

LAM RESEARCH CORP  
Form 10-Q  
October 25, 2016  
Table of Contents

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

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FORM 10-Q

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(Mark One)  
 QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934  
For the quarterly period ended September 25, 2016  
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

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LAM RESEARCH CORPORATION  
(Exact name of registrant as specified in its charter)

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Delaware 94-2634797  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)  
4650 Cushing Parkway 94538  
Fremont, California  
(Address of principal executive offices) (Zip Code)  
(510) 572-0200  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period 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 October 20, 2016, the Registrant had 162,829,959 shares of common stock outstanding.

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Table of ContentsLAM RESEARCH CORPORATION  
TABLE OF CONTENTS

	Page No.
<u>PART I. Financial Information</u>	
Item 1. <u>Financial Statements (Unaudited):</u>	
<u>Condensed Consolidated Statements of Operations for the three months ended September 25, 2016 and September 27, 2015</u>	<u>3</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the three months ended September 25, 2016 and September 27, 2015</u>	<u>4</u>
<u>Condensed Consolidated Balance Sheets as of September 25, 2016 and June 26, 2016</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the three months ended September 25, 2016 and September 27, 2015</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>27</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>35</u>
Item 4. <u>Controls and Procedures</u>	<u>36</u>
<u>PART II. Other Information</u>	
Item 1. <u>Legal Proceedings</u>	<u>37</u>
Item 1A. <u>Risk Factors</u>	<u>37</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>47</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>47</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>47</u>
Item 5. <u>Other Information</u>	<u>47</u>
Item 6. <u>Exhibits</u>	<u>47</u>
<u>Signatures</u>	<u>48</u>
<u>Exhibit Index</u>	<u>49</u>

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Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## LAM RESEARCH CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended	
	September	September
	25,	27,
	2016	2015
Revenue	\$1,632,419	\$1,600,043
Cost of goods sold	916,222	877,680
Gross margin	716,197	722,363
Research and development	235,240	234,209
Selling, general and administrative	165,010	152,726
Total operating expenses	400,250	386,935
Operating income	315,947	335,428
Other expense, net	(23,154 )	(27,121 )
Income before income taxes	292,793	308,307
Income tax expense	(28,958 )	(19,628 )
Net income	\$263,835	\$288,679
Net income per share:		
Basic	\$1.64	\$1.82
Diluted	\$1.47	\$1.66
Number of shares used in per share calculations:		
Basic	160,607	158,352
Diluted	180,017	174,374
Cash dividend declared per common share	\$0.30	\$0.30

Table of ContentsLAM RESEARCH CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended	
	September	September
	25,	27,
	2016	2015
Net income	\$263,835	\$288,679
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustment	4,501	(7,822 )
Cash flow hedges:		
Net unrealized losses during the period	(2,421 )	(544 )
Net losses reclassified into earnings	11,950	341
	9,529	(203 )
Available-for-sale investments:		
Net unrealized (losses) gains during the period	(2,723 )	2,748
Net losses reclassified into earnings	903	20
	(1,820 )	2,768
Defined benefit plans, net change in unrealized component	123	95
Other comprehensive loss, net of tax	12,333	(5,162 )
Comprehensive income	\$276,168	\$283,517

See Notes to Condensed Consolidated Financial Statements

Table of Contents

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

	September 25, 2016 (unaudited)	June 26, 2016 (1)
<b>ASSETS</b>		
Cash and cash equivalents	\$5,861,701	\$5,039,322
Investments	1,352,775	1,788,612
Accounts receivable, less allowance for doubtful accounts of \$7,124 as of September 25, 2016 and \$5,155 as of June 26, 2016	1,290,317	1,262,145
Inventories	931,581	971,911
Prepaid expenses and other current assets	162,628	151,160
Total current assets	9,599,002	9,213,150
Property and equipment, net	649,587	639,608
Restricted cash and investments	255,640	250,421
Goodwill	1,385,838	1,386,276
Intangible assets, net	526,593	564,921
Other assets	219,702	209,939
Total assets	\$12,636,362	\$12,264,315
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Trade accounts payable	\$349,743	\$348,199
Accrued expenses and other current liabilities	765,655	772,910
Deferred profit	417,855	349,199
Current portion of convertible notes and capital leases	952,999	947,733
Total current liabilities	2,486,252	2,418,041
Senior notes, convertible notes, and capital leases, less current portion	3,378,179	3,378,129
Income taxes payable	241,671	231,514
Other long-term liabilities	142,910	134,562
Total liabilities	6,249,012	6,162,246
Commitments and contingencies		
Temporary equity, convertible notes	202,467	207,552
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, 161,706 shares at September 25, 2016 and 160,201 shares at June 26, 2016	162	160
Additional paid-in capital	5,627,839	5,572,898
Treasury stock, at cost, 100,767 shares at September 25, 2016 and 101,071 shares at June 26, 2016	(4,421,665 )	(4,429,317 )
Accumulated other comprehensive loss	(57,000 )	(69,333 )
Retained earnings	5,035,547	4,820,109
Total stockholders' equity	6,184,883	5,894,517
Total liabilities and stockholders' equity	\$12,636,362	\$12,264,315

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements

5

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Table of ContentsLAM RESEARCH CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three Months Ended	
	September 25, 2016	September 27, 2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$263,835	\$288,679
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	74,562	70,590
Deferred income taxes	7,633	(5,563 )
Equity-based compensation expense	38,595	35,774
Income tax benefit on equity-based compensation plans	—	3,545
Excess tax benefit on equity-based compensation plans	—	(3,572 )
Amortization of note discounts and issuance costs	6,830	9,831
Other, net	16,807	10,011
Changes in operating assets and liabilities	64,962	39,702
Net cash provided by operating activities	473,224	448,997
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures and intangible assets	(41,979 )	(49,454 )
Purchases of available-for-sale securities	(38,149 )	(358,854 )
Sales and maturities of available-for-sale securities	469,899	330,651
Transfer of restricted cash and investments	(5,219 )	—
Other, net	(7,800 )	(1,500 )
Net cash provided by (used for) investing activities	376,752	(79,157 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on long-term debt and capital lease obligations and payments for debt issuance costs	(371 )	(96 )
Proceeds from issuance of long-term debt, net of issuance costs	—	—
Excess tax benefit on equity-based compensation plans	—	3,572
Treasury stock purchases	(1,854 )	(98,385 )
Dividends paid	(48,052 )	(47,659 )
Reissuance of treasury stock related to employee stock purchase plan	19,320	19,245
Proceeds from issuance of common stock	1,459	377
Other, net	(10 )	(300 )
Net cash (used for) provided by financing activities	(29,508 )	(123,246 )
Effect of exchange rate changes on cash and cash equivalents	1,911	(3,808 )
Net increase in cash and cash equivalents	822,379	242,786
Cash and cash equivalents at beginning of period	5,039,322	1,501,539
Cash and cash equivalents at end of period	\$5,861,701	\$1,744,325
<b>Schedule of noncash transactions:</b>		
Accrued payables for stock repurchases	—	7,624
Accrued payables for capital expenditures	11,631	6,761
Dividends payable	48,397	47,896
Transfers of inventory to (from) property and equipment, net	13,419	(779 )



See Notes to Condensed Consolidated Financial Statements

6

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Table of Contents

LAM RESEARCH CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 25, 2016

(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 26, 2016, which are included in the Company’s Annual Report on Form 10-K as of and for the year ended June 26, 2016 (the “2016 Form 10-K”). The Company’s reports on Form 10-K, Form 10-Q and Form 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 reports on Form 10-K, Form 10-Q and Form 8-K on its corporate website at <http://investor.lamresearch.com>. The content on any website referred to in this Form 10-Q is not a part of or incorporated by reference in this Form 10-Q unless expressly noted.

The condensed consolidated financial statements include the accounts of Lam Research and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The Company’s reporting period is a 52/53-week fiscal year. The Company’s current fiscal year will end June 25, 2017 and includes 52 weeks. The quarters ended September 25, 2016 (the “September 2016 quarter”) and September 27, 2015 (the “September 2015 quarter”) included 13 weeks.

NOTE 2 — RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB released Accounting Standards Update (“ASU”) 2014-9, “Revenue from Contracts with Customers” to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of the standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The new standard defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation.

In April 2016, FASB released ASU 2016-10, “Revenue from Contracts with Customers.” The amendment clarifies guidance in ASU 2014-09, “Revenue from Contracts with Customers” to improve guidance on criteria in assessing whether promises to transfer goods and services are separately identifiable and improve the understanding of the licensing implementation guidance.

In May 2016, FASB released ASU 2016-12, “Revenue from Contracts with Customers.” which also clarifies guidance in ASU 2014-09 on assessing collectability, non-cash consideration, presentation of sales tax and completed contracts and contract modification in transition.

The Company is required to adopt these standards starting in the first quarter of fiscal year 2019 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the standard; or (ii) retrospective with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per the standard. The Company has not yet selected a transition method, and is in the process of determining the impact that the new standard will have on its Condensed Consolidated Financial Statements. The Company does not plan to early adopt this standard.

In April 2015, the FASB released ASU 2015-3, “Interest – Imputation of Interest.” The amendment requires that debt issuance costs related to recognized debt liability be presented in the balance sheet as a direct deduction from the

carrying amount of that debt liability, consistent with debt discounts. The Company adopted this standard in the September 2016 quarter, with retrospective application to the June 26, 2016 Condensed Consolidated Balance Sheet. The adoption did not have a material impact to the Condensed Consolidated Financial Statements.

In September 2015, the FASB released ASU 2015-16, "Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments," which eliminates the requirement to restate prior period financial statements for

7

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Table of Contents

measurement period adjustments. Instead, the cumulative impact of measurement period adjustments, including the impact on prior periods, is required to be recognized in the reporting period in which the adjustment is identified. The Company adopted this standard in the September 2016 quarter, with no impact to the Condensed Consolidated Financial Statements.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." This ASU amends existing guidance to require that deferred income tax assets and liabilities be classified as non-current in a classified balance sheet, and eliminates the prior guidance which required an entity to separate deferred tax assets and liabilities into a current amount and a non-current amount in a classified balance sheet. The amendments in this ASU are effective for the Company beginning in its first quarter of fiscal year 2018. Earlier application is permitted as of the beginning of an interim or annual period. Additionally, the new guidance may be applied either prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. The Company is evaluating the timing of adoption, but plans to adopt the guidance prospectively with an anticipated reclassification from current assets and liabilities to non-current assets and liabilities on its Condensed Consolidated Balance Sheet.

In January 2016, FASB released ASU 2016-1, "Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities." The amendment changes the accounting for and financial statement presentation of equity investments, other than those accounted for under the equity method of accounting or those that result in consolidation of the investee. The amendment provides clarity on the measurement methodology to be used for the required disclosure of fair value of financial instruments measured at amortized cost on the balance sheet and clarifies that an entity should evaluate the need for a valuation allowance on deferred tax assets related to available-for-sale securities in combination with the entity's other deferred tax assets, among other changes. The Company is required to adopt this standard starting in the first quarter of fiscal year 2019 and does not anticipate that implementation will have a material impact on its Condensed Consolidated Financial Statements.

In January 2016, FASB released ASU 2016-2, "Leases." The amendment requires an entity to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. The amendment offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of the financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. The Company is required to adopt this standard starting in the first quarter of fiscal year 2020. Early adoption is permitted. The Company is currently in the process of evaluating the impact of adoption on its Condensed Consolidated Financial Statements.

In March 2016, FASB released ASU 2016-9, "Compensation - Stock Compensation." Key changes in the amendment include:

- entities will be required to recognize all excess tax benefits or deficiencies as an income tax benefit or expense in the income statement, eliminating APIC pools;
- entities will no longer be required to delay recognition of excess tax benefits until they are realized;
- entities will be required to classify the excess tax benefits as an operating activity in the statement of cash flows;
- entities will be allowed to elect an accounting policy to either estimate the number of forfeitures, or account for forfeitures as they occur; and
- entities can withhold up to the maximum individual statutory tax rate without classifying the awards as a liability, the cash paid to satisfy the statutory income tax withholding obligations shall be classified as a financing activity in the statement of cash flows.

