

LAM RESEARCH CORP
Form 10-Q
November 07, 2008

Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 28, 2008

or

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

For the transition period from ____ to ____

Commission file number 0-12933

LAM RESEARCH CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

94-2634797

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

(I.R.S. Employer Identification Number)

**4650 Cushing Parkway
Fremont, California 94538**

(Address of principal executive offices including zip code)

(510) 572-0200

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated
filer

Non-accelerated filer

Smaller reporting
company

*(Do not check if a smaller reporting
company)*

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

As of October 30, 2008 there were 124,949,098 shares of Registrant's Common Stock outstanding.

**LAM RESEARCH CORPORATION
TABLE OF CONTENTS**

| | Page No. |
|---|---------------------|
| <u>PART I. Financial Information</u> | |
| <u>Item 1. Financial Statements (unaudited):</u> | |
| <u>Consolidated Balance Sheets as of September 28, 2008 and June 29, 2008</u> | 3 |
| <u>Consolidated Statements of Operations for the three months ended September 28, 2008 and September 23, 2007</u> | 4 |
| <u>Condensed Consolidated Statements of Cash Flows for the three months ended September 28, 2008 and September 23, 2007</u> | 5 |
| <u>Notes to Condensed Consolidated Financial Statements</u> | 6 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 20 |
| <u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u> | 32 |
| <u>Item 4. Controls and Procedures</u> | 33 |
| <u>PART II. Other Information</u> | 34 |
| <u>Item 1. Legal Proceedings</u> | 34 |
| <u>Item 1A. Risk Factors</u> | 34 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 42 |
| <u>Item 3. Defaults Upon Senior Securities</u> | 42 |
| <u>Item 4. Submission of Matters to a Vote of Security Holders</u> | 42 |
| <u>Item 5. Other Information</u> | 42 |
| <u>Item 6. Exhibits</u> | 42 |
| <u>Signatures</u> | 43 |
| <u>Exhibit Index</u> | 44 |
| <u>EX-10.147</u> | |
| <u>EX-31.1</u> | |
| <u>EX-31.2</u> | |
| <u>EX-32.1</u> | |
| <u>EX-32.2</u> | |

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

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

| | September 28, 2008 (unaudited) | June 29, 2008 (1) |
|---|---|----------------------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 745,432 | \$ 732,537 |
| Short-term investments | 313,803 | 326,199 |
| Accounts receivable, less allowance for doubtful accounts of \$4,076 as of September 28, 2008 and \$4,102 as of June 29, 2008 | 311,633 | 412,356 |
| Inventories | 272,215 | 282,218 |
| Deferred income taxes | 95,186 | 96,748 |
| Prepaid expenses and other current assets | 69,983 | 67,649 |
| | | |
| Total current assets | 1,808,252 | 1,917,707 |
| Property and equipment, net | 230,377 | 235,735 |
| Restricted cash and investments | 156,148 | 146,072 |
| Deferred income taxes | 33,762 | 19,793 |
| Goodwill | 264,406 | 281,298 |
| Intangible assets, net | 110,132 | 121,889 |
| Other assets | 81,493 | 84,261 |
| | | |
| Total assets | \$ 2,684,570 | \$ 2,806,755 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Trade accounts payable | \$ 62,232 | \$ 89,158 |
| Accrued expenses and other current liabilities | 364,939 | 390,062 |
| Deferred profit | 76,432 | 128,250 |
| Current portion of long-term debt and capital leases | 30,119 | 30,209 |
| | | |
| Total current liabilities | 533,722 | 637,679 |
| Long-term debt and capital leases | 269,256 | 276,121 |
| Income taxes payable | 94,184 | 85,611 |
| Other long-term liabilities | 21,875 | 23,400 |
| | | |
| Total liabilities | 919,037 | 1,022,811 |
| | | |
| Minority interests | 4,789 | 5,347 |
| | | |
| Commitments and contingencies | | |
| Stockholders' equity: | | |

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| | | |
|---|--------------|--------------|
| 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 - 125,784 shares at September 28, 2008 and 125,187 shares at June 29, 2008 | 126 | 125 |
| Additional paid-in capital | 1,356,152 | 1,332,159 |
| Treasury stock, at cost, 34,061 shares at September 28, 2008 and 34,220 shares at June 29, 2008 | (1,486,267) | (1,490,701) |
| Accumulated other comprehensive income (loss) | (44,533) | 10,620 |
| Retained earnings | 1,935,266 | 1,926,394 |
| Total stockholders' equity | 1,760,744 | 1,778,597 |
| Total liabilities and stockholders' equity | \$ 2,684,570 | \$ 2,806,755 |

