and financing activities:

Unrealized gain (loss) on assets measured at fair value, net, included in Accumulated other comprehensive income (loss)	\$ 1,333	\$ (26)
Distribution of deferred compensation from trust assets	\$ 589	\$ 1,380

**See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.**

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**LATTICE SEMICONDUCTOR CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**Note 1 Basis of Presentation and Significant Accounting Policies:**

The accompanying Condensed Consolidated Financial Statements are unaudited and have been prepared by Lattice Semiconductor Corporation (the Company, we, us or our) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) and in our opinion include all adjustments, consisting of normal recurring adjustments, necessary for the fair statement of results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These Condensed Consolidated Financial Statements should be read in conjunction with our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended January 3, 2009.

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting periods. Our most critical estimate relates to auction rate securities, and the estimates of fair value of these securities made in accordance with the provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC) No. 820, Fair Value Measurements and Disclosures. Actual results could differ from these estimates.

We report based on a 52 or 53-week fiscal year ending on the Saturday closest to December 31. Our third quarter of fiscal 2009 and fiscal 2008 ended on October 3, 2009 and September 27, 2008, respectively. All references to quarterly or three and nine months ended financial results are references to the results for the relevant fiscal period.

*Recent Accounting Guidance*

In October 2009, the FASB issued authoritative guidance on revenue recognition that will become effective in fiscal years beginning on or after June 15, 2010, with earlier adoption permitted. This guidance amends the criteria for recognizing revenue in multiple element arrangements and the scope of what constitutes a non-software deliverable. The Company does not expect the application of the new guidance to have a material impact on the Company's Condensed Consolidated Financial Statements.

**Note 2 Net Loss Per Share:**

Net loss per share is computed based on the weighted average number of shares of common stock and potentially dilutive securities assumed to be outstanding during the period using the treasury stock method and the if converted method for convertible securities. Potentially dilutive securities consist of stock options, restricted stock units (RSUs), warrants to purchase shares of common stock and Zero Coupon Convertible Subordinated Notes (Convertible Notes) for the periods in which they were outstanding (see Note 10).

The computation of basic and diluted net loss per share for the three and nine months ended October 3, 2009, excludes the effects of stock options, RSUs and warrants aggregating 10.1 million and 11.7 million shares, respectively, because the effect was antidilutive. The computation of basic and diluted net loss per share for the three and nine months ended September 27, 2008, excludes the effects of stock options, RSUs and warrants aggregating 21.3 million and 21.5 million shares, respectively, because the effect was antidilutive. Stock options, RSUs and warrants are antidilutive when the effects of aggregate exercise price, unrecognized stock-based compensation expense and excess tax benefit are greater than the average market price for our common stock during the period or when the Company is in a net loss position.

For both the three and nine months ended September 27, 2008, the shares of common stock issuable upon exercise of the Convertible Notes, aggregating approximately 3.3 million shares, were excluded from the computation of basic and diluted earnings per share, as the effect was antidilutive. Shares underlying Convertible Notes are antidilutive when there is a loss for the period or if loan servicing costs exceed the profit for the period. Convertible Notes had no impact on basic or diluted earnings per share in fiscal 2009 as all remaining notes were purchased on July 2, 2008 (see Note 10).



**Table of Contents****Note 3 Marketable Securities:**

The following table summarizes the contractual maturities of our marketable securities (at fair value and in thousands):

	October 3, 2009	January 3, 2009
<b>Short-term marketable securities:</b>		
Due within one year	\$	\$ 12,241
<b>Long-term marketable securities:</b>		
Due after five years through ten years	4,032	5,333
Due after ten years	13,428	13,233
No contractual maturity date	196	919
	17,656	19,485
Total marketable securities	\$ 17,656	\$ 31,726

The following table summarizes the composition of our marketable securities (at fair value and in thousands):

	October 3, 2009	January 3, 2009
<b>Short-term marketable securities:</b>		
Corporate and municipal bonds, notes and commercial paper	\$	\$ 7,221
Market rate investments		5,020
		12,241
<b>Long-term marketable securities:</b>		
Auction Rate Securities (by type of underlying asset):		
Federally-insured or FFELP guaranteed student loans	13,428	13,233
Corporate bonds, subject to credit default swap risk	4,032	5,333
Auction market preferred shares	196	919
	17,656	19,485
Total marketable securities	\$ 17,656	\$ 31,726

