

LATTICE SEMICONDUCTOR CORP  
Form 10-Q  
May 10, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**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 MARCH 31, 2007**

**OR**

**o**

**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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Number of shares of common stock outstanding as of May 8, 2007 114,769,861

The information contained in this Form 10-Q is as of May 9, 2007. This Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 30, 2006.

LATTICE SEMICONDUCTOR CORPORATION

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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, and 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 overall semiconductor market conditions, market acceptance and demand for our new products, our dependencies on our silicon wafer suppliers, the impact of competitive products and pricing, technological and product development risks, 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 report. You should not unduly rely on forward-looking statements because our actual results could materially differ from those expressed in any forward-looking statements made by us. Further, any forward-looking statement applies only as of the date on which it is made. We are not required to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.



## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## LATTICE SEMICONDUCTOR CORPORATION

## CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended March 31, 2007	April 1, 2006
<b>Revenue</b>	<b>\$ 58,107</b>	<b>\$ 57,452</b>
<b>Costs and expenses:</b>		
Cost of products sold	26,218	25,145
Research and development	22,008	20,351
Selling, general and administrative	14,566	13,689
Amortization of intangible assets	2,667	2,813
Restructuring	(130 )	119
	<b>65,329</b>	<b>62,117</b>
<b>Loss from operations</b>	<b>(7,222 )</b>	<b>(4,665 )</b>
<b>Interest and other income (expense), net:</b>		
Interest income	2,201	2,755
Interest expense	(22 )	(12 )
Other income, net	829	1,304
	<b>3,008</b>	<b>4,047</b>
<b>Loss before provision for income taxes</b>	<b>(4,214 )</b>	<b>(618 )</b>
<b>Provision for income taxes</b>	<b>169</b>	<b>189</b>
<b>Net loss</b>	<b>\$ (4,383 )</b>	<b>\$ (807 )</b>
<b>Basic net loss per share</b>	<b>\$ (0.04 )</b>	<b>\$ (0.01 )</b>
<b>Diluted net loss per share</b>	<b>\$ (0.04 )</b>	<b>\$ (0.01 )</b>
<b>Shares used in per share calculations:</b>		
Basic	114,688	113,791
Diluted	114,688	113,791

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.



## LATTICE SEMICONDUCTOR CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEET

(In thousands, except share and par value data)

(unaudited)

	March 31, 2007	December 30, 2006
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 34,109	\$ 40,437
Marketable securities	135,547	192,771
Accounts receivable, net	28,659	22,545
Inventories	40,311	38,816
Current portion of foundry investments and advances	26,955	23,714
Prepaid expenses and other current assets	10,116	11,760
<b>Total current assets</b>	<b>275,697</b>	<b>330,043</b>
Foundry investments, advances and other assets	101,749	109,964
Property and equipment, less accumulated depreciation	47,228	46,696
Intangible assets, less accumulated amortization	12,980	15,647
Goodwill	223,556	223,556
	<b>\$ 661,210</b>	<b>\$ 725,906</b>
<b>Liabilities and Stockholders Equity</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued expenses	\$ 32,505	\$ 70,442
Accrued payroll obligations	9,534	12,401
Deferred income and allowances on sales to distributors	7,548	6,230
Other current liabilities	9,120	20,480
<b>Total current liabilities</b>	<b>58,707</b>	<b>109,553</b>
Zero Coupon Convertible Subordinated Notes due in 2010	80,000	89,120
Other long-term liabilities	5,639	15,488
<b>Total liabilities</b>	<b>144,346</b>	<b>214,161</b>
<b>Commitments and contingencies</b>		
<b>Stockholders equity:</b>		
Preferred stock, \$.01 par value, 10,000,000 shares authorized; none issued and outstanding		
Common stock, \$.01 par value, 300,000,000 shares authorized, 114,753,000 and 114,526,000 shares issued and outstanding	1,148	1,145
Paid-in capital	605,833	603,273
Accumulated other comprehensive loss	(501)	(230)
Accumulated deficit	(89,616)	(92,443)
	<b>516,864</b>	<b>511,745</b>
	<b>\$ 661,210</b>	<b>\$ 725,906</b>

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.





## LATTICE SEMICONDUCTOR CORPORATION

## CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands)

(unaudited)

	Three Months Ended	
	March 31, 2007	April 1, 2006
<b>Cash flows from operating activities:</b>		
Net loss	\$ (4,383 )	\$ (807 )
<b>Adjustments to reconcile net loss to net cash used in operating activities:</b>		
Depreciation and amortization	7,099	6,822
Gain on extinguishment of convertible notes	(653 )	(1,200 )
Stock-based compensation	1,389	707
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(6,114 )	(1,816 )
Inventories	(1,495 )	(3,567 )
Prepaid expenses and other assets	1,995	1,022
Wafer advances (includes wafer credits)	2,268	2,685
Accounts payable and accrued expenses	(39,804 )	(2,674 )
Accrued payroll obligations	(2,868 )	(1,932 )
Deferred income and allowances on sales to distributors	1,318	(2,765 )
Other liabilities	22	51
Net cash used in operating activities	(41,226 )	(3,474 )
<b>Cash flows from investing activities:</b>		
Proceeds from sales or maturities of marketable securities	105,480	47,295
Purchase of marketable securities	(48,256 )	(35,183 )
Capital expenditures	(3,915 )	(2,754 )
Net cash provided by investing activities	53,309	9,358
<b>Cash flows from financing activities:</b>		
Extinguishment of Zero Coupon Convertible Subordinated Notes	(19,575 )	(8,738 )
Advances on yen line of credit		607
Paydown on yen line of credit		(420 )
Net proceeds from issuance of common stock	1,164	1,292
Net cash used in financing activities	(18,411 )	(7,259 )
<b>Net decrease in cash and cash equivalents</b>	<b>(6,328 )</b>	<b>(1,375 )</b>
<b>Beginning cash and cash equivalents</b>	<b>40,437</b>	<b>39,336</b>
<b>Ending cash and cash equivalents</b>	<b>\$ 34,109</b>	<b>\$ 37,961</b>
<b>Supplemental disclosures of non-cash investing and financing activities:</b>		
Unrealized (loss) gain on (depreciation) appreciation of foundry investments included in		
Accumulated other comprehensive loss	\$ (249 )	\$ 1,572
Distribution of deferred compensation	\$ 1,274	\$ 2,785



**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 ) pursuant to the rules and regulations of the Securities and Exchange Commission ( SEC ) and in our opinion include all adjustments, consisting only 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 December 30, 2006. Prior period disclosures have been reclassified to the extent required to be consistent with the current period presentation. As a result of the restructuring implemented in the fourth quarter of 2005 (see Note 8 to these Condensed Consolidated Financial Statements), the Company realigned certain departments and job responsibilities in 2006. Due to these changes, the Company reviewed its historical cost center allocations and has reclassified these to reflect post-restructuring operations. Amounts previously reported in the first quarter of 2006 have been reclassified to be consistent with the approach applied in the first quarter of 2007.

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. Actual results could differ from these estimates.

We report based on a 52 or 53-week year ending on the Saturday closest to December 31. Our first quarter for fiscal 2007 and 2006 ended on March 31, 2007 and April 1, 2006, respectively. All references to quarterly or yearly financial results are references to the results for the relevant fiscal period.

Effective December 31, 2006, we adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 ( FIN No. 48 ). We are subject to income taxes in the United States and certain foreign countries. We believe our tax return positions are fully supported, but tax authorities may challenge certain positions, which may not be fully sustained. We assess our income tax positions and record tax benefits for all years subject to examination based upon management's evaluation of the facts, circumstances, and information available at the reporting date. For uncertain tax positions where it is more likely than not that a tax benefit will be sustained, we record the greatest amount of tax benefit that has a greater than 50 percent probability of being realized upon effective settlement with a taxing authority that has full knowledge of all relevant information. For uncertain income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements. Our policy is to recognize interest and penalties that would be assessed in relation to the settlement value of unrecognized tax benefits in the Provision for income taxes. Other than the adoption of FIN No. 48, there have been no changes to the significant accounting policies as included in the audited financial statements included in our Annual Report on Form 10-K for the year ended December 30, 2006.

