LATTICE SEMICONDUCTOR CORP
Form 10-Q/A
April 19, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

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

For the quarterly period ended September 27, 2003

OR

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

For the transition period from to

Commission file number 000-18032

LATTICE SEMICONDUCTOR CORPORATION

(Exact name of Registrant as specified in its charter)

State of Delaware	**93-0835214**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5555 N.E. Moore Court, Hillsboro, Oregon	**97124-6421**
(Address of principal executive offices)	(Zip Code)

(503) 268-8000
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ý No o

At September 27, 2003, there were 112,772,007 shares of the Registrant s common stock, $.01 par value, outstanding.

This Quarterly Report on form 10-Q/A amends the Registrant s Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2003, as filed by the Registrant on November 12, 2003, and is being filed to reflect the restatement of the Registrant s Condensed Consolidated Financial Statements (the Restatement). The Restatement reflects adjustments to revenue, related cost of products sold, deferred income and accrued expenses pertaining to both a correction of an error and a change in estimate to deferred income and a correction to accrued expenses as of September 30, 2003. A discussion of this Restatement and a summary of the effects of the Restatement are presented in Note 15 to the Condensed Consolidated Financial Statements. Changes have been made to the disclosure in Items 1,2 and 4 of this Form 10-Q/A in connection with the Restatement.

The information contained in this Form 10-Q/A is as of November 12, 2003, except for the information related to the Restatement discussed above, which has been updated through April 19, 2004. This Form 10-Q/A should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2003.

LATTICE SEMICONDUCTOR CORPORATION

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(In thousands, except per share data)

(unaudited)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2003	Sept. 30, 2002	Sept. 30, 2003	Sept. 30, 2002
	(Restated)		(Restated)	
Revenue	$ 43,033	$ 56,072	$ 156,905	$ 171,416
Costs and expenses:				
Cost of products sold	19,431	22,429	65,452	68,527
Research and development	21,173	21,523	64,707	63,986
Selling, general and administrative	12,114	11,712	37,211	35,790
In-process research and development		5,653		29,853
Amortization of intangible assets (1)	18,665	18,070	58,466	54,616
Total costs and expenses	71,383	79,387	225,836	252,772
Loss from operations	(28,350)	(23,315)	(68,931)	(81,356)
Other (expense) income, net	(3,611)	2,764	(3,485)	3,941
Loss before benefit for income taxes	(31,961)	(20,551)	(72,416)	(77,415)
Benefit for income taxes	(3,300)	(6,180)	(5,854)	(29,280)
Net loss	$ (28,661)	$ (14,371)	$ (66,562)	$ (48,135)
Basic net loss per share	$ (0.26)	$ (0.13)	$ (0.60)	$ (0.44)
Diluted net loss per share	$ (0.26)	$ (0.13)	$ (0.60)	$ (0.44)

Shares used in per share calculations:

Basic	**111,840**	**110,232**	**111,615**	**109,855**
Diluted	**111,840**	**110,232**	**111,615**	**109,855**

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(1) **Includes $820 and $760 of amortization of deferred stock compensation expense for the three months ended September 30, 2003 and September 30, 2002, respectively, and $4,931 and $1,887 for the nine months ended September 30, 2003 and September 30, 2002, respectively, attributable to Research and Development activities.**

See Accompanying Notes to Condensed Consolidated Financial Statements

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET

(In thousands, except share and par value data)

(unaudited)

	Sept. 30, 2003 (Restated)	December 31, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 153,334	$ 169,475
Short-term investments	125,420	107,405
Accounts receivable, net	26,941	26,374
Inventories	47,942	56,241
Other current assets	12,617	35,033
Total current assets	366,254	394,528
Property and equipment, net	56,520	62,786
Foundry investments, advances and other assets	124,670	104,507
Intangible assets, net	102,466	155,953
Goodwill	223,605	223,489
	$ 873,515	$ 941,263
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 34,356	$ 33,597
Deferred income on sales to		
Distributors	9,766	11,983
Income taxes payable		142
Total current liabilities	44,122	45,722
4 3/4% Convertible notes due in 2006		208,061
Zero Coupon Convertible notes due in 2010	184,000	
Other long-term liabilities	22,053	26,345
Commitments and contingencies		
Stockholders equity:		

Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued or outstanding				
Common stock, $.01 par value, 300,000,000 shares authorized, 112,772,007 and 112,358,043 shares issued and outstanding		**1,128**		**1,124**
Paid-in capital		**584,635**		**580,987**
Deferred stock compensation		**(6,320)**		**(11,540)**
Accumulated other comprehensive income (loss)		**15,264**		**(4,631)**
Retained earnings		**28,633**		**95,195**
Total stockholders equity		**623,340**		**661,135**
	$	**873,515**	**$**	**941,263**

See Accompanying Notes to Condensed Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands)

(unaudited)