The following table summarizes the composition of our auction rate securities (in thousands):

	October 3, 2009			January 3, 2009		
	Par Value	Fair Value	S&P Credit rating	Par Value	Fair Value	S&P Credit rating
<b>Long-term marketable securities:</b>						
Federally-insured or FFELP guaranteed student loans	\$ 15,825	\$ 13,428	AAA	\$ 16,875	\$ 13,233	AAA
Corporate bonds, subject to credit default swap risk	14,000	4,032	BB-/CCC	14,000	5,333	BBB
Auction market preferred shares	8,325	196	C	8,325	919	BBB

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<b>Total long-term marketable securities</b>	\$ 38,150	\$ 17,656	\$ 39,200	\$ 19,485
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At October 3, 2009 and January 3, 2009, the Company held auction rate securities with a par value of \$38.2 million and \$39.2 million, respectively. For the quarter ended October 3, 2009, the Company had three partial redemptions at par value of auction rate securities for a total value of \$0.1 million. The Company intends to sell its auction rate securities as markets for these securities resume or offers become available. At October 3, 2009, due to continued multiple failed auctions and a determination of illiquidity, the \$38.2 million par value of auction rate securities held by the Company had an estimated fair value of \$17.7 million and are classified as Long-term marketable securities.

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Long-term marketable securities with a par value of \$15.8 million are exposed to risks associated with student loan asset-backed notes. Such notes are insured by the federal government or guaranteed by the Federal Family Education Loan Program ( FFELP ). Long-term marketable securities with a par value of \$14.0 million are exposed to risks associated with the sale of credit default swaps, pursuant to which the assets underlying the auction rate securities are exposed to claims in the event of default of certain debt instruments owned by third parties. In addition, long-term marketable securities with a par value of \$8.3 million were replaced on December 3, 2008 by auction market preferred shares issued by Ambac Assurance Corporation ( AMBAC ), as a result of AMBAC exercising their put option feature provided in this security. On August 1, 2009, AMBAC discontinued paying monthly dividends on its auction market preferred shares, which reduced interest income included in Other expense, net, by less than \$0.1 million per quarter.

**Note 4 Fair Value of Financial Instruments:**

As a result of failed auctions on auction rate securities held by us, quoted prices in active markets are not readily available, and thus, all of our Long-term marketable securities use Level 3 data for valuation purposes. We held no Level 1 or Level 2 assets. For a portion of our Level 3 assets, we employed the services of a valuation firm that specializes in valuing illiquid assets. In addition, we collect other available market information regarding auction rate securities, which include third party valuation results, investment broker provided market information and available information on the credit quality of the underlying collateral.

During the nine months ended October 3, 2009, the following changes occurred in our Level 3 assets (in thousands):

Fair value of Long-term marketable securities at January 3, 2009	\$ 19,485
Redemption of Long-term marketable securities, net of \$0.1 million recognized gain	(925)
Other-than-temporary impairment of Long-term marketable securities	(2,267)
Unrealized gain on Long-term marketable securities	1,363
<b>Fair value of Long-term marketable securities at October 3, 2009</b>	<b>\$ 17,656</b>

While the auctions for auction rate securities had historically provided a liquid market for these securities, due to liquidity issues in global credit and capital markets, auction rate securities held by us have experienced multiple failed auctions (a portion beginning in October 2007). These instruments are considered illiquid and have been reclassified as Long-term marketable securities on the Condensed Consolidated Balance Sheets. Due to the severity of the decline in fair value, the duration of the decline, and the downgrading of the credit ratings on some of the securities, the Company determined that an other-than-temporary decline in fair value had occurred, and recorded additional impairment charges of \$1.1 million and \$2.3 million to Other expense, net, for the three and nine months ended October 3, 2009, respectively, related to our corporate bonds and auction market preferred shares auction rate securities. When we liquidate our position in these securities, the amount realized could be materially different than the estimated fair value amounts at which we are carrying these securities and there could be a materially detrimental effect on our financial results.

