

LAM RESEARCH CORP  
Form 10-Q  
January 31, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended December 23, 2012

or

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

For the transition period from            to

Commission file number 0-12933

**LAM RESEARCH CORPORATION**

(Exact name of registrant as specified in its charter)

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

**4650 Cushing Parkway**  
**Fremont, California**  
(Address of principal executive offices)

**94-2634797**  
(I.R.S. Employer  
Identification No.)

**94538**  
(Zip Code)

**(510) 572-0200**  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 that 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:

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) 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

As of January 25, 2013 there were 162,346,938 shares of registrant's common stock outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****LAM RESEARCH CORPORATION****CONSOLIDATED BALANCE SHEETS****(in thousands, except per share data)**

|  | <b>December 23,<br/>2012<br/>(unaudited)</b> | <b>June 24,<br/>2012<br/>(1)</b> |
|--|--|----------------------------------|
| <b>ASSETS</b>  |  |                                  |
| Cash and cash equivalents  | \$ 1,190,189                                 | \$ 1,564,752                     |
| Short-term investments   | 1,330,498                                    | 1,297,931                        |
| Accounts receivable, less allowance for doubtful accounts of \$5,425 as of December 23, 2012 and \$5,248 as of June 24, 2012   | 590,925                                      | 765,818                          |
| Inventories  | 530,272                                      | 632,853                          |
| Deferred income taxes  | 139,300                                      | 47,782                           |
| Prepaid expenses and other current assets  | 65,224                                       | 105,973                          |
| <b>Total current assets</b>  | <b>3,846,408</b>                             | <b>4,415,109</b>                 |
| Property and equipment, net  | 590,547                                      | 584,596                          |
| Restricted cash and investments  | 166,166                                      | 166,335                          |
| Deferred income taxes  | 344  |                                  |
| Goodwill   | 1,454,920                                    | 1,446,303                        |
| Intangible assets, net   | 1,153,301                                    | 1,240,427                        |
| Other assets   | 151,478                                      | 151,882                          |
| <b>Total assets</b>  | <b>\$ 7,363,164</b>                          | <b>\$ 8,004,652</b>              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |  |                                  |
| Trade accounts payable   | \$ 156,237                                   | \$ 258,778                       |
| Accrued expenses and other current liabilities   | 498,787                                      | 492,178                          |
| Deferred profit  | 168,994                                      | 164,833                          |
| Current portion of long-term debt, convertible notes, and capital leases   | 1,464  | 511,139                          |
| <b>Total current liabilities</b>   | <b>825,482</b>                               | <b>1,426,928</b>                 |
| Long-term debt, convertible notes, and capital leases  | 1,286,729                                    | 761,783                          |
| Income taxes payable   | 260,063                                      | 274,240                          |
| Other long-term liabilities  | 294,300                                      | 219,577                          |
| <b>Total liabilities</b>   | <b>2,666,574</b>                             | <b>2,682,528</b>                 |
| Commitments and contingencies  |  |                                  |
| Senior convertible notes (Note 13)   |  | 190,343                          |
| Stockholders' equity:  |  |                                  |
| Preferred stock, at par value of \$0.001 per share; authorized 5,000 shares; none outstanding  |  |                                  |
| Common stock, at par value of \$0.001 per share; authorized - 400,000 shares; issued and outstanding 165,846 shares as of December 23, 2012 and 186,656 shares as of June 24, 2012 | 166  | 187                              |
| Additional paid-in capital   | 5,190,192                                    | 4,943,539                        |
| Treasury stock, at cost; 84,260 shares as of December 23, 2012 and 62,068 shares as of June 24, 2012   | (3,337,269)                                  | (2,636,936)                      |

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|  |                  |                  |
|--|------------------|------------------|
| Accumulated other comprehensive loss       | (24,484)         | (33,818)         |
| Retained earnings                          | 2,867,985        | 2,858,809        |
| <b>Total stockholders' equity</b>          | <b>4,696,590</b> | <b>5,131,781</b> |
| Total liabilities and stockholders' equity | \$ 7,363,164     | \$ 8,004,652     |

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements

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

|  | <b>Three Months Ended</b>    |                              | <b>Six Months Ended</b>      |                              |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
|  | <b>December 23,<br/>2012</b> | <b>December 25,<br/>2011</b> | <b>December 23,<br/>2012</b> | <b>December 25,<br/>2011</b> |
| Revenue  | \$ 860,886                   | \$ 583,981                   | \$ 1,767,774                 | \$ 1,264,417                 |
| Cost of goods sold                               | 545,472                      | 350,014                      | 1,118,474                    | 746,567                      |
| Cost of goods sold restructuring                 |                              | (859)                        |                              | (859)                        |
| Total cost of goods sold                         | 545,472                      | 349,155                      | 1,118,474                    | 745,708                      |
| Gross margin                                     | 315,414                      | 234,826                      | 649,300                      | 518,709                      |
| Research and development                         | 165,951                      | 104,024                      | 329,262                      | 206,583                      |
| Selling, general and administrative              | 144,400                      | 83,256                       | 298,263                      | 163,456                      |
| Restructuring and impairments                    | 1,021                        |                              | 1,021                        | 1,725                        |
| Total operating expenses                         | 311,372                      | 187,280                      | 628,546                      | 371,764                      |
| Operating income                                 | 4,042                        | 47,546                       | 20,754                       | 146,945                      |
| Other expense, net                               | (13,390)                     | (7,785)                      | (23,328)                     | (19,858)                     |
| Income (loss) before income taxes                | (9,348)                      | 39,761                       | (2,574)                      | 127,087                      |
| Income tax expense (benefit)                     | (15,756)                     | 6,549                        | (11,750)                     | 22,037                       |
| Net income                                       | \$ 6,408                     | \$ 33,212                    | \$ 9,176                     | \$ 105,050                   |
| Net income per share:                            |                              |                              |                              |                              |
| Basic net income per share                       | \$ 0.04                      | \$ 0.28                      | \$ 0.05                      | \$ 0.87                      |
| Diluted net income per share                     | \$ 0.04                      | \$ 0.27                      | \$ 0.05                      | \$ 0.86                      |
| Number of shares used in per share calculations: |                              |                              |                              |                              |
| Basic  | 170,699                      | 119,739                      | 175,314                      | 121,435                      |
| Diluted  | 173,027                      | 120,873                      | 177,490                      | 122,382                      |

See Notes to Condensed Consolidated Financial Statements

**Table of Contents****LAM RESEARCH CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(in thousands)****(unaudited)**

|   | <b>Three Months Ended</b>    |                              | <b>Six Months Ended</b>      |                              |
|---|------------------------------|------------------------------|------------------------------|------------------------------|
|   | <b>December 23,<br/>2012</b> | <b>December 25,<br/>2011</b> | <b>December 23,<br/>2012</b> | <b>December 25,<br/>2011</b> |
| Net income  | \$ 6,408                     | \$ 33,212                    | \$ 9,176                     | \$ 105,050                   |
| Other comprehensive income (loss), net of tax:                        |                              |                              |                              |                              |
| Foreign currency translation adjustment                               | 8,969                        | (16,979)                     | 4,844                        | (31,889)                     |
| Cash flow hedges:   |                              |                              |                              |                              |
| Change in unrealized gain (loss)                                      | 2,347                        | (3,581)                      | 1,628                        | (11,793)                     |
| Reclassification adjustment for losses (gains) included in net income | 363                          | 2,906                        | 2,289                        | 5,513                        |
| Net change  | 2,710                        | (675)                        | 3,917                        | (6,280)                      |
| Available-for-sale investments:                                       |                              |                              |                              |                              |
| Change in unrealized gain (loss)                                      | (1,497)                      | 898                          | 1,192                        | 39                           |
| Reclassification adjustment for gains included in net income          | (923)                        | (97)                         | (942)                        | (392)                        |
| Net change  | (2,420)                      | 801                          | 250                          | (353)                        |
| Postretirement benefit plan actuarial losses, net                     | 164                          | 157                          | 323                          | (4,369)                      |
| Other comprehensive income (loss), net of tax                         | 9,423                        | (16,696)                     | 9,334                        | (42,891)                     |
| Comprehensive income  | \$ 15,831                    | \$ 16,516                    | \$ 18,510                    | \$ 62,159                    |

See Notes to Condensed Consolidated Financial Statements

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

|   | <b>Six Months Ended</b>      |                              |
|---|------------------------------|------------------------------|
|   | <b>December 23,<br/>2012</b> | <b>December 25,<br/>2011</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                              |                              |
| Net income  | \$ 9,176                     | \$ 105,050                   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                              |                              |
| Depreciation and amortization   | 153,204                      | 43,732                       |
| Deferred income taxes   | (19,337)                     | (633)                        |
| Restructuring and impairment charges  | 1,021                        | 866                          |
| Impairment of investment  |                              | 1,724                        |
| Equity-based compensation expense   | 48,441                       | 35,968                       |
| Income tax benefit on equity-based compensation plans                             |                              | 1,129                        |
| Excess tax benefit on equity-based compensation plans                             |                              | (2,155)                      |
| Amortization of convertible note discount   | 15,595                       | 13,264                       |
| Other, net  | 24,723                       | 2,506                        |
| Changes in operating assets and liabilities                                       | 209,665                      | 54,465                       |
| Net cash provided by operating activities   | 442,488                      | 255,916                      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                              |                              |
| Capital expenditures and intangible assets  | (82,889)                     | (42,414)                     |
| Cash paid for business acquisition  | (8,716)                      |                              |
| Purchases of available-for-sale securities  | (628,074)                    | (234,576)                    |
| Sales and maturities of available-for-sale securities                             | 588,186                      | 145,123                      |
| Purchase of equity method investment  |                              | (10,740)                     |
| Receipt of loan payment   |                              | 8,375                        |
| Proceeds from sale of assets  | 660                          | 2,677                        |
| Transfer of restricted cash and investments                                       | 179                          | 20                           |
| Net cash used for investing activities  | (130,654)                    | (131,535)                    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                              |                              |
| Principal payments on long-term debt and capital lease obligations                | (780)                        | (3,140)                      |
| Excess tax benefit on equity-based compensation plans                             |                              | 2,155                        |
| Net cash paid in advance for stock repurchase contracts                           |                              | (23,995)                     |
| Treasury stock purchases  | (710,089)                    | (92,695)                     |
| Reissuances of treasury stock related to employee stock purchase plan             | 9,925                        | 8,858                        |
| Proceeds from issuance of common stock  | 7,534                        | 1,475                        |
| Net cash used for financing activities  | (693,410)                    | (107,342)                    |
| Effect of exchange rate changes on cash   | 7,013                        | (2,243)                      |
| Net increase (decrease) in cash and cash equivalents                              | (374,563)                    | 14,796                       |
| Cash and cash equivalents at beginning of period                                  | 1,564,752                    | 1,492,132                    |
| Cash and cash equivalents at end of period  | \$ 1,190,189                 | \$ 1,506,928                 |



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See Notes to Condensed Consolidated Financial Statements

**Table of Contents****LAM RESEARCH CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****December 23, 2012****(Unaudited)****NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The accompanying unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of Lam Research Corporation ( Lam Research or the Company ) for the fiscal year ended June 24, 2012, which are included in the Annual Report on Form 10-K as of and for the year ended June 24, 2012 (the 2012 Form 10-K ). The Company s Forms 10-K, Forms 10-Q and Forms 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is [www.sec.gov](http://www.sec.gov). The Company also posts its Forms 10-K, Forms 10-Q and Forms 8-K on its corporate website at <http://investor.lamresearch.com> .

The consolidated financial statements include the accounts of Lam Research Corporation and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. We use the equity method to account for equity investments in instances in which we own common stock or similar interests and have the ability to exercise significant influence, but not control, over the investee. The Company s reporting period is a 52/53-week fiscal year. The Company s current fiscal year will end June 30, 2013 and includes 53 weeks. The quarters ended December 23, 2012 (the December 2012 quarter ) and December 25, 2011 (the December 2011 quarter ) each included 13 weeks.

**NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued new authoritative guidance that increases the prominence of items reported in other comprehensive income ( OCI ) by eliminating the option to present components of OCI as part of the statement of changes in stockholders equity. The amendments in this standard require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company adopted this guidance in the September 2012 quarter. The implementation of this authoritative guidance did not have an impact on the Company s financial position or results of operations, but did change the presentation of the Company s financial statements.

**NOTE 3 EQUITY-BASED COMPENSATION PLANS**

The Company has stock plans that provide for grants of equity-based awards to eligible participants, including stock options and restricted stock units ( RSUs ), of Lam Research common stock ( Common Stock ). An option is a right to purchase the Company s stock at a set price. An RSU award is an agreement to issue shares of the Company s stock at the time of vesting. The Company s options and RSU awards typically vest over a period of three years or less, although awards assumed in connection with the Novellus acquisition have vesting terms up to four years. The Company also has an employee stock purchase plan that allows employees to purchase its Common Stock at a discount through payroll deductions.

The Company recognized the following equity-based compensation expense and related income tax benefit in the Condensed Consolidated Statements of Operations:

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|   | (in millions)        |                      |                      |                      |
| Equity-based compensation expense                               | \$ 24.0              | \$ 18.2              | \$ 48.4              | \$ 36.0              |
| Income tax benefit related to equity-based compensation expense | \$ 3.3               | \$ 2.1               | \$ 9.0               | \$ 4.8               |

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The estimated fair value of the Company's stock-based awards, less expected forfeitures, is amortized over the awards' vesting term on a straight-line basis. The increase in stock compensation expense during the three and six months ended December 23, 2012 as compared to the three and six months ended December 25, 2011 was primarily due to the increased number of RSUs and stock options outstanding as a result of awards assumed in connection with the Novellus acquisition.

### *Stock Options and RSUs*

The 2007 Stock Incentive Plan provides for grants of equity-based awards to eligible participants. In June 2012, as part of the Novellus acquisition, Lam also assumed the Novellus Systems, Inc. 2011 Stock Incentive Plan (together with the 2007 Stock Incentive Plan, collectively the Plans), which provides for grants of equity-based awards to eligible participants. As of December 23, 2012, there were a total of 8,369,202 shares reserved to cover options and RSUs issued and outstanding under the Plans. As of December 23, 2012, there were an additional 14,351,909 shares reserved and available for future equity-based awards under the Plans.

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A summary of stock option activity under the Plans as of December 23, 2012 and changes during the six months then ended is presented below:

| <b>Options</b>                   | <b>Shares<br/>(in thousands)</b> | <b>Weighted-<br/>Average<br/>Exercise Price</b> | <b>Weighted-Average<br/>Remaining<br/>Contractual<br/>Term<br/>(years)</b> | <b>Aggregate Intrinsic<br/>Value as of<br/>December 23,<br/>2012<br/>(in thousands)</b> |
|----------------------------------|----------------------------------|---|--|---|
| Outstanding at June 24, 2012     | 3,902                            | \$ 25.14  | 4.79   |   |
| Exercised                        | (342)                            | \$ 22.04  |  |   |
| Forfeited or expired             | (32)                             | \$ 24.37  |  |   |
| Outstanding at December 23, 2012 | 3,528                            | \$ 25.45  | 4.38   | \$ 38,111   |
| Exercisable at December 23, 2012 | 2,999                            | \$ 25.25  | 3.80   | \$ 32,982   |

The total intrinsic value of options exercised during the three months ended December 23, 2012 and December 25, 2011 was \$4.1 million and \$0.9 million, respectively. The total intrinsic value of options exercised during the six months ended December 23, 2012 and December 25, 2011 was \$4.7 million and \$1.1 million, respectively. As of December 23, 2012, there was \$7.2 million of total unrecognized compensation cost related to unvested stock options granted and outstanding; that cost is expected to be recognized over a weighted average remaining vesting period of 1.7 years.

A summary of the Company's RSUs as of December 23, 2012 and changes during the six months then ended is presented below:

| <b>Unvested Restricted Stock Units</b> | <b>Shares<br/>(in thousands)</b> | <b>Average Grant-<br/>Date Fair Value</b> |
|--|----------------------------------|---|
| Unvested at June 24, 2012              | 4,331                            | \$ 41.01                                  |
| Granted                                | 1,612                            | \$ 35.01                                  |
| Vested                                 | (987)                            | \$ 40.46                                  |
| Forfeited                              | (115)                            | \$ 39.96                                  |
| Unvested at December 23, 2012          | 4,841                            | \$ 39.13                                  |

The fair value of the Company's RSUs was calculated based upon the fair market value of the Company's stock at the date of grant. As of December 23, 2012, there was \$131.8 million of total unrecognized compensation expense related to unvested RSUs granted; that expense is expected to be recognized over a weighted average remaining period of 2.1 years.

**ESPP**

The 1999 Employee Stock Purchase Plan (as amended and restated, the 1999 ESPP) allows employees to designate a portion of their base compensation to be withheld through payroll deductions and used to purchase the Company's Common Stock at a purchase price per share equal to the lower of 85% of the fair market value of the Company's Common Stock on the first or last day of the applicable purchase period. Each offering period generally lasts up to 12 months and includes up to three interim purchase dates. As of December 23, 2012, there were a total of 10,304,484 shares available for issuance under the 1999 ESPP.

Purchase rights under the 1999 ESPP were valued using the Black-Scholes model assuming no expected dividends and the following weighted-average assumptions for the six months ended December 23, 2012:

Six Months Ended

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|                                 | December 23,<br>2012 |
|---------------------------------|----------------------|
| Expected term (years)           | 0.7                  |
| Expected stock price volatility | 33.26%               |
| Risk-free interest rate         | 0.16%                |

As of December 23, 2012, there was \$5.8 million of unrecognized compensation expense related to the 1999 ESPP, which is expected to be recognized over a remaining period of approximately 8 months.

**Table of Contents****NOTE 4 FINANCIAL INSTRUMENTS**

The Company maintains an investment portfolio of various holdings, types, and maturities. The Company's mutual funds, which are related to the Company's obligations under the deferred compensation plan, are classified as trading securities. Investments classified as trading securities are recorded at fair value based upon quoted market prices. Differences between the cost and fair value of trading securities are recognized as other income (expense) in the Condensed Consolidated Statements of Operations. All of the Company's other short-term investments are classified as available-for-sale and consequently are recorded in the Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax.

**Fair Value**

The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact, and it considers assumptions that market participants would use when pricing the asset or liability.

A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. The level of an asset or liability in the hierarchy is based on the lowest level of input that is significant to the fair value measurement. Assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities with sufficient volume and frequency of transactions.

Level 2: Valuations based on observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or model-derived valuations techniques for which all significant inputs are observable in the market or can be corroborated by, observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuations based on unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities and based on non-binding, broker-provided price quotes and may not have been corroborated by observable market data.