*New Accounting Pronouncements*

There have been no new relevant accounting pronouncements or material changes to the new accounting pronouncements as previously reported in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2006.

**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. Potentially dilutive securities consist of stock options, restricted stock units, warrants to purchase common stock and Zero Coupon Convertible Subordinated Notes due in 2010 ( Convertible Notes ).

The most significant difference between the computation of basic and diluted net income per share is that basic net income per share does not treat potentially dilutive securities such as stock options, restricted stock units, warrants and Convertible Notes as



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outstanding. For both periods presented, the computation of diluted net loss per share excludes the effect of stock options, restricted stock units, warrants and Convertible Notes, as they are antidilutive. A reconciliation of basic and diluted net loss per share is presented below (in thousands, except for per share data):

	Three Months Ended	
	March 31, 2007	April 1, 2006
Basic and diluted net loss	\$ (4,383 )	\$ (807 )
Shares used in basic net loss per share calculations	114,688	113,791
Dilutive effect of stock options, restricted stock units, warrants and Convertible Notes		
Shares used in diluted net loss per share	114,688	113,791
Basic and diluted net loss per share	\$ (0.04 )	\$ (0.01 )

**Note 3 Inventories (in thousands):**

	March 31, 2007	December 30, 2006
Work in progress	\$ 30,215	\$ 27,952
Finished goods	10,096	10,864
	\$ 40,311	\$ 38,816

**Note 4 Changes in Stockholders' Equity (in thousands):**

	Common stock	Paid-in capital	Accumulated other comprehensive loss	Accumulated deficit (1)	Total
Balances, December 30, 2006	\$ 1,145	\$ 603,273	\$ (230 )	\$ (92,443 )	\$ 511,745
Cumulative effect adjustment (See Note 7 Income Taxes )				7,210	7,210
Common stock issued in connection with exercise of stock options and ESPP	3	1,161			1,164
Unrealized loss on foundry investments, net			(249 )		(249 )
Stock-based compensation expense related to employee and director stock options and ESPP		1,389			1,389
Distribution of stock held in deferred compensation plan		10			10
Translation adjustment			(22 )		(22 )

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Net loss for the quarter ended						
March 31, 2007				(4,383	)	(4,383

Balances, March 31, 2007	\$	1,148	\$	605,833	\$	(501	)	\$	(89,616	)	\$	516,864
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(1) We determined in the first quarter of fiscal 2007 that at December 30, 2006 our accrual for the Company's matching contribution for future employee 401(K) plan contributions was overstated by \$2.2 million related to amounts originally provided for in fiscal 2001. We are adjusting the December 30, 2006 Condensed Consolidated Balance Sheet by reducing previously reported Accrued payroll obligations and Accumulated deficit by the same amount under the provisions for making immaterial corrections outlined in Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements."

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Total comprehensive loss for the first three months of 2007 was approximately \$4.7 million and is substantially comprised of a net loss from operations of \$4.4 million and unrealized loss on foundry investments of \$0.2 million.

**Note 5 Foundry Investments, Advances and Other Assets (in thousands):**

		<b>March 31, 2007</b>	<b>December 30, 2006</b>
Foundry investments and other assets		\$ 33,224	\$ 32,440
Wafer supply advances		95,480	101,238
		128,704	133,678
Less:	UMC common stock available for sale	(2,945 )	(3,194 )
	Current portion of wafer advances	(24,010 )	(20,520 )
		\$ 101,749	\$ 109,964

We owned approximately 5.1 million shares of UMC common stock at March 31, 2007, which is unchanged from December 30, 2006. If we further liquidate our UMC common stock, it is likely that the amount of any future realized gain or loss will be different from the unrealized gain or loss reported in Accumulated other comprehensive income (loss) in prior periods.

**Note 6 Purchased Intangible Assets:**

The following tables present details of the Company's total purchased intangible assets (in millions):

<b>March 31, 2007</b>	<b>Gross</b>	<b>Accumulated amortization</b>	<b>Net</b>
Current technology	\$ 273.6	\$ (264.2 )	\$ 9.4
Patents and trademarks	26.8	(26.8 )	
Customer list	17.4	(17.4 )	
Non-compete agreements	14.2	(14.2 )	
Licenses	10.2	(7.6 )	2.6
Core technology	7.3	(6.7 )	0.6
Workforce	4.7	(4.3 )	0.4
Backlog	1.4	(1.4 )	
Total	\$ 355.6	\$ (342.6 )	\$ 13.0

<b>December 30, 2006</b>	<b>Gross</b>	<b>Accumulated amortization</b>	<b>Net</b>
Current technology	\$ 273.6	\$ (262.6 )	\$ 11.0
Patents and trademarks	26.8	(26.8 )	
Customer list	17.4	(17.4 )	
Non-compete agreements	14.2	(14.2 )	
Licenses	10.2	(7.2 )	3.0
Core technology	7.3	(6.3 )	1.0
Workforce	4.7	(4.1 )	0.6
Backlog	1.4	(1.4 )	
Total	\$ 355.6	\$ (340.0 )	\$ 15.6

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The estimated future amortization expense of purchased intangible assets as of March 31, 2007 is as follows (in millions):

Fiscal Year:	Amount
2007 (remaining nine months)	\$ 7.2
2008	5.6
2009	0.2
	\$ 13.0

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**Note 7 Income Taxes:**

As previously described in Note 1 to these Condensed Consolidated Financial Statements, effective December 31, 2006, we adopted FIN No. 48. As a result of the December 31, 2006 transition to the FIN No. 48 recognition and measurement requirement for uncertain tax positions, we recognized as a cumulative effect adjustment, a decrease in Other long-term liabilities of \$8.6 million, an increase in Accounts payable and accrued expenses of \$1.4 million and a reduction in Accumulated deficit of \$7.2 million. As of the date of adoption, our unrecognized tax benefits totaled \$4.9 million, of which \$4.7 million, if recognized, would affect the effective tax rate and future tax provision. The unrecognized tax benefit at December 31, 2006 includes \$0.6 million for the payment of interest and penalties. It also includes \$3.4 million related to tax positions for which it is reasonably possible that the amounts could significantly change during the next twelve months. The \$3.4 million represents a decrease in unrecognized tax benefits comprised of items related to matters currently in IRS appeals, certain federal and state tax credits, matters currently being examined by a foreign jurisdiction and expiring uncertain income tax positions related to foreign tax filings for years no longer subject to examination under expiring statutes of limitations.

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 2000.

The Internal Revenue Service 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. We do not agree with these proposed adjustments and are in the appeals process. Although the final resolution of this appeal is uncertain, we believe that adequate amounts have been provided for in the uncertain tax benefits. There is the possibility of either favorable or unfavorable impact on our results of operations in the period in which these matters are effectively resolved, or in the period in which our estimates of the outcomes change. We are subject to state and local income tax examinations for the years 2001 through 2004. We are subject to examination in the United Kingdom for 2005. To date, there are no proposed adjustments that will have a material adverse effect on our results of operations. We are not currently under examination in any other foreign jurisdictions.

During the three months ended March 31, 2007, we recognized approximately \$0.1 million in potential interest and penalties associated with uncertain tax positions.

**Note 8 Restructuring:**

During the fourth quarter of 2005, we initiated and completed a restructuring plan ( 2005 restructuring plan ) to reduce operating expenses. The restructuring encompassed three major components a streamlining of research and development sites, a voluntary separation program for certain employees and an organizational consolidation within the Company s largest design center. These actions did not impact the Company s product direction or product roll-out strategy.

In the fourth quarter of 2005, the Company recorded an initial restructuring charge of \$11.9 million. The charge primarily related to separation packages, costs to vacate space under long-term lease arrangements and the write-off of an intellectual property license. All of our restructuring accruals as of March 31, 2007 are related to the 2005 restructuring plan.