In accordance with ASC 320, Investments – Debt and Equity Securities, the Company recorded a loss on a previously unrealized gain of less than \$0.1 million for the three and nine months ended October 3, 2009 on certain Short-term marketable securities, which matured during the third quarter ended October 3, 2009. During the nine months ended October 3, 2009, the Company also recorded an unrealized gain of \$1.4 million on Long-term marketable securities primarily consisting of student loan auction rate securities resulting in a carrying cost of \$13.4 million, which has been recorded in Accumulated other comprehensive income (loss). Future fluctuations in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to Accumulated other comprehensive income (loss). If the Company were to determine in the future that any further decline in fair value is other-than-temporary, we would record an other-than-temporary impairment charge, which could have a materially detrimental impact on our operating results. If we were to liquidate our position in these securities, it is likely that the amount of any future realized gain or loss would be different from the unrealized gain reported in Accumulated other comprehensive income (loss).

**Table of Contents****Note 5 Inventories (in thousands):**

	October 3, 2009	January 3, 2009
Work in progress	\$ 18,542	\$ 22,167
Finished goods	8,522	10,536
	\$ 27,064	\$ 32,703

**Note 6 Changes in Stockholders Equity and Comprehensive income (loss) (in thousands):**

	Common stock	Paid-in capital	Treasury stock	Accumulated deficit	Accumulated other comprehensive income (loss)	Total
Balances, January 3, 2009	\$ 1,155	\$ 617,572	\$	\$ (363,255)	\$ (533)	\$ 254,939
Net loss for nine months ended October 3, 2009				(12,583)		(12,583)
Unrealized gain on short and long-term marketable securities, net					1,333	1,333
Recognized gain on redemption of marketable securities, previously unrealized					(38)	(38)
Translation adjustments					(35)	(35)
Comprehensive loss						(11,323)
Common stock issued in connection with exercise of stock options, ESPP and vested RSUs	1	7				8
Taxes withheld in connection with vesting RSUs		(161)				(161)
Stock repurchase			(329)			(329)
Stock-based compensation expense related to stock options, ESPP and RSUs		3,363				3,363
Distribution of stock held by deferred stock compensation plan		238				238
Balances, October 3, 2009	\$ 1,156	\$ 621,019	\$ (329)	\$ (375,838)	\$ 727	\$ 246,735

For the third quarter ended October 3, 2009, the comprehensive loss was \$3.8 million primarily consisting of a net loss of \$4.1 million partially offset by an unrealized gain on marketable securities of \$0.4 million.

On December 13, 2008, the Company's Board of Directors approved a stock repurchase program pursuant to which up to \$20.0 million of outstanding common stock may be repurchased from time to time. The duration of the repurchase program is twelve months. Under the program, the Company may purchase shares of common stock through open market and privately negotiated transactions at prices deemed appropriate by management. The timing and amount of repurchase transactions under this program will depend on market conditions and corporate and regulatory considerations. The purchases have and will be funded from available working capital.

Repurchases during the six months ended July 4, 2009 of approximately 263,000 shares were settled for \$0.3 million and were all open market transactions. There were no repurchases during the three months ended October 3, 2009.

**Table of Contents****Note 7 Other Assets (in thousands):**

	October 3, 2009	January 3, 2009
Foundry advances and other assets	\$ 22,406	\$ 39,237
Less: Foundry advances	(17,956)	(19,157)
	\$ 4,450	\$ 20,080

The Company has an Advance Payment and Purchase Agreement (the Agreement), with Fujitsu Limited (Fujitsu), pursuant to which we previously advanced \$125.0 million in support of the development and construction of a 300mm wafer fabrication facility in Mie, Japan. As of October 3, 2009, we have received back approximately \$77.0 million of the total advance from Fujitsu.

Under the terms of a letter agreement between the Company and Fujitsu, Fujitsu agreed to repay in cash to the Company \$60.0 million (recorded as Other receivable in the Condensed Consolidated Balance Sheets) plus interest, in two installments, \$30.0 million of which was received on April 15, 2009 and the remaining \$30.0 million was received on October 15, 2009. In addition, as of October 3, 2009, we expect to receive the remaining balance of approximately \$18.0 million in the form of advance credits by the end of the second quarter of the Company's fiscal 2010.