	Nine Months Ended September 30, 2003 (Restated)	Nine Months Ended September 30, 2002
Cash flows from operating activities:		
Net loss	$ (66,562)	$ (48,135)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	74,873	70,205
Gain on sale of equity securities	(271)	(4,017)
Loss (Gain) on retirement of convertible notes	1,381	(5,710)
In-process research and development		29,853
Tax benefit of option exercises		797
Changes in assets and liabilities (net of effect of business combination):		
Accounts receivable	(567)	(8,247)
Inventories	8,299	7,534
Foundry, investments, advances and other assets	23,447	27,337
Deferred income taxes		1,369
Accounts payable and accrued expenses	2,451	3,006
Deferred income	(2,217)	(3,701)
Income taxes payable	(142)	(22,513)
Other liabilities	(4,683)	(1,406)
Total adjustments	102,571	94,507
Net cash provided by operating activities	36,009	46,372
Cash flows from investing activities:		
Proceeds from short-term investments, net	311,307	249,048
Purchase of short-term investments	(329,323)	(103,259)
Acquisition of Agere FPGA		(254,232)
Acquisition of Cerdelinx		(2,530)
Purchase of equity securities	(474)	
Proceeds from sale of equity securities	745	9,930
Capital expenditures	(8,015)	(15,314)
Net cash used by investing activities	(25,760)	(116,357)
Cash flows from financing activities:		
Extinguishment of convertible debt, net	(223,684)	(27,441)
Issuance of convertible debt, net	194,558	

Net proceeds from issuance of common stock		**2,736**		**1,864**
Net cash used in financing activities		**(26,390)**		**(25,577)**
Net decrease in cash and cash equivalents		**(16,141)**		**(95,562)**
Beginning cash and cash equivalents		**169,475**		**250,203**
Ending cash and cash equivalents	**$**	**153,334**	**$**	**154,641**
Supplemental disclosures of cash flow information:				
Cash received for income taxes, net	**$**	**(28,370)**	**$**	**(35,083)**
Cash paid for interest	**$**	**6,371**	**$**	**6,527**
Supplemental disclosures of non-cash investing and financing activities:				
Unrealized gain (loss) on appreciation of foundry investments included in other comprehensive income	**$**	**19,752**	**$**	**(23,776)**
Stock issued in conjunction with Cerdelinx acquisition	**$**		**$**	**21,643**

See Accompanying Notes to Condensed Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of Presentation:

The accompanying consolidated financial statements are unaudited and have been prepared by Lattice Semiconductor Corporation (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission and in our opinion include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with our audited financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2002.

On August 26, 2002, we completed the stock for stock acquisition of Cerdelinx Technologies, Inc. (Cerdelinx) for 2.6 million shares valued at $8.30 per share. This transaction was accounted for as an asset purchase, and accordingly, the results of operations for Cerdelinx and estimated fair value of assets acquired and liabilities assumed were included in our condensed consolidated financial statements beginning August 26, 2002. This acquisition is discussed further in Note 4.

On January 18, 2002, we completed the acquisition of the field-programmable gate array (FPGA) business (Agere FPGA) of Agere Systems Inc. (Agere) for $250 million in cash. This transaction was accounted for as an asset purchase, and accordingly, the results of operations for Agere FPGA and estimated fair value of assets acquired and liabilities assumed were included in our condensed consolidated financial statements beginning January 18, 2002. This acquisition is discussed further in Note 5.

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the fiscal periods presented. Actual results could differ from these estimates.

We report based on a 52 or 53 week year ending on the Saturday closest to December 31. For ease of presentation, we have adopted the convention of using March 31, June 30, September 30 and December 31 as period end dates for all financial statement captions.

This Quarterly Report on Form 10-Q/A contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. Actual results could differ materially from those projected in the forward-looking statements as a result of the factors, set forth in the section entitled Factors Affecting Future Results and elsewhere in this report.

Note 2 - Revenue Recognition:

Revenue from sales to OEM customers is recognized upon shipment provided that persuasive evidence of an arrangement exists, the price is fixed and determinable, title has transferred, collection of resulting receivables is probable, there are no customer acceptance requirements and no remaining significant obligations. Certain of our sales are made to distributors under agreements providing price protection and right of return on unsold merchandise. Revenue and cost relating to such distributor sales are deferred until either the product is sold by the distributor or return privileges and price protection rights terminate and related estimated revenue and estimated costs are then reflected in income. Revenue from software sales was not material for the periods presented.

Note 3 Net Income Per Share:

Net income per share is computed based on the weighted average number of shares of common stock and potentially dilutive securities assumed to be outstanding during the period using the treasury stock method. Potentially dilutive securities consist of stock options, warrants to purchase common stock and convertible subordinated notes.