The following table displays the current estimate for each major type of cost associated with the 2005 restructuring plan (in thousands):

	Balance, at December 30, 2006	Charged to expense	Paid or settled	Adjustments to reserve	Balance, at March 31, 2007	As of March 31, 2007 Aggregate expense and adjustments
Severance and related costs	\$ 108	\$	\$	\$	\$ 108	\$ 6,341
Lease loss reserve	1,509	45	(219 )	(175 )	1,160	2,267
Other	143				143	3,509
Total	\$ 1,760	\$ 45	\$ (219 )	\$ (175 )	\$ 1,411	\$ 12,117

Included in our Condensed Consolidated Statement of Operations and reported as Restructuring for the three months ended March 31, 2007 is a net credit to operating expenses of \$0.1 million. The credit was due primarily to a change in estimated future sublease income for the vacated premises in Austin, Texas. In the first quarter of fiscal 2007 we entered into a sublease agreement for the vacated premises and adjusted the

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estimated sublease income to be consistent with that agreement. The above restructuring accrual at March 31, 2007 is based on estimates that are subject to change. Lease charges could change based on our ability to either generate sublease income or terminate lease obligations at the amounts estimated, and are dependent upon lease market conditions at the time we negotiate the potential lease arrangements. Variance from these estimates could alter our ability to achieve anticipated expense reductions in the planned timeframe and modify our expected cash outflows and working capital.

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Balances at December 30, 2006 and March 31, 2007 of \$1.1 million and \$0.8 million, respectively, of the lease loss reserve are classified as long-term and included in Other long-term liabilities, as they relate to operating lease commitments accrued as part of restructuring costs, payable after twelve months.

**Note 9 Long-Term Debt:**

On June 20, 2003, we issued \$200.0 million in Convertible Notes. In October 2003, our Board of Directors authorized management to repurchase up to \$100.0 million of our Convertible Notes. In November 2006, our Board of Directors authorized management to repurchase up to an additional \$20.0 million of our Convertible Notes, for an aggregate potential repurchase amount of \$120.0 million. Included in Other current liabilities on the Condensed Consolidated Balance Sheet is \$9.1 million and \$20.5 million of Convertible Notes at March 31, 2007 and December 30, 2006, respectively, that were repurchased in May 2007 and in the first quarter of fiscal 2007, respectively. The extinguishment of debt in the first quarter of fiscal 2007 resulted in a gain of \$0.7 million that is included in Other income, net for the quarter ended March 31, 2007. The extinguishment of debt in May 2007 resulted in a gain of \$0.4 million that will be included in Other income, net for the quarter ending June 30, 2007.

**Note 10 Stock-Based Compensation:**

Effective January 1, 2006, we began recording employee and director stock option and Employee Stock Purchase Plan ( ESPP ) compensation expense in accordance with Share Based Payment a revision of SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123(R) ), as interpreted by SEC Staff Accounting Bulletin No. 107 ( SAB 107 ).

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

Line Item:	March 31, 2007	April 1, 2006
Cost of products sold	\$ 130	\$ 60
Research and development	703	376
Selling, general and administrative	556	271
	\$ 1,389	\$ 707

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model with the following assumptions and weighted-average fair values:

	Grants for Three Months Ended	
	March 31, 2007	April 1, 2006
<b>Employee and Director Stock Options:</b>		
Weighted-average fair value of grants	\$ 3.11	\$ 2.38
Expected volatility	55.4	% 57.7
Risk-free interest rate	4.8	% 4.5
Expected term (in years)	4.75	4.75
Dividend yield	0.0	% 0.0
<b>Employee Stock Purchase Plan:</b>		
Weighted-average fair value of ESPP	\$ 1.91	\$ 0.53
Expected volatility	47.8	% 31.0
Risk-free interest rate	5.1	% 4.4
Expected term (in years)	.50	.50

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Dividend yield	0.0	%	0.0	%
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As of March 31, 2007, there was \$10.7 million of total unrecognized compensation cost related to employee and director stock options, which are expected to be recognized over a weighted-average period of 3.4 years.

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The following table summarizes our stock option activity and related information for the first quarter ended March 31, 2007:

	Shares (In thousands)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (In thousands)
Balance, December 30, 2006	21,496	\$ 7.10		
Granted	1,118	6.05		
Exercised	(22 )	4.44		
Forfeited or expired	(816 )	9.71		
Balance, March 31, 2007	21,776	\$ 6.95	5.88	\$ 8,067
Vested and expected to vest at March 31, 2007	19,262	\$ 7.16	5.53	\$ 6,707
Exercisable, March 31, 2007	14,570	\$ 7.78	5.23	\$ 3,487

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the first quarter of fiscal 2007 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2007. This amount changes based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the three months ended March 31, 2007 and April 1, 2006 was \$0.1 million and \$0.4 million, respectively.

In February 2007, the compensation committee of our Board of Directors approved the grant of restricted stock units to officers of the Company, including executive officers. These restricted stock units generally vest over four years, however, the vesting of restricted stock units granted to executive officers is contingent upon certain annual appreciation in the Company's stock price. Upon vesting, the restricted stock units will convert into an equivalent number of shares of common stock. Generally, the grant date fair value of the restricted stock units is equal to the closing market price of the Company's common stock on the date of grant, and the fair value is amortized to expense on a straight-line basis over the requisite service period.

A summary of non-vested restricted stock units for the first quarter ended March 31, 2007 is presented as follows:

	Shares (In thousands)	Weighted- Average Grant Date Fair Value
Balance, December 30, 2006		\$
Granted	145	6.05
Exercised		
Forfeited or expired		
Balance, March 31, 2007	145	\$ 6.05

As of March 31, 2007, there was \$0.6 million of total unrecognized compensation cost related to restricted stock units, which is expected to be recognized over a weighted-average period of approximately four years.

**Note 11 Legal Matters:**

We previously announced that the SEC had been conducting an informal inquiry into our restatement of financial results for the first, second, and third quarters of 2003. We also previously announced that our Audit Committee conducted an internal examination concerning issues primarily associated with executive compensation and several items pertaining to our internal controls. We have furnished information regarding our restatement and the other matters examined by the Audit Committee to the SEC. On September 30, 2005 the SEC issued a Cease-and-Desist Order concerning our former Controller, and referenced certain events in connection with our prior restatement of financial results. In September 2006, we made a settlement offer to the SEC to resolve the informal inquiry. We offered to consent to the entry of a cease and desist order with respect to violations of Sections 13(a) and 13(b)(2)(A)-(B) of the Securities Exchange Act of 1934, as amended, and Rule 13a-13 promulgated thereunder. The proposed settlement was approved by the SEC, and on January 12, 2007 the SEC issued an Order instituting Cease-and-Desist Proceedings, making findings, and imposing a Cease-and-Desist Order pursuant to Section 21C of the Securities Exchange Act of 1934.

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We are exposed to certain 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, our financial position or our operating results.

**Note 12 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 were as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
United States:	\$ 11,348	\$ 13,709
Export revenue:		
Europe	13,008	15,362
China	11,214	7,579
Japan	8,400	7,325
Taiwan	6,755	5,083
Other Asia	5,293	4,595
Other Americas	2,089	3,799
Total revenue from exports	46,759	43,743
Total revenue	\$ 58,107	\$ 57,452

Resale of product through our two largest distributors, Arrow Electronics, Inc. and Avnet, Inc., accounted for approximately 10% and eight percent, respectively, of revenue in the first quarter of fiscal 2007, and 12% and nine percent, respectively, of revenue for the first quarter of 2006. More than 90% of our property and equipment is located in the United States.

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

Lattice Semiconductor Corporation (the Company) 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 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 (PLDs) and field programmable gate arrays (FPGAs) - 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 portrayal of a company's financial condition and results 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 other than the adoption of Financial Accounting Standard Board (FASB) Interpretation No. 48 Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109, there have been no significant changes during the three months ended March 31, 2007 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 December 30, 2006.