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis:

|  | Total               | Fair Value Measurement at December 23, 2012                                |   |  |
|--|---------------------|--|---|--|
|  |                     | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (In thousands)                         |                     |  |   |  |
| <b>Assets</b>                          |                     |  |   |  |
| <b>Short-Term Investments</b>          |                     |  |   |  |
| Money Market Funds                     | \$ 884,982          | \$ 884,982   | \$  | \$   |
| Municipal Notes and Bonds              | 270,486             |  | 270,486   |  |
| US Treasury and Agencies               | 177,584             | 173,974  | 3,610   |  |
| Government-Sponsored Enterprises       | 94,120              |  | 94,120  |  |
| Foreign Government Bonds               | 20,568              |  | 20,568  |  |
| Corporate Notes and Bonds              | 805,112             | 164,885  | 640,227   |  |
| Mortgage Backed Securities Residential | 32,608              |  | 32,608  |  |
| Mortgage Backed Securities Commercial  | 96,405              |  | 96,405  |  |
| <b>Total Short-Term Investments</b>    | <b>\$ 2,381,865</b> | <b>\$ 1,223,841</b>  | <b>\$ 1,158,024</b>                                 | <b>\$</b>  |
| <b>Equities</b>                        | 4,545               | 4,545  |   |  |
| <b>Mutual Funds</b>                    | 20,940              | 20,940   |   |  |
| <b>Derivative Assets</b>               | 3,645               |  | 3,645   |  |

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|                        |                     |                     |                     |           |
|------------------------|---------------------|---------------------|---------------------|-----------|
| <b>Total Assets</b>    | <b>\$ 2,410,995</b> | <b>\$ 1,249,326</b> | <b>\$ 1,161,669</b> | <b>\$</b> |
| <b>Liabilities</b>     |                     |                     |                     |           |
| Derivative Liabilities | \$ 715              | \$                  | \$ 465              | \$ 250    |

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The amounts in the table above are reported in the Consolidated Balance Sheet as of December 23, 2012 as follows:

|  | Total               | (Level 1)<br>(In thousands) | (Level 2)           | (Level 3)     |
|--|---------------------|-----------------------------|---------------------|---------------|
| <b>Reported Within:</b>                        |                     |                             |                     |               |
| Cash Equivalents                               | \$ 886,482          | \$ 884,982                  | \$ 1,500            | \$            |
| Short-Term Investments                         | 1,330,498           | 173,974                     | 1,156,524           |               |
| Restricted Cash and Investments                | 164,885             | 164,885                     |                     |               |
| Prepaid Expenses and Other Current Assets      | 3,645               |                             | 3,645               |               |
| Other Assets                                   | 25,485              | 25,485                      |                     |               |
| <b>Total Assets</b>                            | <b>\$ 2,410,995</b> | <b>\$ 1,249,326</b>         | <b>\$ 1,161,669</b> | <b>\$</b>     |
| Accrued Expenses and Other Current Liabilities | \$ 465              | \$                          | \$ 465              | \$            |
| Other Non-current Liabilities                  | 250                 |                             |                     | 250           |
| <b>Total Liabilities</b>                       | <b>\$ 715</b>       | <b>\$</b>                   | <b>\$ 465</b>       | <b>\$ 250</b> |

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis:

|  | Total               | Fair Value Measurement at June 24, 2012                                    |   |  |
|--|---------------------|--|---|--|
|  |                     | Quoted Prices in<br>Active Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|  |                     | (In thousands)   |   |  |
| <b>Assets</b>                          |                     |  |   |  |
| <b>Short-Term Investments</b>          |                     |  |   |  |
| Money Market Funds                     | \$ 1,318,812        | \$ 1,318,812   | \$  | \$   |
| Municipal Notes and Bonds              | 322,567             |  | 322,567   |  |
| US Treasury and Agencies               | 137,446             | 130,624  | 6,822   |  |
| Government-Sponsored Enterprises       | 123,268             |  | 123,268   |  |
| Foreign Government Bond                | 6,358               |  | 6,358   |  |
| Corporate Notes and Bonds              | 768,901             | 164,885  | 604,016   |  |
| Mortgage Backed Securities Residential | 25,972              |  | 25,972  |  |
| Mortgage Backed Securities Commercial  | 84,853              |  | 84,853  |  |
| <b>Total Short-Term Investments</b>    | <b>\$ 2,788,177</b> | <b>\$ 1,614,321</b>  | <b>\$ 1,173,856</b>                                 | <b>\$</b>  |
| <b>Equities</b>                        | 5,913               | 5,913  |   |  |
| <b>Mutual Funds</b>                    | 17,754              | 17,754   |   |  |
| <b>Derivative Assets</b>               | 5,020               |  | 5,020   |  |
| <b>Total Assets</b>                    | <b>\$ 2,816,864</b> | <b>\$ 1,637,988</b>  | <b>\$ 1,178,876</b>                                 | <b>\$</b>  |
| <b>Liabilities</b>                     |                     |  |   |  |
| Derivative Liabilities                 | \$ 4,529            | \$   | \$ 4,328  | \$ 201   |



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The amounts in the table above are reported in the Consolidated Balance Sheet as of June 24, 2012 as follows:

|  | Total               | (Level 1)<br>(In thousands) | (Level 2)           | (Level 3)     |
|--|---------------------|-----------------------------|---------------------|---------------|
| <b>Reported Within:</b>                        |                     |                             |                     |               |
| Cash Equivalents                               | \$ 1,325,361        | \$ 1,318,812                | \$ 6,549            | \$            |
| Short-Term Investments                         | 1,297,931           | 130,624                     | 1,167,307           |               |
| Restricted Cash and Investments                | 164,885             | 164,885                     |                     |               |
| Prepaid Expenses and Other Current Assets      | 5,020               |                             | 5,020               |               |
| Other Assets                                   | 23,667              | 23,667                      |                     |               |
| <b>Total Assets</b>                            | <b>\$ 2,816,864</b> | <b>\$ 1,637,988</b>         | <b>\$ 1,178,876</b> | <b>\$</b>     |
| Accrued Expenses and Other Current Liabilities | \$ 4,328            | \$                          | \$ 4,328            | \$            |
| Other Non-current Liabilities                  | 201                 |                             |                     | 201           |
| <b>Total Liabilities</b>                       | <b>\$ 4,529</b>     | <b>\$</b>                   | <b>\$ 4,328</b>     | <b>\$ 201</b> |

The Company's primary financial instruments include its cash, cash equivalents, short-term investments, restricted cash and investments, long-term investments, accounts receivable, accounts payable, long-term debt and capital leases, and foreign currency related derivatives. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to the short period of time to their maturities. The estimated fair values of capital lease obligations approximate their carrying value as the substantial majority of these obligations have interest rates that adjust to market rates on a periodic basis. Refer to Note 13 for additional information regarding the fair value of the Company's convertible notes.

*Investments*

The following tables summarize the Company's investments (in thousands):

|   | December 23, 2012   |                 |                   |                     | June 24, 2012       |                 |                   |                     |
|---|---------------------|-----------------|-------------------|---------------------|---------------------|-----------------|-------------------|---------------------|
|   | Cost                | Unrealized Gain | Unrealized (Loss) | Fair Value          | Cost                | Unrealized Gain | Unrealized (Loss) | Fair Value          |
| Cash  | \$ 304,988          | \$              | \$                | \$ 304,988          | \$ 240,841          | \$              | \$                | \$ 240,841          |
| Fixed Income Money Market Funds               | 884,982             |                 |                   | 884,982             | 1,318,812           |                 |                   | 1,318,812           |
| Municipal Notes and Bonds                     | 269,347             | 1,185           | (46)              | 270,486             | 321,001             | 1,574           | (8)               | 322,567             |
| US Treasury and Agencies                      | 177,520             | 92              | (28)              | 177,584             | 137,516             | 43              | (113)             | 137,446             |
| Government-Sponsored Enterprises              | 93,953              | 169             | (2)               | 94,120              | 123,269             | 67              | (68)              | 123,268             |
| Foreign Government Bonds                      | 20,470              | 103             | (5)               | 20,568              | 6,315               | 43              |                   | 6,358               |
| Corporate Notes and Bonds                     | 802,788             | 2,603           | (279)             | 805,112             | 767,847             | 1,443           | (389)             | 768,901             |
| Mortgage Backed Securities Residential        | 32,558              | 107             | (57)              | 32,608              | 25,857              | 121             | (6)               | 25,972              |
| Mortgage Backed Securities Commercial         | 96,118              | 673             | (386)             | 96,405              | 84,682              | 555             | (384)             | 84,853              |
| <b>Total Cash and Short -Term Investments</b> | <b>\$ 2,682,724</b> | <b>\$ 4,932</b> | <b>\$ (803)</b>   | <b>\$ 2,686,853</b> | <b>\$ 3,026,140</b> | <b>\$ 3,846</b> | <b>\$ (968)</b>   | <b>\$ 3,029,018</b> |
| Publicly Traded Equity Security               | \$ 9,321            | \$              | \$ (4,776)        | \$ 4,545            | \$ 9,320            | \$              | \$ (3,407)        | \$ 5,913            |
| Private Equity Security                       | 5,000               |                 |                   | 5,000               | 5,000               |                 |                   | 5,000               |
| Mutual Funds                                  | 19,635              | 1,305           |                   | 20,940              | 17,459              | 366             | (71)              | 17,754              |
| <b>Total Financial Instruments</b>            | <b>\$ 2,716,680</b> | <b>\$ 6,237</b> | <b>\$ (5,579)</b> | <b>\$ 2,717,338</b> | <b>\$ 3,057,919</b> | <b>\$ 4,212</b> | <b>\$ (4,446)</b> | <b>\$ 3,057,685</b> |
| <b>Reported Within</b>                        |                     |                 |                   |                     |                     |                 |                   |                     |
| Cash and Cash Equivalents                     | \$ 1,190,189        | \$              | \$                | \$ 1,190,189        | \$ 1,564,752        | \$              | \$                | \$ 1,564,752        |
| Short-Term Investments                        | 1,326,369           | 4,932           | (803)             | 1,330,498           | 1,295,053           | 3,846           | (968)             | 1,297,931           |

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|  |         |       |         |         |         |     |         |         |
|--|---------|-------|---------|---------|---------|-----|---------|---------|
| Restricted Cash and Investments  | 166,166 |       |         | 166,166 | 166,335 |     |         | 166,335 |
| Other assets   | 33,956  | 1,305 | (4,776) | 30,485  | 31,779  | 366 | (3,478) | 28,667  |
| <b>Total \$ 2,716,680   \$ 6,237   \$ (5,579)   \$ 2,717,338   \$ 3,057,919   \$ 4,212   \$ (4,446)   \$ 3,057,685</b> |         |       |         |         |         |     |         |         |

The Company accounts for its investment portfolio at fair value. Realized gains (losses) for investment sales and pay-downs are specifically identified. Management assesses the fair value of investments in debt securities that are not actively traded through consideration of interest rates and their impact on the present value of the cash flows to be received from the investments. The Company also considers whether changes in the credit ratings of the issuer could impact the assessment of fair value. The Company did not recognize any losses on investments due to other-than-temporary impairments during the three or six months ended December 23, 2012 or the three months ended December 25, 2011. The Company recognized a \$1.7 million other-than-temporary impairment of a strategic private equity investment during the six months ended December 25, 2011. Additionally, gross realized gains and gross realized (losses) from sales of investments were approximately \$0.9 million and \$(0.3) million, respectively, in the three months ended December 23, 2012 and \$0.1 million and \$(0.2) million, respectively, in the three months ended December 25, 2011. Gross realized gains and gross realized (losses) from sales of investments were approximately \$1.1 million and \$(0.7) million, respectively, in the six months ended December 23, 2012 and \$0.2 million and \$(0.3) million, respectively, in the six months ended December 25, 2011.

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The following is an analysis of the Company's fixed income securities in unrealized loss positions (in thousands):

|  | Unrealized Losses   |                       | December 23, 2012<br>Unrealized Losses |                       | Total             |                       |
|--|---------------------|-----------------------|--|-----------------------|-------------------|-----------------------|
|  | Less Than 12 Months |                       | 12 Months or Greater                   |                       |                   |                       |
|  | Fair Value          | Gross Unrealized Loss | Fair Value                             | Gross Unrealized Loss | Fair Value        | Gross Unrealized Loss |
| <b>Short-Term Investments</b>          |                     |                       |  |                       |                   |                       |
| Municipal Notes and Bonds              | \$ 39,212           | \$ (46)               | \$                                     | \$                    | \$ 39,212         | \$ (46)               |
| US Treasury and Agencies               | 33,860              | (28)                  |  |                       | 33,860            | (28)                  |
| Government-Sponsored Enterprises       | 3,513               | (2)                   |  |                       | 3,513             | (2)                   |
| Foreign Government Bonds               | 7,601               | (5)                   |  |                       | 7,601             | (5)                   |
| Corporate Notes and Bonds              | 184,816             | (279)                 | 295                                    |                       | 185,111           | (279)                 |
| Mortgage Backed Securities Residential | 3,746               | (57)                  |  |                       | 3,746             | (57)                  |
| Mortgage Backed Securities Commercial  | 53,576              | (348)                 | 2,056                                  | (38)                  | 55,632            | (386)                 |
| <b>Total Short-Term Investments</b>    | <b>\$ 326,324</b>   | <b>\$ (765)</b>       | <b>\$ 2,351</b>                        | <b>\$ (38)</b>        | <b>\$ 328,675</b> | <b>\$ (803)</b>       |

The amortized cost and fair value of cash equivalents, short-term investments, and restricted cash and investments with contractual maturities are as follows as of December 23, 2012:

|                                       | Cost           | Estimated Fair Value |
|---------------------------------------|----------------|----------------------|
|                                       | (in thousands) |                      |
| Due in one year or less               | \$ 1,299,524   | \$ 1,299,915         |
| Due after one year through five years | 905,888        | 909,053              |
| Due in more than five years           | 172,324        | 172,897              |
|                                       | \$ 2,377,736   | \$ 2,381,865         |

Management has the ability, if necessary, to liquidate any of its cash equivalents and short-term investments in order to meet the Company's liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase nonetheless are classified as short-term on the accompanying Consolidated Balance Sheets.

**Derivative Instruments and Hedging**

The Company carries derivative financial instruments ( derivatives ) on its Consolidated Balance Sheets at their fair values. The Company enters into foreign currency forward contracts with financial institutions with the primary objective of reducing volatility of earnings and cash flows related to foreign currency exchange rate fluctuations. The counterparties to these foreign currency forward contracts are large global financial institutions that the Company believes are creditworthy, and therefore, we do not consider the risk of counterparty nonperformance to be material.

**Cash Flow Hedges**

In the normal course of business, the Company's financial position is routinely subjected to market risk associated with foreign currency exchange rate fluctuations on non-US dollar transactions or cash flows, primarily from Japanese yen-denominated revenues and Euro-denominated expenses. The Company's policy is to mitigate the foreign exchange risk arising from the fluctuations in the value of these non-US dollar denominated transactions or cash flows through a foreign currency cash flow hedging program, using foreign currency forward contracts that generally expire within 12 months and no later than 24 months. These foreign currency forward contracts are designated as cash flow hedges and are carried on the Company's balance sheet at fair value with the effective portion of the contracts' gains or losses included in

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accumulated other comprehensive income (loss) and subsequently recognized in the same period the hedged transaction is recognized.

At inception and at each quarter end, hedges are tested prospectively and retrospectively for effectiveness using regression analysis. Changes in the fair value of foreign currency forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in revenue in the current period. The change in time value related to these contracts was not material for all reported periods. To qualify for hedge accounting, the hedge relationship must meet criteria relating both to the derivative instrument and the hedged item. These criteria include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows will be measured. There were no gains or losses during the three or six months ended December 23, 2012 or December 25, 2011 associated with ineffectiveness or forecasted transactions that failed to occur.

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To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be tested to demonstrate an expectation of providing highly effective offsetting changes to future cash flows on hedged transactions. When derivative instruments are designated and qualify as effective cash flow hedges, the Company recognizes effective changes in the fair value of the hedging instrument within accumulated other comprehensive income (loss) until the hedged exposure is realized. Consequently, with the exception of excluded time value and hedge ineffectiveness recognized, the Company's results of operations are not subject to fluctuation as a result of changes in the fair value of the derivative instruments. If hedges are not highly effective or if the Company does not believe that the underlying hedged forecasted transactions will occur, the Company may not be able to account for its derivative instruments as cash flow hedges. If this were to occur, future changes in the fair values of the Company's derivative instruments would be recognized in earnings. Additionally, related amounts previously recorded in other comprehensive income would be reclassified to income immediately. At December 23, 2012, the Company had gains of \$3.7 million accumulated in other comprehensive income, which it expects to reclassify from other comprehensive income into earnings over the next 12 months.

*Balance Sheet Hedges*

The Company also enters into foreign currency forward contracts to hedge fluctuations associated with foreign currency denominated monetary assets and liabilities, primarily intercompany receivables and payables. These foreign currency forward contracts are not designated for hedge accounting treatment. Therefore, the change in fair value of these derivatives is recorded as a component of other income (expense) and offsets the change in fair value of the foreign currency denominated assets and liabilities, recorded in other income (expense).