The most significant difference between the computation of basic and diluted net income per share is that basic net income per share does not treat potentially dilutive securities such as stock options, warrants and convertible subordinated notes as outstanding. For all periods presented, the computation of net loss per share excludes the effect of our stock options, warrants and convertible notes as they were antidilutive. A reconciliation of basic and diluted net income per share is presented below (in thousands, except for per share data):

	Three months ended		**Nine months ended**	
	Sept. 30, 2003 (Restated)	**Sept. 30, 2002**	**Sept. 30, 2003 (Restated)**	**Sept. 30, 2002**
Net loss	$ (28,661)	$ (14,371)	$ (66,562)	$ (48,135)
Shares used in basic net loss per share calculations	111,840	110,232	111,615	109,855
Dilutive effect of stock options, warrants and other potentially dilutive securities				
Shares used in diluted net loss per share	111,840	110,232	111,615	109,855
Basic net loss per share	$ (0.26)	$ (0.13)	$ (0.60)	$ (0.44)
Diluted net loss per share	$ (0.26)	$ (0.13)	$ (0.60)	$ (0.44)

Stock-Based Compensation

We account for our employee and director stock options and employee stock purchase plan in accordance with provisions of Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees. Pro forma disclosures as required under Statement of Financial Accounting Standards (SFAS) 123, Accounting for Stock-Based Compensation and as amended by SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure, are presented below. Pursuant to FASB Interpretation No. 44 Accounting for Certain Transactions Involving Stock Based Compensation an interpretation of APB Opinion No. 25, effective July 1, 2000, the in the money portion of stock options granted to employees in connection with acquisitions is accounted for as Deferred Stock Compensation in Stockholders Equity and amortized to operations as part of Amortization of Intangible Assets over the vesting periods of the options.

The fair value of our stock-based employee compensation cost for purposes of our pro forma disclosures was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Grants for			
	Three months ended		**Nine months ended**	
	Sept. 30, 2003	**Sept. 30, 2002**	**Sept. 30, 2003**	**Sept. 30, 2002**
Stock Options:				
Expected Volatility	57.5%	59.3%	58.1%	59.3%
Risk-free interest rate	2.4%	2.5%	2.1%	2.6%
Expected life from vesting date	1.6 years	1.8 years	0.5 years	1.8 years
Dividend yield	0%	0%	0%	0%

The Black-Scholes option pricing model was developed for use in estimating the fair value of freely tradable, fully transferable options without vesting restrictions. Our stock options have characteristics which differ significantly from those of freely tradable, fully transferable options. The Black-Scholes option pricing model also requires highly subjective assumptions, including expected stock price volatility and expected stock option term which greatly affect the calculated fair value of an option. Our actual stock price volatility and option term may be materially different from the assumptions used herein.

As pertaining to activity for the three and nine months ended September 30, 2003 and 2002, the resultant grant date weighted-average fair values calculated using the Black-Scholes option pricing model and the noted assumptions for stock options granted were $3.35 and $2.78 for the third quarter of 2003 and 2002, respectively, and $1.24 and $3.03 for the nine months ended September 30, 2003 and 2002, respectively. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting period.

Our pro forma information is as follows (in thousands, except per share data):

	Three months ended Sept. 30, 2003 (Restated)	Three months ended Sept. 30, 2002	Nine months ended Sept. 30, 2003 (Restated)	Nine months ended Sept. 30, 2002
Net loss, as reported	$ (28,661)	$ (14,371)	$ (66,562)	$ (48,135)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	820	760	4,931	1,887
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(5,603)	(9,970)	(19,915)	(27,165)
Pro forma net loss	$ (33,444)	$ (23,581)	$ (81,546)	$ (73,413)
Net loss per share:				
Basic-as reported	$ (0.26)	$ (0.13)	$ (0.60)	$ (0.44)
Basic- pro forma	$ (0.30)	$ (0.21)	$ (0.73)	$ (0.67)
Diluted-as reported	$ (0.26)	$ (0.13)	$ (0.60)	$ (0.44)
Diluted-pro forma	$ (0.30)	$ (0.21)	$ (0.73)	$ (0.67)

Note 4 Acquisition of Cerdelinx:

On August 26, 2002, we completed the stock for stock acquisition of Cerdelinx for 2.6 million shares valued at $8.30 per share. Cerdelinx was an early stage fabless semiconductor company focused on the design of application specific standard products targeted towards emerging high-speed communications and storage applications. Cerdelinx had a team of engineers who were developing a portfolio of low-power CMOS transceivers and backplane interfaces with embedded high-speed SERDES I/O to support 10 gigabit-per-second applications. The acquisition serves to enhance our silicon development efforts and our ability to deliver leading-edge programmable solutions within the communications and storage market segments. This acquisition principally comprises intellectual property and a work force. The core technology portion of the intellectual property is valued using a royalty savings methodology which discounts estimated royalties that would be paid on an after tax basis. The in-process technology portion of the intellectual property is valued using a discounted cash flow methodology described in detail below. Work force is valued using a replacement cost methodology which discounts costs to an after tax amount. The transaction was completed pursuant to an Agreement and Plan of Reorganization entered into on July 15, 2002, as amended on July 24, 2002, among Lattice, Cerdelinx and affiliated parties. The components of the purchase price were as follows (in millions):

Stock issued and liabilities assumed	$	22.8
Estimated direct acquisition costs		1.1
Total	$	23.9

In conformity with Financial Accounting Standard SFAS 142, Goodwill and Other Intangible Assets , the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. As Cerdelinx was not considered a business under SFAS 141, Business Combinations, no goodwill was recognized. In estimating the fair value of the assets acquired, management considered various factors, including an appraisal. The total purchase price was allocated as follows (in millions):

Core technology	$	7.2
Deferred stock compensation		5.8
In-process research and development costs		5.7
Work force		4.7
Liabilities assumed		(1.2)
Equipment		1.1
Non compete agreement		0.3
Cash		0.3
Total	$	23.9

There were no significant exit costs incurred or accrued in connection with this transaction. Management does not expect intangible assets acquired to be deductible for income tax purposes.