*Uncertain Tax Positions*

Effective December 31, 2006, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN No. 48). We are subject to income taxes in the United States and certain foreign countries. We believe our tax return positions are fully supported, but tax authorities may challenge certain positions, which may not be fully sustained. We assess our income tax positions and record tax benefits for all years subject to examination based upon management's evaluation of the facts, circumstances, and information available at the reporting date. For uncertain tax positions where it is more likely than not that a tax benefit will be sustained, we record the greatest amount of tax benefit that has a greater than 50 percent probability of being realized upon effective settlement with a taxing authority that has full knowledge of all relevant information. For uncertain income tax positions where it is not more likely than not that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements.

**New Accounting Pronouncements**

There have been no new relevant accounting pronouncements or material changes to the new accounting pronouncements as previously reported 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 December 30, 2006.

**Results of Operations***Revenue*

Key elements of our Condensed Consolidated Statement of Operations (dollars in thousands), and expressed as a percentage of revenues, were as follows:

	Three Months Ended March 31, 2007			April 1, 2006		
Revenue	\$ 58,107	100.0	%	\$ 57,452	100.0	%
Gross margin	31,889	54.9		32,307	56.2	
Research and development expenses	22,008	37.9		20,351	35.4	
Selling, general and administrative expenses	14,566	25.0		13,689	23.8	



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Amortization of intangible assets	2,667		4.6		2,813		4.9			
Restructuring	(130	)	(0.2	)	119		0.2			
Loss from operations	\$	(7,222	)	(12.4	)%	\$	(4,665	)	(8.1	)%

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Revenue for our business in the first quarter of fiscal 2007 increased to \$58.1 million compared to \$57.5 million for the first quarter of 2006, primarily due to growth of New products and FPGA products as well as strength in the industrial, consumer and military end markets. This was partially offset by weakness in the communications and computing end markets. During the first quarter of fiscal 2007, total units sold increased by nine percent while overall average selling price declined by eight percent primarily due to varying product mix.

### Revenue by Product Line

From a product line viewpoint, in the first quarter of fiscal 2007 there was a 23% increase in FPGA units sold and a nine percent increase in PLD units sold, partially offset by a decline in average selling price when compared to the first quarter of 2006, primarily due to varying product mix.

The composition of our revenue by product line for the first quarter of fiscal 2007 and 2006 was as follows (dollars in thousands):

	Three Months Ended			April 1, 2006		
	March 31, 2007					
FPGA	\$ 11,850	20	%	\$ 10,776	19	%
PLD	46,257	80		46,676	81	
Total Revenue	\$ 58,107	100	%	\$ 57,452	100	%

### Revenue by Product Classification

Revenue for New and Mainstream products increased 126% and nine percent, respectively, while Mature product revenue decreased 15% for the first quarter of fiscal 2007 compared to the first quarter of 2006. Among other things, future revenue growth is dependent on overall economic conditions for our industry and market acceptance of our New products.

The composition of our revenue by product classification for the first quarter of fiscal 2007 and 2006 was as follows (dollars in thousands):

	Three Months Ended			April 1, 2006		
	March 31, 2007					
New*	\$ 4,813	8	%	\$ 2,129	4	%
Mainstream*	27,768	48		25,396	44	
Mature*	25,526	44		29,927	52	
Total Revenue	\$ 58,107	100	%	\$ 57,452	100	%

\* Product Classification:

**New:** LatticeSC, LatticeECP2/M, LatticeECP, LatticeXP, MachXO, Power Manager, ispClock  
**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

In the first quarter of fiscal 2007 we reclassified our New, Mainstream and Mature product categories to better reflect our current product portfolio. The New product category was narrowed, and, as such, several products were removed from our New product category and are now classified as Mainstream. As part of the change to product categories, we also reclassified certain products from Mainstream to Mature. Prior period ratios have been recalculated to reflect these new product category classifications.

### Revenue by Geography

Revenue from export sales as a percentage of total revenue was 80% for the first quarter of fiscal 2007 and 76% for the first quarter of fiscal 2006. Export revenue as a percentage of overall revenue increased due to relatively more favorable business conditions in Asia and a continuing

trend towards outsourcing of manufacturing by North American customers.

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

	<b>Three Months Ended March 31, 2007</b>	<b>April 1, 2006</b>
United States:	\$ 11,348	\$ 13,709
Export revenue:		
Europe	13,008	15,362
China	11,214	7,579
Japan	8,400	7,325
Taiwan	6,755	5,083
Other Asia	5,293	4,595
Other Americas	2,089	3,799
Total revenue from exports	46,759	43,743
Total revenue	\$ 58,107	\$ 57,452

### *Gross Margin and Operating Expenses*

**Our gross margin percentage decreased from 56.2% in the first quarter of fiscal 2006 to 54.9% in the first quarter of 2007. The decline in gross margin percentage resulted primarily from revenue growth in New products, which typically carry an initial lower gross margin, and a last-time buy program to obsolete certain Mature products resulting in a charge to Cost of products sold to write down excess inventory.**

Research and development expenses increased to \$22.0 million in the first quarter of fiscal 2007 compared to \$20.4 million for the same period in 2006. The increase is primarily a result of increased labor expense due to increased salaries for existing employees, and, to a lesser extent, additional stock-based compensation expense.

Selling, general and administrative expenses increased to \$14.6 million in the first quarter of fiscal 2007 compared to \$13.7 million in the first quarter of 2006. The increases are primarily a result of increased labor expense due to increased salaries for existing employees, and, to a lesser extent, additional stock-based compensation expense. The increase was partially offset by a \$0.9 million reversal of an accrual for legal expenses in the first quarter of 2007 compared to a \$0.5 million reversal in the first quarter of 2006.

Amortization of intangible assets declined to \$2.7 million in the first quarter of fiscal 2007 compared to \$2.8 million for the same period in 2006. Amortization charges are expected to be substantially eliminated by the end of 2008.

All restructuring activity relates to the restructuring plan implemented during the fourth quarter of fiscal 2005. Included in our Condensed Consolidated Statement of Operations and reported as Restructuring for the three months ended March 31, 2007 is a net credit of \$0.1 million. The credit was due primarily to a change in estimated future sublease income for the vacated premises in Austin, Texas. In the first quarter of fiscal 2007 we entered into a sublease agreement for the vacated premises and adjusted the estimated sublease income to be consistent with that agreement. See Note 8 to the Consolidated Condensed Financial Statements in Item 1, which is incorporated herein by reference.

### *Interest and other income (expense), net*

Interest and other income (expense), net, was \$3.0 million in the first quarter of 2007 and included a gain on the extinguishment of Zero Coupon Convertible Subordinated Notes due July 1, 2010 ( Convertible Notes ) of \$0.7 million and interest on marketable securities and cash equivalents of \$2.2 million. Interest and other income (expense), net, of \$4.0 million in the first quarter of 2006 included a gain on the extinguishment of Convertible Notes of \$1.2 million and interest on marketable securities and cash equivalents of \$2.8 million. The decrease in interest income is the result of a reduction in the average invested balances in Marketable securities for the periods presented.

### *Provision for income taxes*

We are paying foreign income taxes, which are reflected in the Provision for income taxes in the Condensed Consolidated Statement of Operations and are primarily related to the cost of operating an offshore research and development subsidiary and sales subsidiaries. We are not

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currently paying federal income taxes and do not expect to pay such taxes until the benefits of our tax net operating losses are fully utilized. We expect to pay a nominal amount of state income tax. We accrue interest and penalties related to unrecognized tax benefits in the Provision for income taxes. See Note 7 to the Consolidated Condensed Financial Statements in Item 1, which is incorporated herein by reference.

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## Liquidity and Capital Resources

### *Financial Condition (Sources and Uses of Cash)*

	<b>Three Months Ended</b>	
	<b>March 31, 2007</b>	<b>April 1, 2006</b>
Net cash used in operating activities	\$ (41,226 )	\$ (3,474 )
Net cash provided by investing activities	53,309	9,358
Net cash used in financing activities	(18,411 )	(7,259 )
Net decrease in cash and cash equivalents	\$ (6,328 )	\$ (1,375 )

### *Operating Activities*

Net cash used in operating activities increased by \$37.8 million in the first quarter of fiscal 2007 as compared to the first quarter of 2006. The increase was primarily related to the \$37.5 million advance payment made to Fujitsu Limited ( Fujitsu ) in the first quarter of fiscal 2007, while no payment was made in the first quarter of 2006.