(1) Derived from
audited financial
statements

See Notes to Condensed Consolidated Financial Statements

3

Table of Contents

LAM RESEARCH CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

| | Three Months Ended | |
|--|-----------------------------------|-----------------------------------|
| | September 28, 2008 | September 23, 2007 |
| Total revenue | \$ 440,361 | \$ 684,621 |
| Cost of goods sold | 254,203 | 340,734 |
| Cost of goods sold restructuring and asset impairments | 3,048 | |
| Total cost of goods sold | 257,251 | 340,734 |
| Gross margin | 183,110 | 343,887 |
| Research and development | 81,563 | 76,288 |
| Selling, general and administrative | 69,060 | 69,713 |
| Restructuring and asset impairments | 15,968 | |
| Total operating expenses | 166,591 | 146,001 |
| Operating income | 16,519 | 197,886 |
| Other income (expense), net | 9,017 | 7,633 |
| Income before income taxes | 25,536 | 205,519 |
| Income tax expense | 16,663 | 56,931 |
| Net income | \$ 8,873 | \$ 148,588 |
| Net income per share: | | |
| Basic net income per share | \$ 0.07 | \$ 1.20 |
| Diluted net income per share | \$ 0.07 | \$ 1.18 |
| Number of shares used in per share calculations: | | |
| Basic | 125,527 | 124,057 |
| Diluted | 126,819 | 126,358 |

See Notes to Condensed Consolidated Financial Statements

Table of Contents

LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

| | Three Months Ended | |
|---|---------------------------|------------------|
| | September | September |
| | 28, | 23, |
| | 2008 | 2007 |
| | (unaudited) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 8,873 | \$ 148,588 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 17,896 | 11,239 |
| Deferred income taxes | (12,407) | (10,790) |
| Equity-based compensation expense | 15,408 | 10,802 |
| Income tax benefit on equity-based compensation plans | 5,039 | 35,900 |
| Excess tax benefit on equity-based compensation plans | (4,269) | (21,151) |
| Restructuring and asset impairments | 19,016 | |
| Other, net | 2,665 | 1,377 |
| Changes in operating asset accounts | (9,089) | 46,482 |
| Net cash provided by operating activities | 43,132 | 222,447 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures and intangible assets | (15,151) | (14,144) |
| Acquisitions of businesses, net of cash acquired | (2,427) | |
| Purchases of available-for-sale securities | (125,408) | (52,048) |
| Sales and maturities of available-for-sale securities | 132,388 | 36,063 |
| Transfer of restricted cash and investments | (16,128) | |
| Net cash used for investing activities | (26,726) | (30,129) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Principal payments on long-term debt and capital lease obligations | (2,390) | (49) |
| Net proceeds from issuance of long-term debt | 127 | |
| Excess tax benefit on equity-based compensation plans | 4,269 | 21,151 |
| Treasury stock purchases | (2,755) | (9,464) |
| Reissuances of treasury stock | 7,584 | 7,301 |
| Proceeds from issuance of common stock | 3,150 | 6,708 |
| Net cash provided by financing activities | 9,985 | 25,647 |
| Effect of exchange rate changes on cash | (13,496) | 1,236 |
| Net increase in cash and cash equivalents | 12,895 | 219,201 |
| Cash and cash equivalents at beginning of period | 732,537 | 573,967 |

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| | | |
|--|------------|------------|
| Cash and cash equivalents at end of period | \$ 745,432 | \$ 793,168 |
|--|------------|------------|

See Notes to Condensed Consolidated Financial Statements

5

Table of Contents

LAM RESEARCH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 28, 2008
(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 for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles 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 29, 2008, which are included in the Annual Report on Form 10-K as of and for the year ended June 29, 2008 (the 2008 Form 10-K). The Company s Forms 10-K, Forms 10-Q and Forms 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is www.sec.gov. The Company also posts the Forms 10-K, Forms 10-Q and Forms 8-K on the corporate website at www.lamresearch.com.

The Company s reporting period is a 52/53-week fiscal year. The Company s current fiscal year will end June 28, 2009 and includes 52 weeks. The quarters ended September 28, 2008 and September 23, 2007 each included 13 weeks.

NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS

On June 30, 2008, the Company adopted the required portions of Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). There was no material impact to the Company s consolidated financial statements from the adoption of SFAS No. 157. This Statement defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. SFAS No. 157 currently applies to all financial assets and liabilities, and nonfinancial assets and liabilities that are recognized or disclosed at fair value on a recurring basis. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 157-2, delaying the effective date of SFAS No. 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value on a recurring basis. The delayed portions of SFAS No. 157 will be adopted by the Company beginning in its fiscal year ending June 27, 2010. In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active, which clarifies the application of Statement 157 when the market for a financial asset is inactive. Specifically, FSP FAS 157-3 clarifies how (1) management s internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be take into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance of FSB FAS 157-3 is effective immediately and the Company has adopted its provisions with respect to its financial assets and liabilities as of September 28, 2008. The impact of adopting the non delayed portions of SFAS No. 157 is more fully described in Note 4.