The Company is required to adopt this standard starting in the first quarter of fiscal year 2018. The Company is currently in the process of evaluating the impact of adoption on its Condensed Consolidated Financial Statements.

In June 2016, FASB released ASU 2016-13, "Financial Instruments - Credit Losses." The amendment revises the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in more timely recognition of losses on financial instruments, including, but not limited to, available for sale debt securities and accounts receivable. The Company is required to adopt this standard starting in the first quarter of fiscal year 2021. Early adoption is permitted. The Company is currently in the process of evaluating the

impact of adoption on its Condensed Consolidated 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, restricted stock units (“RSUs”), and market-based performance RSUs (“market-based PRSUs”) of Lam Research common

8

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Table of Contents

stock (“Common Stock”). An option is a right to purchase Common Stock at a set price. An RSU award is an agreement to issue a set number of shares of Common Stock at the time of vesting. The Company’s market-based PRSUs contain both a market condition and a service condition. The Company’s options, RSU and market-based PRSU awards typically vest over a period of three 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 September	
	25, 2016	27, 2015
	(in thousands)	
Equity-based compensation expense	\$38,595	\$ 35,774
Income tax benefit recognized related to equity-based compensation expense	\$ 10,905	\$ 6,097

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.

**Stock Options and RSUs**

The Lam Research Corporation 2015 Stock Incentive Plan, as amended, 2007 Stock Incentive Plan, as amended and 2011 Stock Incentive Plan, as amended (collectively the “Stock Plans”) provide for the grant of non-qualified equity-based awards to eligible employees and non-employee directors of the Company and its subsidiaries. A summary of stock plan transactions is as follows:

	Options Outstanding		Restricted Stock Units Outstanding	
	Number of Shares	Weighted- Average Exercise Price	Number of Shares	Weighted- Average Fair Market Value at Grant
June 26, 2016	907,411	\$ 47.41	4,335,104	\$ 69.30
Granted	—	\$ —	34,458	\$ 87.59
Exercised	(54,364 )	\$ 32.29	N/A	N/A
Canceled	—	\$ —	(50,640 )	\$ 67.67
Vested restricted stock	N/A	N/A	(61,540 )	\$ 65.09
September 25, 2016	853,047	\$ 48.37	4,257,382	\$ 69.51

As of September 25, 2016, there was \$4.1 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 2.2 years. As of September 25, 2016, there was \$187.4 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 2.0 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 Common Stock at a purchase price per share equal to the lower of 85% of the fair market value of Common Stock on the first or last day of the applicable purchase period. Each offering period generally lasts up to 14 months and includes three interim purchase dates.



Table of Contents

Purchase rights under the 1999 ESPP were valued using the Black-Scholes option valuation model and the following weighted-average assumptions for the three months ended September 25, 2016 and September 27, 2015:

	Three Months Ended		
	September 25, 2016	September 27, 2015	
Expected term (years)	0.77	0.68	
Expected stock price volatility	33.02 %	31.56 %	%
Risk-free interest rate	0.43 %	0.18 %	%
Dividend Yield	1.14 %	0.93 %	%

As of September 25, 2016, there was \$19.0 million of unrecognized compensation expense related to the 1999 ESPP, which is expected to be recognized over a remaining period of approximately 1.1 years.

## NOTE 4 — OTHER EXPENSE, NET

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

	Three Months Ended	
	September 25, 2016	September 27, 2015
	(in thousands)	
Interest income	\$12,763	\$5,760
Interest expense	(41,429 )	(24,661 )
Gains (losses) on deferred compensation plan related assets, net	6,172	(5,164 )
Foreign exchange gains (losses), net	1,219	(698 )
Other, net	(1,879 )	(2,358 )
	\$ (23,154 )	\$ (27,121 )

Interest income in the three months ended September 25, 2016 increased, as compared to the three months ended September 27, 2015, due to higher cash balances and increased interest rates. Interest expense in the three months ended September 25, 2016 increased, as compared to the three months ended September 27, 2015, primarily due to interest expense associated with the \$2.4 billion Senior Note issuance in the three months ended June 26, 2016.

## NOTE 5 — INCOME TAX EXPENSE

The Company recorded an income tax expense of \$29.0 million for the three months ended September 25, 2016, which yielded an effective tax rate of approximately 9.9%.

The difference between the U.S. federal statutory tax rate of 35% and the Company's effective tax rate for the three months ended September 25, 2016 is primarily due to income in lower tax jurisdictions.



Table of Contents

## NOTE 6 — NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of shares of Common Stock outstanding during the period. Diluted net income per share is computed using the treasury stock method, for dilutive stock options, RSUs, convertible notes, and warrants. Dilutive shares outstanding include the effect of the convertible notes. Refer to Note 11 for additional information regarding the Company's convertible notes. The following table reconciles the numerators and denominators of the basic and diluted computations for net income per share.

	Three Months Ended	
	September 25, 2016	September 27, 2015
	(in thousands, except per share data)	
Numerator:		
Net income	\$ 263,835	\$ 288,679
Denominator:		
Basic average shares outstanding	160,607	158,352
Effect of potential dilutive securities:		
Employee stock plans	2,142	2,544
Convertible notes	15,220	13,120
Warrants	2,048	358
Diluted average shares outstanding	180,017	174,374
Net income per share - basic	\$ 1.64	\$ 1.82
Net income per share - diluted	\$ 1.47	\$ 1.66

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	
	September 25, 2016	September 27, 2015
	(in thousands)	
Number of options and RSUs excluded	196	93

Diluted shares outstanding do not include any effect resulting from the note hedges associated with the Company's 2018 Notes as their impact would have been anti-dilutive.

## NOTE 7 — 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 investments are classified as available-for-sale and consequently are recorded in the Condensed 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:

11

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Table of Contents

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 Company's primary financial instruments include its cash, cash equivalents, investments, restricted cash and investments, long-term investments, accounts receivable, accounts payable, long-term debt and capital leases, and foreign currency related derivative instruments. 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 11 for additional information regarding the fair value of the Company's convertible notes senior notes.

The following table sets forth the Company's cash, cash equivalents, investments, restricted cash and investments, and other assets measured at fair value on a recurring basis as of September 25, 2016 and June 26, 2016:

September 25, 2016

	Cost	Unrealized Gain	Unrealized (Loss)	Fair Value	(Reported Within)		Restricted Cash & Investments	Other Assets
					Cash and Equivalents	Investments		
	(in thousands)							
Cash	\$768,071	\$—	\$—	\$768,071	\$762,458	\$—	\$5,613	\$—
Level 1:								
Time Deposit	913,725	—	—	913,725	663,698	—	250,027	—
Money Market Funds	4,180,031	—	—	4,180,031	4,180,031	—	—	—
U.S. Treasury and Agencies	366,017	951	(3 )	366,965	86,092	280,873	—	—
Mutual Funds	39,010	1,773	(195 )	40,588	—	—	—	40,588
Level 1 Total	5,498,783	2,724	(198 )	5,501,309	4,929,821	280,873	250,027	40,588
Level 2:								
Municipal Notes and Bonds	201,502	183	(76 )	201,609	—	201,609	—	—
Government-Sponsored Enterprises	31,701	49	(14 )	31,736	—	31,736	—	—
Foreign Government Bonds	14,357	20	(1 )	14,376	—	14,376	—	—
Corporate Notes and Bonds	937,712	2,871	(201 )	940,382	169,422	770,960	—	—
Mortgage Backed Securities — Residential	15,747	53	(141 )	15,659	—	15,659	—	—
Mortgage Backed Securities — Commercial	37,661	18	(117 )	37,562	—	37,562	—	—
Level 2 Total	1,238,680	3,194	(550 )	1,241,324	169,422	1,071,902	—	—
Total	\$7,505,534	\$5,918	\$(748 )	\$7,510,704	\$5,861,701	\$1,352,775	\$255,640	\$40,588



Table of Contents

June 26, 2016

	Cost	Unrealized Gain	Unrealized (Loss)	Fair Value	(Reported Within)		Restricted Cash & Investments	Other Assets
					Cash and Equivalents	Investments		
	(in thousands)							
Cash	\$418,216	\$ —	\$ —	\$418,216	\$412,573	\$ —	\$ 5,643	\$ —
Level 1:								
Time Deposit	904,243	—	—	904,243	659,465	—	244,778	—
Money Market Funds	3,904,288	—	—	3,904,288	3,904,288	—	—	—
U.S. Treasury and Agencies	446,530	2,041	(2 )	448,569	62,996	385,573	—	—
Mutual Funds	39,318	1,400	(397 )	40,321	—	—	—	40,321
Level 1 Total	5,294,379	3,441	(399 )	5,297,421	4,626,749	385,573	244,778	40,321
Level 2:								
Municipal Notes and Bonds	265,386	355	(16 )	265,725	—	265,725	—	—
U.S. Treasury and Agencies	8,068	151	—	8,219	—	8,219	—	—
Government-Sponsored Enterprises	31,885	91	(13 )	31,963	—	31,963	—	—
Foreign Government Bonds	41,440	76	(4 )	41,512	—	41,512	—	—
Corporate Notes and Bonds	979,566	4,341	(566 )	983,341	—	983,341	—	—
Mortgage Backed Securities — Residential	17,395	37	(152 )	17,280	—	17,280	—	—
Mortgage Backed Securities — Commercial	55,129	30	(160 )	54,999	—	54,999	—	—
Level 2 Total	1,398,869	5,081	(911 )	1,403,039	—	1,403,039	—	—
Total	\$7,111,464	\$ 8,522	\$(1,310 )	\$7,118,676	\$5,039,322	\$1,788,612	\$ 250,421	\$40,321

The Company accounts for its investment portfolio at fair value. Realized gains (losses) for investment sales 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 months ended September 25, 2016 or September 27, 2015. Additionally, gross realized gains and gross realized (losses) from sales of investments were approximately \$2.6 million and \$0.2 million, respectively, in the three months ended September 25, 2016 and \$0.2 million and \$0.7 million, respectively, in the three months ended September 27, 2015.

Table of Contents

The following is an analysis of the Company's cash, cash equivalents, investments, and restricted cash and investments in unrealized loss positions:

	September 25, 2016		September 25, 2016		September 25, 2016	
	Unrealized Losses		Unrealized Losses		Total	
	Less Than 12 Months	12 Months or Greater	Less Than 12 Months	12 Months or Greater	Total	
	Gross	Gross	Gross	Gross	Gross	Gross
	Fair Value	Fair Value	Fair Value	Fair Value	Fair Value	Fair Value
	Unrealized	Unrealized	Unrealized	Unrealized	Unrealized	Unrealized
	Loss	Loss	Loss	Loss	Loss	Loss
	(in thousands)					
Municipal Notes and Bonds	\$110,401	\$ (71 )	\$ 1,995	\$ (5 )	\$112,396	\$ (76 )
U.S. Treasury & Agencies	8,247	(3 )	—	—	8,247	(3 )
Mutual Funds	—	—	8,964	(195 )	8,964	(195 )
Government-Sponsored Enterprises	419	—	621	(14 )	1,040	(14 )
Foreign Government Bonds	4,250	(1 )	—	—	4,250	(1 )
Corporate Notes and Bonds	147,348	(83 )	47,805	(118 )	195,153	(201 )
Mortgage Backed Securities — Residential	8,469	(57 )	3,897	(84 )	12,366	(141 )
Mortgage Backed Securities — Commercial	28,585	(82 )	6,318	(35 )	34,903	(117 )
	\$307,719	\$ (297 )	\$ 69,600	\$ (451 )	\$377,319	\$ (748 )

The amortized cost and fair value of cash equivalents, investments and restricted investments with contractual maturities are as follows as of September 25, 2016:

	Cost	Estimated Fair Value
	(in thousands)	
Due in one year or less	\$5,898,756	\$5,898,959
Due after one year through five years	730,005	733,625
Due in more than five years	69,692	69,461
	\$6,698,453	\$6,702,045

The Company has the ability, if necessary, to liquidate its 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 Condensed Consolidated Balance Sheets.