### *Investing Activities*

Net cash provided by investing activities increased by \$44.0 million in the first quarter of fiscal 2007 as compared to the first quarter of 2006. The increase was due to the sales of marketable securities to fund the \$37.5 million advance payment to Fujitsu, and the \$19.6 million used to extinguish Convertible Notes in the first quarter of fiscal 2007, compared to \$8.7 million used to extinguish Convertible Notes in the first quarter of 2006. Further, capital expenditures increased in the first quarter of fiscal 2007, totaling \$3.9 million compared to \$2.8 million in the first quarter of 2006.

### *Financing Activities*

Net cash used in financing activities increased \$11.2 million for the first quarter of fiscal 2007 as compared to the first quarter of 2006. The increase was primarily due to the use of \$19.6 million to extinguish our Convertible Notes in the first quarter of fiscal 2007 compared to \$8.7 million in the first quarter of 2006.

### *Liquidity*

As of March 31, 2007, our principal source of liquidity was \$169.7 million of cash and marketable securities, which was approximately \$63.6 million less than the balance of \$233.2 million at December 30, 2006. This decrease was due primarily to the \$37.5 million advance payment made to Fujitsu and \$19.6 million used to extinguish Convertible Notes. Working capital decreased to \$217.0 million at March 31, 2007 from \$220.5 million at December 30, 2006. This decrease was primarily attributable to the reclassification of \$9.1 million of Convertible Notes to Other current liabilities at March 31, 2007 on the Condensed Consolidated Balance Sheet. This was partially offset by an increase in estimated wafer advances that will be utilized in the next twelve months and working capital generated from operations.

We believe that our existing liquid resources and cash expected to be generated from future operations, combined with wafer credits from foundries and our ability to borrow additional funds, will be adequate to meet our operating and capital requirements and obligations for the next twelve months. As of March 31, 2007, we had completed the unsecured advance payments of an aggregate of \$125.0 million to Fujitsu for prepaid wafers. The advance payments will be returned to us in the form of wafer credits or other repayment, subject to the right of either party to terminate the agreement upon the occurrence of certain events. As of March 31, 2007, \$4.4 million had been returned to us in the form of wafer credits, and we expect an additional \$24.0 million to be returned to us in the form of wafer credits during the next twelve months. If we do not use all of our wafer credits by December 31, 2008, we may request a refund of the unused amount of the advance payment. The repayment obligation of Fujitsu is unsecured.

From 2003 through March 31, 2007, we paid an aggregate of \$97.6 million to extinguish \$110.9 million principal amount of Convertible Notes. In addition, in May 2007 we paid \$8.7 million to extinguish \$9.1 million in principal amount of Convertible Notes. From time to time we will

## Investing Activities

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assess our liquidity and capital resources, and overall economic and market conditions, and may repurchase additional Convertible Notes prior to their maturity date. Although the Convertible Notes are due for payment in 2010 unless they have otherwise been redeemed, purchased, repurchased or converted prior to their maturity date, holders of the Convertible Notes have a right to require payment of the Convertible Notes on July 1, 2008. At March 31, 2007 Convertible Notes with an aggregate principal amount of \$89.1 million remain outstanding.

We may in the future seek new or additional sources of funding. In addition, in order to secure additional wafer supply, we may from time to time consider various financial arrangements including equity investments, advance purchase payments,

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loans, or similar arrangements with independent wafer manufacturers in exchange for committed wafer capacity. To the extent that we pursue any such additional financing arrangements, additional debt or equity financing may be required. There can be no assurance that such additional financing will be available when needed or, if available, will be on favorable terms. Any future equity financing will decrease existing stockholders' equity percentage ownership and may, depending on the price at which the equity is sold, result in dilution.

#### **Contractual Obligations**

There have been no significant changes to the Company's contractual obligations outside of the ordinary course of business in the first quarter of fiscal 2007 as summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended December 30, 2006.

#### **Off-Balance Sheet Arrangements**

As of March 31, 2007 we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes to the quantitative and qualitative disclosures about market risk reported in our Annual Report on Form 10-K for the year ended December 30, 2006.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report.

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

There has been no change in our internal control over financial reporting that occurred in our fiscal quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The information set forth above under Note 11 contained in the Notes to Consolidated Condensed Financial Statements is incorporated herein by reference.

### ITEM 1A. RISK FACTORS

The risk factors included herein include any material changes to and supersede the description of the risk factors associated with our business previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 30, 2006. The following risk factors and other information included in this Quarterly Report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected.

#### **The cyclical nature of the semiconductor industry may limit our ability to maintain revenue levels and operating results during industry downturns.**

The semiconductor industry is highly cyclical, to a greater extent than other less technology-driven industries. Our financial performance has periodically been negatively affected by downturns in the semiconductor industry. Factors that contribute to these industry downturns include:

- the cyclical nature of the demand for the products of semiconductor customers;
- general reductions in inventory levels by customers;
- excess production capacity;
- general decline in end-user demand; and
- accelerated declines in average selling prices.

Historically, the semiconductor industry has experienced periodic downturns of varying degrees of severity and duration. Typically, after such downturns, semiconductor industry conditions improve, although such improvement may not be significant or sustainable. Increased demand for semiconductor industry products may not proportionately increase demand for programmable logic products in general, or our products in particular. Even if demand for our products increases, average selling prices for our products may not increase, and could decline. Whenever adverse semiconductor industry conditions or other similar conditions exist, there is likely to be an adverse effect on our operating results.

Further, our ability to predict end-user demand is limited. Typically, the majority of our revenue comes from turns orders, which are orders placed and filled within the same quarter. By definition, turns orders are not captured in a backlog measurement at the beginning of a quarter. Accordingly, we cannot use backlog as a reliable measure of predicting revenue.

#### **A downturn in the communications equipment end market or computing end market could cause a reduction in demand for our products and limit our ability to maintain revenue levels and operating results.**

The majority of our revenue is derived from customers in the communications equipment and computing end markets. Any deterioration in these end markets or any reduction in technology capital spending could lead to a reduction in demand for our products. For example, in the past, a general weakening in demand for programmable logic products from customers in the communications end market has adversely affected our revenue. Whenever adverse economic or end market conditions exist, there is likely to be an adverse effect on our operating results.

#### **We may be unsuccessful in defining, developing or selling the new FPGA products required to maintain or expand our business.**

As a semiconductor company, we operate in a dynamic environment marked by rapid product obsolescence. The programmable logic market is characterized by rapid technology and product evolution and historically the market for FPGA products has grown faster than the market for

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PLD products. Currently we derive a greater proportion of our revenue from PLD products than FPGA products. Consequently, our future success depends on our ability to introduce new FPGA and associated software design tool products that meet evolving customer needs while achieving acceptable margins. We are presently shipping our next generation FPGA product families that are critical to our ability to grow our FPGA product revenue and expand our overall revenue. We also plan to continue upgrading our customer design tool products and increase

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our offerings of intellectual property cores. If we fail to introduce new products in a timely manner, or if these products or future new products fail to achieve market acceptance, our operating results would be harmed.

Fujitsu has agreed to manufacture our current and future FPGA products on its 130 nanometer and 90 nanometer CMOS process technologies, as well as on 130 nanometer and 90 nanometer technologies with embedded flash memory that we have jointly developed with Fujitsu. We have access to 65 nanometer CMOS process technology from Fujitsu. Fujitsu is our sole source supplier for our newest FPGA products, our new wafer fabrication processes and our planned future FPGA products. The success of our next generation FPGA products is dependent on our ability to successfully partner with Fujitsu. If for any reason we are unsuccessful in our efforts to partner with Fujitsu in connection with these next generation FPGA products, our future revenue growth would be materially adversely affected.