As of December 23, 2012, the Company had the following outstanding foreign currency forward contracts that were entered into under its cash flow and balance sheet hedge program:

|   | Derivatives Designated as Hedging Instruments: |                | Derivatives Not Designated as Hedging Instruments: |                |
|---|--|----------------|--|----------------|
|   | Buy Contracts                                  | Sell Contracts | Buy Contracts                                      | Sell Contracts |
|   | (in thousands)                                 |                |  |                |
| <b>Foreign Currency Forward Contracts</b> |  |                |  |                |
| Japanese Yen                              | \$   | \$ 47,126      | \$   | \$ 42,593      |
| Swiss Francs                              |  |                | 16,159   |                |
| British Pound Sterling                    |  |                | 4,614  |                |
| Euro                                      | 60,477   |                | 782  |                |
|   | \$ 60,477                                      | \$ 47,126      | \$ 21,555  | \$ 42,593      |

The fair value of derivative instruments in the Company's Consolidated Balance Sheet as of December 23, 2012 was as follows:

|   | Fair Value of Derivative Instruments |                           |                        |               |
|---|--------------------------------------|---------------------------|------------------------|---------------|
|   | Asset Derivatives                    |                           | Liability Derivatives  |               |
|   | Balance Sheet Location               | Fair Value (in thousands) | Balance Sheet Location | Fair Value    |
| <b>Derivatives designated as hedging instruments:</b>     |                                      |                           |                        |               |
| Foreign exchange forward contracts                        | Prepaid expense and other assets     | \$ 3,458                  | Accrued liabilities    | \$ 70         |
| <b>Derivatives not designated as hedging instruments:</b> |                                      |                           |                        |               |
| Foreign exchange forward contracts                        | Prepaid expense and other assets     | \$ 187                    | Accrued liabilities    | \$ 395        |
| <b>Total derivatives</b>                                  |                                      | <b>\$ 3,645</b>           |                        | <b>\$ 465</b> |



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The fair value of derivative instruments in the Company's Consolidated Balance Sheet as of June 24, 2012 was as follows:

|   | Fair Value of Derivative Instruments |                 |                        |                 |
|---|--------------------------------------|-----------------|------------------------|-----------------|
|   | Asset Derivatives                    |                 | Liability Derivatives  |                 |
|   | Balance Sheet Location               | Fair Value      | Balance Sheet Location | Fair Value      |
|   | (in thousands)                       |                 |                        |                 |
| <b>Derivatives designated as hedging instruments:</b>     |                                      |                 |                        |                 |
| Foreign exchange forward contracts                        | Prepaid expense and other assets     | \$ 3,358        | Accrued liabilities    | \$ 3,403        |
| <b>Derivatives not designated as hedging instruments:</b> |                                      |                 |                        |                 |
| Foreign exchange forward contracts                        | Prepaid expense and other assets     | \$ 1,662        | Accrued liabilities    | \$ 925          |
| <b>Total derivatives</b>                                  |                                      | <b>\$ 5,020</b> |                        | <b>\$ 4,328</b> |

The effect of derivative instruments designated as cash flow hedges on the Company's Consolidated Statements of Operations was as follows:

|   | Three Months Ended December 23, 2012       |  |  |  | Six Months Ended December 23, 2012         |  |  |  |
|---|--|--|--|--|--|--|--|--|
|   | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Ineffective Portion) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Ineffective Portion) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) |
|   | (1)  | (2)  | (3)  | (4)  | (1)  | (2)  | (3)  | (4)  |
|   | (in thousands)                             |  |  |  |  |  |  |  |
| <b>Derivatives Designated as Hedging Instruments:</b> |  |  |  |  |  |  |  |  |
| Foreign exchange forward contracts                    | \$ 2,347                                   | \$ (363)                                   | \$ 8   | \$ (26)  | \$ 1,628                                   | \$ (2,289)                                 | \$   | \$ (47)  |

|   | Three Months Ended December 25, 2011       |  |  |  | Six Months Ended December 25, 2011         |  |  |  |
|---|--|--|--|--|--|--|--|--|
|   | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Ineffective Portion) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Effective Portion) | Gain (Loss) Recognized (Ineffective Portion) | Gain (Loss) Recognized (Excluded from Effectiveness Testing) |
|   | (1)  | (2)  | (3)  | (4)  | (1)  | (2)  | (3)  | (4)  |
|   | (in thousands)                             |  |  |  |  |  |  |  |
| <b>Derivatives Designated as Hedging Instruments:</b> |  |  |  |  |  |  |  |  |
| Foreign exchange forward contracts                    | \$ (3,581)                                 | \$ (2,906)                                 | \$ (1)                                       | \$ 223   | \$ (11,793)                                | \$ (5,513)                                 | \$ (2)                                       | \$ 754   |

- (1) Amount recognized in other comprehensive income (loss) (effective portion).
  - (2) Amount of gain (loss) reclassified from accumulated other comprehensive income into income (loss) (effective portion) located in revenue.
  - (3) Amount of gain (loss) recognized in income on derivative (ineffective portion) located in other expense, net.
  - (4) Amount of gain (loss) recognized in income on derivative (amount excluded from effectiveness testing) located in other expense, net.
- The effect of derivative instruments not designated as cash flow hedges on the Company's Condensed Consolidated Statement of Operations was as follows:

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|   | Gain<br>(Loss)       | Gain (Loss)          | Gain<br>(Loss)       | Gain (Loss)          |
|   | Recognized (5)       | Recognized (5)       | Recognized (5)       | Recognized (5)       |
|   | (in thousands)       |                      |                      |                      |
| <b>Derivatives Not Designated as Hedging Instruments:</b> |                      |                      |                      |                      |
| Foreign exchange forward contracts                        | \$ 5,667             | \$ (20,411)          | \$ 286               | \$ (42,823)          |

(5) Amount of gain (loss) recognized in income located in other income (expense), net.



**Table of Contents***Concentrations of Credit Risk*

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short term investments, restricted cash and investments, trade accounts receivable, and derivative financial instruments used in hedging activities. Cash is placed on deposit in large global financial institutions. Such deposits may be in excess of insured limits. Management believes that the financial institutions that hold the Company's cash are creditworthy and, accordingly, minimal credit risk exists with respect to these balances.

The Company's over-all portfolio of available-for-sale securities must maintain an average minimum rating of AA- or Aa3 as rated by Standard and Poor's or Moody's Investor Services, respectively. To ensure diversification and minimize concentration, the Company's policy limits the amount of credit exposure with any one financial institution or commercial issuer.

The Company is exposed to credit losses in the event of nonperformance by counterparties on the foreign currency forward contracts that are used to mitigate the effect of exchange rate fluctuations and on contracts related to structured share repurchase agreements. These counterparties are large global financial institutions and to date, no such counterparty has failed to meet its financial obligations to the Company.

Credit risk evaluations, including trade references, bank references and Dun & Bradstreet ratings, are performed on all new customers and the Company monitors its customers' financial statements and payment performance. In general, the Company does not require collateral on sales.

**NOTE 5 INVENTORIES**

Inventories are stated at the lower of cost (first-in, first-out method) or market. Shipments to Japanese customers, to whom title does not transfer until customer acceptance, are classified as finished goods inventory and carried at cost until title transfers. Inventories consist of the following:

|                 | December 23,<br>2012 | June 24,<br>2012 |
|-----------------|----------------------|------------------|
|                 | (in thousands)       |                  |
| Raw materials   | \$ 307,806           | \$ 342,283       |
| Work-in-process | 78,459               | 118,566          |
| Finished goods  | 144,007              | 172,004          |
|                 | \$ 530,272           | \$ 632,853       |

During the three months and six ended December 23, 2012, the Company incurred charges of \$15.5 million and \$18.7 million resulting from the write-off of inventory related to the decision to stop future development of certain product configurations and transition them to a sustaining mode with existing customers. These charges were included in cost of goods sold in the Condensed Consolidated Statement of Operations.

**NOTE 6 PROPERTY AND EQUIPMENT, NET**

Property and equipment, net, consists of the following:

|   | December 23,<br>2012 | June 24,<br>2012 |
|---|----------------------|------------------|
|   | (in thousands)       |                  |
| Manufacturing, engineering and office equipment | \$ 487,647           | \$ 468,739       |
| Computer equipment and software                 | 111,255              | 104,919          |
| Land  | 65,289               | 65,228           |
| Buildings                                       | 238,581              | 231,536          |
| Leasehold improvements                          | 63,025               | 54,327           |
| Furniture and fixtures                          | 20,957               | 19,770           |
|   | 986,754              | 944,519          |

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|   |            |            |
|---|------------|------------|
| Less: accumulated depreciation and amortization | (396,207)  | (359,923)  |
|   | \$ 590,547 | \$ 584,596 |

The Company's long lived assets held for use, including property, plant, and equipment and intangible assets, are measured at fair value when an impairment exists. Long lived assets held for use are assessed for impairment when events occur that indicate a potential impairment. The Company did not record an impairment of long lived assets held for use during the three or six months ended December 23, 2012 or December 25, 2011.

**Table of Contents****NOTE 7 GOODWILL AND INTANGIBLE ASSETS****Goodwill**

There was no significant change in the goodwill balance during the six months ended December 23, 2012. Of the \$1,455 million goodwill balance as of December 23, 2012, \$69.7 million is tax deductible and the remaining balance is not tax deductible due to purchase accounting and applicable foreign law.

The Company's goodwill is measured at fair value when an impairment exists. Goodwill is assessed at least annually for impairment. The Company did not record impairments of goodwill during the three or six months ended December 23, 2012 or December 25, 2011.

**Intangible Assets**

The following table provides details of the Company's intangible assets, including the impact of foreign currency translation adjustments, as of December 23, 2012 (in thousands, except years):

|   | <b>Gross</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b>   | <b>Weighted-<br/>Average Useful<br/>Life (years)</b> |
|---|--------------|-------------------------------------|--------------|--|
| Customer relationships                        | \$ 615,771   | \$ (67,568)                         | \$ 548,203   | 9.04   |
| Existing technology                           | 643,032      | (94,079)                            | 548,953      | 6.97   |
| Patents                                       | 32,053       | (19,911)                            | 12,142       | 6.05   |
| Backlog                                       | 10,000       | (5,548)                             | 4,452        | 1.00   |
| Other intangible assets                       | 35,216       | (34,765)                            | 451          | 4.10   |
| <br>  |              |                                     |              |  |
| Intangible assets subject to amortization     | 1,336,072    | (221,871)                           | 1,114,201    |  |
| In process research and development           | 30,000       |                                     | 30,000       |  |
| Development rights                            | 9,100        |                                     | 9,100        |  |
| <br>  |              |                                     |              |  |
| Intangible assets not subject to amortization | 39,100       |                                     | 39,100       |  |
| <br>  |              |                                     |              |  |
| Total intangible assets                       | \$ 1,375,172 | \$ (221,871)                        | \$ 1,153,301 |  |

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The following table provides details of the Company's intangible assets, including the impact of foreign currency translation adjustments, as of June 24, 2012 (in thousands, except years):

|   | Gross        | Accumulated<br>Amortization | Net          | Weighted-<br>Average Useful<br>Life (years) |
|---|--------------|-----------------------------|--------------|---|
| Customer relationships                        | \$ 615,411   | \$ (32,041)                 | \$ 583,370   | 9.04  |
| Existing technology                           | 642,311      | (48,378)                    | 593,933      | 6.97  |
| Patents                                       | 30,870       | (17,525)                    | 13,345       | 6.05  |
| Backlog                                       | 10,000       | (548)                       | 9,452        | 1.00  |
| Other intangible assets                       | 35,216       | (33,989)                    | 1,227        | 4.10  |
| <br>  |              |                             |              |   |
| Intangible assets subject to amortization     | 1,333,808    | (132,481)                   | 1,201,327    |   |
| In process research and development           | 30,000       |                             | 30,000       |   |
| Development rights                            | 9,100        |                             | 9,100        |   |
| <br>  |              |                             |              |   |
| Intangible assets not subject to amortization | 39,100       |                             | 39,100       |   |
| <br>  |              |                             |              |   |
| Total intangible assets                       | \$ 1,372,908 | \$ (132,481)                | \$ 1,240,427 |   |

The Company recognized \$44.7 million and \$4.5 million in intangible asset amortization expense during the three months ended December 23, 2012 and December 25, 2011, respectively. The Company recognized \$89.3 million and \$9.0 million in intangible asset amortization expense during the six months ended December 23, 2012 and December 25, 2011, respectively.

The estimated future amortization expense of purchased intangible assets as of December 23, 2012 is as follows (in thousands):

| Fiscal Year     | Amount       |
|-----------------|--------------|
| 2013 (6 months) | \$ 87,174    |
| 2014            | 161,136      |
| 2015            | 152,897      |
| 2016            | 151,074      |
| 2017            | 150,844      |
| Thereafter      | 411,076      |
|                 | <br>         |
|                 | \$ 1,114,201 |

**NOTE 8 ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

|                                | December 23,<br>2012 | June 24,<br>2012 |
|--------------------------------|----------------------|------------------|
|                                | (in thousands)       |                  |
| Accrued compensation           | \$ 305,747           | \$ 274,165       |
| Warranty reserves              | 56,191               | 63,988           |
| Income and other taxes payable | 17,954               | 24,745           |
| Other                          | 118,895              | 129,280          |
|                                | <br>                 |                  |
|                                | \$ 498,787           | \$ 492,178       |



**Table of Contents****NOTE 9 OTHER EXPENSE, NET**

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

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|   | (in thousands)       |                      |                      |                      |
| Interest income   | \$ 4,376             | \$ 2,472             | \$ 8,176             | \$ 5,061             |
| Interest expense  | (14,975)             | (9,346)              | (30,119)             | (18,606)             |
| Gains (losses) on deferred compensation plan related assets | 1,234                | (348)                | 3,975                | (2,213)              |
| Foreign exchange losses                                     | (3,274)              | (142)                | (3,642)              | (1,232)              |
| Other, net  | (751)                | (421)                | (1,718)              | (2,868)              |
|   | \$ (13,390)          | \$ (7,785)           | \$ (23,328)          | \$ (19,858)          |

**NOTE 10 INCOME TAX EXPENSE**

The Company recorded an income tax benefit of \$(15.8) million and \$(11.8) million for the three and six months ended December 23, 2012, respectively. The income tax benefit yielded an effective tax rate of 168.6% and 456.4% for the three and six months ended December 23, 2012, respectively.

The differences between the U.S. federal statutory tax rate of 35% and the Company's effective tax rates for the three and six months ended December 23, 2012 were primarily due to the recognition of previously unrecognized tax benefits due to lapse of statute of limitations and successful resolution of certain tax matters, the geographic mix of income, and the treatment of discrete items in determining the effective tax rate, partially offset by the tax effect of non-deductible stock-based compensation. The effective tax rates recorded during the three and six months ended December 23, 2012 included the tax impact of discrete items, which were recorded during the quarter in which they occurred. During the three and six months ended December 23, 2012, tax discrete items primarily consisted of: (1) a tax benefit of \$30.5 million and \$30.9 million for the three months and six months, respectively, from the recognition of previously unrecognized tax benefits due to lapse of statutes of limitation and successful resolution of certain tax matters, and (2) the effective tax rate impact of integration and impairment expenses of \$28.3 million and \$45.3 million for the three months and six months, respectively, for which little tax benefit is derived.

The total gross unrecognized tax benefits as of each date noted below were as follows:

|                                       | December 23,<br>2012 | June 24,<br>2012 |
|---------------------------------------|----------------------|------------------|
|                                       | (in millions)        |                  |
| Total gross unrecognized tax benefits | \$ 333.9             | \$ 343.8         |

If the gross unrecognized tax benefits were recognized in a future period, it would result in a net tax benefit of \$264.4 million and a reduction of the effective tax rate.

The Company recognizes interest expense and penalties related to the above unrecognized tax benefits within income tax expense (benefit). As of December 23, 2012, the Company had accrued approximately \$24.7 million for the payment of gross interest and penalties, relating to unrecognized tax benefits, compared to \$25.2 million as of June 24, 2012.

The Internal Revenue Service ( IRS ) is examining the Company's U.S. income tax returns for fiscal years 2008 and 2009. As of December 23, 2012, no significant adjustments have been proposed by the IRS. The IRS has completed its audit of Novellus' calendar year 2006 through calendar year 2008 tax returns. No significant adjustments were proposed by the IRS. The Company is also subject to audits by foreign tax authorities. The Company is unable to make a reasonable estimate as to when cash settlements, if any, with the relevant taxing authorities will occur.

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The Company files U.S. federal, U.S. state, and foreign income tax returns. As of December 23, 2012, tax years 2003-2012 remain subject to examination in the jurisdictions where the Company operates.

The Company is in various stages of the examinations in connection with all of its tax audits worldwide, and it is difficult to determine when these examinations will be settled. It is reasonably possible that over the next twelve-month period the Company may experience a significant increase or decrease in its unrecognized tax benefits. It is not possible to determine either the magnitude or the range of any increase or decrease at this time.

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Realization of the Company's net deferred tax assets is based upon the weight of available evidence, including such factors as the recent earnings history and expected future taxable income. The Company believes it is more likely than not that such assets will be realized with the exception of \$55.2 million related to certain California and foreign deferred tax assets. However, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. If the valuation allowance related to deferred tax assets were released as of December 23, 2012, approximately \$55.2 million would be credited to the statement of operations.

**NOTE 11 NET INCOME PER SHARE**

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the treasury stock method, for dilutive stock options, RSUs, and convertible notes. The following table reconciles the numerators and denominators of the basic and diluted computations for net income per share.

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
| (in thousands, except per share data)           |                      |                      |                      |                      |
| <b>Numerator:</b>                               |                      |                      |                      |                      |
| Net income                                      | \$ 6,408             | \$ 33,212            | \$ 9,176             | \$ 105,050           |
| <b>Denominator:</b>                             |                      |                      |                      |                      |
| Basic average shares outstanding                | 170,699              | 119,739              | 175,314              | 121,435              |
| <b>Effect of potential dilutive securities:</b> |                      |                      |                      |                      |
| Employee stock plans                            | 2,328                | 1,134                | 2,176                | 947                  |
| Diluted average shares outstanding              | 173,027              | 120,873              | 177,490              | 122,382              |
| Net income per share - basic                    | \$ 0.04              | \$ 0.28              | \$ 0.05              | \$ 0.87              |
| Net income per share - diluted                  | \$ 0.04              | \$ 0.27              | \$ 0.05              | \$ 0.86              |

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

|  | Three Months Ended   |                      | Six Months Ended     |                      |
|--|----------------------|----------------------|----------------------|----------------------|
|  | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
| (in thousands)                                   |                      |                      |                      |                      |
| Number of potential dilutive securities excluded | 1,543                | 90                   | 1,551                | 841                  |

In addition to the above, diluted shares outstanding do not include any effect resulting from warrants, assumed conversion of the Notes, or note hedges (as described in Note 13) as their impact would have been anti-dilutive.