Employees who joined Lattice as a result of this acquisition held Cerdelinx shares and options which were converted into 0.9 million Lattice shares and options which were either unvested or otherwise restricted from sale over terms up to four years at a grant price from $0.41 per share to $2.54 per share. The spread, which is the difference between grant price and market value of our common stock on the Closing Date, aggregating $5.8 million on these shares and options, was recorded as Paid-in capital and Deferred stock compensation and is being amortized to operations equally over the vesting (or restriction lapsing) period as part of Amortization of intangible assets.

In-Process Research and Development (IPR&D)

IPR&D consists of those products obtained through acquisition that are not yet proven to be technologically feasible but have been developed to a point where there is value associated with them in relation to potential future revenue. Because technological feasibility was not yet proven and no alternative future uses are believed to exist for the in-process technologies, the assigned value was expensed immediately after the closing of the acquisition.

The fair value underlying the $5.7 million assigned to acquired IPR&D from the Cerdelinx acquisition (recognized in the third quarter of 2002) was determined by identifying research projects in areas for which technological feasibility had not been established and there were no alternative future uses. The acquired IPR&D consists of low-power CMOS transceivers and backplane

interfaces with embedded high-speed SERDES I/O. These products were approximately 60% complete and were estimated to be completed in 2003 at an estimated cost of approximately $2 million. This project is now estimated to be complete in the first half of 2004. There has been no material change in the estimated cost of this project.

The fair value was determined by an income approach where fair value is the present value of projected free cash flows that will be generated by the products incorporating the acquired technologies under development, assuming they are successfully completed. The estimated net free cash flows generated by the products over six year periods were discounted at rates ranging from 15 to 17 percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. The net cash flows for such projects were based on management s estimates of revenue, expenses and asset requirements.

All of these projects have completion risks related to silicon functionality, architecture performance, process technology availability, packaging technology, continued availability of key technical personnel and product reliability. To the extent that estimated completion dates are not met, the risk of competitive product introduction is greater and revenue opportunity may be permanently lost.

The core technology included in the acquisition of Cerdelinx has an estimated weighted average useful life of approximately six years, and the work force and non-compete agreements included in the Cerdelinx acquisition have estimated useful lives of approximately four years resulting in a weighted average useful life of approximately five years.

Note 5 Acquisition of Agere FPGA:

On January 18, 2002, we completed the acquisition of Agere FPGA for $250 million in cash. This acquisition increased our share of the PLD market, accelerated our entry into the FPGA portion of the market and provided us with additional technical employees and intellectual property. This acquisition principally comprises intellectual property, which was valued using a discounted cash flow methodology of which goodwill was a by-product. The transaction was completed pursuant to an Asset Purchase Agreement dated as of December 7, 2001 between Lattice and Agere. The components of the purchase price were as follows (in millions):

Cash	$	250.0
Estimated direct acquisition costs		6.3
Total	$	256.3

In accordance with SFAS 141, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. In estimating the fair value of the assets acquired, management considered various factors, including an appraisal. The total purchase price was allocated as follows (in millions):

Excess of purchase price over net assets acquired	$	142.4
Current technology		63.4
In-process research and development		24.2
Fair value of non-compete agreement		13.8
Licensed technology		10.2
Inventory		3.5
Backlog		1.4
Property, plant and equipment		0.2
Accrued liabilities		(2.8)
Total	$	256.3

There were no significant exit costs incurred or accrued in connection with this transaction.

Employees joining us from Agere during the first quarter of 2002 were awarded approximately 1.1 million stock options which vest equally over four years at a grant price of $14.76 per share. The difference between grant price and market value of our common stock on the grant date, aggregating approximately $7.0 million, was recorded as Paid-in capital and Deferred stock compensation and is being amortized to operations ratably over the vesting period as part of Amortization of intangible assets.

In-Process Research and Development (IPR&D)

IPR&D consists of those products obtained through acquisition that are not yet proven to be technologically feasible but have been developed to a point where there is value associated with them in relation to potential future revenue. Because technological feasibility was not yet proven and no alternative future uses are believed to exist for the in-process technologies, the assigned value was expensed immediately upon the closing date of the acquisition.