**Derivative Instruments and Hedging**

The Company carries derivative financial instruments ("derivatives") on its Condensed Consolidated Balance Sheets at their fair values. The Company enters into foreign currency forward derivative contracts and foreign currency options 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 derivative contracts are large global financial institutions that the Company believes are creditworthy, and therefore, it does not consider the risk of counterparty nonperformance to be material.



Table of Contents

## Cash Flow Hedges

The Company's financial position is routinely subjected to market risk associated with foreign currency exchange rate fluctuations on non-U.S. dollar transactions or cash flows, primarily from Japanese yen-denominated revenues, and euro denominated and Korean won-denominated expenses. The Company's policy is to mitigate the foreign exchange risk arising from the fluctuations in the value of these non-U.S. dollar denominated transactions or cash flows through a foreign currency cash flow hedging program, using forward contracts and foreign currency options that generally expire within 12 months and no later than 24 months. These hedge contracts are designated as cash flow hedges and are carried on the Company's balance sheet at fair value with the effective portion of the contracts' gains or losses included in accumulated other comprehensive income (loss) and subsequently recognized in revenue/expense in the same period the hedged items are recognized.

In addition, the Company enters into forward-starting interest rate swap agreements to hedge against the variability of cash flows due to changes in certain benchmark interest rates on fixed rate debt. These instruments are designated as cash flow hedges at inception and are settled in conjunction with the issuance of debt. The effective portion of the contracts' gain or loss is included in accumulated other comprehensive (loss) and is amortized into income as the hedged item impacts earnings. During fiscal year ended June 26, 2016 and June 28, 2015, the Company entered into and settled a series of forward-starting interest rate swap agreements, with a total notional value of \$600 million and \$375 million, respectively, that were settled in conjunction with the issuance of debt during the three months ended June 26, 2016 and March 29, 2015, respectively.

At inception and at each quarter end, hedges are tested prospectively and retrospectively for effectiveness using regression analysis. Changes in the fair value of the forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in revenue or expense in the current period. The change in time value related to these contracts was not material for all reported periods. Changes in the fair value of foreign exchange options due to changes in time value are included in the assessment of effectiveness. 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 material gains or losses during three months ended September 25, 2016 and September 27, 2015 associated with ineffectiveness or forecasted transactions that failed to occur.

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 associated with the forward contracts 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. As of September 25, 2016, the Company had losses of \$5.3 million accumulated in other comprehensive income, net of tax, related to foreign exchange cash flow hedges which it expects to reclassify from other comprehensive income into earnings over the next 12 months. Additionally, the Company had a net loss of \$0.8 million accumulated in other comprehensive income, net of tax, related to interest rate contracts which it expects to reclassify from other comprehensive income into earnings over the next 9.7 years. As a result of the October 5, 2016 termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporation ("KLA-Tencor") (see Note 15 for additional information), a gain of approximately \$1.1 million accumulated in other comprehensive income, net of tax, related to interest rate contracts associated with the 2026 Notes (as defined in Note 11) will be reclassified into earnings in the three months ended December 25, 2016.



Fair Value Hedges

During the fiscal year ended June 26, 2016, the Company entered into a series of interest rate contracts with a total notional value of \$400 million whereby the Company receives fixed rates and pays variable rates based on certain benchmark interest rates, resulting in a net increase or decrease to interest expense, a component of Other expense, net in our Condensed Consolidated Statement of Operations. These interest rate contracts are designated as fair value hedges and hedge against changes in the fair value of our debt portfolio. The Company concluded that these interest rate contracts meet the criteria necessary to qualify for the short-cut method of hedge accounting, and as such an assumption is made that the change in the fair value of the hedged debt, due to changes in the benchmark rate, exactly offsets the change in the fair value of the interest rate swap. Therefore, the derivative is considered to be effective at achieving offsetting changes in the fair value of the hedged liability, and no ineffectiveness is recognized.

Table of Contents

## 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 third party accounts receivables, accounts payables and intercompany receivables and payables. These 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, which are also recorded in other income (expense).

As of September 25, 2016, the Company had the following outstanding foreign currency contracts that were entered into under its cash flow and balance sheet hedge program:

	Notional Value		Derivatives Not	
	Derivatives Designated		Designated	
	as		as	
	Hedging Instruments:		Hedging Instruments:	
	(in thousands)			
Foreign Currency Forward Contracts	Buy Contracts	Sell Contracts	Buy Contracts	Sell Contracts
Japanese yen	\$—	\$ 104,039	\$—	\$ 181,405
Swiss franc	—	—	7,387	—
Euro	24,049	—	31,518	—
Korean won	5,740	—	9,402	—
Chinese renminbi	—	—	8,215	—
Singapore dollar	—	—	33,867	—
Taiwan dollar	—	—	22,790	—
	\$29,789	\$ 104,039	\$113,179	\$ 181,405

## Foreign Currency Option Contracts

	Buy Put	Sell Put	Buy Put (1)	Sell Put
Japanese yen	\$—	\$ —	\$15,695	\$ 15,695

(1) Contracts were entered into and designated as cash flow hedges under ASC 815, contracts were subsequently de-designated, changes in fair market value subsequent to de-designation effect current earnings.

The fair value of derivative instruments in the Company's Condensed Consolidated Balance Sheets as of September 25, 2016 and June 26, 2016 were as follows:

September 25, 2016				June 26, 2016				
Fair Value of Derivative Instruments (Level 2)				Fair Value of Derivative Instruments (Level 2)				
Asset Derivatives		Liability Derivatives		Asset Derivatives		Liability Derivatives		
Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	
(in thousands)								
Derivatives designated as hedging instruments:								
Foreign exchange forward contracts	Prepaid expense and other assets	\$ 113	Accrued liabilities	\$ 5,734	Prepaid expense and other assets	\$ 249	Accrued liabilities	\$ 16,585
Interest rate contracts, short-term	Accrued expenses and other current liabilities	2,623	Prepaid expense and other assets	—	Accrued expenses and other current liabilities	50	Prepaid expense and other assets	159

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Interest rate contracts, long-term	Other assets	4,968	Other long-term liabilities	—	Other assets	8,661	Other long-term liabilities	—
Derivatives not designated as hedging instruments:								
Foreign exchange forward contracts	Prepaid expense and other assets	279	Accrued liabilities	83	Prepaid expense and other assets	107	Accrued liabilities	1,529
Total derivatives		\$ 7,983		\$ 5,817		\$ 9,067		\$ 18,273

16

Table of Contents

Under the master netting agreements with the respective counterparties to the Company's derivative contracts, subject to applicable requirements, the Company is allowed to net settle transactions of the same currency with a single net amount payable by one party to the other. However, the Company has elected to present the derivative assets and derivative liabilities on a gross basis on its balance sheet. As of September 25, 2016, the potential effect of rights of off-set associated with the above foreign exchange and interest rate contracts would be an offset to assets and liabilities by \$4.4 million, resulting in a net derivative asset of \$3.6 million and net derivative liability of \$1.4 million. As of June 26, 2016, the potential effect of rights of set-off associated with the above foreign exchange contracts would be an offset to both assets and liabilities by \$6.4 million, resulting in a net derivative asset of \$2.7 million and a net derivative liability of \$11.9 million. The Company is not required to pledge, nor is the Company entitled to receive, cash collateral for these derivative transactions.

The effect of derivative instruments designated as cash flow hedges on the Company's Condensed Consolidated Statements of Operations, including accumulated other comprehensive income ("AOCI") was as follows:

	Three Months Ended September 25, 2016			Three Months Ended September 27, 2015		
	Effective Portion	Ineffective Portion and Amount Excluded from Effectiveness	Gain (Loss) Recognized in AOCI	Effective Portion	Ineffective Portion and Amount Excluded from Effectiveness	Gain (Loss) Recognized in AOCI
Location of Gain (Loss) Recognized in or Reclassified into Income	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Income	Loss Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Income
Derivatives Designated as Hedging Instruments	(in thousands)					
Foreign Exchange Contracts Revenue	\$ (2,913)	\$ (13,605 )	\$ 705	\$ (69 )	\$ (1,378 )	\$ 32
Foreign Exchange Contracts Cost of goods sold	235	173	(67 )	(415 )	1,505	(22 )
Foreign Exchange Contracts Selling, general, and administrative	(24 )	(9 )	(21 )	(173 )	258	(7 )
Interest Rate Contracts Other expense, net	—	9	—	—	(94 )	—
	\$ (2,702)	\$ (13,432 )	\$ 617	\$ (657)	\$ 291	\$ 3

The effect of derivative instruments not designated as cash flow hedges on the Company's Condensed Consolidated Statements of Operations was as follows:

	Location of (Loss) Gain Recognized in Income	Three Months Ended September 25, 2016	September 27, 2015
Derivatives Not Designated as Hedging Instruments:	Loss Recognized in Income	Gain Recognized in Income	
		(in thousands)	
Foreign Exchange Contracts	Other income	\$ (383)	\$ 6,007

#### Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, investments, restricted cash and investments, trade accounts receivable, and derivative financial instruments used in hedging activities. Cash is placed on deposit at 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 overall portfolio of available-for-sale securities must maintain an average minimum rating of "AA-" or "Aa3" as rated by Standard and Poor's, Moody's Investor Services, or Fitch Ratings. To ensure diversification and minimize concentration, the Company's policy limits the amount of credit exposure with any one financial institution or commercial issuer.

Table of Contents

The Company is exposed to credit losses in the event of nonperformance by counterparties on foreign currency forward hedge contracts that are used to mitigate the effect of exchange rate fluctuations, and on contracts related to structured share repurchase arrangements. 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 condition and payment performance. In general, the Company does not require collateral on sales.

**NOTE 8 — INVENTORIES**

Inventories are stated at the lower of cost (first-in, first-out method) or market. System shipments to Japanese customers, for which 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:

	September 25, 2016	June 26, 2016
	(in thousands)	
Raw materials	\$549,406	\$536,844
Work-in-process	139,120	151,406
Finished goods	243,055	283,661
	\$931,581	\$971,911

**NOTE 9 — GOODWILL AND INTANGIBLE ASSETS****Goodwill**

The balance of goodwill is approximately \$1.4 billion as of September 25, 2016 and June 26, 2016. As of September 25, 2016, \$61.1 million of the goodwill balance is tax deductible and the remaining balance is not tax deductible due to purchase accounting and applicable foreign law.

**Intangible Assets**

The following table provides the Company's intangible assets as of September 25, 2016:

	Gross	Accumulated Amortization	Net
	(in thousands)		
Customer relationships	\$615,193	\$(317,130)	\$298,063
Existing technology	643,261	(422,518)	220,743
Patents	36,553	(29,335)	7,218
Other intangible assets	36,114	(35,545)	569
Total intangible assets	\$1,331,121	\$(804,528)	\$526,593

The following table provides the Company's intangible assets as of June 26, 2016:

	Gross	Accumulated Amortization	Net
	(in thousands)		
Customer relationships	\$615,272	\$(300,711)	\$314,561
Existing technology	643,433	(401,036)	242,397
Patents	36,053	(28,701)	7,352
Other intangible assets	36,114	(35,503)	611
Total intangible assets	\$1,330,872	\$(765,951)	\$564,921

The Company recognized \$38.7 million and \$39.0 million in intangible asset amortization expense during the three months ended September 25, 2016 and September 27, 2015, respectively.