**NOTE 12 ACCUMULATED OTHER COMPREHENSIVE LOSS**

The balance of accumulated other comprehensive loss, on an after-tax basis where applicable, is as follows:

| December 23,<br>2012 | June 24,<br>2012 |
|----------------------|------------------|
| (in thousands)       |                  |



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|  |             |             |
|--|-------------|-------------|
| Accumulated foreign currency translation adjustment                  | \$ (17,637) | \$ (22,481) |
| Accumulated unrealized gain (loss) on cash flow hedges               | 3,705       | (212)       |
| Accumulated unrealized gain (loss) on available-for-sale investments | (58)        | (308)       |
| Unrealized components of post retirement benefit plan                | (10,494)    | (10,817)    |
| Accumulated other comprehensive loss                                 | \$ (24,484) | \$ (33,818) |

**Table of Contents****NOTE 13 LONG TERM DEBT**

The following table reflects the carrying value of the Company's convertible notes and other long-term debt as of December 23, 2012 and June 24, 2012:

|   | December 23,<br>2012 | June 24,<br>2012 |
|---|----------------------|------------------|
|   | <i>(in millions)</i> |                  |
| 0.50% Notes due 2016                                | \$ 450.0             | \$ 450.0         |
| Less: Unamortized interest discount                 | (53.1)               | (60.3)           |
| <b>Net carrying amount of 0.50% Notes due 2016</b>  | <b>396.9</b>         | <b>389.7</b>     |
| 1.25% Notes due 2018                                | 450.0                | 450.0            |
| Less: Unamortized interest discount                 | (83.7)               | (90.4)           |
| <b>Net carrying amount of 1.25% Notes due 2018</b>  | <b>366.3</b>         | <b>359.6</b>     |
| 2.625% Notes due 2041                               | 699.9                | 699.9            |
| Less: Unamortized interest discount                 | (188.6)              | (190.3)          |
| <b>Net carrying amount of 2.625% Notes due 2041</b> | <b>511.3</b>         | <b>509.6</b>     |
| <b>Total debt</b>                                   | <b>1,274.5</b>       | <b>1,258.9</b>   |
| <b>Less: current portion of debt</b>                |                      | <b>(509.6)</b>   |
| <b>Long-term debt</b>                               | <b>\$ 1,274.5</b>    | <b>\$ 749.3</b>  |

**Convertible Senior Notes**

In May 2011, the Company issued and sold \$450.0 million in aggregate principal amount of 0.50% Convertible Senior Notes due May 2016 (the 2016 Notes) at par. At the same time, the Company issued and sold \$450.0 million in aggregate principal amount of 1.25% Convertible Senior Notes due May 2018 (the 2018 Notes) at par. The 2016 Notes and the 2018 Notes may be converted, under certain circumstances, based on an initial conversion rate of 15.8687 shares of common stock per \$1,000 principal amount of notes (which represents an initial conversion price of approximately \$63.02 per share of common stock). The net proceeds to the Company from the sale of the 2016 Notes and the 2018 Notes were \$835.5 million. The Company pays cash interest at an annual rate of 0.5% and 1.25%, respectively, on the 2016 Notes and the 2018 Notes, payable semi-annually on May 15 and November 15 of each year.

In June 2012, with the acquisition of Novellus Systems, Inc. (see Note 16), the Company assumed \$700.0 million in aggregate principal amount of 2.625% Convertible Senior Notes due May 2041 (the 2041 Notes, and collectively with the 2016 Notes and the 2018 Notes, the Notes). The 2041 Notes may be converted, under certain circumstances, based on an initial conversion rate of 28.4781 shares of common stock per \$1,000 principal amount of notes (which represents an initial conversion price of approximately \$35.11 per share of common stock). The Company pays cash interest at an annual rate of 2.625%, payable semi-annually on May 15 and November 15 of each year. The 2041 Notes also have a contingent interest payment provision that may require us to pay additional interest based on certain thresholds, beginning with the semi-annual interest payment commencing on May 15, 2021, and upon the occurrence of certain events, as outlined in the indenture governing the 2041 Notes. The maximum amount of the contingent interest will accrue at a rate of 2.1% per annum, excluding any potential impact from dividends deemed payable to holders of the 2041 Notes. The contingent interest payment provision has been identified as an embedded derivative, to be accounted for separately, and is recorded at fair value at the end of each reporting period in other non-current liabilities, with any gains and losses recorded in interest expense, within the Condensed Consolidated Statements of Operations.

In connection with the acquisition of Novellus in June 2012, the 2041 Notes could have been converted into the Company's common stock at any time from and after the later of (1) the date that was 30 scheduled trading days immediately prior to the anticipated closing date of the merger

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and (2) the date on which we delivered to the note holders notice of the merger, until 35 business days after the actual closing date of the merger, or July 24, 2012. Accordingly, the carrying amount of the 2041 Notes was classified in current liabilities in our Consolidated Balance Sheet as of June 24, 2012. The excess of the amount of cash payable, if converted, over the carrying amount of the 2041 Notes was classified as temporary equity as of June 24, 2012. When the conversion period closed, on July 24, 2012, all 2041 Notes not converted were reclassified back to noncurrent liabilities and the temporary equity was reclassified to permanent equity. During the period ending June 24, 2012, 65 of the 2041 Notes, with a total par value of \$65,000, were converted at the note holders' option. In conjunction with the conversion, 137 shares of common stock were issued.

The Company separately accounts for the liability and equity components of the Notes. The initial debt components of the 2016 Notes, the 2018 Notes, and the 2041 Notes were valued at \$373.8 million, \$345.1 million, and \$509.5 million, respectively, based on the present value of the future cash flows using discount rates of 4.29%, 5.27%, and 4.28%, respectively, the Company's borrowing

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rate at the date of the issuance or assumption for similar debt instruments without the conversion feature. The carrying values of the equity components of the 2016 Notes, the 2018 Notes, and the 2041 Notes were \$76.2 million, \$104.9 million, and \$328.1 million, respectively as of December 23, 2012. The effective interest rates on the liability components of the 2016 Notes, the 2018 Notes, and the 2041 Notes for the three months ended December 23, 2012 were 4.29%, 5.27%, and 4.28% respectively. The following table presents the amount of interest cost recognized relating to both the contractual interest coupon and amortization of the discount on the liability component of the Notes during the three and six months ended December 23, 2012 and December 25, 2011.

|                                   | Three Months Ended   |                      | Six Months Ended     |                      |
|-----------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|                                   | <i>(in millions)</i> |                      |                      |                      |
| Contractual interest coupon       | \$ 6.6               | \$ 1.9               | 13.1                 | 3.9                  |
| Amortization of interest discount | 7.8                  | 6.7                  | 15.6                 | 13.3                 |
| Amortization of issuance costs    | 0.6                  | 0.6                  | 1.2                  | 1.2                  |
| Total interest cost recognized    | \$ 15.0              | \$ 9.2               | \$ 29.9              | \$ 18.4              |

The remaining bond discount of the 2016 Notes of \$53.1 million as of December 23, 2012 will be amortized over their remaining life, which is approximately 3.4 years. The remaining bond discount of the 2018 Notes of \$83.7 million as of December 23, 2012 will be amortized over their remaining life, which is approximately 5.4 years. The remaining bond discount of the 2041 Notes of \$188.6 million as of December 23, 2012 will be amortized over their remaining life, which is approximately 28.4 years. As of December 23, 2012, the if-converted value of the 2016 Notes and the 2018 Notes did not exceed the aggregate principal amount. As of December 23, 2012, the if-converted value of the 2041 Notes exceeded the aggregate principal amount by \$22.5 million.

**Convertible Note Hedges and Warrants**

Concurrently with the issuance of the 2016 Notes and the 2018 Notes, the Company purchased convertible note hedges and sold warrants. The separate convertible note hedge and warrant transactions are collectively structured to reduce the potential future economic dilution associated with the conversion of the 2016 Notes and the 2018 Notes and to increase the effective initial conversion price to \$71.34 and \$76.10 per share, respectively. Each of these components is discussed separately below:

Concurrent with the issuance of the 2016 Notes, the Company sold warrants to purchase up to approximately 7.1 million shares of the Company's common stock at an exercise price of \$71.34 per share. The warrants expire on a series of dates between August 15, 2016 and October 21, 2016. At expiration, the Company may, at its option, elect to settle the warrants on a net share basis. As of December 23, 2012, the warrants had not been exercised and remained outstanding. In addition, counterparties agreed to sell to the Company up to approximately 7.1 million shares of the Company's common stock, which is the number of shares initially issuable upon conversion of the 2016 Notes in full, at a price of \$63.02 per share. The convertible note hedge transaction will be settled in net shares and will terminate upon the earlier of the maturity date of the 2016 Notes or the first day none of the 2016 Notes remains outstanding due to conversion or otherwise. Settlement of the convertible note hedge in net shares, based on the number of shares issued upon conversion of the 2016 Notes, on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 2016 Notes.

Concurrent with the issuance of the 2018 Notes, the Company sold warrants to purchase up to approximately 7.1 million shares of the Company's common stock at an exercise price of \$76.10 per share. The warrants expire on a series of dates between August 15, 2018 and October 23, 2018. At expiration, the Company may, at its option, elect to settle the warrants on a net share basis. As of December 23, 2012, the warrants had not been exercised and remained outstanding. In addition, counterparties agreed to sell to the Company up to approximately 7.1 million shares of the Company's common stock, which is the number of shares initially issuable upon conversion of the 2018 Notes in full, at a price of \$63.02 per share. The convertible note hedge transaction will be settled in net shares and will terminate upon the earlier of the maturity date of the 2018 Notes or the first day none of the 2018 Notes remains outstanding due to conversion or otherwise. Settlement of the convertible note hedge in net shares, based on the number of shares issued upon conversion of the 2018 Notes, on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 2018 Notes.

**Fair Value of Notes**

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As of December 23, 2012, the face values of the 2016 Notes, the 2018 Notes, and the 2041 Notes were \$450.0 million, \$450.0 million, and \$699.9 million, respectively. As of December 23, 2012, the fair values of the 2016 Notes, the 2018 Notes, and the 2041 Notes, which includes the debt and equity components, were approximately \$432.0 million, \$446.4 million, and \$880.2 million respectively, based on quoted market prices (level 1 inputs within the fair value hierarchy).

**Table of Contents****NOTE 14 COMMITMENTS***Capital Leases*

Capital leases reflect building and office equipment leases. The amounts in the table below include the interest portion of payment obligations.

The Company's contractual cash obligations relating to its existing capital leases, including interest, as of December 23, 2012 were as follows:

|   | <b>Capital<br/>Leases<br/>(in thousands)</b> |
|---|--|
| Payments due by period:                 |  |
| One year                                | \$ 1,685                                     |
| Two years                               | 1,565  |
| Three years                             | 1,497  |
| Four years                              | 9,636  |
| Five years                              |  |
| Over 5 years                            |  |
| <br>                                    |  |
| Total                                   | 14,383                                       |
| Less: Interest on capital leases        | 649  |
| <br>                                    |  |
| Less: Current portion of capital leases | 1,464  |
| <br>                                    |  |
| Long-term portion of capital leases     | \$ 12,270                                    |

*Operating Leases and Related Guarantees*

The Company leases certain of its administrative, R&D and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases. Certain of the Company's facility leases for buildings located at its Fremont, California headquarters and certain other facility leases provide the Company with options to extend the leases for additional periods or to purchase the facilities. Certain of the Company's facility leases provide for periodic rent increases based on the general rate of inflation.

On December 18, 2007, the Company entered into two operating leases regarding certain improved properties in Livermore, California. These leases were amended on April 3, 2008 and July 9, 2008 (as so amended, the Livermore Leases). On December 21, 2007, the Company entered into a series of four amended and restated operating leases (the New Fremont Leases, and collectively with the Livermore Leases, the Operating Leases) with regard to certain improved properties at the Company's headquarters in Fremont, California.

The Operating Leases have a term of approximately seven years ending on the first business day in January 2015. The Company may, at its discretion and with 30 days' notice, elect to purchase the property that is the subject of the Operating Lease for an amount approximating the sum required to pay the amount of the lessor's investment in the property and any accrued but unpaid rent.

The Company is required, pursuant to the terms of the Operating Leases, to maintain collateral in an aggregate of approximately \$164.9 million in separate interest-bearing accounts as security for the Company's obligations under the Operating Leases. This amount is recorded as restricted cash in the Company's Consolidated Balance Sheet as of as of December 23, 2012.

When the terms of the Operating Leases expire, the property subject to that Operating Lease may be remarketed. The Company has guaranteed to the lessor that each property will have a certain minimum residual value. The aggregate guarantee made by the Company under the Operating Leases is generally no more than approximately \$141.7 million; however, under certain default circumstances, the guarantee with regard to an Operating Lease may be 100% of the lessor's aggregate investment in the applicable property, which in no case will exceed \$164.9 million, in the aggregate.

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The Company recognized at lease inception \$0.6 million in estimated liabilities related to the Operating Leases, which represents the fair value guarantee premium that would be required had the guarantee been issued in a standalone transaction. These liabilities are recorded in other long-term liabilities with the offsetting entry recorded as prepaid rent in other assets. The balances in prepaid rent and the guarantee liability are amortized to the Condensed Consolidated Statement of Operations on a straight line basis over the life of the leases. If it becomes probable that the Company will be required to make a payment under the residual guarantee, the Company will increase its liability with a corresponding increase to prepaid rent and amortize the increased prepaid rent over the remaining lease term with no corresponding reduction in the liability. As of December 23, 2012, the unamortized portion of the fair value of the residual value guarantees remaining in other long-term liabilities and prepaid rent was \$0.1 million.

**Table of Contents***Other Guarantees*

The Company has issued certain indemnifications to its lessors for taxes and general liability under some of its agreements. The Company has entered into certain insurance contracts that may limit its exposure to such indemnifications. As of December 23, 2012, the Company had not recorded any liability on its Consolidated Financial Statements in connection with these indemnifications, as it does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

Generally, the Company indemnifies, under pre-determined conditions and limitations, its customers for infringement of third-party intellectual property rights by the Company's products or services. The Company seeks to limit its liability for such indemnity to an amount not to exceed the sales price of the products or services subject to its indemnification obligations. The Company does not believe, based on information available, that it is probable that any material amounts will be paid under these guarantees.

The Company provides guarantees and standby letters of credit to certain parties as required for certain transactions initiated during the ordinary course of business. As of December 23, 2012, the maximum potential amount of future payments that we could be required to make under these arrangements and letters of credit was \$21.4 million. We do not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid.

*Warranties*

The Company provides standard warranties on its systems. The liability amount is based on actual historical warranty spending activity by type of system, customer, and geographic region, modified for any known differences such as the impact of system reliability improvements.

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

|  | Three Months Ended   |                      | Six Months Ended     |                      |
|--|----------------------|----------------------|----------------------|----------------------|
|  | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|  | (in thousands)       |                      |                      |                      |
| Balance at beginning of period                   | \$ 67,836            | \$ 36,160            | \$ 70,161            | \$ 40,951            |
| Warranties issued during the period              | 14,856               | 8,421                | 34,548               | 16,353               |
| Settlements made during the period               | (21,484)             | (11,925)             | (45,859)             | (23,146)             |
| Changes in liability for pre-existing warranties | 1,714                | 78                   | 4,072                | (1,424)              |
| <b>Balance at end of period</b>                  | <b>\$ 62,922</b>     | <b>\$ 32,734</b>     | <b>\$ 62,922</b>     | <b>\$ 32,734</b>     |
| Less: Long-term portion                          | (6,731)              |                      | (6,731)              |                      |
| <b>Accrued warranty, current</b>                 | <b>\$ 56,191</b>     | <b>\$ 32,734</b>     | <b>\$ 56,191</b>     | <b>\$ 32,734</b>     |

**NOTE 15 RESTRUCTURING AND IMPAIRMENTS**

Prior to incurring charges under the restructuring plans discussed below, management approved and announced the specific actions to be taken under each plan. Severance packages were communicated to affected employees in sufficient detail that the employees could determine their type and amount of benefit. The termination of the affected employees occurred as soon as practical after the restructuring plans were announced. The amount of remaining future lease payments for facilities the Company ceased to use and included in the restructuring charges is based on management's estimates using known prevailing real estate market conditions at that time based, in part, on the opinions of independent real estate experts. Leasehold improvements relating to the vacated buildings were written off, as these items will have no future economic benefit to the Company and have been abandoned.

Accounting for restructuring activities, as compared to regular operating cost management activities, requires an evaluation of formally committed and approved plans. Restructuring activities have comparatively greater strategic significance and materiality and may involve exit activities, whereas regular cost containment activities are more tactical in nature and are rarely characterized by formal and integrated action plans or exiting a particular product, facility, or service.



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The following table summarizes restructuring and impairment charges and adjustments during the three and six months ended December 23, 2012 and December 25, 2011. In addition to charges incurred under specific restructuring plans, the Company incurred asset impairment charges of \$1.7 million related to a decline in the market value of certain facilities.

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|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|   | (in thousands)       |                      |                      |                      |
| June 2008 Plan  | \$                   | \$ (859)             | \$                   | \$ (859)             |
| March 2009 Plan   | (1,440)              |                      | (1,440)              |                      |
| Adjustments to restructuring liability assumed in acquisition   | 2,461                |                      | 2,461                |                      |
| Asset impairments outside of specific restructuring plans       |                      |                      |                      | 1,725                |
| <b>Total restructuring and impairment charges (adjustments)</b> | <b>\$ 1,021</b>      | <b>\$ (859)</b>      | <b>\$ 1,021</b>      | <b>\$ 866</b>        |

The amounts in the table above were recorded in the Consolidated Statements of Operations for the respective periods as follows:

|   | Three Months Ended   |                      | Six Months Ended     |                      |
|---|----------------------|----------------------|----------------------|----------------------|
|   | December 23,<br>2012 | December 25,<br>2011 | December 23,<br>2012 | December 25,<br>2011 |
|   | (in thousands)       |                      |                      |                      |
| Cost of goods sold  | \$                   | \$ (859)             | \$                   | \$ (859)             |
| Operating expense   | 1,021                |                      | 1,021                | 1,725                |
| <b>Total restructuring and impairment charges (adjustments)</b> | <b>\$ 1,021</b>      | <b>\$ (859)</b>      | <b>\$ 1,021</b>      | <b>\$ 866</b>        |

**June 2008 Plan**

During the June 2008 quarter, the Company incurred restructuring expenses related to the integration of SEZ and overall streamlining of the Company's combined Clean Product Group ( June 2008 Plan ). During the three months ended December 25, 2011 the Company released \$0.9 million related to a recorded obligation not realized for a previously restructured product line. There were no remaining liabilities related to the June 2008 Plan as of either December 23, 2012 or June 24, 2012.

**March 2009 Plan**

Beginning in the March 2009 quarter, the Company incurred restructuring expenses designed to align the Company's cost structure with its outlook for the current economic environment and future business opportunities ( March 2009 Plan ). During the three and six months ended December 23, 2012, the Company released charges of \$1.4 million primarily as the result of changes in sublease assumptions for a previously restructured building. There were no charges incurred under the March 2009 Plan during the three or six months ended December 25, 2011. Total charges incurred through December 23, 2012 under the March 2009 Plan were \$59.9 million.

Below is a table summarizing activity relating to the March 2009 Plan during the six months ended December 23, 2012:

|                                     | Facilities<br>(in thousands) |
|-------------------------------------|------------------------------|
| Balance at June 24, 2012            | \$ 27,749                    |
| Fiscal year 2013 release            | (1,440)                      |
| <b>Balance at December 23, 2012</b> | <b>\$ 26,309</b>             |

This balance expected to be paid by the end of fiscal year 2015.

*Acquired Restructuring Liabilities*

In addition to restructuring plans initiated by the Company, a restructuring liability of \$11.2 million was assumed in the Novellus acquisition, related to future rent obligations on unoccupied facilities. During the three months ended December 23, 2012, the Company incurred charges of \$2.5 million as the result of changes in sublease assumptions for a previously restructured building. No other restructuring expenses have been recognized related to this obligation subsequent to the Novellus acquisition. The liability balance as of December 23, 2012 was \$12.2 million.