The introduction of new silicon and software design tool products in a dynamic market environment presents significant business challenges. Product development commitments and expenditures must be made well in advance of product sales. The market reception of new products depends on accurate projections of long-term customer demand, which by their nature are uncertain.

Our future revenue growth is dependent on market acceptance of our new silicon and software design tool products and the continued market acceptance of our current products. The success of these products is dependent on a variety of specific technical factors including:

- successful product definition;
- timely and efficient completion of product design;
- timely and efficient implementation of wafer manufacturing and assembly processes;
- product performance;
- product cost; and
- the quality and reliability of the product.

If, due to these or other factors, our new silicon and software products do not achieve market acceptance, our operating results would be harmed.

**The potential impact of customer design-in activity on future revenue is inherently uncertain and could impact our ability to manage production or our ability to forecast sales.**

We face uncertainties relating to the potential impact of customer design-in activity because it is unknown whether any particular customer design-in will ultimately result in sales of significant volume. After a specific customer design-in is obtained, many factors can impact the timing and amount of sales that are ultimately realized from the specific customer design-in. Changes in the competitive position of our technology, our customer's product competitiveness, our customer's product strategy, the financial position of our customer, and many other factors can all impact the timing and amount of sales ultimately realized from any specific customer design-in. As a result, we may not be able to accurately manage the production levels of our new products or accurately forecast the future sales of such products, and, thus, our operating results could be harmed.

**Our products may not be competitive if we are unsuccessful in migrating our manufacturing processes to more advanced technologies or alternative fabrication facilities.**

To develop new products and maintain the competitiveness of existing products, we need to migrate to more advanced wafer manufacturing processes that use smaller device geometries. We also may need to use additional foundries. Because we depend upon foundries to provide their facilities and support for our process technology development, we may experience delays in the availability of advanced wafer manufacturing process technologies at existing or new wafer fabrication facilities. As a result, volume production of our advanced process technologies at fabrication facilities may not be achieved. This could harm our operating results.

**Our wafer supply could be interrupted or reduced, which may result in a shortage of products available for sale.**

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We do not manufacture finished silicon wafers and many of our products, including all of our newest FPGA products, are manufactured by a sole source. Currently, our silicon wafers are manufactured by Fujitsu in Japan, Seiko Epson in Japan, UMC in Taiwan and Chartered Semiconductor in Singapore. If any of our current or future foundry partners significantly interrupts or reduces our wafer supply, our operating results could be harmed.

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In the past, we have experienced delays in obtaining wafers and in securing supply commitments from our foundries. At present, we anticipate that our supply commitments are adequate. However, these existing supply commitments may not be sufficient for us to satisfy customer demand in future periods. Additionally, notwithstanding our supply commitments, we may still have difficulty in obtaining wafer deliveries consistent with the supply commitments. We negotiate wafer prices and supply commitments from our suppliers on at least an annual basis. If any of our foundry partners were to reduce its supply commitment or increase its wafer prices, and we cannot find alternative sources of wafer supply, our operating results could be harmed.

Many other factors that could disrupt our wafer supply are beyond our control. Since worldwide manufacturing capacity for silicon wafers is limited and inelastic, we could be harmed by significant industry-wide increases in overall wafer demand or interruptions in wafer supply. Additionally, a future disruption of any of our foundry partners' foundry operations as a result of a fire, earthquake, act of terrorism, political unrest, governmental uncertainty, war, or other natural disaster or catastrophic event could disrupt our wafer supply and could harm our operating results.

**If our foundry partners experience quality or yield problems, we may face a shortage of products available for sale.**

We depend on our foundries to deliver high quality silicon wafers with acceptable yields in a timely manner. As is common in our industry, we have experienced wafer yield problems and delivery delays. If our foundries are unable for a prolonged period to produce silicon wafers that meet our specifications, with acceptable yields, our operating results could be harmed.

The reliable manufacture of high performance programmable logic devices is a complicated and technically demanding process requiring:

- a high degree of technical skill;
- state-of-the-art equipment;
- the availability of certain basic materials and supplies, such as chemicals, gases, polysilicon, silicon wafers and ultra-pure metals;
- the absence of defects in production wafers;
- the elimination of minute impurities and errors in each step of the fabrication process; and
- effective cooperation between the wafer supplier and us.

As a result, our foundries may experience difficulties in achieving acceptable quality and yield levels when manufacturing our silicon wafers.

**Our supply of assembled and tested products could be interrupted or reduced, which may result in a shortage of products available for sale.**

We do not assemble our finished products or perform all testing of our products. Currently, our finished products are assembled and tested by ASE in Malaysia, Amkor in the Philippines and South Korea, Fujitsu in Japan, AIT in Indonesia, and other independent contractors in Asia. If any of our current or future assembly or test contractors significantly interrupts or reduces our supply of assembled and tested devices, our operating results could be harmed.

In the past, we have experienced delays in obtaining assembled and tested products and in securing assembly and test capacity commitments from our suppliers. At present, we anticipate that our assembly and test capacity commitments are adequate. However, these existing commitments may not be sufficient for us to satisfy customer demand in future periods. Additionally, notwithstanding our assembly and test capacity commitments we may still have difficulty in obtaining deliveries of finished products consistent with the capacity commitments. We negotiate assembly and test prices and capacity commitments from our contractors on a periodic basis. If any of our assembly or test contractors were to reduce its capacity commitment or increase its prices, and we cannot find alternative sources, our operating results could be harmed.

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Many other factors that could disrupt our supply of finished products are beyond our control. Because worldwide capacity for assembly and testing of semiconductor products is limited and inelastic, we could be harmed by significant industry-wide increases in overall demand or interruptions in supply. The assembly of complex packages requires a consistent supply of a variety of raw materials such as substrates, leadframes, and mold compound. The worldwide manufacturing capacity for these materials is also limited and inelastic. A significant industry-wide increase in demand, or interruptions in the supply of these materials to our assembly or test contractors, could harm our operating results. Additionally, a future disruption of any of our assembly or test contractors' operations as a result of a fire, earthquake, act of terrorism, political unrest, governmental uncertainty, war, or other natural disaster or catastrophic event could disrupt our supply of assembled and tested devices and could harm our operating results.

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In addition, our quarterly revenue levels may be affected to a significant extent by our ability to match inventory and current production mix with the product mix required to fulfill orders. The large number of individual parts we sell and the large number of customers for our products, combined with limitations on our and our customer's ability to forecast orders accurately and our relatively lengthy manufacturing cycles, may make it difficult to achieve a match of inventory on hand, production units, and shippable orders sufficient to realize quarterly or annual revenue projections.

**If our assembly and test supply contractors experience quality or yield problems, we may face a shortage of products available for sale.**

We rely on contractors to assemble and test our devices with acceptable quality and yield levels. As is common in our industry, we have experienced quality and yield problems in the past. If we experience prolonged quality or yield problems in the future, our operating results could be harmed.

The majority of our revenue is derived from semiconductor devices assembled in advanced packages. The assembly of advanced packages is a complex process requiring:

- a high degree of technical skill;
- state-of-the-art equipment;
- the absence of defects in assembly and packaging manufacturing;
- the elimination of raw material impurities and errors in each step of the process; and
- effective cooperation between the assembly contractor and us.

As a result, our contractors may experience difficulties in achieving acceptable quality and yield levels when assembling and testing our semiconductor devices.

**Product quality problems could lead to reduced revenue, gross margins, and net income.**

We generally warrant our products for varying lengths of time against non-conformance to our specifications and certain other defects. Because our products, including hardware and software, are highly complex and incorporate leading-edge technology, our quality assurance programs may not detect all defects, whether manufacturing defects in individual products or systematic defects that could affect numerous shipments. On occasion we have repaired or replaced certain components and software or refunded the purchase price or license fee paid by our customers due to product defects. If there are material increases in warranty claims or the costs to resolve warranty claims compared with our historical experience, our revenue, gross margins, and net income may be adversely affected. For example, an inability to cure a product defect in a timely manner could result in product reengineering expenses, increased inventory costs, or damage to our reputation, any of which could materially impact our revenue, gross margins, and net income.