All other terms and conditions of the Agreement remain in full force and effect until repayment of the advance payment in full. The repayment obligation of Fujitsu is unsecured.

**Note 8 Income Taxes:**

We are subject to federal income tax as well as income tax of multiple state and foreign jurisdictions. We are no longer subject to federal, state and local, or foreign income tax examinations for years before 2001. We have federal net operating loss carryforwards that expire at various dates between 2021 and 2029. We have state net operating loss carryforwards that expire at various dates from 2010 through 2029. We also have federal and state credit carryforwards, some of which do not expire, with the remainder expiring at various dates from 2010 through 2029. We have provided a valuation allowance equal to our net federal and state deferred tax assets as we have not met the more likely than not realization threshold for deferred tax asset recognition. As of October 3, 2009, the net deferred tax asset relates to foreign jurisdictions where we have concluded it is more likely than not that we will realize the net deferred tax assets in future periods.

On February 17, 2009, The American Recovery and Reinvestment Act of 2009 was signed into law. This act extends the election to forego bonus depreciation and accelerate certain unutilized income tax credits in 2009. The Company recorded an income tax benefit of \$0.3 million during the quarter ended April 4, 2009 related to the acceleration of its research tax credits.

The Internal Revenue Service (IRS) has examined our income tax returns for 2001 and 2002, and has issued proposed adjustments of \$1.4 million, plus interest. These adjustments relate to the treatment of acquisition costs and a tax accounting method change for prepaid expenses. Although we do not agree with the proposed adjustment related to the prepaid expense matter, we believe that we have reached a tentative agreement concerning the acquisition costs. During the three months ended March 29, 2008, we made a payment of \$0.3 million related to this tentative agreement. On May 23, 2008, the Company filed a petition with the Tax Court seeking a redetermination of the prepaid expense adjustment. Although the final resolution of this matter is uncertain, we believe that adequate amounts have been provided for as unrecognized tax benefits. There is the possibility of either a favorable or unfavorable effect on our results of operations in the period in which these matters are effectively settled. We will recognize any uncertain tax benefit in the period settled.

We are subject to state and local income tax examinations for the years 2001 through 2003. To date, there are no proposed adjustments that are expected to have a material adverse effect on our results of operations. We are not currently under examination in any foreign jurisdictions.

We believe that it is reasonably possible that \$1.5 million of unrecognized tax benefits and \$0.8 million of associated interest and penalties could significantly change during the next twelve months. The \$2.3 million potential change would represent a decrease in unrecognized tax benefits, comprised of items related to matters currently in IRS appeals, certain federal and state credits and uncertain income tax positions related to foreign tax filings for years that will no longer be subject to examination under expiring statutes of limitations.





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During the third quarter of fiscal 2009, the Company initiated a restructuring plan ( 2009 restructuring plan ) to lower operating expenses primarily by reducing headcount, reducing occupancy in certain leased facilities and transferring certain of its warehouse operations from its headquarters in Hillsboro, Oregon to Singapore. The 2009 restructuring plan is expected to be substantially completed in the fourth quarter of fiscal 2009. At October 3, 2009, the Condensed Consolidated Balance Sheet included \$1.2 million primarily related to operating lease commitments accrued under the provisions of the 2009 restructuring plan.

The following table displays the current estimate for each major type of cost associated with the 2009 restructuring plan (in thousands):

	Initial accrual	Paid or Settled	Balance at October 3, 2009
Severance and related	\$ 1,341	\$ (1,323)	\$ 18
Lease loss reserve	1,199	(49)	1,150
Other	31	(18)	13
Total	\$ 2,571	\$ (1,390)	\$ 1,181

During the third quarter of fiscal 2008, the Company initiated a restructuring plan ( 2008 restructuring plan ) to better align operating expenses with near-term revenue expectations, primarily by reducing headcount. The 2008 restructuring plan was substantially complete by the end of fiscal 2008. From the period beginning with the third quarter of fiscal 2008 through the third quarter of fiscal 2009, the aggregate expense under the 2008 restructuring plan was \$4.0 million.