**Table of Contents****NOTE 16 BUSINESS COMBINATIONS**

On June 4, 2012 ( the acquisition date ), the Company acquired all of the outstanding common shares of Novellus in an all-stock transaction valued at approximately \$3.0 billion. The results of Novellus operations have been included in the consolidated financial statements from the date of acquisition. Lam's primary reasons for this acquisition were to complement existing product offerings and to provide opportunities for revenue and cost synergies. Novellus primary business focus is to develop, manufacture, sell and support equipment used in the fabrication of integrated circuits, commonly called semiconductors. Customers for this equipment manufacture semiconductors for sale or for incorporation in their own products, or provide semiconductor-manufacturing services to third parties. Novellus also develops, manufactures, sells and supports grinding, lapping and polishing equipment for a broad spectrum of industrial applications.

*Consideration Transferred*

The table below details the consideration transferred to acquire Novellus:

| (in thousands, except per share amounts)                                      | Conversion<br>Calculation | Estimated<br>Fair Value |
|---|---------------------------|-------------------------|
| Lam common stock issued at merger   | 82,689                    |                         |
| Per share price of Lam common stock as of June 4, 2012                        | \$ 35.99                  | \$ 2,975,977            |
| Estimated fair value of vested Lam equivalent restricted stock <sup>(1)</sup> |                           | \$ 9,599                |
| Estimated fair value of vested Lam equivalent stock options <sup>(2)</sup>    |                           | 41,412                  |
| <b>Estimated purchase price consideration</b>                                 |                           | <b>\$ 3,026,988</b>     |

- (1) The fair value of Lam Research equivalent restricted stock as of the acquisition date was estimated based upon the per share price of Lam Research common stock as of June 4, 2012, and giving effect to the exchange ratio of 1.125.
- (2) The fair value of the Lam Research equivalent stock options as of the acquisition date was estimated using the Black-Scholes valuation model. Assumptions used are the same as those for acquired awards as disclosed in Note 11 of Notes to Condensed Consolidated Financial Statements.

*Net Assets Acquired*

The transaction has been accounted for using the acquisition method of accounting which requires that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. The following table summarizes the assets acquired and liabilities assumed as of the acquisition date:

|  | June 4, 2012<br>(in thousands) |
|--|--------------------------------|
| Cash and investments                           | \$ 1,059,859                   |
| Accounts receivable                            | 241,924                        |
| Inventory                                      | 309,213                        |
| Other current assets                           | 56,314                         |
| Property and equipment                         | 289,126                        |
| Intangible assets                              | 1,219,100                      |
| Goodwill                                       | 1,277,121                      |
| Other long-term assets                         | 35,826                         |
| <b>Total assets acquired</b>                   | <b>4,488,483</b>               |
| Accounts payable                               | (83,028)                       |
| Accrued expenses and other current liabilities | (196,677)                      |

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|                                    |                     |
|------------------------------------|---------------------|
| Deferred revenue                   | (20,388)            |
| Debt                               | (509,805)           |
| Other long-term liabilities        | (323,471)           |
| Convertible notes equity component | (328,126)           |
| <b>Net assets acquired</b>         | <b>\$ 3,026,988</b> |

The goodwill recognized is attributable primarily to expected synergies and other benefits that the Company believes will result from combining the operations of Novellus with the operations of Lam. The \$1.3 billion goodwill that was acquired is not expected to be deductible for income tax purposes. As of December 23, 2012, there were no changes in the recognized amounts of goodwill resulting from the acquisition of Novellus.

**Table of Contents***Preliminary Pre-Acquisition Contingencies Assumed*

The Company evaluated and continues to evaluate pre-acquisition contingencies relating to Novellus that existed as of the acquisition date. The Company determined that certain of these pre-acquisition contingencies are probable in nature and estimable as of the acquisition date and, accordingly, has preliminarily recorded the best estimates for these contingencies as a part of the purchase price allocation for Novellus. The Company continues to gather information for and evaluate these pre-acquisition contingencies, primarily related to tax positions that were assumed from Novellus. If changes are made to the amounts recorded or additional pre-acquisition contingencies are identified during the remainder of the measurement period, such amounts will be included in the purchase price allocation during the measurement period and, subsequently, in the Company's results of operations.

**NOTE 17 STOCK REPURCHASE PROGRAM**

On December 14, 2011, the Board of Directors authorized the repurchase of up to \$1.6 billion of Company common stock, which replaces the previous repurchase authorizations. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance with applicable law. Repurchases will be funded using the Company's available cash. This repurchase program has no termination date and may be suspended or discontinued at any time.

Repurchases under the repurchase program were as follows during the periods indicated:

| Period                                | Total Number of Shares Repurchased | Total Cost of Repurchase<br>(in thousands, except per share data) | Average Price Paid Per Share* | Amount Available Under Repurchase Program |
|---------------------------------------|------------------------------------|---|-------------------------------|---|
| Available balance as of June 24, 2012 |                                    |   |                               | \$ 911,933                                |
| Quarter ended September 23, 2012      | 11,970                             | \$ 344,001  | \$ 34.79                      | \$ 567,932                                |
| Quarter ended December 23, 2012       | 10,190                             | 354,029   | \$ 34.74                      | 213,903                                   |

\* Average price paid per share excludes accelerated share repurchases for which cost was incurred in fiscal year 2012, but shares were received in fiscal year 2013. See *Collared Accelerated Share Repurchases* section below for details regarding average price associated with these transactions.

In addition to shares repurchased under Board authorized repurchase program shown above, during the six months ended December 23, 2012, the Company acquired 322,000 shares at a total cost of \$11.4 million which the Company withheld through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company's equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company's equity compensation plans.

As part of its share repurchase program, the Company may from time-to-time enter into structured share repurchase arrangements with financial institutions using general corporate funds. Such arrangements entered into or settled during the six months ended December 23, 2012 included the following.

*Collared Accelerated Share Repurchases*

During the year ended June 24, 2012, the Company entered into two share repurchase transactions under one master repurchase arrangement. Under these collared accelerated share repurchase transactions (ASRs), the Company made up-front cash payments of \$375 million and \$200 million, respectively, three days after the respective trade date in exchange for an initial delivery of 6.6 million and 3.9 million shares of its common stock, respectively. The number of shares to ultimately be repurchased by the Company is based generally on the volume-weighted average price (VWAP) of the Company's common stock during the term of the ASR minus a pre-determined discount set at inception of the ASR, subject to collar provisions that provide a minimum and maximum number of shares that the Company could repurchase under the agreements.

The minimum and maximum thresholds for each transaction are established based on the average of the VWAP prices for the Company's common stock during an initial hedge period. The Company received incremental shares on top of the initial shares delivered such that the total number of shares received after the initial hedge period equaled 8.8 million and 4.8 million shares, equivalent to the minimum number of shares

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to be delivered under the terms of the ASRs, respectively. The ASRs were scheduled to end on or before December 18, 2012 and October 9, 2012, respectively. However, each ASR is subject to acceleration at the option of the counterparty at any time after June 27, 2012 and July 19, 2012, respectively. At the conclusion of the ASRs, the Company may receive additional shares based on the VWAP of the Company's common stock during the term of the agreement minus the pre-determined fixed discount, such that the total number of shares received under the ASRs does not exceed the maximum of 10.8 million and 6.6 million shares, respectively.

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The Company accounted for each ASR as two separate transactions: (a) as shares of common stock acquired in a treasury stock transaction recorded on the acquisition date and (b) as a forward contract indexed to the Company's own common stock and classified in stockholders equity. As such, the Company accounted for the shares that it received under the ASRs as a repurchase of its common stock for the purpose of calculating earnings per common share. The Company has determined that the forward contract indexed to the Company's common stock met all of the applicable criteria for equity classification in accordance with the Derivatives and Hedging topic of the FASB ASC, and, therefore, the ASRs were not accounted for as derivative instruments. As of June 24, 2012, the aggregate repurchase price of \$575.0 million is reflected as Treasury stock, at cost, in the Consolidated Balance Sheet.

The counterparty designated July 6, 2012 as the accelerated termination date, at which time the Company settled the \$375 million ASR and received an additional 1.3 million shares of common stock in addition to the minimum shares already received, which represented a weighted average share price of approximately \$36.80 for the transaction period. The counterparty designated July 25, 2012 as the accelerated termination date, at which time the Company settled the \$200 million ASR and received an additional 0.7 million shares of common stock in addition to the minimum shares already received, which represented a weighted average share price of approximately \$36.12 for the transaction period.

**NOTE 18 LEGAL PROCEEDINGS**

The Company is either a defendant or plaintiff in various actions that have arisen from time to time in the normal course of business, including intellectual property claims. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company believes that the amount of any such additional loss would be immaterial to the Company's business, financial condition, and results of operations.



**Table of Contents****ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS**

*With the exception of historical facts, the statements contained in this discussion are forward-looking statements, which are subject to the safe harbor provisions created by the Private Securities Litigation Reform Act of 1995. Certain, but not all, of the forward-looking statements in this report are specifically identified as forward-looking, by use of phrases and words such as we believe, we anticipate, we expect, may, should, could and other future-oriented terms. The identification of certain statements as forward-looking is not intended to mean that other statements not specifically identified are not forward-looking. Forward-looking statements include, but are not limited to, statements that relate to: trends in the global economic environment and the semiconductor industry; the anticipated levels of, and rates of change in, future shipments, margins, market share, capital expenditures, revenue and operating expenses generally; volatility in our quarterly results; customer requirements and our ability to satisfy those requirements; customer capital spending and their demand for our products; our ability to defend our market share and to gain new market share; anticipated growth in the industry and the total market for wafer-fabrication equipment and our growth relative to such growth; levels of research and development ( R&D ) expenditures; the estimates we make, and the accruals we record, in order to implement our critical accounting policies (including but not limited to the adequacy of prior tax payments, future tax liabilities and the adequacy of our accruals relating to them); our access to capital markets; our ability to manage and grow our cash position; and the sufficiency of our financial resources to support future business activities (including but not limited to operations, investments, debt service requirements and capital expenditures). Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value, and effect, including without limitation those discussed below under the heading Risk Factors within Part II Item 1A and elsewhere in this report and other documents we file from time to time with the Securities and Exchange Commission ( SEC ), such as our annual report on Form 10-K for the year ended June 24, 2012 (our 2012 Form 10-K ), our quarterly report on Form 10-Q for the quarter ended September 23, 2012, and our current reports on Form 8-K. Such risks, uncertainties and changes in condition, significance, value, and effect could cause our actual results to differ materially from those expressed in this report and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known to us. We undertake no obligation to release the results of any revisions to these forward-looking statements, which may be made to reflect events or circumstances that occur after the date hereof or to reflect the occurrence or effect of anticipated or unanticipated events.*

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

For a full understanding of our financial position and results of operations for the three months ended December 23, 2012, and the related Management's Discussion and Analysis of Financial Condition and Results of Operations below, you should also read the Condensed Consolidated Financial Statements and notes presented in this Form 10-Q and the financial statements and notes in our 2012 Form 10-K.

***Overview***

Management's Discussion and Analysis of Financial Condition and Results of Operations consists of the following sections:

*Executive Summary* provides an overview of the Company's operations and a summary of certain highlights of our results of operations

*Results of Operations* provides an analysis of operating results

*Critical Accounting Policies and Estimates* discusses accounting policies that reflect the more significant judgments and estimates we use to prepare our Condensed Consolidated Financial Statements

*Liquidity and Capital Resources* provides an analysis of cash flows and financial position.

**EXECUTIVE SUMMARY**

We design, manufacture, market, refurbish, and service semiconductor processing equipment used in the fabrication of integrated circuits and are recognized as a major provider of such equipment to the worldwide semiconductor industry. Our customers include semiconductor manufacturers that make DRAM, flash memory, microprocessors, and other logic integrated circuits for a wide range of consumer and industrial electronics. Semiconductor wafers are subjected to a complex series of process and preparation steps that result in the simultaneous creation of many individual integrated circuits. We leverage our expertise in semiconductor processing to develop technology and productivity solutions that typically benefit our customers through lower defect rates, enhanced yields, faster processing time, and reduced cost as well as by facilitating their ability to meet more stringent performance and design standards.



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The semiconductor capital equipment industry is cyclical in nature and has historically experienced periodic and pronounced changes in customer demand resulting in industry downturns and upturns. Today's leading indicators of change in customer investment patterns, such as electronics demand, memory pricing, and foundry utilization rates, may not be any more reliable than in prior years. Demand for our equipment can vary significantly from period to period as a result of various factors, including, but not limited to, economic conditions (both general and in the semiconductor and electronics industries), industry supply and demand, prices for semiconductors, customer capacity requirements, and our ability to develop, acquire, and market competitive products. For these and other reasons, our results of operations during any particular fiscal period are not necessarily indicative of future operating results.

Demand for our products declined during the second half of calendar year 2012 as certain semiconductor device manufacturers, particularly NAND memory manufacturers, reduced their investment levels. We believe demand for mobile products, which require semiconductor devices such as NAND memory, will continue to grow in calendar year 2013, eventually requiring additional investment in capital equipment. As a result, we believe capital equipment spending has the potential to increase in calendar year 2013, and currently believe that the second half of the year has greater potential than the first half of 2013. Further, we believe that, over the long term, demand for our products will increase as customers' capital expenditures rise to address the increasing complexity of semiconductor device manufacturing and meet growing demand for semiconductor devices, particularly in the mobility space.

The following table summarizes certain key financial information for the periods indicated below (in thousands, except percentage and per share data):

|                                      | <b>Three Months Ended</b>    |                               |                              |
|--------------------------------------|------------------------------|-------------------------------|------------------------------|
|                                      | <b>December 23,<br/>2012</b> | <b>September 23,<br/>2012</b> | <b>December 25,<br/>2011</b> |
| Revenue                              | \$ 860,886                   | \$ 906,888                    | \$ 583,981                   |
| Gross margin                         | \$ 315,414                   | \$ 333,886                    | \$ 234,826                   |
| Gross margin as a percent of revenue | 36.6%                        | 36.8%                         | 40.2%                        |
| Total operating expenses             | \$ 311,372                   | \$ 317,174                    | \$ 187,280                   |
| Net income                           | \$ 6,408                     | \$ 2,768                      | \$ 33,212                    |
| Diluted net income per share         | \$ 0.04                      | \$ 0.02                       | \$ 0.27                      |

In the quarter ended December 23, 2012, revenue decreased as compared to the quarter ended September 23, 2012 due to the decline in demand for semiconductor capital equipment. Gross margin as a percent of revenues decreased as compared to the September 2012 quarter due primarily to increased costs related to rationalization of certain product configurations, unfavorable factory utilization, as well as product mix changes, offset by a decrease in costs associated with Novellus acquisition-related inventory fair value adjustments. Operating expenses in the December 2012 quarter decreased as compared to the quarter ended September 2012, as a result of reductions in field and support group spending, lower integration costs, and lower variable compensation associated with the decline in operating income.

Our cash and cash equivalents, short-term investments, and restricted cash and investments balances totaled approximately \$2.7 billion as of December 23, 2012 compared to \$2.9 billion as of September 23, 2012. Cash generated by operations was approximately \$193 million during the December 2012 quarter. We used cash during the December 2012 quarter to repurchase \$355 million of our shares and purchase \$39 million of property and equipment. As of December 23, 2012, employee headcount remained flat to the September quarter at approximately 6,600 people.

**RESULTS OF OPERATIONS***Shipments*

|                         | <b>Three Months Ended</b>    |                               |                              |
|-------------------------|------------------------------|-------------------------------|------------------------------|
|                         | <b>December 23,<br/>2012</b> | <b>September 23,<br/>2012</b> | <b>December 25,<br/>2011</b> |
| Shipments (in millions) | \$ 803                       | \$ 935                        | \$ 563                       |
| North America           | 29%                          | 18%                           | 19%                          |
| Taiwan                  | 22%                          | 29%                           | 18%                          |
| Asia Pacific            | 14%                          | 22%                           | 8%                           |

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|        |     |     |     |
|--------|-----|-----|-----|
| Japan  | 14% | 8%  | 10% |
| Korea  | 12% | 16% | 37% |
| Europe | 9%  | 7%  | 8%  |

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Shipments for the December 2012 quarter decreased 14% compared to the September 2012 quarter and increased 43% year over year. The year over year increase reflects operations post-acquisition of Novellus, which occurred on June 4, 2012. During the December 2012 quarter, applications below the 40 nanometer technology node were 78% of total systems shipments. The system shipments in the memory, foundry, and logic/integrated device manufacturing markets were approximately 20%, 51% and 29%, respectively. During the September 2012 quarter, applications below the 40 nanometer technology node were 81% of total systems shipments. The system shipments in the memory, foundry, and logic/integrated device manufacturing markets were approximately 42%, 48% and 10%, respectively.

**Revenue**

|                       | December 23,<br>2012 | Three Months Ended<br>September 23,<br>2012 | December 25,<br>2011 | Six Months Ended<br>December 23,<br>2012 | December 25,<br>2011 |
|-----------------------|----------------------|---|----------------------|--|----------------------|
| Revenue (in millions) | \$ 861               | \$ 907                                      | \$ 584               | \$ 1,768                                 | \$ 1,264             |
| Taiwan                | 26%                  | 28%   | 17%                  | 27%                                      | 15%                  |
| North America         | 24%                  | 18%   | 18%                  | 21%                                      | 19%                  |
| Korea                 | 12%                  | 24%   | 34%                  | 18%                                      | 29%                  |
| Asia Pacific          | 20%                  | 15%   | 8%                   | 17%                                      | 11%                  |
| Japan                 | 10%                  | 8%  | 14%                  | 9%                                       | 16%                  |
| Europe                | 8%                   | 7%  | 9%                   | 8%                                       | 10%                  |

Revenue for the December 2012 quarter decreased 5% compared to the September 2012 quarter due to the decline in demand for semiconductor capital equipment. Revenue for the three and six months ended December 23, 2012 increased 47% and 40%, respectively, as compared to the same periods last year, reflecting operations post-acquisition of Novellus. Our deferred revenue balance decreased to \$282 million as of December 23, 2012 compared to \$364 million as of September 23, 2012. Our deferred revenue balance does not include shipments to Japanese customers, to whom title does not transfer until customer acceptance. Shipments to Japanese customers are classified as inventory at cost until the time of acceptance. The anticipated future revenue value from shipments to Japanese customers was approximately \$46 million as of December 23, 2012 compared to \$21 million as of September 23, 2012.