The fair value underlying the $24.2 million assigned to acquired IPR&D in the Agere FPGA acquisition was determined by identifying research projects in areas for which technological feasibility had not been established and there was no alternative future use. Projects in the IPR&D category are the ORCA 4 FPGA family, the next generation FPGA family and the FPSC field-programmable system chips. The following is a brief description of these projects. The ORCA 4 FPGA family project, increasing speed and density and enhancing yields, was approximately 85% complete and estimated to be completed by 2003 at an estimated cost of $1.5 million. This project was completed during 2002 with no material change in cost. The next generation FPGA family project, increasing speed and density while reducing die size, was approximately 50% complete and estimated to be completed by 2004 at an estimated cost of $2 million. There has been no material change in the schedule or estimated cost of this project. The future development of FPSC field-programmable system chips (field-programmable system chips which combine embedded pre-defined logic circuits

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with an FPGA platform) was approximately 25% to 90% complete, and estimated to be completed by 2004 at an estimated cost of $2 million. There has been no material change in the schedule or estimated cost of this project. The IPR&D value of $24.2 million was determined by an income approach where fair value is the present value of projected free cash flows that will be generated by the products incorporating the acquired technologies under development, assuming they are successfully completed. The estimated net free cash flows generated by the products over 5-7 year periods were discounted at rates ranging from 23 to 25 percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. The net cash flows for such projects were based on management s estimates of revenue, expenses and asset requirements. Any delays or failures in the completion of these projects could impact our expected return on investment and future results. In addition, our financial condition would be adversely affected if the value of other intangible assets acquired became impaired.

All of these projects have completion risks related to silicon functionality, architecture performance, process technology availability, packaging technology, continued availability of key technical personnel, product reliability and availability of software support. To the extent that estimated completion dates are not met, the risk of competitors product introductions is greater and revenue opportunity may be permanently lost.

The non-compete agreement from Agere and the current and licensed technology included in the acquisition of Agere FPGA have an estimated weighted average useful life of approximately 6.3 years. In accordance with SFAS 142, the excess of purchase price over net assets acquired, or Goodwill, is subject to an impairment test at least annually and is not amortized.

Pro forma results

The following pro forma results of operations information are provided for illustrative purposes only and do not purport to be indicative of the consolidated results of operations for future periods or that actually would have been realized had Lattice and Agere FPGA been a consolidated entity during the periods presented. The pro forma results combine the results of operations as if Agere FPGA had been acquired as of the beginning of the periods presented. The results include the impact of certain adjustments such as intangible asset amortization, estimated changes in interest income (expense) related to cash outlays associated with the transaction and income tax benefits related to the aforementioned adjustments. Additionally, the IPR&D charge of $24.2 million discussed above has been excluded from the periods presented due to its non-recurring nature.

(in thousands, except per share amounts-unaudited)

	Nine months ended			
	Sept. 30, 2003 (Restated)		Sept. 30, 2002 (Proforma)	
Revenue	$	156,905	$	176,808
Net loss	$	(66,562)	$	(32,607)
Basic net loss per share	$	(0.60)	$	(0.30)
Diluted net loss per share	$	(0.60)	$	(0.30)

Note 6 - Acquisition of Vantis:

On June 15, 1999, we paid approximately $500.1 million in cash to AMD for all of the outstanding capital stock of Vantis Corporation. The total purchase price of Vantis was $583.1 million, including certain direct acquisition costs, the accrual of certain exit costs and the assumption of certain liabilities related to the Vantis business. Of this purchase price, approximately $422.6 million was allocated to goodwill and intangible assets.

The recorded balances of goodwill and intangible assets, net of accumulated amortization, related to the Vantis acquisition approximated $77.1 million and $36.0 million, respectively, at September 30, 2003 and $77.1 million and $74.2 million, respectively, at December 31, 2002. Amortization expense related to intangible assets approximated $38.2 million for both the first nine months of 2003 and the first nine months of 2002.

Note 7 - Inventories (in thousands):

		Sept. 30, 2003		Dec. 31, 2002
Work in progress	$	36,314	$	40,515
Finished goods		11,628		15,726
	$	47,942	$	56,241

Note 8 - Changes in Stockholders Equity (in thousands) (Restated):

		Common Stock		Paid-in Capital		Deferred Stock Comp.		Accumulated Other Comprehensive Income (Loss)		Retained Earnings		Total
Balances, Dec. 31, 2002	**$**	**1,124**	**$**	**580,987**	**$**	**(11,540)**	**$**	**(4,631)**	**$**	**95,195**	**$**	**661,135**
Common stock issued		4		3,937								3,941
Unrealized gain on foundry investments (Note 11)								19,752				19,752
Deferred stock compensation				(289)		289						
Amortization of deferred stock compensation						4,931						4,931
Translation adjustment								143				143

Net loss for the nine-month period					(66,562)	(66,562)
Balances, Sept. 30, 2003	$ 1,128	$ 584,635	$ (6,320)	$ 15,264	$ 28,633	$ 623,340

Total comprehensive loss for the first nine-month period of 2003 was approximately $46.7 million (restated) and is substantially comprised of $66.6 million net loss (restated) partially offset by $19.8 million in unrealized gain related to foundry investments.