Table of Contents

The estimated future amortization expense of intangible assets, excluding those with indefinite lives, as of September 25, 2016 was as follows:

Fiscal Year	Amount (in thousands)
2017 (remaining 9 months)	\$ 116,002
2018	153,337
2019	115,263
2020	50,194
2021	47,792
Thereafter	44,005
	\$ 526,593

**NOTE 10 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

	September 25, 2016	June 26, 2016
	(in thousands)	
Accrued compensation	\$ 357,134	\$ 331,528
Warranty reserves	103,226	100,321
Income and other taxes payable	68,057	86,723
Dividend payable	48,397	48,052
Other	188,841	206,286
	\$ 765,655	\$ 772,910



Table of Contents

## NOTE 11 — LONG-TERM DEBT AND OTHER BORROWINGS

As of September 25, 2016 and June 26, 2016, the Company's outstanding debt consisted of the following:

	September 25, 2016		June 26, 2016	
	Amount	Effective	Amount	Effective
	(in	Interest	(in	Interest
	thousands)	Rate	thousands)	Rate
Fixed-rate 1.25% Convertible Notes Due May 15, 2018 ("2018 Notes")	\$449,947	(1) 5.27 %	\$449,954	(3) 5.27 %
Fixed-rate 2.75% Senior Notes Due March 15, 2020 ("2020 Notes")	500,000	2.88 %	500,000	2.88 %
Fixed-rate 2.80% Senior Notes Due June 15, 2021 ("2021 Notes")	800,000	2.95 %	800,000	2.95 %
Fixed-rate 3.45% Senior Notes Due June 15, 2023 ("2023 Notes")	600,000	3.60 %	600,000	3.60 %
Fixed-rate 3.80% Senior Notes Due March 15, 2025 ("2025 Notes")	500,000	3.87 %	500,000	3.87 %
Fixed-rate 3.90% Senior Notes Due June 15, 2026 ("2026 Notes")	1,000,000	4.01 %	1,000,000	4.01 %
Fixed-rate 2.625% Convertible Notes Due May 15, 2041 ("2041 Notes")	699,883	(1) 4.28 %	699,895	(3) 4.28 %
Total debt outstanding, at par	4,549,830		4,549,849	
Unamortized discount	(226,811 )		(232,727 )	
Fair value adjustment - interest rate contracts	7,592		8,552	
Unamortized bond issuance costs	(6,781 )		(7,213 )	(4)
Total debt outstanding, at carrying value	\$4,323,830		\$4,318,461	
Reported as:				
Current portion of long-term debt	\$945,836	(2)	\$940,537	(2)
Long-term debt	3,377,994		3,377,924	
Total debt outstanding, at carrying value	\$4,323,830		\$4,318,461	

(1) As of September 25, 2016, these notes were convertible at the option of the bondholder, as a result of the condition described in (2) below. Upon closure of the conversion period, Notes not converted will be reclassified back into noncurrent liabilities and the temporary equity will be reclassified into permanent equity.

(2) As of the report date the market value of the Company's Common Stock was greater than 130% of the convertible notes conversion price for 20 or more of the 30 consecutive trading days preceding the quarter-end. As a result, the convertible notes were classified in current liabilities and a portion of the equity component, representing the unamortized discount, was classified in temporary equity on the Company's Consolidated Balance Sheets.

(3) As of June 26, 2016, these notes were convertible at the option of the bond holder, as a result of the condition described in (2) above.

(4) The Company adopted ASU 2015-3, regarding the simplification of the presentation of bond issuance costs, which requires that bond issuance costs related to a recognized liability be presented on the balance sheet as a direct reduction from the carrying amount of that debt liability, consistent with debt discounts. The Company applied the accounting standard update on a retrospective basis by reclassifying the presentation of bond issuance costs totaling \$1.76 million which was originally included in prepaid assets and other current assets against current portion of convertible notes and capital leases, and \$5.45 million which was originally included in other assets against senior notes, convertible notes, and capital leases, less current portion on the Condensed Consolidated Balance Sheets for June 26, 2016. There is no impact to the Company's Condensed Consolidated Statements of Operation, Stockholders' Equity, or Cash Flows for the fiscal year ended June 26, 2016.

Convertible Senior Notes

In May 2011, the Company issued and sold \$450 million in aggregate principal amount of 1.25% Convertible Senior Notes due May 2018 (the "2018 Notes") at par. The Company pays cash interest at an annual rate of 1.25%, on the 2018

Notes, on a semi-annual basis on May 15 and November 15 of each year.

In June 2012, with the acquisition of Novellus, the Company assumed \$700 million in aggregate principal amount of 2.625% Convertible Senior Notes due May 2041 (the “2041 Notes,” and collectively with the 2018 Notes, the “Convertible Notes”). The Company pays cash interest at an annual rate of 2.625%, on a semi-annual basis on May 15 and November 15 of each year on the 2041 Notes. The 2041 Notes also have a contingent interest payment provision that may require the Company to pay additional interest, up to 0.60% per year, based on certain thresholds, beginning with the semi-annual interest payment on May 15, 2021, and upon the occurrence of certain events, as outlined in the indenture governing the 2041 Notes.

The Company separately accounts for the liability and equity components of the Convertible Notes. The initial debt components of the Convertible Notes were valued based on the present value of the future cash flows using the Company’s

20

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Table of Contents

borrowing rate at the date of the issuance or assumption for similar debt instruments without the conversion feature, which equals the effective interest rate on the liability component disclosed in the table below, respectively. The equity component was initially valued equal to the principle value of the notes, less the present value of the future cash flows using the Company's borrowing rate at the date of the issuance or assumption for similar debt instruments without a conversion feature, which equated to the initial debt discount.

Under certain circumstances, the Convertible Notes may be converted into shares of the Company's Common Stock. The number of shares each debenture is convertible into is based on conversion rates, disclosed in the table below. Conversions in the three months ended September 25, 2016 were not material.

Selected additional information regarding the Convertible Notes outstanding as of September 25, 2016 and June 26, 2016, the Convertible Notes consisted of the following:

	September 25, 2016		June 26, 2016	
	2018	2041 Notes	2018 Notes	2041 Notes
	(in thousands, except years, percentages, conversion rate, and conversion price)			
Carrying amount of permanent equity component, net of tax	\$77,064	\$153,384	\$72,992	\$152,397
Carrying amount of temporary equity component, net of tax	\$27,818	\$174,649	\$31,894	\$175,658
Remaining amortization period (years)	1.6	24.6	1.9	24.9
Fair Value of Notes (Level 2)	\$701,242	\$1,906,194		
Conversion rate (shares of common stock per \$1,000 principal amount of notes)	16.3893	29.4126		
Conversion price (per share of common stock)	\$61.02	\$34.00		
If-converted value in excess of par value	\$226,868	\$1,189,443		
Estimated share dilution using average quarterly stock price \$90.25 per share	2,389	12,830		

#### Convertible Note Hedges and Warrants

Concurrent with the issuance of the 2018 Notes and \$450 million of notes that matured in May of 2016 (the "2016 Notes"), the Company purchased a convertible note hedge and sold warrants. The warrants settlement is contractually defined as net share settlement. The exercise price is adjusted for certain corporate events, including dividends on the Company's Common Stock. During the three months ended September 25, 2016, warrants associated with the 2016 Notes were exercised resulting in the issuance of approximately 1.1 million shares of the Company's Common Stock. As of September 25, 2016, the warrants associated with the 2018 Notes had not been exercised and remained outstanding.

In conjunction with the convertible note hedge, counterparties agreed to sell to the Company shares of Common Stock equal to the number of shares issuable upon conversion of the 2018 Notes in full. The convertible note hedge transactions will be settled in net shares and will terminate upon the earlier of the maturity date or the first day none of the respective notes remain 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. The exercise price is adjusted for certain corporate events, including dividends on the Company's Common Stock.

Table of Contents

The following table presents the details of the warrants and convertible note hedge arrangements as of September 25, 2016:

	2016	2018
	Notes	Notes
	(shares in thousands)	
Warrants:		
Underlying shares	3,098	7,375
Estimated share dilution using average quarterly stock price \$90.25 per share	694	1,354
Exercise price	\$69.07	\$ 73.68
Expiration date range	August 15 - October 21, 2016	August 15 - October 23, 2018
Convertible Note Hedge:		
Number of shares available from counterparties	—	7,374
Exercise price	\$—	\$ 61.02

## Senior Notes

On March 12, 2015, the Company completed a public offering of \$500 million aggregate principal amount of the Company's Senior Notes due March, 2020 (the "2020 Notes") and \$500 million aggregate principal amount of the Company's Senior Notes due March, 2025 (the "2025 Notes" and, together with the 2020 Notes, the "Senior Notes"). The Company pays interest at an annual rate of 2.75% and 3.80%, respectively, on the 2020 Notes and 2025 Notes, on a semi-annual basis on March 15 and September 15 of each year. During the year ended June 26, 2016, the Company entered into a series of interest rate contracts hedging the fair value of a portion of the 2025 Notes par value, whereby the Company receives a fixed rate and pays a variable rate based on a certain benchmark interest rate. Refer to Note 7 for additional information regarding these interest rate contracts.

The Company may redeem the Senior Notes at a redemption price equal to 100% of the principal amount of such series ("par"), plus a "make whole" premium as described in the indenture in respect of the Senior Notes and accrued and unpaid interest before February 15, 2020, for the 2020 Notes and before December 15, 2024 for the 2025 Notes. The Company may redeem the Senior Notes at par, plus accrued and unpaid interest at any time on or after February 15, 2020 for the 2020 Notes and on or after December 24, 2024 for the 2025 Notes. In addition, upon the occurrence of certain events, as described in the indenture, the Company will be required to make an offer to repurchase the Senior Notes at a price equal to 101% of the principal amount of the Senior Notes, plus accrued and unpaid interest.

On June 7, 2016, The Company completed a public offering of \$800.0 million aggregate principal amount of Senior Notes due June 2021 (the "2021 Notes"), \$600.0 million aggregate principal amount of Senior Notes due June 2023 (the "2023 Notes") and \$1.0 billion aggregate principal amount of Senior Notes due June 2026 (the "2026 Notes" together with the 2020, 2021, 2023, and 2025 Notes, the "Senior Notes"). The Company will pay interest at an annual rate of 2.80%, 3.45% and 3.90%, respectively, on the 2021 Notes, 2023 Notes and 2026 Notes, on a semi-annual basis on June 15 and December 15 of each year, beginning December 15, 2016.

As a result of the October 5, 2016 termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor (see Note 15 for additional information), the 2023 Notes and the 2026 Notes were redeemed on October 13, 2016 under the Special Mandatory Redemption terms of the indenture governing these Notes. The Company was required to redeem all of the 2023 Notes and the 2026 Notes then outstanding, at a special mandatory redemption price equal to 101% of the aggregate principal amount of such notes, plus accrued and unpaid interest of approximately \$21.0 million from the date of initial issuance. In addition, in conjunction with the Special Mandatory

Redemption of the 2023 Notes and the 2026 Notes in the three months ended December 25, 2016, the Company will recognize approximately \$2.5 million of loan issuance costs to other expense, net. The 2021 Notes are not subject to Special Mandatory Redemption.

The Company may redeem the 2021 Notes at a redemption price equal to 100% of the principal amount of such series ("par"), plus a "make whole" premium as described in the indenture in respect to the 2021 Notes and accrued and unpaid interest before May 15, 2021. The Company may redeem the 2021 Notes at par, plus accrued and unpaid interest at any time on or after May 15, 2021. In addition, upon the occurrence of certain events, as described in the indenture, the Company will be required to make an offer to repurchase the 2021 Notes at a price equal to 101% of the principal amount of the respective note, plus accrued and unpaid interest.

Table of Contents

Selected additional information regarding the Senior Notes outstanding as of September 25, 2016 is as follows:

Remaining Amortization period (years)	Fair Value of Notes (Level 2) (in thousands)
2020 Notes 3.4	\$501,375
2021 Notes 4.7	\$821,224
2023 Notes *	\$615,000
2025 Notes 8.4	\$514,100
2026 Notes *	\$1,046,340

\* As a result of the October 5, 2016 termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor (see Note 15 for additional information), the 2023 Notes and the 2026 Notes were redeemed on October 13, 2016 under the Special Mandatory Redemption terms of the indenture governing these Notes.

**Interest Cost**

The following table presents the amount of interest cost recognized relating to both the contractual interest coupon and amortization of the debt discount, issuance costs, and effective portion of interest rate contracts with respect to the Convertible Notes, the Senior Notes, the term loan agreement and the revolving credit facility during the three months ended September 25, 2016 and September 27, 2015.