**Gross Margin**

|                    | December 23,<br>2012               | Three Months Ended<br>September 23,<br>2012 | December 25,<br>2011 | Six Months Ended<br>December 23,<br>2012 | December 25,<br>2011 |
|--------------------|------------------------------------|---|----------------------|--|----------------------|
|                    | (in thousands, except percentages) |   |                      |  |                      |
| Gross margin       | \$ 315,414                         | \$ 333,886                                  | \$ 234,826           | \$ 649,300                               | \$ 518,709           |
| Percent of revenue | 36.6%                              | 36.8%                                       | 40.2%                | 36.7%                                    | 41.0%                |

The decrease in gross margin as a percentage of revenue during the December 2012 quarter as compared to the September 2012 quarter is primarily due to costs incurred related to rationalization of certain product configurations, which increased from \$3 million to \$17 million, unfavorable factory utilization, as well as product mix changes. These declines were partially offset by costs associated with Novellus acquisition-related inventory fair value adjustments, which decreased from approximately \$44 million to \$27 million.

The decrease in gross margin as a percentage of revenue during the December 2012 quarter as compared to the December 2011 quarter is primarily due to \$27 million in costs associated with Novellus acquisition-related inventory fair value adjustments, \$21 million of amortization of acquired Novellus intangible assets, and \$17 million of costs incurred related to rationalization of certain product configurations.

The decrease in gross margin as a percentage of revenue during the six months ended December 23, 2012 quarter as compared to the same period in the prior year is primarily due to acquisition-related inventory fair value adjustments of approximately \$71 million and amortization of acquired intangible assets of approximately \$41 million, which did not occur in the six months ended December, 25 2011.

**Table of Contents****Research and Development**

|                                  | December 23,<br>2012               | Three Months Ended<br>September 23,<br>2012 | December 25,<br>2011 | Six Months Ended<br>December 23,<br>2012 | December 25,<br>2011 |
|----------------------------------|------------------------------------|---|----------------------|--|----------------------|
|                                  | (in thousands, except percentages) |   |                      |  |                      |
| Research and development ( R&D ) | \$ 165,951                         | \$ 163,311                                  | \$ 104,024           | \$ 329,262                               | \$ 206,583           |
| Percent of revenue               | 19.3%                              | 18.0%                                       | 17.8%                | 18.6%                                    | 16.3%                |

We continue to make significant R&D investments focused on leading-edge plasma etch, single-wafer clean, deposition, and other semiconductor manufacturing requirements. The increase in R&D expenses during the December 2012 quarter compared to the September 2012 quarter was primarily due to an increase in supplies and outside services costs offset by a reduction in variable compensation due to lower operating income levels.

While December 2011 reflects Lam standalone results, December 2012 reflects combined operations with Novellus. The increase in R&D expenses during the December 2012 quarter compared to the same period in the prior year was primarily due to a \$27 million increase in employee compensation and benefits, mainly as a result of higher headcount, a \$16 million increase in supplies and facilities costs, a \$7 million increase in depreciation and amortization, and a \$5 million increase in outside services.

While the six months ended December 25, 2011 reflect Lam standalone results, the six months ended December 23, 2012 reflect combined operations with Novellus. The increase in R&D expenses during the six months ended December 23, 2012 compared to the same period in the prior year was primarily due to a \$57 million increase in employee compensation and benefits, mainly as a result of higher headcount, a \$24 million increase in supplies and facilities costs, a \$14 million increase in depreciation and amortization, and a \$10 million increase in outside services.

**Selling, General and Administrative**

|  | December 23,<br>2012               | Three Months Ended<br>September 23,<br>2012 | December 25,<br>2011 | Six Months Ended<br>December 23,<br>2012 | December 25,<br>2011 |
|--|------------------------------------|---|----------------------|--|----------------------|
|  | (in thousands, except percentages) |   |                      |  |                      |
| Selling, general and administrative ( SG&A ) | \$ 144,400                         | \$ 153,863                                  | \$ 83,256            | \$ 298,263                               | \$ 163,456           |
| Percent of revenue                           | 16.8%                              | 17.0%                                       | 14.3%                | 16.9%                                    | 12.9%                |

The decrease in SG&A expenses during the December 2012 quarter compared to the September 2012 quarter was primarily due to an \$8 million decline in salaries and benefits as a result of reduction in variable compensation on lower operating income and \$5 million lower integration costs.

The increase in SG&A expenses during the December 2012 quarter compared to the same period in the prior year was primarily due to the impact of combined operations with Novellus. Increased expenses included \$29 million in employee compensation and benefits, \$19 million in intangible asset amortization, and \$10 million in supplies and facilities costs.

The increase in SG&A expenses in the six months ended December 23, 2012 compared to the same period in the prior year was primarily due to the impact of combined operations with Novellus. Increased expenses included \$63 million in employee compensation and benefits, \$39 million in intangible asset amortization, \$14 million in integration and acquisition-related expenses, and \$18 million in supplies and facilities costs.

**Restructuring and Asset Impairments**

During the three and six months ended December 23, 2012 we incurred net restructuring charges of \$1.0 million primarily related to changes in sublease assumptions for previously restructured buildings. During the six months ended December 25, 2011, the Company incurred asset impairment charges of \$1.7 million related to a decline in the market value of certain facilities.



**Table of Contents****Other Expense, Net**

Other expense, net consisted of the following:

|   | December 23,<br>2012 | Three Months Ended<br>September 23,<br>2012 | December 25,<br>2011<br>(in thousands) | Six Months Ended<br>December 23,<br>2012 | December 25,<br>2011 |
|---|----------------------|---|--|--|----------------------|
| Interest income   | \$ 4,376             | \$ 3,800                                    | \$ 2,472                               | \$ 8,176                                 | \$ 5,061             |
| Interest expense  | (14,975)             | (15,144)                                    | (9,346)                                | (30,119)                                 | (18,606)             |
| Gains (losses) on deferred compensation plan related assets | 1,234                | 2,741                                       | (348)                                  | 3,975                                    | (2,213)              |
| Foreign exchange losses                                     | (3,274)              | (368)                                       | (142)                                  | (3,642)                                  | (1,232)              |
| Other, net  | (751)                | (967)                                       | (421)                                  | (1,718)                                  | (2,868)              |
|   | \$ (13,390)          | \$ (9,938)                                  | \$ (7,785)                             | \$ (23,328)                              | \$ (19,858)          |

Interest expense increased in the three and six months ended December 23, 2012 as compared to the same periods in the prior year due to the 2041 Notes assumed in June 2012 in connection with the Novellus acquisition.

Foreign exchange losses in December 2012 were related to un-hedged portions of the balance sheet exposures, primarily in the Taiwan dollar and Korean Won.

In the three and six months ended December 23, 2012, we recognized gains on assets which are related to obligations under our deferred compensation plan, whereas during the same periods in the prior year we recognized losses on assets due to changes in the market value of securities in this portfolio.

**Income Tax Expense**

Our tax benefits for the three and six months ended December 23, 2012 were \$(15.8) million and \$(11.8) million, respectively, which yielded effective income tax rates of 168.6% and 456.4%, respectively. Our tax expenses for the three and six months ended December 25, 2011 were \$6.5 million and \$22.0 million, respectively, which yielded effective income tax rates of 16.5% and 17.3%, respectively. The increase in the effective tax rate for the three and six months ended December 23, 2012 compared to the three and six months ended December 25, 2011 was primarily due to the recognition of previously unrecognized tax benefits due to lapse of statute of limitations and the successful resolution of certain tax matters, the reduced level of income, an increase in the percentage of profits in jurisdictions with lower tax rates combined with a projected pre-tax loss in higher tax jurisdictions, and the treatment of integration and impairment expenses as a discrete event in determining the annual effective tax rate, offset by an increase in the non-deductible stock based compensation. In addition, the U.S. federal research and development (R&D) tax credit has expired as of December 31, 2011 and no tax benefit has been included in the calculation of the provision for income taxes for the three and six months ended December 23, 2012. On January 2, 2013 the American Taxpayer Relief Act of 2012 was signed into law, which includes retroactive extension of the U.S. federal R&D tax credit through December 31, 2013. The Company is currently evaluating the impact of this R&D credit extension on the provision for income taxes for the remainder of fiscal year 2013.

The effective tax rate of 168.6% and 456.4% for the three and six months ended December 23, 2012 includes the tax impact of the following discrete items which are recorded in the period in which they occur: (1) a tax benefit of \$30.5 million and \$30.9 million for the three months and six months, respectively, due to the recognition of previously unrecognized tax benefits due to lapse of statute of limitations and successful resolution of certain tax matters, and (2) the effective tax rate impact of integration and impairment expenses of \$28.3 million and \$45.3 million for the three months and six months, respectively, for which little tax benefit is derived. The effective tax rate of 16.5% and 17.3% for the three and six months ended December 25, 2011 includes the tax impact of the following discrete items which are recorded in the period in which they occur: (1) a tax expense of \$2.2 million and \$3.8 million, respectively, related to the filing of prior year foreign tax returns, which resulted in provision to return true-ups, (2) a tax expense of \$0.8 million and \$1.7 million, respectively, of interest related to uncertain tax positions, (3) a tax benefit of \$2.5 million and \$3.7 million, respectively, related to the acquisition, restructuring and asset impairment related expenses, and (4) a tax benefit of \$6.9 million and \$7.1 million, respectively, related to the recognition of previously unrecognized tax benefits and the reversal of the related interest accruals due to finalization of certain foreign uncertain tax positions.



*Deferred Income Taxes*

We had gross deferred tax assets, related primarily to reserves and accruals that are not currently deductible and tax credit carryforwards, of \$345.6 million and \$253.7 million as of December 23, 2012 and June 24, 2012, respectively. The gross deferred tax assets were offset by deferred tax liabilities of \$357.7 million and a valuation allowance of \$55.2 million as of December 23, 2012. The gross deferred tax assets were offset by deferred tax liabilities of \$285.6 million and a valuation allowance of \$55.2 million as of June 24, 2012.

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We record a valuation allowance to reduce our deferred tax assets to the amount that is more-likely-than-not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more likely than not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more-likely-than-not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

We evaluate the realizability of the deferred tax assets quarterly and will continue to assess the need for changes in valuation allowances, if any.

### ***Uncertain Tax Positions***

We reevaluate uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

A critical accounting policy is defined as one that has both a material impact on our financial condition and results of operations and requires us to make difficult, complex and/or subjective judgments, often as a result of the need to make estimates about matters that are inherently uncertain. The preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles ( GAAP ) requires management to make certain judgments, estimates and assumptions that could affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We based our estimates and assumptions on historical experience and on various other assumptions we believed to be applicable and evaluate them on an ongoing basis to ensure they remain reasonable under current conditions. Actual results could differ significantly from those estimates, which could have a material impact on our business, results of operations, and financial condition.

We believe that the following critical accounting policies reflect the more significant judgments and estimates used in the preparation of our consolidated financial statements.

*Revenue Recognition:* We recognize all revenue when persuasive evidence of an arrangement exists, delivery has occurred and title has passed or services have been rendered, the selling price is fixed or determinable, collection of the receivable is reasonably assured, and we have received customer acceptance, completed our system installation obligations, or are otherwise released from our installation or customer acceptance obligations. If terms of the sale provide for a lapsing customer acceptance period, we recognize revenue upon the expiration of the lapsing acceptance period or customer acceptance, whichever occurs first. If the practices of a customer do not provide for a written acceptance or the terms of sale do not include a lapsing acceptance provision, we recognize revenue when it can be reliably demonstrated that the delivered system meets all of the agreed-to customer specifications. In situations with multiple deliverables, we recognize revenue upon the delivery of the separate elements to the customer and when we receive customer acceptance or are otherwise released from our customer acceptance obligations. We allocate revenue from multiple-element arrangements among the separate elements based on their relative selling prices, provided the elements have value on a stand-alone basis. Our sales arrangements do not include a general right of return. The maximum revenue we recognize on a delivered element is limited to the amount that is not contingent upon the delivery of additional items. We generally recognize revenue related to sales of spare parts and system upgrade kits upon shipment. We generally recognize revenue related to services upon completion of the services requested by a customer order. We recognize revenue for extended maintenance service contracts with a fixed payment amount on a straight-line basis over the term of the contract. When goods or services have been delivered to the customer but all conditions for revenue recognition have not been met, we record deferred revenue and/or deferred costs of sales in deferred profit on our Consolidated Balance Sheet.

*Inventory Valuation:* Inventories are stated at the lower of cost or market using standard costs that generally approximate actual costs on a first-in, first-out basis. We maintain a perpetual inventory system and continuously record the quantity on-hand and standard cost for each product, including purchased components, subassemblies, and finished goods. We maintain the integrity of perpetual inventory records through periodic physical counts of quantities on hand. Finished goods are reported as inventories until the point of title transfer to the customer. Generally, title transfer is documented in the terms of sale. Unless specified in the terms of sale, title generally transfers when we complete physical transfer of the products to the freight carrier. Transfer of title for shipments to Japanese customers generally occurs at the time of customer acceptance. We eliminate all intercompany profits related to the sales and purchases of inventory between our legal entities from our Consolidated Financial Statements.

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Management evaluates the need to record adjustments for impairment of inventory at least quarterly. Our policy is to assess the valuation of all inventories including manufacturing raw materials, work-in-process, finished goods, and spare parts in each reporting period. Obsolete inventory or inventory in excess of management's estimated usage requirements over the next 12 to 36 months is written down to its estimated market value if less than cost. Estimates of market value include, but are not limited to, management's forecasts related to our future manufacturing schedules, customer demand, technological and/or market obsolescence, general semiconductor market conditions, and possible alternative uses. If future customer demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of goods sold in the period in which we make the revision.

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*Warranty:* Typically, the sale of semiconductor capital equipment includes providing parts and service warranty to customers as part of the overall price of the system. We provide standard warranties for our systems. When appropriate, we record a provision for estimated warranty expenses to cost of sales for each system when we recognize revenue. We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. The amount recorded is based on an analysis of historical activity that uses factors such as type of system, customer, geographic region, and any known factors such as tool reliability trends. All actual or estimated parts and labor costs incurred in subsequent periods are charged to those established reserves on a system-by-system basis.

Actual warranty expenses are accounted for on a system-by-system basis and may differ from our original estimates. While we periodically monitor the performance and cost of warranty activities, if actual costs incurred are different than our estimates, we may recognize adjustments to provisions in the period in which those differences arise or are identified. In addition to the provision of standard warranties, we offer customer-paid extended warranty services. Revenues for extended maintenance and warranty services with a fixed payment amount are recognized on a straight-line basis over the term of the contract. Related costs are recorded as incurred.

*Equity-based Compensation Employee Stock Purchase Plan ( ESPP ) and Employee Stock Plans:* GAAP requires us to recognize the fair value of equity-based compensation in net income. We determine the fair value of our restricted stock units ( RSUs ) based upon the fair market value of Company stock at the date of grant. We estimate the fair value of our stock options and ESPP awards using the Black-Scholes option valuation model. This model requires us to input highly subjective assumptions, including expected stock price volatility and the estimated life of each award. We amortize the fair value of equity-based awards over the vesting periods of the awards, and we have elected to use the straight-line method of amortization.

We make quarterly assessments of the adequacy of our tax credit pool related to equity-based compensation to determine if there are any deficiencies that we are required to recognize in our Consolidated Statements of Operations. We will only recognize a benefit from stock-based compensation in paid-in-capital if we realize an incremental tax benefit after all other tax attributes currently available to us have been utilized. In addition, we have elected to account for the indirect benefits of stock-based compensation on the research tax credit through the income statement (continuing operations) rather than through paid-in-capital. We have also elected to net deferred tax assets and the associated valuation allowance related to net operating loss and tax credit carryforwards for the accumulated stock award tax benefits for income tax footnote disclosure purposes. We will track these stock award attributes separately and will only recognize these attributes through paid-in-capital.

*Income Taxes :* Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as the tax effect of carryforwards. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more-likely-than-not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at the time. In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more-likely-than-not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

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

We recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. Our policy is to include interest and penalties related to unrecognized tax benefits as a component of income tax expense. Please refer to Note 10 of the Notes to the Consolidated Financial Statements for additional information.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for uncertain tax positions based on the two-step process prescribed within FASB ASC 740-10. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more-likely-than-not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires us to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period such determination is made.

*Goodwill and Intangible Assets:* Goodwill represents the amount by which the purchase price in each business combination exceeds the fair value of the net tangible and identifiable intangible assets acquired. We allocate the carrying value of goodwill to our reporting units. We test goodwill and identifiable intangible assets with indefinite useful lives for impairment at least annually. We amortize intangible assets with

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estimable useful lives over their respective estimated useful lives, and we review for impairment whenever events or changes in circumstances indicate that the carrying amount of the intangible asset may not be recoverable and the carrying amount exceeds its fair value.

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We review goodwill at least annually for impairment. If certain events or indicators of impairment occur between annual impairment tests, we would perform an impairment test of goodwill at that date. In testing for a potential impairment of goodwill, we: (1) allocate goodwill to our reporting units to which the acquired goodwill relates; (2) estimate the fair value of our reporting units; and (3) determine the carrying value (book value) of those reporting units, as some of the assets and liabilities related to those reporting units are not held by those reporting units but by a corporate function. Prior to this allocation of the assets to the reporting units, we are required to assess long-lived assets for impairment. Furthermore, if the estimated fair value of a reporting unit is less than the carrying value, we must estimate the fair value of all identifiable assets and liabilities of that reporting unit, in a manner similar to a purchase price allocation for an acquired business. This can require independent valuations of certain internally generated and unrecognized intangible assets such as in-process R&D and developed technology. Only after this process is completed can the amount of goodwill impairment, if any, be determined. Beginning with our fiscal year 2012 goodwill impairment analysis, we adopted new accounting guidance that allowed us to first assess qualitative factors to determine whether it was necessary to perform a quantitative analysis. Under the revised guidance, an entity is no longer required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more-likely-than-not that its fair value is less than its carrying amount.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. We determine the fair value of our reporting units by using a weighted combination of both a market and an income approach, as this combination is deemed to be the most indicative of fair value in an orderly transaction between market participants.

Under the market approach, we use information regarding the reporting unit as well as publicly available industry information to determine various financial multiples to value our reporting units. Under the income approach, we determine fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn.

In estimating the fair value of a reporting unit for the purposes of our annual or periodic analyses, we make estimates and judgments about the future cash flows of our reporting units, including estimated growth rates and assumptions about the economic environment. Although our cash flow forecasts are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying businesses, there is significant judgment involved in determining the cash flows attributable to a reporting unit. In addition, we make certain judgments about allocating shared assets to the estimated balance sheets of our reporting units. We also consider our market capitalization and that of our competitors on the date we perform the analysis. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge.