**Conditions in Asia may disrupt our existing supply arrangements and result in a shortage of finished products available for sale.**

All of our major silicon wafer suppliers operate fabrication facilities located in Asia. Additionally, our finished silicon wafers are assembled and tested by independent contractors located in China, Indonesia, Japan, Malaysia, the Philippines and South Korea. Economic, financial, social and political conditions in Asia have historically been volatile. Financial difficulties, the effects of currency fluctuation, governmental actions or restrictions, prolonged work stoppages, political unrest, war, natural disaster, disease or any other difficulties experienced by our suppliers may disrupt our supply and could harm our operating results.

**Export sales account for the majority of our revenue and may decline in the future due to economic and governmental uncertainties.**

We derive a majority of our revenue from export sales. Accordingly, if we experience a decline in export sales, our operating results could be adversely affected. Our export sales are subject to numerous risks, including:

- changes in local economic conditions;

- exchange rate volatility;
- governmental controls and trade restrictions;
- export license requirements and restrictions on the export of technology;
- political instability, war or terrorism;

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- changes in tax rates, tariffs or freight rates;
- interruptions in air transportation; and
- difficulties in staffing and managing foreign sales offices.

**We may not be able to successfully compete in the highly competitive semiconductor industry.**

The semiconductor industry is intensely competitive and many of our direct and indirect competitors have substantially greater financial, technological, manufacturing, marketing and sales resources. If we are unable to compete successfully in this environment, our future results will be adversely affected.

The current level of competition in the programmable logic market is high and may increase in the future. We currently compete directly with companies that have licensed our technology or have developed similar products. We also compete indirectly with numerous semiconductor companies that offer products based on alternative technical solutions. These direct and indirect competitors are established multinational semiconductor companies as well as emerging companies.

**We may fail to retain or attract the specialized technical and management personnel required to successfully operate our business.**

To a greater degree than most non-technology companies or larger technology companies, our future success depends on our ability to attract and retain highly qualified technical and management personnel. As a mid-sized company, we are particularly dependent on a relatively small group of key employees. Competition for skilled technical and management employees is intense within our industry. As a result, we may not be able to retain our existing key technical and management personnel. In addition, we may not be able to attract additional qualified employees in the future. If we are unable to retain existing key employees or are unable to hire new qualified employees, our operating results could be adversely affected.

**We may have failed to adequately insure against certain risks, and, as a result, our financial condition and results may be adversely affected.**

We carry insurance customary for companies in our industry, including, but not limited to, liability, property and casualty, worker's compensation and business interruption insurance. We also self-insure our employees for basic medical expenses, subject to a true insurance stop loss for catastrophic illness. In addition, we have insurance contracts that provide director and officer liability coverage for our directors and officers. Other than the specific areas mentioned above, we are self-insured with respect to most other risks and exposures, and the insurance we carry in many cases is subject to a significant policy deductible or other limitation before coverage applies. Based on management's assessment and judgment, we have determined that it is more cost effective to self-insure against certain risks than to incur the insurance premium costs. The risks and exposures for which we self-insure include, but are not limited to, natural disasters, product defects, political risk, theft, patent infringement and some employment practice matters. Should there be a catastrophic loss due to an uninsured event such as an earthquake or a loss due to adverse occurrences in any area in which we are self-insured, our financial condition, results of operations and liquidity may be adversely affected.

**Changes in accounting for equity compensation will adversely affect our consolidated statement of operations and could adversely affect our ability to attract and retain employees.**

We have historically used equity incentives as a key component of employee compensation in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board has adopted changes to generally accepted accounting principles that require us and other companies to record a charge to earnings for employee stock option grants and other equity incentives beginning in the quarter ended April 1, 2006. To the extent that these or other new regulations make it more difficult or expensive to grant stock options and other equity incentives to employees, we will incur increased compensation costs. We also have changed our equity compensation strategy, and this could make it difficult to attract, retain and motivate employees. Any of these results could materially and adversely affect our business.

**If we are unable to effectively and efficiently improve our internal controls in response to changing business, accounting and regulatory factors there could be a material adverse effect on our operations or financial results.**

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No assurance can be given that we will be able to successfully maintain, change and enhance as appropriate, our internal controls and procedures, or that any changes or enhancements to our controls and procedures will have the desired effect. In addition, we may be required to hire additional employees, and may experience higher than anticipated capital expenditures and operating expenses, during the implementation of any changes and enhancements and thereafter. Furthermore, future

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assessments of our internal controls and procedures may reveal material weaknesses. If we are unable to maintain, and effectively and efficiently change and enhance as appropriate, our internal controls and procedures, or if we discover material weaknesses, there could be a material adverse effect on our operations or financial results.

**If we are unable to adequately protect our intellectual property rights, our financial results and competitive position may suffer.**

Our success depends in part on our proprietary technology. However, we may fail to adequately protect this technology. As a result, we may lose our competitive position or face significant expense to protect or enforce our intellectual property rights.

We intend to continue to protect our proprietary technology through patents, copyrights and trade secrets. Despite this intention, we may not be successful in achieving adequate protection. Claims allowed on any of our patents may not be sufficiently broad to protect our technology. Patents issued to us also may be challenged, invalidated or circumvented. Finally, our competitors may develop similar technology independently.

Companies in the semiconductor industry vigorously pursue their intellectual property rights. If we become involved in protracted intellectual property disputes or litigation we may be forced to use substantial financial and management resources, which could have an adverse effect on our operating results.

Our industry is characterized by frequent claims regarding patents and other intellectual property rights of others. We have been, and from time to time expect to be, notified of claims that we are infringing the intellectual property rights of others. If any third party makes a valid claim against us, we could face significant liability and could be required to make material changes to our products and processes. In response to any claims of infringement, we may seek licenses under patents that we are alleged to be infringing. However, we may not be able to obtain a license on favorable terms, or at all, without our operating results being adversely affected.

**We face risks related to litigation.**

We are exposed to certain 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. We have been and may in the future be subject to various other legal proceedings, including, as discussed in greater detail hereafter, claims that involve possible infringement of patent and other intellectual property rights of third parties. It is inherently difficult to assess the outcome of litigation matters, and there can be no assurance that we will prevail in any litigation. Any such litigation could result in a substantial diversion of our efforts and the use of substantial management and financial resources, which by itself could have a material adverse effect on our financial condition and operating results. Further, an adverse determination in any such litigation could result in a material adverse impact on our financial position and the results of operations for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

**Our future quarterly operating results may fluctuate and therefore may fail to meet expectations.**

Our quarterly operating results have fluctuated in the past and may continue to fluctuate. Consequently, our operating results may fail to meet the expectations of analysts and investors. As a result of industry conditions and the following specific factors, our quarterly operating results are more likely to fluctuate and are more difficult to predict than a typical non-technology company of our size and maturity:

- general economic conditions in the countries where we sell our products;
- conditions within the end markets into which we sell our products;
- the cyclical nature of demand for our customers' products;
- excessive inventory accumulation by our end customers;
- the timing of our and our competitors' new product introductions;
- product obsolescence;

- the scheduling, rescheduling and cancellation of large orders by our customers;
- the willingness and ability of our customers and distributors to make payment to us in a timely manner;
- our ability to develop new process technologies and achieve volume production at wafer fabrication facilities;
- changes in manufacturing yields including delays in achieving target yields on new products;

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- adverse movements in exchange rates, interest rates or tax rates; and
- the availability of adequate supply commitments from our wafer foundries and assembly and test subcontractors.

**Our stock price may continue to experience large fluctuations.**

Historically, the price of our common stock has at times experienced rapid and severe price fluctuations that have left investors little time to react. The price of our common stock may continue to fluctuate greatly in the future due to a variety of company specific factors, including:

- quarter-to-quarter variations in our operating results;
- shortfalls in revenue or earnings from levels expected by investors;
- announcements of technological innovations or new products by other companies; and
- any developments that materially adversely impact investors' perceptions of our business prospects.