Note 9 - New Accounting Pronouncements:

In June 2001, the FASB issued SFAS 142, which supersedes APB Opinion No. 17, Intangible Assets. SFAS 142, among other things, establishes new standards for intangible assets acquired in a business combination, eliminates amortization of goodwill and sets forth requirements to periodically evaluate goodwill for impairment. We adopted this statement during the first quarter of 2002 and thus goodwill and certain intangibles with indefinite lives are no longer being amortized. To apply SFAS 142, a company is divided into separate reporting units, each representing groups of products that are separately managed. For this purpose, we have one reporting unit. To determine whether or not goodwill may be impaired, a test is required comparing the book value of the reporting unit to its trading price. Similar tests are required in the future, at least annually, and more often where there is a change in circumstances that could result in an impairment of goodwill. If the trading price of our common stock is below the book value for a sustained period, a goodwill impairment test will be performed by comparing book value to estimated market value (trading price plus a control premium). The excess of book value over estimated market value will then be subtracted from the goodwill account with a resulting charge to operations. Subsequent unrealized recoveries in market value, if any, will not be recorded. We completed an initial goodwill impairment assessment as of January 1, 2002 to determine if a transition impairment charge should be recognized under SFAS 142. Upon assessment, no transition impairment charge was recorded. We also completed our annual goodwill impairment assessment in December 2002, upon which no impairment charge was recorded. Additional goodwill impairment tests will be performed at least annually.

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

Sept. 30, 2003		**Gross**		**Accumulated amortization**		**Net**
Current technology	$	273.6	$	(200.8)	$	72.8
Core technology		7.3		(1.5)		5.8
Licenses		10.2		(2.5)		7.7
Non-compete agreements		14.2		(8.0)		6.2
Workforce		4.7		(1.0)		3.7
Backlog		1.4		(1.4)		
Customer list		17.4		(14.9)		2.5
Patents and trademarks		26.8		(23.0)		3.8
Total	$	355.6	$	(253.1)	$	102.5

December 31, 2002		Gross		Accumulated amortization		Net
Current technology	$	273.6	$	(160.3)	$	113.3
Core technology		7.3		(.5)		6.8
Licenses		10.2		(1.4)		8.8
Non-compete agreements		14.2		(4.4)		9.8
Workforce		4.7		(.3)		4.4
Backlog		1.4		(1.4)		
Customer list		17.4		(12.3)		5.1
Patents and trademarks		26.8		(19.0)		7.8
Total	$	355.6	$	(199.6)	$	156.0

The estimated future amortization expense of purchased intangible assets as of September 30, 2003 is as follows (in millions):

Fiscal Year:		Amount
2003 (remaining three months)	$	17.8
2004		43.8
2005		14.4
2006		10.8
2007		9.8
Later years		5.9
	$	102.5

The estimated future amortization expense of deferred stock compensation attributable to Research and Development activities as of September 30, 2003 is approximately $0.8 million for the remainder of 2003, $3.3 million for 2004, and $2.2 million for 2005.

In May 2002, the FASB issued SFAS 145, Rescission of FAS Nos. 4, 44, and 64, Amendment of FAS 13, and Technical Corrections. Among other things, SFAS 145 rescinds various pronouncements regarding early extinguishment of debt and allows extraordinary accounting treatment for early extinguishment only when the provisions of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions are met. SFAS 145 provisions regarding early extinguishment of debt are generally effective for fiscal years beginning after May 15, 2002. Management adopted this pronouncement during the second quarter of 2002. During the second through fourth quarters of 2002, we extinguished approximately $51.9 million face value of our 4¾% convertible notes for approximately $42.8 million in cash, including accrued interest. We recognized a gain of approximately $9.3 million in connection with these transactions. During the first quarter of 2003, we extinguished approximately $32.8 million of these notes for approximately $29.9 million in cash including accrued interest and recognized a gain of approximately $2.9 million. During the second quarter of 2003, we extinguished $3.0 million of these notes for approximately the same amount in cash including accrued interest, at approximately carrying cost. As specified in SFAS 145, gains recognized were recorded in Other (expense) income, net in the accompanying Consolidated Statement of Operations. During the third quarter of 2003, we extinguished our remaining 4¾% convertible notes (see Note 14). Expenses related to the call of these notes were recorded in Other (expense) income, net in the accompanying Consolidated Statement of Operations. Also during the third quarter of 2003, a $1.4 million gain recognized in connection with the early extinguishment of a portion of our Zero Coupon Convertible Subordinated Notes issued in June 2003 (see Note 14) was recorded in accordance with SFAS 145.

In December 2002, the FASB issued SFAS 148, Accounting for Stock-Based Compensation Transition and Disclosure. This statement provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, it amends the disclosure requirements of SFAS 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reporting results. This statement is effective for fiscal years ending after December 15, 2002 and for the interim periods beginning after December 15, 2002. As we continue to report stock-based employee compensation costs using the intrinsic value method as defined by APB 25, adoption of the provisions of the new statement affects only our disclosure of these costs, which is presented in Note 3.