As a result, several factors could result in impairment of a material amount of our goodwill balance in future periods, including, but not limited to: (1) weakening of the global economy, weakness in the semiconductor equipment industry, or our failure to reach our internal forecasts, which could impact our ability to achieve our forecasted levels of cash flows and reduce the estimated discounted cash flow value of our reporting units; and (2) a decline in our stock price and resulting market capitalization, if we determine that the decline is sustained and indicates a reduction in the fair value of our reporting units below their carrying value. In addition, the value we assign to intangible assets, other than goodwill, is based on our estimates and judgments regarding expectations such as the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from our estimates, we may be required to record an impairment charge to write down the asset to its realizable value.

*Recent Accounting Pronouncements*

In June 2011, the Financial Accounting Standards Board ( FASB ) issued new authoritative guidance that increases the prominence of items reported in other comprehensive income ( OCI ) by eliminating the option to present components of OCI as part of the statement of changes in stockholders' equity. The amendments in this standard require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. We adopted this guidance in the September 2012 quarter. The implementation of this authoritative guidance did not have an impact on our financial position or results of operations, but did change the presentation of our financial statements.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

As of December 23, 2012, we had \$2.7 billion in cash and cash equivalents, short-term investments, and restricted cash and investments (total cash and investments) compared to \$3.0 billion as of June 24, 2012.

***Cash Flows from Operating Activities***

Net cash provided by operating activities of \$442.5 million during the six months ended December 23, 2012 consisted of (in millions):

|   |          |
|---|----------|
| Net income  | \$ 9.2   |
| Non-cash charges:                                 |          |
| Depreciation and amortization                     | 153.2    |
| Equity-based compensation                         | 48.4     |
| Amortization of convertible note discount         | 15.6     |
| Restructuring charges                             | 1.0      |
| Deferred income taxes                             | (19.3)   |
| Changes in operating asset and liability accounts | 209.7    |
| Other   | 24.7     |
|   | \$ 442.5 |

Changes in operating asset and liability accounts, net of foreign exchange impact, included the following sources of cash: decreases in accounts receivable of \$171.3 million, inventories of \$105.3 million, and prepaid and other assets of \$37.9 million and increases in deferred profit of \$4.2 million, partially offset by a use of cash resulting from decreases in trade accounts payable of \$102.1 million and accrued liabilities of \$6.9 million.

***Cash Flows from Investing Activities***

Net cash used for investing activities during the six months ended December 23, 2012 was \$130.7 million, primarily consisting of capital expenditures of \$82.9 million, net purchases of available-for-sale securities of \$40.0 million, and cash paid for a business acquisition of \$8.7 million.

***Cash Flows from Financing Activities***

Net cash used for financing activities during the six months ended December 23, 2012 was \$693.4 million, primarily consisting of \$710.0 million in treasury stock repurchases partially offset by net proceeds from issuance of common stock related to employee equity-based plans of \$17.5 million.

***Liquidity***

Given the cyclical nature of the semiconductor equipment industry, we believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in R&D and capital infrastructure. Based upon our current business outlook, we expect that our levels of cash, cash equivalents, and short-term investments at December 23, 2012 will be sufficient to support our anticipated levels of operations, investments, debt service requirements, and capital expenditures, through at least the next 12 months.

In the longer term, liquidity will depend to a great extent on our future revenues and our ability to appropriately manage our costs based on demand for our products and services. While we have substantial cash balances in the United States and offshore, we may require additional funding and need to raise the required funds through borrowings or public or private sales of debt or equity securities. We believe that, if necessary, we will be able to access the capital markets on terms and in amounts adequate to meet our objectives. However, given the possibility of changes in market conditions or other occurrences, there can be no certainty that such funding will be available in needed quantities or on terms favorable to us.

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

For financial market risks related to changes in interest rates, marketable equity security prices, and foreign currency exchange rates, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our 2012 Form 10-K. Other than noted below, our exposure related to market risk has not changed materially since June 24, 2012. All of the potential changes noted below are based on sensitivity analyses performed on our financial position as of December 23, 2012. Actual results may differ materially.



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Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio, long-term debt, and operating leases. We maintain a conservative investment policy, which focuses on the safety and preservation of our invested funds by limiting default risk, market risk, and reinvestment risk. We mitigate default risk by investing in high credit quality securities and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to achieve portfolio liquidity and maintain a prudent amount of diversification.

We conduct business on a global basis in several major international currencies. As such, we are potentially exposed to adverse as well as beneficial movements in foreign currency exchange rates. The majority of our revenues and expenses are denominated in U.S. dollars except for certain revenues denominated in Japanese yen, certain revenues and expenses denominated in the Euro, certain spares and service contracts denominated in various currencies, and expenses related to our non-U.S. sales and support offices denominated in the related countries' local currency. We currently enter into foreign currency forward contracts to minimize the short-term impact of foreign currency exchange rate fluctuations on Japanese yen-denominated revenue and monetary asset and liability exposure, Euro-denominated expenses and monetary assets and liabilities, as well as monetary assets and liabilities denominated in Swiss francs, Taiwanese dollars, and Great British pounds. We currently believe these are our primary exposures to currency rate fluctuation.

We enter into foreign currency forward contracts to hedge the gains and losses generated by the remeasurement of Japanese yen, Euros, Swiss franc, Taiwanese dollar, and Great British pound -denominated monetary assets and liabilities against the U.S. dollar. The change in fair value of these balance sheet hedge contracts is recorded into earnings as a component of other income (expense), net and offsets the change in fair value of the foreign currency denominated monetary assets and liabilities also recorded in other income (expense), net, assuming the hedge contract fully covers the intercompany and trade receivable balances.

The notional amount and unrealized loss of our outstanding foreign currency forward contracts that are designated as balance sheet hedges, as of December 23, 2012 are shown in the table below. This table also shows the change in fair value of these balance sheet hedges, assuming a hypothetical foreign currency exchange rate movement of plus-or-minus 10 percent and plus-or-minus 15 percent. These changes in fair values would be offset in other income (expense), net, by corresponding change in fair values of the foreign currency denominated monetary assets and liabilities, assuming the hedge contract fully covers the intercompany and trade receivable balances.

|                            | Notional<br>Amount | Unrealized FX Gain<br>/ (Loss)<br>December 23,<br>2012 | Valuation of Fx Contracts Given an X%<br>Increase (+)/Decrease(-)<br>in Each Fx Rate |                |
|----------------------------|--------------------|--|--|----------------|
|                            |                    |  | + / -<br>(10%)   | + / -<br>(15%) |
| (in \$ Millions)           |                    |  |  |                |
| <b>Balance Sheet Hedge</b> |                    |  |  |                |
| Sell Japanese Yen          | \$ 42.6            | \$ 0.0   | \$ 4.2   | \$ 6.5         |
| Buy Swiss Francs           | \$ 16.2            | \$ 0.0   | \$ 1.6   | \$ 2.4         |
| Buy Euro                   | \$ 0.8             | \$ 0.0   | \$ 0.1   | \$ 0.1         |
| Buy Great British Pounds   | \$ 4.6             | \$ 0.0   | \$ 0.5   | \$ 0.7         |
|                            |                    | \$ 0.0   | \$ 6.4   | \$ 9.7         |

We believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in our business activities. Anticipated cash flows from operations based on our current business outlook, combined with our current levels of cash, cash equivalents, and short-term investments at December 23, 2012 are expected to be sufficient to support our anticipated levels of operations, investments, debt service requirements, and capital expenditures, through at least the next 12 months. However, uncertainty in the global economy and the semiconductor industry, as well as disruptions in credit markets have in the past, and could in the future, impact customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers, and creditors.

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**ITEM 4. Controls and Procedures**

***Disclosure Controls and Procedures***

As required by Exchange Act Rule 13a-15(b), as of December 23, 2012, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer, along with our Chief Financial Officer, concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

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

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

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

***Effectiveness of Controls***

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

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**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

The Company is either a defendant or plaintiff in various actions that have arisen from time to time in the normal course of business, including intellectual property claims. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company believes that the amount of any such additional loss would be immaterial to the Company's business, financial condition, and results of operations.

**ITEM 1A. Risk Factors**

In addition to the other information in this Form 10-Q, the following risk factors should be carefully considered in evaluating the Company and its business because such factors may significantly impact our business, operating results, and financial condition. As a result of these risk factors, as well as other risks discussed in our other SEC filings, our actual results could differ materially from those projected in any forward-looking statements. No priority or significance is intended, nor should be attached, to the order in which the risk factors appear.

***The Semiconductor Equipment Industry is Subject to Major Fluctuations and, as a Result, We Face Risks Related to Our Strategic Resource Allocation Decisions***

The business cycle in the semiconductor equipment industry has historically been characterized by frequent periods of rapid change in demand that challenge our management to adjust spending and other resources allocated to operating activities. During periods of rapid growth or decline in demand for our products and services, we face significant challenges in maintaining adequate financial and business controls, management processes, information systems, procedures for training and managing our work force, and in appropriately sizing our supply chain infrastructure, work force, and other components of our business on a timely basis. If we do not adequately meet these challenges during periods of demand decline, our gross margins and earnings may be negatively impacted.

We continuously reassess our strategic resource allocation choices in response to the changing business environment. If we do not adequately adapt to the changing business environment, we may lack the infrastructure and resources to scale up our business to meet customer expectations and compete successfully during a period of growth, or we may expand our capacity too rapidly and/or beyond what is appropriate for the actual demand environment.

Especially during transitional periods, resource allocation decisions can have a significant impact on our future performance, particularly if we have not accurately anticipated industry changes. Our success will depend, to a significant extent, on the ability of our executive officers and other members of our senior management to identify and respond to these challenges effectively.

***Future Declines in the Semiconductor Industry, and the Overall World Economic Conditions on Which it is Significantly Dependent, Could Have a Material Adverse Impact on Our Results of Operations and Financial Condition***

Our business depends on the capital equipment expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits. The semiconductor industry is cyclical in nature and experiences periodic downturns. Global economic and business conditions, which are often unpredictable, have historically impacted customer demand for our products and normal commercial relationships with our customers, suppliers, and creditors. Additionally, in times of economic uncertainty our customers' budgets for our products, or their ability to access credit to purchase them, could be adversely affected. This would limit their ability to purchase our products and services. As a result, economic downturns can cause material adverse changes to our results of operations and financial condition including, but not limited to:

a decline in demand for our products or services;

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an increase in reserves on accounts receivable due to our customers' inability to pay us;

an increase in reserves on inventory balances due to excess or obsolete inventory as a result of our inability to sell such inventory;

valuation allowances on deferred tax assets;

restructuring charges;

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asset impairments including the potential impairment of goodwill and other intangible assets;

a decline in the value of our investments;

exposure to claims from our suppliers for payment on inventory that is ordered in anticipation of customer purchases that do not come to fruition;

a decline in the value of certain facilities we lease to less than our residual value guarantee with the lessor; and

challenges maintaining reliable and uninterrupted sources of supply.

Fluctuating levels of investment by semiconductor manufacturers may materially affect our aggregate shipments, revenues and operating results. Where appropriate, we will attempt to respond to these fluctuations with cost management programs aimed at aligning our expenditures with anticipated revenue streams, which sometimes result in restructuring charges. Even during periods of reduced revenues, we must continue to invest in research and development ( R&D ) and maintain extensive ongoing worldwide customer service and support capabilities to remain competitive, which may temporarily harm our profitability and other financial results.

***Our Long-term Success, Results of Operations and the Value of Our Common Stock Depend on Our Ability to Successfully Combine the Novellus Business With Our Pre-existing Business, Which May Be More Difficult, Costly or Time-consuming Than Expected***

On June 4, 2012, we acquired Novellus, and we are currently combining Novellus' business with our pre-existing business. Our future success, results of operations and the value of our common stock depend, in part, on our ability to realize the anticipated benefits of the acquisition. To realize these anticipated benefits, we must successfully combine our businesses in an efficient and effective manner and communicate the impact that a business combination will have on our financial statements. If we are not able to achieve and clearly communicate these objectives within the anticipated time frame, or at all, the anticipated benefits and cost savings of the acquisition may not be realized fully, or at all, or may take longer than expected to realize, and our results of operations and the value of our common stock may be adversely affected.

Specific issues that must be addressed in integrating the operations of Novellus into our pre-existing operations in order to realize the anticipated benefits of the acquisition include, among other things:

integrating and optimizing the utilization of the properties, equipment, suppliers, distribution channels, manufacturing, service, marketing, promotion and sales activities and information technologies of the combined company;

consolidating corporate and administrative infrastructures of the combined company;

coordinating geographically dispersed organizations of the combined company;

retaining and growing business at existing customers and attracting new customers to the combined company;

managing our contractual and business relationships with common suppliers and customers to reduce inconsistent or inefficient effects;

retaining key employees and utilizing their technical knowledge and business expertise;

communicating the inherently complex factors that a business combination will have on our financial position and results of operations; and

conforming standards, controls, procedures, policies, business cultures and compensation structures throughout the combined company.

In addition, integration efforts will also divert management attention and resources, the actual integration may result in additional and unforeseen expenses, and the anticipated benefits of the integration plan may not be realized. Actual synergies, if achieved at all, may be lower than what we expect and may take longer to achieve than anticipated. If we are not able to adequately address these challenges, we may be unable to successfully integrate the combined company's operations or to realize the anticipated benefits of the acquisition.

***Our Quarterly Revenues and Operating Results Are Unpredictable***

Our revenues and operating results may fluctuate significantly from quarter to quarter due to a number of factors, not all of which are in our control. We manage our expense levels based in part on our expectations of future revenues. Because our operating expenses are based in part on anticipated future revenues, and a certain amount of those expenses are relatively fixed, a change in the timing of recognition of revenue and/or the level of gross profit from a small number of transactions can unfavorably affect operating results in a particular quarter. Factors that may cause our financial results to fluctuate unpredictably include, but are not limited to:

economic conditions in the electronics and semiconductor industries in general and specifically the semiconductor equipment industry;

the size and timing of orders from customers;

procurement shortages;

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the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;

manufacturing difficulties;

customer cancellations or delays in shipments, installations, and/or customer acceptances;

the extent that customers continue to purchase and use our products and services in their business;

changes in average selling prices, customer mix, and product mix;

our ability in a timely manner to develop, introduce and market new, enhanced, and competitive products;

our competitors' introduction of new products;

legal or technical challenges to our products and technology;

transportation, communication, demand, information technology or supply disruptions based on factors outside our control such as strikes, acts of God, wars, terrorist activities, and natural disasters;

legal, tax, accounting, or regulatory changes (including but not limited to change in import/export regulations) or changes in the interpretation or enforcement of existing requirements;

changes in our estimated effective tax rate;

foreign currency exchange rate fluctuations; and

the dilutive impact of our convertible notes and related warrants on our earnings per share.

***Our Leverage and Debt Service Obligations and Potential Note Conversion or Related Hedging Activities May Adversely Affect Our Financial Condition, Results of Operations and Earnings Per Share***

As a result of the sale of our 2016 and 2018 convertible notes and the assumption of the 2041 convertible notes in connection with the Novellus acquisition (collectively the "Notes"), we have a greater amount of debt than we have maintained in the past. Our maintenance of higher levels of indebtedness could have adverse consequences including:

impacting our ability to satisfy our obligations;

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increasing the portion of our cash flows that may have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes; and

impairing our ability to obtain additional financing in the future.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. Furthermore, our operations may not generate sufficient cash flows to enable us to meet our expenses and service our debt. As a result, we may need to enter into new financing arrangements to obtain the necessary funds. If we determine it is necessary to seek additional funding for any reason, we may not be able to obtain such funding or, if funding is available, obtain it on acceptable terms. If we fail to make a payment on our debt, we could be in default on such debt, and this default could cause us to be in default on our other outstanding indebtedness.

Conversion of our Notes may cause dilution to our shareholders and to our earnings per share. Upon conversion of any Notes, we will deliver cash in the amount of the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our common stock, which would result in dilution to our shareholders. This dilution may be mitigated to some extent by the hedging transactions we entered into in connection with the sale of the 2016 and 2018 Notes. Prior to the maturity of the Notes, if the price of our common stock exceeds the conversion price, U.S. GAAP requires that we report an increase in diluted share count, which would result in lower reported earnings per share. The price of our common stock could also be affected by sales of our common stock by investors who view the Notes as a more attractive means of equity participation in our company and by hedging activity that may develop involving our common stock by holders of the Notes.

### ***We Derive Our Revenues Primarily from a Relatively Small Number of High-Priced Systems***

System sales constitute a significant portion of our total revenue. Our systems are priced up to approximately \$6 million per unit, and our revenues in any given quarter are dependent upon the acceptance of a limited number of systems. As a result, the inability to recognize revenue on even a few systems can cause a significantly adverse impact on our revenues for a given quarter.



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

Sales to a limited number of large customers constitute a significant portion of our overall revenue, shipments and profitability. As a result, the actions of even one customer may subject us to variability in those areas that are difficult to predict. In addition, large customers may be able to negotiate requirements that result in increased costs and/or lower margins for us. Similarly, significant portions of our credit risk may, at any given time, be concentrated among a limited number of customers, so that the failure of even one of these key customers to pay its obligations to us could significantly impact our financial results.

### ***Variations in the Amount of Time it Takes for Our Customers to Accept Our Systems May Cause Fluctuation in Our Operating Results***

We generally recognize revenue for new system sales on the date of customer acceptance or the date the contractual customer acceptance provisions lapse. As a result, the fiscal period in which we are able to recognize new systems revenues is typically subject to the length of time that our customers require to evaluate the performance of our equipment after shipment and installation, which may vary from customer to customer and tool to tool. Such variations could cause our quarterly operating results to fluctuate.

### ***We Depend on New Products and Processes for Our Success. Consequently, We are Subject to Risks Associated with Rapid Technological Change***

Rapid technological changes in semiconductor manufacturing processes subject us to increased pressure to develop technological advances that enable those processes. We believe that our future success depends in part upon our ability to develop and offer new products with improved capabilities and to continue to enhance our existing products. If new products have reliability, quality, or design problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may be unable to develop and manufacture new products successfully, or new products that we introduce may fail in the marketplace. The expected industry transition to a 450mm platform represents an emerging challenge for our business. Our failure to commercialize new products in a timely manner could result in loss of market share, unanticipated costs, and inventory obsolescence, which would adversely affect our financial results.

In order to develop new products and processes, we expect to continue to make significant investments in R&D and to pursue joint development relationships with customers, suppliers or other members of the industry. We must manage product transitions and joint development relationships successfully, as the introduction of new products could adversely affect our sales of existing products. Future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both. Moreover, customers may adopt new technologies or processes to address the complex challenges associated with next generation devices. This shift may result in a reduction in the size of Lam's addressable markets. For example, the timing of the adoption of extreme ultraviolet lithography may adversely impact Lam's served available market.