	Three Months Ended	
	September 25, 2016	September 27, 2015
	(in thousands)	
Contractual interest coupon	\$34,712	\$14,451
Amortization of interest discount	5,914	9,122
Amortization of issuance costs	918	652
Effect of interest rate contracts, net	(1,058)	94
Total interest cost recognized	\$40,486	\$24,319

**Term Loan Agreement**

On May 13, 2016, we entered into an Amended and Restated Term Loan Agreement (the "Amended and Restated Term Loan Agreement"), which amends and restates the Term Loan Agreement we entered into on November 10, 2015 with a syndicate of lenders. The Amended and Restated Term Loan Agreement provides for a commitment of \$1,530.0 million senior unsecured term loan facility composed of two tranches (the "Commitments"); (i) a \$1,005.0 million tranche of 3-year senior unsecured loans; and (ii) a \$525.0 million tranche of 5-year senior unsecured loans. The Commitments automatically terminated on October 5, 2016, upon termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporation (see Note 15 for additional detail). In conjunction with the termination of the Commitments the Company will release approximately \$3.7 million of loan issuance costs to other expense, net in the three months ended December 25, 2016.

**Revolving Credit Facility**

On November 10, 2015, we entered into an Amendment and Restatement Agreement (as amended on April 26, 2016 by Amendment No. 1 to the Amended and Restated Credit Agreement, and as further amended, restated, supplemented or otherwise modified from time to time, the "Amended and Restated Credit Agreement"), which amends and restates the Company's prior unsecured Credit Agreement, dated March 12, 2014 (as amended by Amendment No. 1, dated March 5, 2015). The Amended and Restated Credit Agreement provides for an increase to our revolving unsecured credit facility, from \$300.0 million to \$750.0 million with a syndicate of lenders. It includes an expansion

option, subject to certain requirements, for us to request an increase in the facility of up to an additional \$250.0 million, for a potential total commitment of \$1.0 billion. Proceeds from the credit facility can be used for general corporate purposes. The facility matures on November 10, 2020. Termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporate has no effect to the Amended and Restated Credit Agreement. Interest on amounts borrowed under the credit facility is, at the Company's option, based on (i) a base rate, defined as the greatest of (a) prime rate, (b) Federal Funds rate plus 0.5%, or (c) one-month LIBOR plus 1.0%, plus a spread of 0.0% to 0.5%, or (ii) LIBOR multiplied by the statutory rate, plus a spread of 0.9% to 1.5% in each case as the applicable spread is determined

Table of Contents

based on the rating of the Company's non-credit enhanced, senior unsecured long-term debt. Principal and any accrued and unpaid interest is due and payable upon maturity. Additionally, the Company will pay the lenders a quarterly commitment fee that varies based on the Company's credit rating. The Restated Credit Agreement contains affirmative covenants, negative covenants, financial covenants and events of default that are substantially similar to those in the Amended and Restated Term Loan Agreement. As of September 25, 2016, the Company had no borrowings outstanding under the credit facility and was in compliance with all financial covenants.

NOTE 12 — COMMITMENTS AND CONTINGENCIES

Operating Leases and Related Guarantees

The Company leases certain of its administrative, research and development ("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.

The Company has operating leases regarding certain improved properties in Fremont and Livermore, California (the "Operating Leases"). The Company was required to maintain cash collateral in an aggregate of approximately \$250.0 million in separate interest-bearing accounts as security for the Company's obligations. These amounts are recorded with other restricted cash and investments in the Company's Condensed Consolidated Balance Sheet as of September 25, 2016.

During the term of the Operating Leases and when the terms of the Operating Leases expire, the property subject to those Operating Leases 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 \$220.4 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 \$250.0 million, in the aggregate.

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 are intended to limit its exposure to such indemnifications. As of September 25, 2016, the Company had not recorded any liability 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 September 25, 2016, the maximum potential amount of future payments that it could be required to make under these arrangements and letters of credit was \$13.0 million. The Company does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid.



Table of Contents

## 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	
	September	September
	25,	27,
	2016	2015
	(in thousands)	
Balance at beginning of period	\$ 100,321	\$ 93,209
Warranties issued during the period	34,855	34,203
Settlements made during the period	(32,228 )	(28,458 )
Changes in liability for pre-existing warranties	278	14
Balance at end of period	\$ 103,226	\$ 98,968

## Legal proceedings

While the Company is not currently a party to any legal proceedings that it believes material, 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.

## NOTE 13 — STOCK REPURCHASE PROGRAM

On April 29, 2014, the Board of Directors authorized the repurchase of up to \$850 million of Common Stock. 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 on-shore cash and on-shore cash generation. This repurchase program has no termination date and may be suspended or discontinued at any time. As of September 25, 2016 the Company has approximately \$229.1 million available for purchase under this repurchase program.

The Company suspended share repurchase activity under the repurchase program and made no share repurchases during the three months ended September 25, 2016. The Company continues to withhold shares 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, during the three months ended September 25, 2016, the Company acquired 20,475 shares at a total cost of \$1.9 million related to tax withholding. 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 plan.

Table of Contents

## NOTE 14 — ACCUMULATED OTHER COMPREHENSIVE LOSS

The components of accumulated other comprehensive income (loss) (“AOCI”), net of tax at the end of the period, as well as the activity during the period, were as follows:

	Accumulated currency translation adjustment	Accumulated foreign unrealized holding gain (loss) on cash flow hedges	Accumulated unrealized holding gain (loss) on available- for-sale investments	Accumulated unrealized components of defined benefit plans	Total
	(in thousands)				
Balance as of June 26, 2016	\$(39,528)	\$ (15,623 )	\$ 4,896	\$(19,078 )	\$(69,333)
Other comprehensive income (loss) before reclassifications	4,302	(2,421 )	(2,723 )	123	(719 )
Losses reclassified from accumulated other comprehensive income (loss) to net income	199	(2) 11,950	(1) 903	(2) —	13,052
Net current-period other comprehensive income (loss)	\$4,501	\$ 9,529	\$ (1,820 )	\$ 123	\$12,333
Balance as of September 25, 2016	\$(35,027)	\$ (6,094 )	\$ 3,076	\$(18,955 )	\$(57,000)

(1) Amount of after tax gain reclassified from AOCI into net income located in revenue: \$12,094 loss; cost of goods sold: \$147 gain; selling, general and administrative expenses: \$9 loss; and other income and expense: \$6 gain.

(2) Amount of after tax gain reclassified from accumulated other comprehensive income into net income located in other expense, net.

## NOTE 15 – BUSINESS COMBINATIONS

On October 20, 2015, the Company entered into an Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporation. On October 5, 2016, the Company and KLA-Tencor announced that they had mutually agreed to terminate their previously announced Agreement and Plan of Merger and Reorganization. No termination fee is payable by either the Company or KLA-Tencor.

During the three months ended September 25, 2016 the Company expensed acquisition-related costs as incurred of \$10.0 million, within selling, general, and administrative expense in the Condensed Consolidated Statement 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 “believe,” “anticipate,” “expect,” “may,” “should,” “could,” and “estimated” 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 and opportunities 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, international sales, revenue and operating expenses generally; management’s plans and objectives for our current and future operations and business focus; volatility in our quarterly results; customer and end user requirements and our ability to satisfy those requirements; customer capital spending and their demand for our products, and the reliability of indicators of change in customer spending and demand; the effect of variability in our customers’ business plans on demand for our equipment and services; changes in demand for our products and in our market share resulting from, among other things, increases in our customers’ proportion of capital expenditure (with respect to certain technology inflections); hedging transactions; our ability to defend our market share; our ability to obtain and qualify alternative sources of supply; factors that affect our tax rates; 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 expenditures; the success of joint development relationships with customers, suppliers or other industry members, and outsourced activities; the role of component suppliers in our business; the resources invested to comply with evolving standards and the impact of such efforts; 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 intention to pay quarterly dividends and the amounts thereof, if any; our ability and intention to repurchase our shares; 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 26, 2016 (our “2016 Form 10-K”) 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 do not undertake any 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 of this report 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 September 25, 2016, 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 2016 Form 10-K.

EXECUTIVE SUMMARY

Lam Research Corporation (“Lam Research,” “Lam,” “we,” or “our”) has been an innovative supplier of wafer fabrication equipment and services to the semiconductor industry for more than 35 years. Our customers include semiconductor manufacturers that make memory, microprocessors, and other logic integrated circuits for a wide range of electronics; including mobile phones, computers, tablets, wearables, automotive features, storage devices, and networking

equipment.

Our market-leading products are designed to help our customers build small, fast, and sophisticated chips essential to computing devices, cars, cloud services and other technologies and devices that power the modern economy. The process of integrated circuits fabrication consists of a complex series of process and preparation steps, and our product offerings in deposition, etch, and clean address a number of the most critical steps in the fabrication process. We leverage our expertise in semiconductor processing to develop technology and/or productivity solutions that typically benefit our customers through

27

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Table of Contents

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.

The semiconductor capital equipment industry has been highly competitive and characterized by rapid changes in demand. Industry cyclicality has been mitigated in recent years by market demands and consolidation among our customers. However, with a reduced number of customers, variability in their business plans can lead to rapid changes in demand for Lam's equipment and services. The variability in our customers' investments during any particular period is dependent on several factors including but not limited to electronics demand, economic conditions (both general and in the semiconductor and electronics industries), industry supply and demand, prices for semiconductors, and our customers' ability to develop and manufacture increasingly complex and costly semiconductor devices.

Demand for our products increased in the quarter ended September 25, 2016 (the "September 2016 quarter") compared to the quarter ended June 26, 2016 (the "June 2016 quarter") primarily as foundry customers made capacity and technology investments. This demand trend manifested as higher shipments in the September 2016 quarter, and we believe demand for our products will strengthen over the next quarter. Technology inflections in our industry, including FinFET transistors, 3D NAND, multiple patterning and advanced packaging have led to an increase in our served addressable market for our deposition and etch products. We believe that, over the longer term, demand for our products should increase as the proportion of customers' capital expenditures rises in these technology inflection areas and we continue to gain market share.

In October 2015, we entered into an Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporation. On October 5, 2016, we announced that both parties have mutually agreed to terminate that agreement. The following summarizes certain key financial information for the periods indicated below:

	Three Months Ended		
	September 25, 2016	June 26, 2016	September 27, 2015
	(in thousands, except per share data and percentages)		
Revenue	\$1,632,419	\$1,546,261	\$1,600,043
Gross margin	\$716,197	\$698,784	\$722,363
Gross margin as a percent of total revenue	43.9	% 45.2	% 45.1
Total operating expenses	\$400,250	\$389,543	\$386,935
Net income	\$263,835	\$258,939	\$288,679
Diluted net income per share	\$1.47	\$1.46	\$1.66

In the September 2016 quarter, revenue increased compared to the June 2016 quarter, primarily as a result of an increase in investment from our foundry customers. Gross margin as a percentage of revenue in the September 2016 quarter decreased as compared to the June 2016 quarter due to changes in customer concentration and product mix. Operating expenses in the September 2016 quarter increased compared to the June 2016 quarter mainly due to a \$15 million gain recognized in June 2016 for the sale of assets, net of associated exit costs.

Our cash and cash equivalents, investments, and restricted cash and investments balances increased to approximately \$7.5 billion as of September 25, 2016 as compared to \$7.1 billion as of June 26, 2016. Cash generated by operations was approximately \$473 million during the September 2016 quarter. We used cash during the September 2016 quarter for \$42 million of capital expenditures and \$48 million of dividends paid to our stockholders. Employee headcount as of September 25, 2016 was approximately 7,800 people.