During the third quarter of fiscal 2007, the Company approved and initiated a restructuring plan ( 2007 restructuring plan ) to lower operating expenses primarily by reducing headcount. This plan encompassed a reduction in work force, a voluntary separation program for certain employees and the closure of certain leased facilities. The 2007 restructuring plan was substantially complete by the end of fiscal 2008. From the period beginning with the third quarter of fiscal 2007 through the third quarter of fiscal 2009, the aggregate expense under the 2007 restructuring plan was \$5.4 million.

At October 3, 2009 the Condensed Consolidated Balance Sheet included \$0.4 million related to operating lease commitments accrued as remaining costs under provisions of a restructuring plan initiated and substantially completed during the fourth quarter of 2005 ( 2005 restructuring plan ) to reduce operating expenses. From the period beginning with the fourth quarter of fiscal 2005 through the third quarter of fiscal 2009, the aggregate expense under the 2005 restructuring plan was \$11.9 million.

Total Restructuring charges included in our Condensed Consolidated Statements of Operations were as follows (in thousands):

	Three months ended		Nine months ended	
	October 3, 2009	September 27, 2008	October 3, 2009	September 27, 2008
<b>2009 Restructuring Plan</b>	\$ 2,571	\$	\$ 2,571	\$
<b>Pre-2009 Restructuring Plans:</b>				
Severance and related costs	(28)	3,639	(34)	4,900
Lease loss reserve	1	25	1	1,381
Other		218	(34)	249
	\$ 2,544	\$ 3,882	\$ 2,504	\$ 6,530

For the third quarter and first nine months of fiscal 2009, a net credit of less than \$0.1 million was primarily related to changes in original estimates under the pre-2009 restructuring plans. For the third quarter and first nine months of fiscal 2008, we recorded a net charge of \$3.9 million and \$6.5 million, respectively, primarily related to severance costs and costs to vacate leased properties under the 2007 and 2008 restructuring plans.

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We cannot be certain as to the actual amount of any remaining restructuring charges or the timing of their recognition for financial reporting purposes.

**Table of Contents****Note 10 Zero Coupon Convertible Subordinated Notes:**

On June 20, 2003, we issued \$200.0 million in Convertible Notes. The Company purchased a total of \$160.0 million in Convertible Notes from 2003 through 2007. On July 2, 2008, the Company completed the purchase of \$40.0 million in principal amount of its Convertible Notes in accordance with the provisions of the Indenture dated June 20, 2003 and pursuant to the exercise by the noteholders of their repurchase rights. As a result of these purchases, no Convertible Notes remain outstanding.

**Note 11 Stock-Based Compensation:**

Total stock-based compensation expense included in the Condensed Consolidated Statements of Operations is as follows (in thousands):

<b>Line item:</b>	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>October 3, 2009</b>	<b>September 27, 2008</b>	<b>October 3, 2009</b>	<b>September 27, 2008</b>
Cost of products sold	\$ 75	\$ 120	\$ 264	\$ 332
Research and development	369	680	1,128	1,939
Selling, general and administrative	569	695	1,971	1,886
	\$ 1,013	\$ 1,495	\$ 3,363	\$ 4,157

On December 22, 2008, the Company's Board of Directors approved an offer to exchange stock options to purchase up to an aggregate of 7,875,084 shares of the Company's common stock that were previously granted with an exercise price equal to or greater than \$3.91 under the Company's 1996 Stock Incentive Plan (the "1996 Plan") and the Company's 2001 Stock Plan (the "2001 Plan"), for new options issuable under the 1996 Plan or new restricted stock units issuable under the 2001 Plan. The offer was not extended to the Company's executive officers, members of the board of directors or employees based outside the United States. The offer expired on February 3, 2009 at which time the exchange was consummated. Approximately 300 eligible option holders elected to participate in the exchange and the Company accepted for cancellation options to purchase an aggregate of 3,571,228 shares of the Company's common stock under the 1996 Plan and options to purchase an aggregate of 2,493,826 shares under the 2001 Plan. Subject to the terms and conditions of the exchange offer, the Company granted new options to purchase up to an aggregate of 727,537 shares of the Company's common stock under the 1996 Plan and 227,412 restricted stock units under the 2001 Plan. The stock-based compensation expense impact for the exchange was approximately \$0.4 million and is being amortized over four years from the date of exchange.