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

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

a decline in demand for even a limited number of our products;

a failure to achieve continued market acceptance of our key products;

export restrictions or other regulatory or legislative actions that could limit our ability to sell those products to key customer or market segments;

an improved version of products being offered by a competitor in the market in which we participate;

increased pressure from competitors that offer broader product lines;

technological changes that we are unable to address with our products; or

a failure to release new or enhanced versions of our products on a timely basis.

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

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### ***Strategic Alliances and Potential Customer Consolidation May Have Negative Effects on Our Business***

Increasingly, semiconductor manufacturing companies are entering into strategic alliances or consolidating with one another to expedite the development of processes and other manufacturing technologies and/or achieve economies of scale. The outcomes of such an alliance can be the definition of a particular tool set for a certain function and/or the standardization of a series of process steps that use a specific set of manufacturing equipment; while the outcomes of consolidation can lead to an overall reduction in the market for semiconductor manufacturing equipment as customers' operations achieve economies of scale and/or increased purchasing power based on their higher volumes. While in certain instances this could work to our advantage, if our equipment becomes the basis for the function or process as the tool of choice for the larger consolidated customer or alliance, it could also work to our disadvantage if a competitor's tools or equipment become the standard equipment for such functions or processes.

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

### ***We Depend On a Limited Number of Key Suppliers***

We obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. We have established long-term contracts with many of these suppliers. These long-term contracts can take a variety of forms. We may renew these contracts periodically. In some cases, these suppliers have sold us products for a substantial period of time, and we expect that we and they will continue to renew these contracts in the future or that we will otherwise replace them with competent alternative suppliers. However, certain of our suppliers are relatively new providers to us so that our experience with them and their performance is limited. Where practical, we intend to establish alternative sources to mitigate the risk that the failure of any single supplier will adversely affect our business. Nevertheless, a prolonged inability to obtain certain components could impair our ability to ship products and generate revenues, which could adversely affect our operating results and damage our customer relationships.

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

Outsource providers have played and will continue to play a key role in our manufacturing operations and in many of our transactional and administrative functions, such as information technology, facilities management, and certain elements of our finance organization. Although we attempt to select reputable providers and secure their performance on terms documented in written contracts, it is possible that one or more of these providers could fail to perform as we expect and such failure could have an adverse impact on our business.

In addition, the expansive role of our outsource providers has required and may continue to require us to implement changes to our existing operations and to adopt new procedures to deal with and manage the performance of these outsource providers. Any delay or failure in the implementation of our operational changes and new procedures could adversely affect our customer and/or employee relationships, which could have a negative effect on our operating results.

### ***Once a Semiconductor Manufacturer Commits to Purchase a Competitor's Semiconductor Manufacturing Equipment, the Manufacturer Typically Continues to Purchase that Competitor's Equipment, Making it More Difficult for Us to Sell Our Equipment to that Customer***

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

### ***We Face a Challenging and Complex Competitive Environment***

We face significant competition from multiple competitors. Other companies continue to develop systems and products that are competitive to ours and may introduce new products, which may affect our ability to sell our existing products. We face a greater risk if our competitors enter into strategic relationships with leading semiconductor manufacturers covering products similar to those we sell or may develop, as this could adversely affect our ability to sell products to those manufacturers.



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We believe that to remain competitive we must devote significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide, and to invest in product and process R&D. Certain of our competitors, especially those that are created and financially backed by foreign governments, have substantially greater financial resources and more extensive engineering, manufacturing, marketing, and customer service and support resources than we do and therefore have the potential to increasingly dominate the semiconductor equipment industry. These competitors may deeply discount or give away products similar to those that we sell, challenging or even exceeding our ability to make similar accommodations and threatening our ability to sell those products. We also face competition from our own customers, who in some instances have established affiliated entities that manufacture equipment similar to ours. For these reasons, we may fail to continue to compete successfully worldwide.

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

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

Non-U.S. sales accounted for approximately 79% of total revenue during the six months ended December 23, 2012, 83% of total revenue in fiscal year 2012, 88% of total revenue in fiscal year 2011, and 91% of total revenue in fiscal year 2010. We expect that international sales will continue to account for a substantial portion of our total revenue in future years.

We are subject to various challenges related to international sales and the management of global operations including, but not limited to:

trade balance issues;

global economic and political conditions, including the ongoing macroeconomic challenges associated with sovereign debt levels in certain Euro-zone countries and the financial contagion to global markets;

changes in currency controls;

differences in the enforcement of intellectual property and contract rights in varying jurisdictions;

our ability to respond to customer and foreign government demands for locally sourced systems, spare parts and services and develop the necessary relationships with local suppliers;

compliance with U.S. and international laws and regulations affecting foreign operations, including U.S. export restrictions;

fluctuations in interest and foreign currency exchange rates;

the need for technical support resources in different locations; and

our ability to secure and retain qualified people in all necessary locations for the successful operation of our business.

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Certain international sales depend on our ability to obtain export licenses from the U.S. government. Our failure or inability to obtain such licenses would substantially limit our markets and severely restrict our revenues. Many of the challenges noted above are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships among China, Taiwan, Japan, South Korea, and the United States, that political and diplomatic influences might lead to trade disruptions. This would adversely affect our business with China, Taiwan, Japan, and/or South Korea and perhaps the entire Asia Pacific region. A significant trade disruption in these areas could have a materially adverse impact on our future revenue and profits.

We are potentially exposed to adverse as well as beneficial movements in foreign currency exchange rates. The majority of our sales and expenses are denominated in U.S. dollars. However, we are exposed to foreign currency exchange rate fluctuations related to certain of our revenues denominated in Japanese yen and Euros, as well as certain of our spares and service contracts, Euro denominated expenses, and expenses related to our non-U.S. sales and support offices that are denominated in the related countries' local currency.

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We currently enter into foreign currency forward contracts to minimize the short-term impact of the foreign currency exchange rate fluctuations on Japanese yen-denominated ( JPY ) revenue and monetary assets and liabilities, Euro-denominated ( EUR ) expenses and monetary assets and liabilities, as well as monetary assets and liabilities denominated in Swiss francs ( CHF ), Taiwanese dollars ( TWD ), and Great British pounds ( GBP ). We believe these are our primary exposures to currency rate fluctuation. We expect to continue to enter into hedging transactions, for the purposes outlined, for the foreseeable future. However, these hedging transactions may not achieve their desired effect because differences between the actual timing of the underlying exposures and our forecasts of those exposures may leave us either over-or under-hedged on any given transaction. Moreover, by hedging these foreign currency denominated revenues, expenses, monetary assets and liabilities with foreign currency forward contracts, we may miss favorable currency trends that would have been advantageous to us but for the hedges. Additionally, we are exposed to short-term foreign currency exchange rate fluctuations on non-U.S. dollar-denominated ( USD ) assets and liabilities (other than those currency exposures previously discussed) and currently we do not enter into foreign currency hedge contracts against these exposures. Therefore, we are subject to both favorable and unfavorable foreign currency exchange rate fluctuations to the extent that we transact business (including intercompany transactions) for these currencies.

***Our Ability To Attract, Retain and Motivate Key Employees Is Critical To Our Success***

Our ability to compete successfully depends in large part on our ability to attract, retain and motivate key employees. This is an ongoing challenge due to intense competition for top talent, as well as fluctuations in industry economic conditions that may require cycles of hiring activity and workforce reductions. Our success in hiring depends on a variety of factors, including the attractiveness of our compensation and benefit programs and our ability to offer a challenging and rewarding work environment. We periodically evaluate our overall compensation programs and make adjustments, as appropriate, to maintain or enhance their competitiveness. If we are not able to successfully attract, retain and motivate key employees, we may be unable to capitalize on market opportunities and our operating results may be materially and adversely affected.

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

We maintain and rely upon certain critical information systems for the effective operation of our business. These information systems include telecommunications, the internet, our corporate intranet, various computer hardware and software applications, network communications, and e-mail. These information systems may be owned and maintained by us, our outsource providers or third parties such as vendors and contractors. These information systems are subject to attacks, failures, and access denials from a number of potential sources including viruses, destructive or inadequate code, power failures, and physical damage to computers, hard drives, communication lines, and networking equipment. Confidential information stored on these information systems could be compromised. To the extent that these information systems are under our control, we have implemented security procedures, such as virus protection software and emergency recovery processes, to mitigate the outlined risks. However, security procedures for information systems cannot be guaranteed to be failsafe and our inability to use or access these information systems at critical points in time, or unauthorized releases of confidential information, could unfavorably impact the timely and efficient operation of our business.

***Our Financial Results May be Adversely Impacted by Higher than Expected Tax Rates or Exposure to Additional Tax Liabilities***

As a global company, our effective tax rate is highly dependent upon the geographic composition of worldwide earnings and tax regulations governing each region. We are subject to income taxes in the United States and various foreign jurisdictions, and significant judgment is required to determine worldwide tax liabilities. Our effective tax rate could be adversely affected by changes in the split of earnings between countries with differing statutory tax rates, in the valuation of deferred tax assets, in tax laws, by material audit assessments, or changes in or expirations of agreements with tax authorities. These factors could affect our profitability. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. In addition, the amount of income taxes we pay is subject to ongoing audits in various jurisdictions, and a material assessment by a governing tax authority could affect our profitability.

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

We are subject to a variety of governmental regulations related to the handling, discharge, and disposal of toxic, volatile or otherwise hazardous chemicals. We believe that we are generally in compliance with these regulations and that we have obtained (or will obtain or are otherwise addressing the need for) all environmental permits necessary to conduct our business. These permits generally relate to the handling and disposal of hazardous wastes. Nevertheless, the failure to comply with present or future regulations could result in fines being imposed on us, require us to suspend production, or cease operations or cause our customers to not accept our products. These regulations could require us to alter our current operations, to acquire significant additional equipment or to incur substantial other expenses to comply with environmental regulations. Any failure to comply with regulations governing the use, handling, sale, transport or disposal of hazardous substances could subject us to future liabilities.





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

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

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

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

The market price for our Common Stock is volatile and has fluctuated significantly over the past years. The trading price of our Common Stock could continue to be highly volatile and fluctuate widely in response to a variety of factors, many of which are not within our control or influence. These factors include but are not limited to the following:

general market, semiconductor, or semiconductor equipment industry conditions;

economic or political events and trends occurring globally or in any of our key sales regions;

variations in our quarterly operating results and financial condition, including our liquidity;

variations in our revenues, earnings or other business and financial metrics from forecasts by us or securities analysts, or from those experienced by other companies in our industry;

announcements of restructurings, reductions in force, departure of key employees, and/or consolidations of operations;

government regulations;

developments in, or claims relating to, patent or other proprietary rights;

technological innovations and the introduction of new products by us or our competitors;

commercial success or failure of our new and existing products;

disruptions of relationships with key customers or suppliers; or

dilutive impacts of our Notes and related warrants.

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

**Table of Contents*****Intellectual Property, Indemnity and Other Claims Against Us Can be Costly and We Could Lose Significant Rights That are Necessary to Our Continued Business and Profitability***

Third parties may assert infringement, unfair competition, product liability, breach of contract, or other claims against us. From time to time, other parties send us notices alleging that our products infringe their patent or other intellectual property rights. In addition, law enforcement authorities may seek criminal charges relating to intellectual property or other issues. We also face risks of claims arising from commercial and other relationships. In addition, our Bylaws and indemnity obligations provide that we will indemnify officers and directors against losses that they may incur in legal proceedings resulting from their service to Lam Research. From time to time, in the normal course of business, we indemnify third parties with whom we enter into contractual relationships, including customers and suppliers, with respect to certain matters. We have agreed, under certain conditions, to hold these third parties harmless against specified losses, such as those arising from a breach of representations or covenants, other third party claims that our products when used for their intended purposes infringe the intellectual property rights of such other third parties, or other claims made against certain parties. In such cases, it is our policy either to defend the claims or to negotiate licenses or other settlements on commercially reasonable terms. However, we may be unable in the future to negotiate necessary licenses or reach agreement on other settlements on commercially reasonable terms, or at all, and any litigation resulting from these claims by other parties may materially adversely affect our business and financial results, and we may be subject to substantial damage awards and penalties. Moreover, although we have insurance to protect us from certain claims and cover certain losses to our property, such insurance may not cover us for the full amount of any losses, or at all, and may be subject to substantial exclusions and deductibles.

***We May Fail to Protect Our Critical Proprietary Technology Rights, Which Could Affect Our Business***

Our success depends in part on our proprietary technology and our ability to protect key components of that technology through patents, copyrights and trade secret protection. Protecting our key proprietary technology helps us to achieve our goals of developing technological expertise and new products and systems that give us a competitive advantage; increasing market penetration and growth of our installed base; and providing comprehensive support and service to our customers. As part of our strategy to protect our technology we currently hold a number of United States and foreign patents and pending patent applications. However, other parties may challenge or attempt to invalidate or circumvent any patents the United States or foreign governments issue to us or these governments may fail to issue patents for pending applications. Additionally, even when patents are issued, the legal systems in certain of the countries in which we do business do not enforce patents and other intellectual property rights as rigorously as the United States. The rights granted or anticipated under any of our patents or pending patent applications may be narrower than we expect or, in fact, provide no competitive advantages. Any of these circumstances could have a material adverse impact on our business.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**  
***Repurchases of Company Shares***

On December 14, 2011, the Board of Directors authorized the repurchase of up to \$1.6 billion of our common stock in conjunction with the acquisition of Novellus, which replaces the previous repurchase authorizations. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance with applicable law. Repurchases will be funded using our available cash. This repurchase program has no termination date and may be suspended or discontinued at any time.

As part of our share repurchase program, we may from time-to-time enter into structured share repurchase arrangements with financial institutions using general corporate funds. Such arrangements entered into or settled during the six months ended December 23, 2012 included the following.

***Collared Accelerated Share Repurchases***

During the year ended June 24, 2012, we entered into two share repurchase transactions under one master repurchase arrangement. Under these collared accelerated share repurchase transactions ( ASRs ), we made up-front cash payments of \$375 million and \$200 million, respectively, three days after the respective trade date in exchange for an initial delivery of 6.6 million and 3.9 million shares of our common stock, respectively. The number of shares to ultimately be repurchased by us is based generally on the volume-weighted average price ( VWAP ) of our common stock during the term of the ASR minus a pre-determined, fixed discount set at inception of the ASR, subject to collar provisions that provide a minimum and maximum number of shares that we could repurchase under the agreements.



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The minimum and maximum thresholds for each transaction are established based on the average of the VWAP prices for our common stock during an initial hedge period. We received incremental shares on top of the initial shares delivered such that the total number of shares received under the ASRs after the initial hedge period equaled 8.8 million and 4.8 million shares, representing the minimum number of shares to be delivered under the terms of the ASRs, respectively. The ASRs were scheduled to end on or before December 18, 2012 and October 9, 2012, respectively. However, each ASR is subject to acceleration at the option of the counterparty at any time after June 27, 2012 and July 19, 2012, respectively. At the conclusion of the ASRs, we may receive additional shares based on the VWAP of our common stock during the term of the agreement minus the pre-determined fixed discount, such that the total number of shares received under the ASRs does not exceed the maximum of 10.8 and 6.6 million shares, respectively.

We accounted for each ASR as two separate transactions: (a) as shares of common stock acquired in a treasury stock transaction recorded on the acquisition date and (b) as a forward contract indexed to our own common stock and classified in stockholders' equity. As such, we accounted for the shares that we received under the ASRs as a repurchase of our common stock for the purpose of calculating earnings per common share. We have determined that the forward contracts indexed to our common stock met all of the applicable criteria for equity classification in accordance with the Derivatives and Hedging topic of the FASB ASC, and, therefore, the ASRs were not accounted for as derivative instruments. As of June 24, 2012, the aggregate repurchase price of \$575.0 million is reflected as Treasury stock, at cost, in our Consolidated Balance Sheet.

The counterparty designated July 6, 2012 as the accelerated termination date, at which time we settled the \$375 million ASR and received an additional 1.3 million shares of common stock in addition to the minimum shares already received, which represented a weighted average share price of approximately \$36.80 for the transaction period. The counterparty designated July 25, 2012 as the accelerated termination date, at which time we settled the \$200 million ASR and received an additional 0.7 million shares of common stock in addition to the minimum shares already received, which represented a weighted average share price of approximately \$36.12 for the transaction period.

Share repurchases, including those under the repurchase program, were as follows:

| Period                                | Total Number of Shares Repurchased (1) | Average Price Paid Per Share* (in thousands, except per share data) | Total Number of Shares Purchased as Part of Publicly Announced Plan or Program | Amount Available Under Repurchase Program |
|---------------------------------------|--|---|--|---|
| Amount available at June 24, 2012     |  |   |  | \$ 911,933                                |
| Quarter ending September 23, 2012     | 12,098                                 | \$ 34.79  | 11,970   | 567,932                                   |
| September 24, 2012 - October 23, 2012 | 3,331                                  | \$ 32.72  | 3,320  | \$ 459,285                                |
| October 24, 2012 - November 23, 2012  | 2,933                                  | \$ 35.63  | 2,920  | \$ 355,235                                |
| November 24, 2012 - December 23, 2012 | 4,120                                  | \$ 35.79  | 3,950  | \$ 213,903                                |
| Total                                 | 22,482                                 | \$ 34.76  | 22,160   |   |

\* Average price paid per share excludes accelerated share repurchases for which cost was incurred in fiscal year 2012, but shares were received in fiscal year 2013. See *Collared Accelerated Share Repurchases* section above for details regarding average price associated with these transactions.

- (1) In addition to shares repurchased under Board authorized repurchase program (as described above), included in this column are 322,000 shares acquired at a total cost of \$11.4 million which the Company withheld through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company's equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company's equity compensation plans.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

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**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

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**LAM RESEARCH CORPORATION**

**SIGNATURES**

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

Date: January 31, 2013

LAM RESEARCH CORPORATION

(Registrant)

/s/ ERNEST E. MADDOCK

**Ernest E. Maddock**

**Senior Vice President, Chief Financial Officer**

**(Principal Financial Officer and Principal Accounting Officer)**



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**Table of Contents****EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Description</b>   |
|-----------------------|--|
| 4.20*                 | Lam Research Corporation 1999 Employee Stock Purchase Plan (as amended and restated on November 1, 2012) |
| 31.1                  | Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer)                                     |
| 31.2                  | Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer)                                     |
| 32.1                  | Section 1350 Certification (Principal Executive Officer)   |
| 32.2                  | Section 1350 Certification (Principal Financial Officer)   |
| 101.INS               | XBRL Instance Document   |
| 101.SCH               | XBRL Taxonomy Extension Schema Document  |
| 101.CAL               | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF               | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB               | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE               | XBRL Taxonomy Extension Presentation Linkbase Document   |

\* Indicates management contract or compensatory plan or arrangement in which executive officers of the Company are eligible to participate.