Table of Contents

## RESULTS OF OPERATIONS

## Shipments

	Three Months Ended			
	September 25, 2016	June 26, 2016	September 27, 2015	
Shipments (in millions)	\$1,708	\$1,587	\$1,579	
Taiwan	26	% 20	% 26	%
Korea	28	% 15	% 13	%
Japan	11	% 14	% 17	%
China	11	% 17	% 25	%
Southeast Asia	11	% 20	% 8	%
United States	8	% 10	% 8	%
Europe	5	% 4	% 3	%

Shipments for the September 2016 quarter increased 8% from both the June 2016 and September 2015 quarter levels, reflecting continued strengthening of customer demand for semiconductor equipment. The increase in the September 2016 quarter from the June 2016 quarter was mainly driven by investments from our Foundry customers.

The percentages of system shipments to each of the markets we serve were as follows for the periods presented:

	Three Months Ended			
	September 25, 2016	June 26, 2016	September 27, 2015	
Memory	56%	66%	72%	%
Foundry	36%	27%	18%	%
Logic/integrated device manufacturing	8%	7%	10%	%

## Revenue

	Three Months Ended			
	September 25, 2016	June 26, 2016	September 27, 2015	
Revenue (in millions)	\$1,632	\$1,546	\$1,600	
Taiwan	26	% 15	% 28	%
Korea	23	% 15	% 17	%
Japan	15	% 14	% 18	%
China	14	% 22	% 16	%
Southeast Asia	12	% 21	% 8	%
United States	7	% 10	% 9	%
Europe	3	% 3	% 4	%

Revenue for the September 2016 quarter increased 6% from the June 2016 quarter and increased 2% compared to the September 2015 quarter, reflecting an increase in technology and capacity investments by our customers. Our deferred revenue balance increased to \$704 million as of September 25, 2016 compared to \$566 million as of June 26, 2016, as a result of timing of shipments. Our deferred revenue balance does not include system shipments to Japanese customers, for which title does not transfer until customer acceptance. Shipments to Japanese customers are classified as inventory at cost until the time of acceptance. The estimated future revenue value from shipments to Japanese customers was approximately \$65 million as of September 25, 2016 and \$132 million as of June 26, 2016.



Table of Contents

## Gross Margin

	Three Months Ended		
	September 25, 2016	June 26, 2016	September 27, 2015
	(in thousands, except percentages)		
Gross margin	\$716,197	\$698,784	\$722,363
Percent of total revenue	43.9	% 45.2	% 45.1

Gross margin as a percentage of revenue in the September 2016 quarter decreased as compared to the June 2016 quarter as well as the September 2015 quarter due primarily to unfavorable changes in customer and product mix.

## Research and Development

	Three Months Ended		
	September 25, 2016	June 26, 2016	September 27, 2015
	(in thousands, except percentages)		
Research & development ("R&D")	\$235,240	\$237,255	\$234,209
Percent of total revenue	14.4	% 15.3	% 14.6

We continued to make significant R&D investments focused on leading-edge deposition, plasma etch, single-wafer clean and other semiconductor manufacturing requirements. The spending in the September 2016 quarter decreased compared to the June 2016 quarter mainly due to a \$5 million decrease in campus consolidation costs offset by an increase of \$2 million in employee compensation and \$1 million in depreciation and amortization. The increase in R&D expenses during the September 2016 quarter compared to the same period in the prior year was mainly due to a \$8 million increase in salaries and benefits from increased headcount and a \$3 million increase in outside services, offset by a \$12 million decrease in supplies resulting from lower project materials and wafer spend.

## Selling, General and Administrative

	Three Months Ended		
	September 25, 2016	June 26, 2016	September 27, 2015
	(in thousands, except percentages)		
Selling, general & administrative ("SG&A")	\$165,010	\$152,288	\$152,726
Percent of total revenue	10.1	% 9.8	% 9.5

The increase in SG&A expenses during the September 2016 quarter compared to the June 2016 quarter was due to a \$15 million gain on sale of assets, net of associated exit cost, recognized in June 2016, a \$2 million increase in rent, and a \$3 million increase in employee compensation offset by a \$9 million decrease in KLA-Tencor acquisition-related costs. The increase in SG&A expenses during the September 2016 quarter compared to the same period in the prior year was due to a \$5 million increase in salaries and benefits from an increased headcount and a \$10 million increase from KLA-Tencor acquisition-related costs.





Table of Contents

## Other Expense, Net

Other expense, net consisted of the following:

	Three Months Ended		
	September 25, 2016	June 26, 2016	September 27, 2015
	(in thousands)		
Interest income	\$12,763	\$8,875	\$5,760
Interest expense	(41,429 )	(33,479 )	(24,661 )
Gains (losses) on deferred compensation plan related assets, net	6,172	185	(5,164 )
Foreign exchange gains (losses), net	1,219	(1,963 )	(698 )
Other, net	(1,879 )	(867 )	(2,358 )
	\$ (23,154 )	\$ (27,249 )	\$ (27,121 )

Interest income increased in the September 2016 quarter, as compared to the June 2016 quarter and September 2016 quarter, primarily as a result of higher average cash and investment balances.

Interest expense increased in the September 2016 quarter, as compared to both the June 2016 and September 2015 quarter, due to the \$2.4 billion Senior Note issuance in the June 2016 quarter.

Changes in the market value of securities in the portfolio drove the noted variability in the gains/losses on assets related to obligations under our deferred compensation plan.

Foreign exchange gains in the September 2016 quarter, in comparison to losses in the June 2016 and September 2015 quarters, were related to volatility in the foreign currency market and its impact on unhedged portions of the balance sheet exposures.

## Income Tax Expense

Our provision for income taxes and effective tax rate for the periods indicated were as follows:

	Three Months Ended		
	September 25, 2016	June 26, 2016	September 27, 2015
	(in thousands, except percentages)		
Income tax expense	\$28,958	\$23,053	\$19,628
Effective tax rate	9.9	% 8.2	% 6.4

The increase in the effective tax rate for the September 2016 quarter compared to the June 2016 quarter was primarily due to the change in level and proportion of income in higher and lower tax jurisdictions.

The increase in the effective tax rate for the September 2016 quarter compared to the same period in 2015 was primarily due to the change in level and proportion of income in higher and lower tax jurisdictions, and recognition of the tax benefit of the Altera court ruling net of federal research and development credit expiration in the September 2015 quarter.

International revenues account for a significant portion of our total revenues, such that a material portion of our pre-tax income is earned and taxed outside the United States at rates that are generally lower than in the United States. Please refer to Note 6 of the notes to our Consolidated Financial Statements in our 2016 Form 10-K for additional information.

## 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. Any change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

31

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Table of Contents**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 base our estimates and assumptions on historical experience and on various other assumptions we believe 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. Our critical accounting estimates include:

- the recognition and valuation of revenue from multiple-element arrangements, which impacts revenue;
- the valuation of inventory, which impacts gross margin;
- the valuation of warranty reserves, which impacts gross margin;
- the valuation of equity based compensation expense, including forfeiture estimates, which impacts both gross margin and operating expenses;
- the recognition and measurement of current and deferred income taxes, including the measurement of uncertain tax positions, which impact our provision for income tax expenses; and
- the valuation and recoverability of long-lived assets, which impacts gross margin and operating expenses when we record asset impairments or accelerate their depreciation or amortization.

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

**Revenue Recognition:** We recognize 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 or are otherwise released from our 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 using their relative selling prices, based on our best estimate of selling price. Our sales arrangements do not include a general right of return. The maximum revenue recognized 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, deferred revenue and deferred costs are recorded in deferred profit on our Consolidated Balance Sheet.

**Inventory Valuation:** 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 requirement 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.

Warranty: We record a provision for estimated warranty expenses to cost of sales for each system when we recognize revenue. 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. We do not maintain a general or unspecified reserves; all warranty reserves are related to specific systems.

32

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Table of Contents

Equity-based Compensation: Employee Stock Purchase Plan (“ESPP”) and Employee Stock Plans: We determine the fair value of our restricted stock units (“RSUs”), excluding market-based performance RSUs, based upon the fair market value of our common stock at the date of grant, discounted for dividends. We estimate the fair value of our market-based performance RSUs using a Monte Carlo simulation model at the date of the grant. We estimate the fair value of our stock options and ESPP awards using a Black-Scholes option valuation model. This model requires the input of highly subjective assumptions, including expected stock price volatility and the estimated life of each award. We amortize the fair value of equity-based awards over the vesting periods of the award and we have elected to use the straight-line method of amortization. We estimate expected equity award forfeitures based on historical forfeiture rate activity and expected future employee turnover. We recognize the effect of adjustments made to the forfeiture rate, if any in the period that we change the forfeiture estimate.

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 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.

Long-lived assets: We review goodwill at least annually for impairment. If certain events or indicators of impairment occur between annual impairment tests, we will perform an impairment test at that date. In testing for a potential impairment of goodwill, we: (1) allocate goodwill to the 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. Prior to this allocation of the assets to the reporting units, we 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. In our goodwill impairment process we first assess qualitative factors to determine whether it is necessary to perform a quantitative analysis. We do not calculate the fair value of a reporting unit unless we determine, based on a qualitative assessment, that it is more likely than not that the reporting unit’s 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 an income approach. 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, 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. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge.

As a result, several factors could result in an 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 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 common stock price and resulting market capitalization, to the extent we determine that the decline is sustained and indicates a reduction in the fair value of our reporting units below their carrying value. Further, the value assigned to intangible assets, other than goodwill, is based on estimates and judgments regarding expectations such as the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from the estimates, we may be required to record an impairment charge to write down the asset to its realizable value.

33

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Table of Contents

For other long-lived assets, we routinely consider whether indicators of impairment are present. If such indicators are present, we determine whether the sum of the estimated undiscounted cash flows attributable to the assets is less than their carrying value. If the sum is less, we recognize an impairment loss based on the excess of the carrying amount of the assets over their respective fair values. Fair value is determined by discounted future cash flows, appraisals or other methods. We recognize an impairment charge to the extent the present value of anticipated net cash flows attributable to the asset are less than the asset's carrying value. The fair value of the asset then becomes the asset's new carrying value, which we depreciate over the remaining estimated useful life of the asset. Assets to be disposed of are reported at the lower of the carrying amount or fair value.

**Recent Accounting Pronouncements**

For a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our condensed consolidated financial statements, see Note 2, "Recent Accounting Pronouncements," of our Condensed Consolidated Financial Statements, included in Part 1 of this report.

**LIQUIDITY AND CAPITAL RESOURCES**

As of September 25, 2016, we had \$7.5 billion in gross cash and cash equivalents, investments, and restricted cash and investments (together comprising total cash and investments) compared to \$7.1 billion as of June 26, 2016. As a result of the October 5, 2016 termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor, our Senior Notes maturing in 2023 and 2026 were redeemed on October 13, 2016 under the Special Mandatory Redemption terms of the indenture governing these Notes, thereby reducing our total cash and investment balance by approximately \$1.6 billion. Approximately \$3.5 billion and \$3.1 billion of our total cash and investments as of September 25, 2016 and June 26, 2016, respectively, was held outside the United States in our foreign subsidiaries, the majority of which is held in U.S. Dollars and, of which, substantially all would be subject to tax at U.S. rates if it were to be repatriated.

**Cash Flows from Operating Activities**

Net cash provided by operating activities of \$473.2 million during the three months ended September 25, 2016 consisted of (in millions):

Net income	\$263.8
Non-cash charges:	
Depreciation and amortization	74.6
Equity-based compensation	38.6
Deferred income taxes	7.6
Amortization of note discounts and issuance costs	6.8
Changes in operating asset and liability accounts	65.0
Other	16.8
	\$473.2

Changes in operating asset and liability accounts, net of foreign exchange impact, included the following uses of cash: increases in accounts receivable of \$27.2 million and prepaid expense and other assets of \$16.9 million. The uses of cash are offset by sources of cash resulting from a decrease in inventory of \$26.9 million, increases in trade accounts payable of \$11.1 million, accrued expenses and other liabilities of \$3.1 million, and an increase in deferred profit of \$68.0 million.

**Cash Flows from Investing Activities**

Net cash provided by investing activities during the three months ended September 25, 2016 was \$376.8 million, primarily consisting of net sales of available-for-sale securities of \$431.8 million offset by capital expenditures of \$42.0 million.