**Note 12 Legal Matters:**

On June 11, 2007, a patent infringement lawsuit was filed by Lizy K. John ( "John" ) against Lattice Semiconductor Corporation in the U.S. District Court for the Eastern District of Texas, Marshall Division. John seeks an injunction, unspecified damages, and attorneys' fees and expenses. The Company filed a request for re-examination of the patent that is the subject of a lawsuit by the United States Patent and Trademark Office ( "PTO" ), which was granted by the PTO, and the re-examination is in progress. The litigation has been stayed pending the results of the re-examination. Neither the likelihood nor the amount of any potential exposure to the Company can be estimated at this time.

We are exposed to certain other asserted and unasserted potential claims. There can be no assurance that, with respect to potential claims made against us, we could resolve such claims under terms and conditions that would not have a material adverse effect on our business, our liquidity or our financial results.

**Table of Contents****Note 13 Segment and Geographic Information:**

We operate in one industry segment comprising the design, development, manufacture and marketing of high performance programmable logic devices. Our revenue by major geographic area was as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
United States:	\$ 6,108	12%	\$ 9,877	17%	\$ 21,164	15%	\$ 28,794	17%
Export revenue:								
Asia Pacific (primarily China and Taiwan)	27,551	56	27,171	47	77,184	56	77,068	44
Europe	8,414	17	11,473	20	25,135	18	35,930	21
Japan	5,673	12	7,170	13	11,547	8	23,927	14
Other Americas	1,351	3	1,919	3	4,303	3	6,574	4
Total export revenue	42,989	88	47,733	83	118,169	85	143,499	83
Total revenue	\$ 49,097	100%	\$ 57,610	100%	\$ 139,333	100%	\$ 172,293	100%

Our five largest customers make up a significant portion of our total revenue. In the first nine months of fiscal 2009 and fiscal 2008, revenue attributable to two large telecommunications equipment providers, one of which was supported through one of our distributors, accounted for approximately 20% and 10% of total revenue, respectively. More than 90% of our property and equipment is located in the United States.

**Note 14 Subsequent Events:**

On October 15, 2009, the Company received \$30.0 million plus accrued interest from Fujitsu, pursuant to the letter agreement as described in Note 7.

The Company has evaluated the impact of subsequent events through November 5, 2009, the date on which the financial statements were issued, and has determined that all subsequent events have been appropriately reflected in the accompanying financial statements.

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Lattice Semiconductor Corporation (the Company, we, us or our) designs, develops and markets high performance programmable logic products and related software. Programmable logic products are widely used semiconductor components that can be configured by the end customer as specific logic circuits, and thus enable the end customer to shorten design cycle times and reduce development costs. Within the programmable logic market there are two groups of products - programmable logic devices (PLD) and field programmable gate arrays (FPGA) - each representing a distinct silicon architectural approach. Products based on the two alternative programmable logic architectures are generally optimal for different types of logic functions, although many logic functions can be implemented using either architecture. We believe that a substantial portion of programmable logic customers utilize both PLD and FPGA architectures. Our end customers are primarily original equipment manufacturers in the communications, computing, industrial, consumer, automotive, medical and military end markets.

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

Critical accounting policies are those that are both most important to the presentation of a company's financial condition and results of operations and require management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Management believes that there have been no significant changes during the nine months ended October 3, 2009 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended January 3, 2009.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and classification of assets, such as marketable securities, accounts receivable, inventory and deferred income taxes and liabilities, such as accrued liabilities (including restructuring charges), income taxes and deferred income and allowances on sales to certain distributors, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the fiscal periods presented. Our most critical estimate relates to auction rate securities, and the estimates of fair value of these securities made in accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC) No. 820, Fair Value Measurements and Disclosures. Actual results could differ from these estimates.

#### **Recent Accounting Guidance**

In October 2009, the FASB issued authoritative guidance on revenue recognition that will become effective in fiscal years beginning on or after June 15, 2010, with earlier adoption permitted. This guidance amends the criteria for recognizing revenue in multiple element arrangements and the scope of what constitutes a non-software deliverable. The Company does not expect the application of the new guidance to have a material impact on the Company's Condensed Consolidated Financial Statements.