Note 10 - Legal Matters:

We are not currently a party to any material legal proceedings. We are exposed to certain asserted and unasserted potential claims. There can be no assurance with respect to potential claims made against us, that we could resolve such claims under terms and conditions that would not have a material adverse effect on our financial position, cash flows or results of operations.

Note 11 Foundry Investment:

In 1995, we entered into a series of agreements with United Microelectronics Corporation (UMC), a public Taiwanese company, pursuant to which we agreed to join UMC and several other companies to form a separate Taiwanese corporation, (UICC), for the purpose of building and operating an advanced semiconductor manufacturing facility in Taiwan, Republic of China. Under the terms of the agreements, we invested approximately $49.7 million for an approximate 10% equity interest in the corporation and the right to receive a percentage of the facility s wafer production at market prices.

In 1996, we entered into an agreement with Utek Corporation (Utek), a public Taiwanese company in the wafer foundry business that became affiliated with the UMC group in 1998, pursuant to which we agreed to make a series of equity investments in Utek under specific terms. In exchange for these investments, we received the right to purchase a percentage of Utek s wafer production. Under this agreement, we invested approximately $17.5 million. On January 3, 2000, UICC and Utek merged into UMC.

During 2002, we sold approximately 7.6 million of our UMC shares for approximately $9.9 million in cash, resulting in a gain of $4.0 million. In the future, we may or may not choose to liquidate additional UMC shares. As of September 30, 2003, we owned approximately 91.7 million shares of

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UMC common stock of which approximately 23.3 million are restricted from sale for more than one year by the terms of our agreement with UMC. Under the terms of the UMC agreement, if we sell any of these restricted shares, our rights to guaranteed wafer capacity at UMC may be reduced on a pro-rata basis based on the number of shares that we sell. If we sell over 10.1 million of these restricted shares, we may lose all of our rights to guaranteed wafer capacity at UMC.

For financial reporting purposes, all of our UMC shares are accounted for as available for sale and marked to market in our Consolidated Balance Sheet until they are sold, at which time a gain or loss is recognized in our Consolidated Statement of Operations. Unrealized gains and losses are included in Accumulated other comprehensive income (loss) within Stockholders Equity. An other than temporary impairment of UMC share value could result in a reduction of the Consolidated Balance Sheet carrying value and would result in a charge to our Consolidated Statement of Operations.

The carrying value of our investment in UMC was approximately $76.2 million and $56.3 million at September 30, 2003 and December 31, 2002, respectively, and this balance is classified as part of Foundry investments, advances and other assets. During the first nine months of 2003, we recorded unrealized gains of $19.8 million related to the change in market value of our UMC shares. If we liquidate our UMC shares, it is likely that the amount of any future realized gain or loss will be different from the accounting gain or loss reported in prior periods**.**

Note 12 Segment and Geographic Information:

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

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2003 (Restated)	**Sept. 30, 2002**	**Sept. 30, 2003 (Restated)**	**Sept. 30, 2002**
United States	$ 12,277	$ 21,906	$ 50,712	$ 70,617
Export sales:				
Europe	8,786	14,825	40,749	45,272
Asia	20,347	17,133	58,078	47,247
Other	1,623	2,208	7,366	8,280
	30,756	34,166	106,193	100,799
	$ 43,033	$ 56,072	$ 156,905	$ 171,416

Resale of product through two distributors accounted for approximately 20% and 17% of revenue in the first nine months of 2003, and 23% and 19%, respectively, for the first nine months of 2002. More than 90% of our property and equipment is located in the United States. Other long-lived assets located outside the United States consist primarily of foundry investments and advances.

Note 13 - Stock Option Exchange Program:

On March 14, 2003, we completed a stock option exchange program. Under the exchange offer, eligible employees had the opportunity to tender for cancellation certain stock options in exchange for new options to be granted at least six months and one day after the cancellation of the tendered options. Each eligible participant received four new options to purchase shares of common stock for every seven options submitted for cancellation. We accepted approximately 11.2 million options for exchange at various exercise prices between $6.30 and $32.25 and granted approximately 6.4 million new options on September 18, 2003, the new grant date. The exercise price per share of the new options of $8.21 was equal to the fair market value of our common stock on the new grant date.

In connection with the stock option exchange program, we accelerated the write-off of accrued deferred compensation recorded in conjunction with certain of our acquisitions, due to the cancellation of certain assumed in-the-money stock options. Such acceleration resulted in $2.2 million of additional intangible asset amortization expense in the first quarter of 2003. However, we do not expect to record any additional compensation expense as a result of the exchange program.