**Cash Flows from Financing Activities**

Net cash used for financing activities during the three months ended September 25, 2016 was \$29.5 million, primarily consisting of \$1.9 million in treasury stock repurchases, \$48.1 million of dividends paid, partially offset by \$20.8 million of stock issuance and treasury stock reissuances associated with our employee stock-based compensation



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34

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Table of Contents

Liquidity

Given that the semiconductor equipment industry is highly competitive and has experienced rapid changes in demand historically, we believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in R&D and capital infrastructure. Anticipated cash flows from operations based on our current business outlook, combined with our current levels of cash, cash equivalents, and short term investments as of September 25, 2016, are expected to be sufficient to support our anticipated levels of operations, investments, debt service requirements, capital expenditures, capital redistributions, and dividends, 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.

As a result of the October 5, 2016 termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor, the 2023 Notes and the 2026 Notes were redeemed on October 13, 2016 under the Special Mandatory Redemption terms of the indenture governing these Notes. We were required to redeem all of the 2023 Notes and the 2026 Notes then outstanding, on October 13, 2016, at a special mandatory redemption price equal to 101% of the aggregate principal amount of such notes, plus accrued and unpaid interest from the date of initial issuance.

On May 13, 2016, we entered into an Amended and Restated Term Loan Agreement (the "Amended and Restated Term Loan Agreement"), which amends and restates the Term Loan Agreement we entered into on November 10, 2015 with a syndicate of lenders. The Amended and Restated Term Loan Agreement provides for a commitment of \$1,530.0 million senior unsecured term loan facility composed of two tranches (the "Commitments"); (i) a \$1,005.0 million tranche of 3-year senior unsecured loans; and (ii) a \$525.0 million tranche of 5-year senior unsecured loans. The Commitments automatically terminated on October 5, 2016, upon termination of the Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporation.

In the long 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 2016 Form 10-K. Other than noted below, our exposure related to market risk has not changed materially since June 26, 2016. All of the potential changes noted below are based on sensitivity analysis performed on our financial position as of September 25, 2016. Actual results may differ materially.

Table of Contents

## Fixed Income Securities

Our investments in various interest earning securities carry a degree of market risk for changes in interest rates. At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our fixed income investment portfolio. Conversely, declines in interest rates could have a material adverse impact on interest income for our investment portfolio. We target to maintain a conservative investment policy, which focuses on the safety and preservation of our capital by limiting default risk, market risk, reinvestment risk, and concentration risk. The following table presents the hypothetical fair values of fixed income securities that would result from selected potential decreases and increases in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points (“BPS”), 100 BPS, and 150 BPS. The hypothetical fair values as of September 25, 2016 were as follows:

	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of September 25, 2016	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)		50 BPS	100 BPS	150 BPS
	(in thousands)						
Time Deposit	\$913,725	\$913,725	\$913,725	\$ 913,725	\$913,725	\$913,725	\$913,725
Municipal Notes and Bonds	202,611	202,527	202,135	201,609	201,083	200,557	200,031
U.S. Treasury & Agencies	370,052	370,041	368,949	366,965	364,935	362,905	360,875
Government-Sponsored Enterprises	32,060	32,054	31,935	31,736	31,537	31,338	31,140
Foreign Government Bonds	14,585	14,558	14,469	14,376	14,284	14,191	14,099
Bank and Corporate Notes	950,873	948,561	944,537	940,382	936,226	932,070	927,914
Mortgage Backed Securities - Residential	16,137	16,023	15,842	15,659	15,475	15,292	15,108
Mortgage Backed Securities - Commercial	38,229	38,007	37,784	37,562	37,339	37,116	36,893
Total	\$2,538,272	\$2,535,496	\$2,529,376	\$ 2,522,014	\$2,514,604	\$2,507,194	\$2,499,785

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.

## ITEM 4. Controls and Procedures

## Design of Disclosure Controls and Procedures and Internal Control over Financial Reporting

We maintain disclosure controls and procedures and internal control over financial reporting that are designed to comply with Rule 13a-15 of the Exchange Act. In designing and evaluating the controls and procedures associated with each, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and that 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.

## Disclosure Controls and Procedures

As required by Exchange Act Rule 13a-15(b), as of September 25, 2016, 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.



## Table of Contents

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.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

While we are not currently a party to any legal proceedings that we believe are material, we are 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. We accrue 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, we believe that the amount of any such additional loss would be immaterial to our 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 us and our 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 Capital Equipment Industry is Subject to Variability and, as a Result, We Face Risks Related to Our Strategic Resource Allocation Decisions

The semiconductor capital equipment industry has historically been characterized by rapid changes in demand. The industry environment has moved toward an environment more characterized by variability across segments and customers accentuated by consolidation within the industry. Variability in our customers' business plans may lead to changes in demand for our equipment and services, which could negatively impact our results. The variability in our customers' investments during any particular period is dependent on several factors including but not limited to electronics demand, economic conditions (both general and in the semiconductor and electronics industries), industry supply and demand, prices for semiconductors, and our customers' ability to develop and manufacture increasingly complex and costly semiconductor devices. The changes in demand may require 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.



## Table of Contents

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. With the consolidation of customers within the industry, the semiconductor capital equipment market may experience rapid changes in demand driven both by changes in the market generally and the plans and requirements of particular customers. 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;
- 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;
- 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, operating results, and earnings. 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 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 Quarterly Revenues and Operating Results Are Variable

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;
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consolidation of the customer base, which may result in the investment decisions of one customer or market having a significant effect on demand for our products or services;

procurement shortages;

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;

our customers' reuse of existing and installed products, to the extent that such reuse decreases their need to purchase new products or services;



Table of Contents

• 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 or man-made 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 (as defined below) and related warrants on our earnings per share.

**We May Incur Impairments to Goodwill or Long-Lived Assets**

We review our long-lived assets, including goodwill and other intangible assets, for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Negative industry or economic trends, including reduced market prices of our Common Stock, reduced estimates of future cash flows, disruptions to our business, slower growth rates, or lack of growth in our relevant business units, could lead to impairment charges against our long-lived assets, including goodwill and other intangible assets. If, in any period, our stock price decreases to the point where our fair value, as determined by our market capitalization, is less than the book value of our assets, this could also indicate a potential impairment, and we may be required to record an impairment charge in that period, which could adversely affect our result of operations.

Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. We operate in a highly competitive environment and projections of future operating results and cash flows may vary significantly from actual results. Additionally, if our analysis indicates potential impairment to goodwill in one or more of our business units, we may be required to record additional charges to earnings in our financial statements, which could negatively affect our results of operations.

**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**

We have \$2.95 billion in aggregate principal amount of senior unsecured notes and convertible note instruments outstanding. Additionally, we have \$750 million available to us in revolving credit arrangements, with an option for us to request an increase in the facility of up to an additional \$250 million, for a potential total commitment of \$1 billion. We may, in the future, decide to borrow amounts under the revolving credit agreement, or to enter into additional debt arrangements.

In addition, we have entered, and in the future may enter, into derivative instrument arrangements to hedge against the variability of cash flows due to changes in the benchmark interest rate of fixed rate debt. We could be exposed to losses in the event of nonperformance by the counterparties to our derivative instruments.

Our indebtedness could have adverse consequences including:

• risk associated with any inability to satisfy our obligations;  
• a 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, particularly in the United States, 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 Convertible Notes and resulting exercise of the related warrants may cause dilution to our stockholders and to our earnings per share. The number of shares of our Common Stock into which the Convertible Notes are convertible for and the related warrants are exercisable for may be adjusted from time to time, including increases in such rates as a result of

39

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Table of Contents

dividends that we pay to our stockholders. Upon conversion of any Convertible Notes, we will deliver cash in the amount of the principal amount of the Convertible Notes and, with respect to any excess conversion value greater than the principal amount of the Convertible Notes, shares of our Common Stock, which would result in dilution to our stockholders. This dilution may not be completely mitigated by the hedging transactions we entered into in connection with the sale of certain Convertible Notes or through share repurchases. Prior to the maturity of the Convertible Notes, if the price of our Common Stock exceeds the conversion price, U.S. generally accepted accounting principles require 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 Convertible Notes as a more attractive means of equity participation in our company and also by hedging activity that may develop involving our Common Stock by holders of the Convertible Notes.

**Our Credit Agreements Contain Covenant Restrictions That May Limit Our Ability To Operate Our Business**

We may be unable to respond to changes in business and economic conditions, engage in transactions that might otherwise be beneficial to us, or obtain additional financing, because our debt agreements contain, and any of our other future similar agreements may contain, covenant restrictions that limit our ability to, among other things:

- incur additional debt, assume obligations in connection with letters of credit, or issue guarantees;
- create liens;
- enter into transactions with our affiliates;
- sell certain assets; and
- merge or consolidate with any person.

Our ability to comply with these covenants is dependent on our future performance, which will be subject to many factors, some of which are beyond our control, including prevailing economic conditions. In addition, our failure to comply with these covenants could result in a default under the Senior Notes, the Convertible Notes or our other debt, which could permit the holders to accelerate such debt. If any of our debt is accelerated, we may not have sufficient funds available to repay such debt, which could materially and negatively affect our financial condition and results of operation.

**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, cash flows, collections, and profitability. For the three months ended September 25, 2016, and the years ended June 26, 2016 and June 28, 2015, three customers collectively accounted for 51%, 45%, and 51% of total revenue, respectively. 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 decreased pricing, increased costs and/or lower margins for us; compliance with specific environmental, social and corporate governance standards; and limitations on our ability to share jointly developed technology with others. Similarly, significant portions of our credit risk may, at any given time, be concentrated among a limited number of customers, so that the failure of even one of these key customers to pay its obligations to us could significantly impact our financial results.

**We Depend on Creating New Products and Processes and Enhancing Existing 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 or existing products have reliability, quality, design, or safety 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 products successfully, or products that we introduce may fail in the marketplace. For over 25 years the primary driver of technology advancement in the semiconductor industry has been to shrink the lithography that prints the circuit design on semiconductor chips. That driver could be approaching its technological limit, leading semiconductor manufacturers to investigate more complex changes in multiple technologies in an effort to continue technology development. In the face of uncertainty on which technology solutions will become successful, we will need to focus our efforts on

developing the technology changes that are ultimately successful in supporting our customer requirements. Our failure to develop and offer the correct technology solutions in a timely manner with productive and cost-effective products could adversely affect our business in a material way. 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.

40

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## Table of Contents

In order to develop new products and processes and enhance existing products and processes, we expect to continue to make significant investments in R&D, to investigate the acquisition of complementary products and technologies, and to pursue joint development relationships with customers, suppliers, or other members of the industry. We may find that acquisitions are not available to us, for regulatory or other reasons, and that we must therefore limit ourselves to collaboration and joint venture development activities which do not have the same benefits as acquisitions. Pursuing development through collaboration and/or joint development activities rather than through an acquisition poses substantial challenges for management, including challenges related to aligning business objectives, sharing confidential information and IP, sharing value with third parties, and realizing synergies that might have been available in an acquisition but are not available through a joint development project.

We must manage product transitions and joint development relationships successfully, as the introduction of new products could adversely affect our sales of existing products and certain jointly developed technologies may be subject to restrictions on our ability to share that technology with other customers, which could limit our market for products incorporating those technologies. 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 our addressable markets or could increase the relative size of markets in which we either do not compete or have relatively low market share.

### **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. Our products are priced up to approximately \$9.8 million per system, and our revenues in any given quarter are dependent upon customer 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, and, in the longer term, the continued market acceptance of these products is 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 customers or customers within certain markets;
- an improved version of products being offered by a competitor in the markets 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. 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 semiconductors 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.

### **Strategic Alliances and 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. In certain instances, this could work to our disadvantage if a competitor's tools or equipment become the standard equipment for such functions or processes. Additional outcomes of such consolidation may include our customers re-evaluating their

future supplier relationships to consider other competitors' products and/or gaining additional influence over the pricing of products and the control of intellectual property.