**Table of Contents****Results of Operations****Revenue**

Key elements of our Condensed Consolidated Statements of Operations (dollars in thousands) were as follows:

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
Revenue	\$ 49,097	100.0%	\$ 57,610	100.0%	\$ 139,333	100.0%	\$ 172,293	100.0%
Gross margin	26,619	54.2	31,117	54.0	73,883	53.0	95,089	55.2
Research and development	14,789	30.1	17,534	30.4	43,491	31.2	53,139	30.8
Selling, general and administrative	12,739	25.9	14,547	25.3	39,255	28.1	44,741	26.0
Amortization of intangible assets			1,369	2.4	228	0.2	4,218	2.5
Restructuring	2,544	5.2	3,882	6.7	2,504	1.8	6,530	3.8
Loss from operations	\$ (3,453)	(7.0)%	\$ (6,215)	(10.8)%	\$ (11,595)	(8.3)%	\$ (13,539)	(7.9)%

Revenue in the three and nine months ended October 3, 2009 decreased to \$49.1 million and \$139.3 million, respectively, compared to \$57.6 million and \$172.3 million in the three and nine months ended September 27, 2008.

We experienced a sequential increase in revenue of 5% during the third quarter of fiscal 2009, when compared to the second quarter of fiscal 2009, primarily as a result of an increase in sales in the computing end-market sector partially offset by a decrease in sales as a result of a pause in the China 3G telecommunications network build-out.

In April 2009, we notified two of our distributors in Taiwan and China of our intention to terminate the distribution agreements between the Company and those distributors, effective June 6, 2009. This action was taken in connection with the transition of our distribution channels in the Asia Pacific region, from a sell-in to a sell-through distribution model. One of the distributors represented approximately 10% of the Company's revenue in each of the fiscal 2008 and 2007 years. Additionally, we converted in-place selected distributors in the Asia Pacific region and Europe from a sell-in to a sell-through model, effective for the beginning of the fourth quarter of fiscal 2009. As a result, revenue was lower in the third quarter of fiscal 2009 by an estimated \$2.0 million and is expected to be lower in the fourth quarter of fiscal 2009 by approximately \$1.0 million compared to forecasted revenue in the respective quarters had we not embarked on this conversion. We rely on our channel partners to sell our products to end users. The sell-in distribution model allows the Company to recognize revenue upon shipment to the distributor. The sell-through distribution model is an arrangement that does not include firm prices and includes right of return conditions, and thus revenue is recognized upon resale by the sell-through distributor. Our future revenue from our distribution network in the Asia Pacific and European regions is partially dependent on our ability to manage this transition.

**Revenue by Product Line**

FPGA revenue decreased in the third quarter of fiscal 2009 compared to the third quarter of fiscal 2008 due to a decrease in units sold partially offset by an increase in average selling price. FPGA revenue increased in the first nine months of fiscal 2009 compared to the first nine months of fiscal 2008 due to an increase in units sold partially offset by a decrease in average selling price. PLD revenue decreased in the third quarter and first nine months of fiscal 2009, when compared to the third quarter and first nine months of fiscal 2008, respectively, due to a decline in units sold partially offset by an increase in average selling prices.

The composition of our revenue by product line for the third quarter and first nine months of fiscal 2009 and 2008 was as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
FPGA	\$ 15,201	31%	\$ 16,453	29%	\$ 47,920	34%	\$ 43,528	25%
PLD	33,896	69	41,157	71	91,413	66	128,765	75

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Total revenue	\$ 49,097	100%	\$ 57,610	100%	\$ 139,333	100%	\$ 172,293	100%
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### *Revenue by End Market*

The communications end market accounted for approximately 54% of our revenue for the quarters ended October 3, 2009 and September 27, 2008. We continued to support the China 3G telecommunications network build-out in the quarter ended October 3, 2009, primarily with products sold to two large telecommunications equipment providers, one of which was through one of our distributors. We expect that a significant portion of our revenue will continue to be dependent on the health of the communications end market. The computing end market accounted for 17% of revenue for the quarter ended October 3, 2009 compared to 11% in the same period last year. This was primarily due to strength in the server market.