At March 31, 2007, our book value per share was \$4.50 compared to our stock price, which has ranged from a low of \$5.60 per share to a high of \$6.80 per share for the quarter ended March 31, 2007. Presently, our stock price is trading above our consolidated book value. Should our stock price drop below book value for a sustained period, it may become necessary to record an impairment charge to goodwill, which would negatively impact our results of operations.

**ITEM 6. EXHIBITS**

Exhibit Number	Description
3.1	The Company's Restated Certificate of Incorporation filed February 24, 2004 (Incorporated by reference to Exhibit 3.1 filed with the Company's Annual Report on Form 10-K for the year ended January 3, 2004).
3.2	The Company's Bylaws, as amended and restated as of January 31, 2006 (Incorporated by reference to Exhibit 99.1 filed with the Company's Current Report on Form 8-K filed February 3, 2006).
4.4	Indenture, dated as of June 20, 2003, between the Company and U.S. Bank National Association (Incorporated by reference to Exhibit 4.1 filed with the Company's Registration Statement on Form S-3 on August 13, 2003).
4.5	Form of Note for the Company's Zero Coupon Convertible Subordinated Notes (Incorporated by reference to Exhibit 4.2 filed with the Company's Registration Statement on Form S-3 on August 13, 2003).
10.23	Advance Production Payment Agreement dated March 17, 1997 among Lattice Semiconductor Corporation and Seiko Epson Corporation and S MOS Systems, Inc. (Incorporated by reference to Exhibit 10.23 filed with the Company's Annual Report on Form 10-K for the fiscal year ended January 1, 2005)(1).
10.24	Lattice Semiconductor Corporation 1996 Stock Incentive Plan, as amended, and Related Form of Option Agreement (Incorporated by reference to Exhibits (d)(1) and (d)(2) to the Company's Schedule TO filed on February 13, 2003).
10.33	2001 Outside Directors' Stock Option Plan, as amended and restated effective May 1, 2007 (Incorporated by reference to Appendix A filed with the Company's 2007 Definitive Proxy Statement filed on Schedule 14A on April 5, 2007).
10.34	2001 Stock Plan, as amended, and related Form of Option Agreement (Incorporated by reference to Exhibits (d)(3) and (d)(4) to the Company's Schedule TO filed on February 13, 2003).
10.35	Intellectual Property Agreement by and between Agere Systems Inc. and Agere Systems Guardian Corporation and Lattice Semiconductor Corporation as Buyer, dated January 18, 2002 (Incorporated by reference to Exhibit 10.35 filed with the Company's Annual Report on Form 10-K for the year ended December 29, 2001).
10.37	Lattice Semiconductor Corporation Executive Deferred Compensation Plan, as amended and restated effective as of August 11, 1997 (Incorporated by reference to Exhibit 99.3 filed with the Company's Registration Statement on Form S-3, as amended, dated October 17, 2002).
10.38	Amendment No. 1, to the Lattice Semiconductor Corporation Executive Deferred Compensation Plan, as amended, dated November 19, 1999 (Incorporated by reference to Exhibit 99.4 filed with the Company's Registration Statement on Form S-3, as amended, dated October 17, 2002).
10.39	Registration Rights Agreement, dated as of June 20, 2003, between the Company and the initial purchaser named therein (Incorporated by reference to Exhibit 4.3 filed with the Company's Registration Statement on Form S-3 on August 13, 2003).
10.41	Form of Indemnification Agreement executed by each director and executive officer of the Company and certain other officers and employees of the Company and its subsidiaries (Incorporated by reference to Exhibit 10.41 filed with the Company's Annual Report on Form 10-K for the year ended January 3, 2004).
10.42	Amendment dated March 25, 2004 to Advance Production Payment Agreement dated March 17, 1997, as amended, among Lattice Semiconductor Corporation and Seiko Epson Corporation and S MOS Systems, Inc. (Incorporated by reference to Exhibit 10.42 filed with the Company's Quarterly Report on Form 10-Q for the quarter ended April 3, 2004)(1).

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Exhibit Number	Description
10.43	Advance Payment and Purchase Agreement dated September 10, 2004 between Lattice Semiconductor Corporation and Fujitsu Limited (Incorporated by reference to Exhibit 10.1 filed with the Company's Quarterly Report on Form 10-Q for the quarter ended October 2, 2004)(1).
10.44	Employment Agreement between Lattice Semiconductor Corporation and Stephen A. Skaggs dated August 9, 2005 (Incorporated by reference to Exhibit 99.1 filed with the Company's Current Report on Form 8-K filed on August 12, 2005).
10.45	Compensation Arrangement between Lattice Semiconductor Corporation and Patrick S. Jones, Chairman of the Board of Directors (Incorporated by reference to Exhibit 99.2 filed with the Company's Current Report) on Form 8-K filed on August 12, 2005).
10.46	Employment Agreement between Lattice Semiconductor Corporation and Jan Johannessen dated November 1, 2005 (Incorporated by reference to Exhibit 10.1 filed with the Company's Quarterly Report on Form 10-Q filed on November 4, 2005).
10.47	Employment Agreement between Lattice Semiconductor Corporation and Martin R. Baker dated November 1, 2005 (Incorporated by reference to Exhibit 10.2 filed with the Company's Quarterly Report on Form 10-Q filed on November 4, 2005).
10.48	Employment Agreement between Lattice Semiconductor Corporation and Stephen M. Donovan dated November 1, 2005 (Incorporated by reference to Exhibit 10.3 filed with the Company's Quarterly Report on Form 10-Q filed on November 4, 2005).
10.49	2005 Executive Bonus Plan (Incorporated by reference to Exhibit 10.4 filed with the Company's Quarterly Report on Form 10-Q filed on November 4, 2005).
10.50	Compensation Arrangement between Lattice Semiconductor Corporation and Chairpersons for Committees of the Board of Directors (Incorporated by reference to Exhibit 99.1 filed with the Company's Current Report on Form 8-K filed on December 12, 2005).
10.51	Form of Amendment to Stock Option Agreements for 1996 Stock Incentive Plan, as amended, and 2001 Stock Plan, as amended (Incorporated by reference to Exhibit 99.3 filed with the Company's Current Report on Form 8-K filed on December 12, 2005).
10.52	2006 Executive Bonus Plan (Incorporated by reference to Exhibit 99.4 filed with the Company's Current Report on Form 8-K filed on December 12, 2005).
10.53	Addendum dated March 22, 2006 to the Advance Payment and Purchase Agreement dated September 10, 2004 between Lattice Semiconductor Corporation and Fujitsu Limited (Incorporated by reference to Exhibit 10.53 filed with the Company's Quarterly Report on Form 10-Q filed on November 7, 2006).
10.54	Addendum No. 2 dated effective October 1, 2006 to the Advance Payment and Purchase Agreement dated September 10, 2004 between Lattice Semiconductor Corporation and Fujitsu Limited (Incorporated by reference to Exhibit 10.54 filed with the Company's Quarterly Report on Form 10-Q filed on November 7, 2006)(1).
10.55	2007 Executive Variable Compensation Plan, as amended (Incorporated by reference to Exhibit 99.1 filed with the Company's Current Report on Form 8-K filed on December 7, 2006, as amended as described in the Company's Current Report on Form 8-K filed on February 8, 2007).
10.56	Form of Notice of Grant of Restricted Stock Units to Executive Officer (Incorporated by reference to Exhibit 99.1 filed with the Company's Current Report on Form 8-K filed on February 8, 2007).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.





**Exhibit  
Number**

**Description**

31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(1) Pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, confidential treatment has been granted to portions of this exhibit, which portions have been deleted and filed separately with the Securities and Exchange Commission.

**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.

LATTICE SEMICONDUCTOR CORPORATION  
(Registrant)

/s/ JAN JOHANNESSEN  
Jan Johannessen  
*Senior Vice President and Chief Financial Officer  
(Duly Authorized Officer and Principal Financial  
and Accounting Officer)*

Date: May 9, 2007

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