Note 14- Convertible Subordinated Notes:

On June 20, 2003, we issued $200 million in Zero Coupon Convertible Subordinated Notes due on July 1, 2010. No interest will accrue or be payable related to these notes. Holders of these notes may convert the notes into shares of our common stock at any time before the close of business on the date of their maturity, unless the notes have been previously redeemed or repurchased, if (1) the price of our common stock issuable upon conversion of a note reaches a specified threshold, (2) the notes are called for redemption, (3) specified corporate transactions occur or (4) the trading price of the notes falls below certain thresholds. The conversion price is approximately $12.06 per share, subject to adjustment in certain circumstances. On or after July 1, 2008, we have the option to redeem all or a portion of the notes that have not been previously repurchased or converted at 100% of the principal amount of the notes. On July 1, 2008, holders have the option to require us to purchase all or a portion of their notes in cash at 100% of the principal amount of the notes. The notes are subordinated in right of payment to all of our senior indebtedness, and are subordinated by operation of law to all liabilities of our subsidiaries. At September 30, 2003, we had no senior indebtedness and our subsidiaries had approximately $2.6 million of debt and other liabilities outstanding. Issuance costs relative to these convertible notes are included in Foundry investments, advances and other assets and aggregated approximately $5.5 million and are being amortized to expense over the lives of the notes. Accumulated amortization of these issuance costs was approximately $0.4 million as of September 30, 2003.

During the third quarter of 2003, we extinguished approximately $16.0 million of these notes for approximately $14.2 million in cash and recognized a gain of approximately $1.4 million. In connection with this transaction, we also wrote off approximately $0.4 million of unamortized issuance costs.

On July 21, 2003, we redeemed for cash all of our outstanding 4¾% Convertible Subordinated Notes due in 2006 plus accrued interest. Total cash paid at redemption approximated $178.8 million, including par value of $172.3 million, accrued interest of approximately $1.8 million and a call premium of 2.71% of the outstanding notes, or approximately $4.7 million. This call premium, plus unamortized issuance costs of approximately $1.0 million as of the redemption date, was recorded as Other expense in the quarter ended September 30, 2003.

Note 15 Restatement:

In January 2004, management learned of certain incorrect accounting entries relating to our deferred income accounting for sales to distributors in the quarters ended June 30, 2003 and September 30, 2003. Pursuant to our accounting principles for revenue recognition, we defer reporting revenue from sales to distributors until the period in which the distributors resell our product to their customers. The Audit Committee of our Board of Directors undertook an investigation of this matter with the assistance of our independent auditor and outside legal counsel. That investigation is complete and the Audit Committee has recommended the adoption of certain internal control and system enhancements. We are currently implementing these Audit Committee directives. As a result of the investigation, we have determined that entries made in the second and third quarters of 2003 which reduced Accrued Expenses in the amount of $1.3 million and $4.2 million, respectively, were inappropriate. We also determined that our systems, procedures and controls surrounding (1) our estimation of resale by our distributors and (2) our determination of deferred revenue related to distributor inventories needed to be improved. During the investigation, we carried out additional procedures to (1) refine our estimate of the amount of distributor resale revenue and (2) refine our method for estimating deferred revenue related to distributor inventories. As a result of those additional procedures, we believe our Consolidated Balance Sheet Deferred Income account was understated at March 31, 2003, June 30, 2003 and September 30, 2003 by amounts requiring an adjustment of approximately $1.0 million, $1.6 million and $8.0 million, respectively to reduce Revenues previously recognized and approximately $0.2 million, $0.3 million and $1.3 million, respectively, to reduce Cost of Products Sold previously recognized. As previously noted, approximately $1.3 million and $4.2 million of the resulting adjustments to the Deferred Income account were incorrectly restored to the Deferred Income account in our June 30, 2003 and September 30, 2003 balance sheet, respectively, through an entry to Accrued Expenses instead of the

Consolidated Statement of Operations. The Deferred Income account balance fell below the minimum required level to support inventory on distributors shelves primarily due to (1) non recurring transactions in the September 30, 2003 quarter related to distributor price adjustments and incorrect distributor reporting of resale in previously reported quarterly financial statements, and (2) over-estimates of revenue related to resale occurring in the current fiscal year. We have already implemented certain of the internal control and systems enhancements recommended by the Audit Committee and are currently implementing other Audit Committee directives that resulted from its investigation.

Balance Sheet at September 30, 2003 (in thousands)	**As Reported**	**As Restated**
Accounts Payable and Accrued Expenses	$ 28,846	$ 34,356
Deferred Income	6,361	9,766
Current Liabilities	35,207	44,122
Retained Earnings	37,548	28,633
Total Liabilities and Shareholders Equity	873,515	873,515

Statement of Operations for the three months and nine months ended September 30, 2003 (in thousands, except per share data)

	Three months ended Sept 30, 2003		**Nine months ended Sept 30, 2003**	
	As Reported	**As Restated**	**As Reported**	**As Restated**
Revenue	$ 51,038	$ 43,033	$ 167,527	$ 156,905
Cost of products sold	20,662	19,431	67,159	65,452
Operating expenses	51,952	51,952	160,384	160,384
Loss from operations	(21,576)	(28,350)	(60,016)	(68,931)
Net Loss	(21,887)	(28,661)	(57,647)	(66,562)
Net Loss per share				
Basic	$ (0.20)			