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The composition of our revenue by end market for the third quarter and first nine months of fiscal 2009 and 2008 was as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
Communications	\$ 26,670	54%	\$ 31,361	54%	\$ 80,436	58%	\$ 92,377	54%
Industrial and other	8,212	17	12,185	21	24,177	17	39,130	23
Computing	8,349	17	6,269	11	17,757	13	21,375	12
Consumer and automotive	5,866	12	7,795	14	16,963	12	19,411	11
<b>Total revenue</b>	<b>\$ 49,097</b>	<b>100%</b>	<b>\$ 57,610</b>	<b>100%</b>	<b>\$ 139,333</b>	<b>100%</b>	<b>\$ 172,293</b>	<b>100%</b>

*Revenue by Product Classification*

Revenue for New products increased 15% and 41% for the third quarter and first nine months of fiscal 2009, respectively, compared to the third quarter and first nine months of fiscal 2008, as a result of increased unit sales. Revenue for Mainstream products decreased 25% and 34% for the third quarter and first nine months of fiscal 2009, respectively, compared to the third quarter and first nine months of fiscal 2008 and Mature product revenue decreased 33% and 45% for the third quarter and first nine months of fiscal 2009, respectively, compared to the third quarter and first nine months of fiscal 2008, primarily due to lower demand associated with the current weak economic conditions.

The composition of our revenue by product classification for the third quarter and first nine months of fiscal 2009 and 2008 was as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
New *	\$ 20,220	41%	\$ 17,511	30%	\$ 57,855	42%	\$ 41,032	24%
Mainstream *	18,740	38	24,968	43	53,603	38	80,770	47
Mature *	10,137	21	15,131	27	27,875	20	50,491	29
<b>Total revenue</b>	<b>\$ 49,097</b>	<b>100%</b>	<b>\$ 57,610</b>	<b>100%</b>	<b>\$ 139,333</b>	<b>100%</b>	<b>\$ 172,293</b>	<b>100%</b>

\* Product Classification:

**New:** LatticeECP3, LatticeXP2, LatticeSC, LatticeECP2/M, LatticeECP, LatticeXP, MachXO, Power Manager1/2, ispClock1/2, ispMACH 4000ZE

**Mainstream:** FPSC, ispXPLD, ispGDX2, ispMACH 4/LV, ispGDX/V, ispMACH 4000/Z, ispXPGA, Software and IP

**Mature:** ORCA 2, ORCA 3, ORCA 4, ispPAC, ispLSI 8000V, ispMACH 5000B, ispMACH 2LV, ispMACH 5LV,

ispLSI 2000V, ispLSI 5000V, ispMACH 5000VG, all 5-Volt CPLDs, all SPLDs

*Revenue by Geography*

Export revenue as a percentage of total revenue was 88% and 85% for the third quarter and first nine months of fiscal 2009, respectively, compared to 83% for both the third quarter and first nine months of fiscal 2008. Export revenue as a percentage of overall revenue increased primarily due to the on-going shift of manufacturing operations to Asia. We believe the export market to Asia will remain the primary source of our revenue due to more favorable business conditions in Asia and a continuing trend towards outsourcing of manufacturing by North American and European customers to Asia. We allocate revenue by geography by our ship-to location which may not represent the final consumption of our products by the ultimate end customer.



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The composition of our revenue by geographic location of our direct and indirect customers is as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 3, 2009		September 27, 2008		October 3, 2009		September 27, 2008	
United States:	\$ 6,108	12%	\$ 9,877	17%	\$ 21,164	15%	\$ 28,794	17%
Export revenue:								
Asia Pacific (primarily China and Taiwan)	27,551	56	27,171	47	77,184	56	77,068	44
Europe	8,414	17	11,473	20	25,135	18	35,930	21
Japan	5,673	12	7,170	13	11,547	8	23,927	14
Other Americas	1,351	3	1,919	3	4,303	3	6,574	4
Total export revenue	42,989	88	47,733	83	118,169	85	143,499	83
Total revenue	\$ 49,097	100%	\$ 57,610	100%	\$ 139,333	100%	\$ 172,293	100%