Similarly, our customers may partner 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. Even if they select our equipment, the institutions and the customers that follow their lead could impose conditions on acceptance of that equipment, such as adherence to standards and requirements or limitations on how we license our proprietary

41

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## Table of Contents

rights that increase our costs or require us to take on greater risk. These actions could adversely impact our market share and financial results.

### **We Depend On a Limited Number of Key Suppliers and Outsource Providers, and We Run the Risk That They Might Not Perform as We Expect**

Outsource providers and component suppliers have played and will continue to play a key role in our manufacturing operations, field installation and support, and many of our transactional and administrative functions, such as information technology, facilities management, and certain elements of our finance organization. These providers and suppliers might suffer financial setbacks, be acquired by third parties, become subject to exclusivity arrangements that preclude further business with us or be unable to meet our requirements or expectation due to their independent business decisions, or force majeure events that could interrupt or impair their continued ability to perform as we expect.

Although we attempt to select reputable providers and suppliers, and we attempt to secure their performance on terms documented in written contracts, it is possible that one or more of these providers or suppliers could fail to perform as we expect, or fail to secure or protect intellectual property rights, and such failure could have an adverse impact on our business. In some cases, the requirements of our business mandate that we obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. Where practical, we endeavor to establish alternative sources to mitigate the risk that the failure of any single provider or supplier will adversely affect our business, but this is not feasible in all circumstances. There is therefore a risk that a prolonged inability to obtain certain components or secure key services could impair our ability to manage operations, ship products and generate revenues, which could adversely affect our operating results and damage our customer relationships.

### **We Face Risks Related to the Disruption of Our Primary Manufacturing Facilities**

Our manufacturing facilities are concentrated in just a few locations. These locations are subject to disruption for a variety of reasons such as natural or man-made disasters, terrorist activities, disruptions of our information technology resources, and utility interruptions. Such disruptions may cause delays in shipping our products, which could result in the loss of business or customer trust, adversely affecting our business and 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, especially for customers that are more focused on tool re-use. 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 and with increased consolidation efforts in our industry we may face increasing competitive pressures. 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.

We believe that to remain competitive we must devote significant financial resources to offer products that meet our customers' needs, to maintain customer service and support centers worldwide, and to invest in product and process R&D. Certain of our competitors, including 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 offer customers a more comprehensive array of products and to therefore achieve additional relative success in 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. In addition, we face competition from companies that exist in a more favorable legal or regulatory environment than we do, allowing them freedom of action in ways that we may be unable to match. For these reasons, we may fail to continue to compete successfully worldwide.

42

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Table of Contents

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 92%, 92%, and 83% of total revenue in the three months ended September 25, 2016 and fiscal years 2016 and 2015, respectively. We expect that international sales will continue to account for a substantial majority 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;

• tariffs and other barriers;

• global or national economic and political conditions;

• 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. and international trade restrictions and sanctions, anti-bribery, anti-corruption, environmental, and labor laws;

• fluctuations in interest and foreign currency exchange rates;

• our ability to repatriate cash in a tax-efficient manner;

• the need for technical support resources in different locations; and

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

Certain international sales depend on our ability to obtain export licenses from the U.S. government. Our failure or inability to obtain such licenses would substantially limit our markets and severely restrict our revenues. Many of the challenges noted above are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships 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. In addition, there are risks that the Chinese government may, among other things: insist on the use of local suppliers; compel companies that do business in China to partner with local companies to design and supply equipment on a local basis, requiring the transfer of intellectual property rights and/or local manufacturing; and provide special incentives to government-backed local customers to buy from local competitors, even if their products are inferior to ours; all of which could adversely impact our revenues and margins.

We are exposed to potentially adverse 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 primarily related to revenues denominated in Japanese yen and expenses denominated in euro and Korean won.

Currently, we hedge certain anticipated foreign currency cash flows, primarily anticipated revenues denominated in Japanese yen and euro-denominated and Korean won-denominated expenses. In addition, we enter into foreign currency hedge contracts to minimize the short-term impact of the foreign currency exchange rate fluctuations on certain foreign currency monetary assets and liabilities; primarily third party accounts receivables, accounts payables and intercompany receivables and payables. 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, 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

43

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## Table of Contents

monetary 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 potential unfavorable foreign currency exchange rate fluctuations to the extent that we transact business (including intercompany transactions) for these currencies.

The magnitude of our overseas business also affects where our cash is generated. Certain uses of cash, such as share repurchases, payment of dividends or the repayment of our notes, can usually only be made with on-shore cash balances. Since the majority of our cash is generated outside of the United States, this may impact certain business decisions and adversely affect business outcomes.

### **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. Following the termination of our recent acquisition activity, certain employees may experience uncertainty regarding their future role or continuing relationship with the Company which may negatively impact retention of existing employees. 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 Which are Susceptible to Cybersecurity and Other Threats or Incidents**

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 outsourced providers or third parties such as vendors and contractors. Many of these information systems and outsourced service providers, including certain hosted software applications that we use for confidential data (e.g., company related, whether intellectual property or not; customer related; supplier related; and / or employee related) storage, employ “cloud computing” technology for such storage (which refers to an information technology hosting and delivery system in which data is not stored within the user’s physical infrastructure but instead is delivered to and consumed by the user as an Internet-based service). All of 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 and/or sensitive information stored on these information systems or transmitted to or from cloud storage could be intentionally or unintentionally compromised, lost and/or stolen. While we have implemented ISO 27001 compliant security procedures, such as virus protection software, intrusion prevention system and emergency recovery processes, to mitigate the outlined risks with respect to information systems that are under our control, they 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 proprietary or confidential information, could unfavorably impact the timely and efficient operation of our business, including our results of operations, and our reputation.

### **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 allowance 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.

44

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Table of Contents

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

We are subject to a variety of domestic and international governmental regulations related to the handling, discharge, and disposal of toxic, volatile, or otherwise hazardous chemicals. Failure to comply with present or future environmental regulations could result in fines being imposed on us, require us to suspend production, cease operations, or cause our customers to not accept our products. These regulations could require us to alter our current operations, acquire significant additional equipment, incur substantial other expenses to comply with environmental regulations, or take other actions. Any failure to comply with regulations governing the use, handling, sale, transport or disposal of hazardous substances could subject us to future liabilities that may adversely affect our operating results, financial condition and ability to operate our business.

**If We Choose to Acquire or Dispose of Businesses, 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 seek to 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. For regulatory or other reasons, we may not be successful in our attempts to acquire or dispose of businesses, products or technologies, resulting in significant financial costs, reduced or lost opportunities and diversion of management's attention.

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/or 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, cash flows, 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, trends and unexpected developments 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 Convertible 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 price of and markets for semiconductors. These and other 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

45

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## Table of Contents

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.

### 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 persons 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 other indemnity obligations provide that we will indemnify officers and members of our board of directors against losses that they may incur in legal proceedings resulting from their service to us. 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 U.S. and foreign patents and pending patent applications, and we keep certain information, processes and techniques as trade secrets. However, other parties may challenge or attempt to invalidate or circumvent any patents the United States or foreign governments issue to us, these governments may fail to issue patents for pending applications, or we may lose trade secret protection over valuable information due to the intentional or unintentional actions or omissions of third parties, of ours or even our own employees. Additionally, intellectual property litigation can be expensive and time-consuming and even when patents are issued or trade secret processes are followed, 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, pending patent applications or trade secrets may be narrower than we expect or, in fact, provide no competitive advantages. Moreover, because we determine the jurisdictions in which to file patents at the time of filing, we may not have adequate protection in the future based on such previous decisions. Any of these circumstances could have a material adverse impact on our business.

### We Are Exposed to Various Risks from Our Regulatory Environment

We are subject to various risks related to (i) new, different, inconsistent or even conflicting laws, rules and regulations that may be enacted by legislative bodies and/or regulatory agencies in the countries that we operate; (ii) disagreements or disputes between national or regional regulatory agencies related to international trade; and (iii) the interpretation and application of laws, rules and regulations. As a public company with global operations, we are subject to the laws of multiple jurisdictions and the rules and regulations of various governing bodies, including those related to financial and other disclosures, corporate governance, privacy, anti-corruption, such as the Foreign Corrupt Practices Act and other local laws prohibiting corrupt payments to governmental officials, conflict minerals or

other social responsibility legislation, and antitrust regulations, among others. Each of these laws, rules and regulations imposes costs on our business, including financial costs and potential diversion of our management's attention associated with compliance, and may present risks to our business, including potential fines, restrictions on our actions, and reputational damage if we are unable to fully comply.

To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with all evolving standards. Changes in or ambiguous interpretations of laws, regulations and standards may create uncertainty regarding compliance matters. Efforts to comply with new and changing regulations have resulted in, and are likely to continue to result in, increased selling, general and administrative expenses and a diversion of management's time and attention from revenue generating activities to compliance activities. If we are found by a court or regulatory agency



Table of Contents

not to be in compliance with the laws and regulations, our business, financial condition, and/or results of operations could be adversely affected.

**There Can Be No Assurance That We Will Continue To Declare Cash Dividends Or Repurchase Our Shares At All Or In Any Particular Amounts**

Our Board of Directors has declared quarterly dividends since April 2014. Our intent to continue to pay quarterly dividends and to repurchase our shares is subject to capital availability; and, in the case of dividends, periodic determinations by our Board of Directors that cash dividends are in the best interest of our stockholders and are in compliance with all laws and agreements applicable to the declaration and payment of cash dividends by us. Future dividends and share repurchases may also be affected by, among other factors: our views on potential future capital requirements for investments in acquisitions and the funding of our research and development; legal risks; changes in federal and state income tax laws or corporate laws; contractual restrictions, such as financial or operating covenants in our debt arrangements; availability of onshore cash flow; and changes to our business model. Our dividend payments and share repurchases may change from time to time, and we cannot provide assurance that we will continue to declare dividends or repurchase shares at all or in any particular amounts. A reduction or suspension in our dividend payments could have a negative effect on our stock price.

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

**Repurchases of Company Shares**

On April 29, 2014, the Board of Directors authorized us to repurchase up to \$850 million of common stock, which included the remaining value available under our prior authorization. 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 on-shore cash and on-shore cash generation. This repurchase program has no termination date and may be suspended or discontinued at any time. As of September 25, 2016 we have approximately \$229.1 million available for purchase under this repurchase program.

We suspended share repurchase activity under the repurchase program and made no share repurchases during the three months ended September 25, 2016. We continue to withhold shares through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under our equity compensation plans, during the three months ended September 25, 2016, we acquired 20,475 shares at a total cost of \$1.9 million related to tax withholding. The shares retained by us through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under our equity compensation plan.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**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.

Table of Contents

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: October 24, 2016 LAM RESEARCH CORPORATION  
(Registrant)

/s/ Douglas R. Bettinger  
Douglas R. Bettinger  
Executive Vice President, Chief Financial Officer  
(Principal Financial Officer and Principal Accounting  
Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
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- |                    |   |
|--------------------|---|
| 2.1(1)             | Termination Agreement, dated October 5, 2016, by and between Lam Research Corporation and KLA-Tencor Corporation.               |
| 10.1               |   |
| 10.1               | Form of Market-Based Performance Restricted Stock Unit Award Agreement (U.S. Participants) - 2015 Stock Incentive Plan          |
| 10.2               | Form of Market-Based Performance Restricted Stock Unit Award Agreement (International Participants) - 2015 Stock Incentive Plan |
| 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. <del>NS</del> | <del>NS</del> IRL Instance Document   |
| 101. <del>SC</del> | <del>SC</del> IRL Taxonomy Extension Schema Document  |
| 101. <del>CA</del> | <del>CA</del> IRL Taxonomy Extension Calculation Linkbase Document  |
| 101. <del>DB</del> | <del>DB</del> IRL Taxonomy Extension Definition Linkbase Document   |
| 101. <del>XL</del> | <del>XL</del> IRL Taxonomy Extension Label Linkbase Document  |
| 101. <del>PR</del> | <del>PR</del> IRL Taxonomy Extension Presentation Linkbase Document   |
- (1) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on October 5, 2016 (SEC File No 000-12933)