In February 2007, FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities . This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. This Statement was effective for the Company beginning June 30, 2008. The Company has not applied the fair value option to any items; therefore, the Statement did not have an impact on the consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS No. 141R). SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R is effective as of the beginning of an entity s fiscal year that begins after December 15, 2008. The Company expects to

adopt SFAS No. 141R in the beginning of fiscal year 2010 and is currently evaluating the potential impact, if any, of the adoption of SFAS No. 141R on its consolidated results of operations and financial condition.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements – An Amendment of ARB 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for the treatment of noncontrolling interests in a subsidiary. Noncontrolling interests in a subsidiary will be reported as a component of equity in the consolidated financial statements and any retained noncontrolling equity investment upon deconsolidation of a subsidiary is initially measured at fair value. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 will result in the reclassification of minority interests to stockholders' equity. The Company is currently assessing any further impacts of SFAS 160 on its results of operations and financial condition.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities – An Amendment of FASB Statement 133* (SFAS 161). SFAS 161 requires expanded and enhanced disclosure for derivative instruments, including those used in hedging activities. SFAS 161 is effective for fiscal years and interim periods beginning after

Table of Contents

November 15, 2008. The Company is currently assessing the impact of the adoption of SFAS 161 on its consolidated financial statement disclosures.

In April 2008, the FASB issued FASB Staff Position Statement of Financial Accounting Standards 142-3, *Determination of the Useful Life of Intangible Assets* (FSP SFAS 142-3). FSP SFAS 142-3 provides guidance with respect to estimating the useful lives of recognized intangible assets acquired on or after the effective date and requires additional disclosure related to the renewal or extension of the terms of recognized intangible assets. FSP SFAS 142-3 is effective for fiscal years and interim periods beginning after December 15, 2008. The Company is currently assessing the impact of the adoption of FSP SFAS 142-3 on its results of operations and financial condition.

NOTE 3 EQUITY-BASED COMPENSATION PLANS

The Company has adopted stock plans that provide for the grant to eligible participants of equity-based awards, including stock options and restricted stock units, of Lam Research common stock (Common Stock). The Company also has an employee stock purchase plan (ESPP) that allows employees to purchase its Common Stock.

The Company accounts for equity-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123R) using the modified prospective method. The Company recognized equity-based compensation expense of \$15.4 million and \$10.8 million during the three months ended September 28, 2008 and September 23, 2007, respectively. The income tax benefit recognized in the consolidated statements of operations related to equity-based compensation expense was \$2.8 million and \$1.6 million during the three months ended September 28, 2008 and September 23, 2007, respectively. The estimated fair value of the Company's stock-based awards, less expected forfeitures, is amortized over the awards' vesting period on a straight-line basis for awards granted after the adoption of SFAS No. 123R and on a graded vesting basis for awards granted prior to the adoption of SFAS No. 123R.

Stock Options and Restricted Stock Units

The 2007 Stock Incentive Plan provides for the grant of non-qualified equity-based awards to eligible participants. Additional shares are reserved for issuance pursuant to awards previously granted under the Company's 1997 Stock Incentive Plan and its 1999 Stock Option Plan. As of September 28, 2008, there were a total of 4,154,261 equity-based awards issued and outstanding. There are an additional 15,508,431 shares reserved and available for future issuance under the 1999 Stock Option Plan and 2007 Stock Incentive Plan (Plans) as of September 28, 2008.

The Company did not grant any stock options during the three months ended September 28, 2008 and September 23, 2007.

A summary of stock option activity under the Plans as of September 28, 2008 and changes during the three months then ended is presented below:

| | Shares (in thousands) | Weighted- Average Exercise Price | Weighted- Average Remaining Contractual Term (years) | Aggregate Intrinsic Value as of September 28, 2008 (in thousands) |
|-----------------------------------|-----------------------------|---|---|--|
| Options | | | | |
| Outstanding at June 29, 2008 | 2,607 | \$ 21.60 | 1.59 | |
| Granted | | | | |
| Exercised | (156) | 20.31 | | |
| Forfeited or expired | (3) | \$ 43.23 | | |
| Outstanding at September 28, 2008 | 2,448 | \$ 21.65 | 1.37 | \$ 26,484 |
| Exercisable at September 28, 2008 | 2,426 | \$ 21.64 | 1.36 | \$ 26,424 |

The total intrinsic value of options exercised during the three months ended September 28, 2008 and September 23, 2007 was \$2.1 million and \$11.9 million, respectively. As of September 28, 2008, there was less than \$0.1 million of total unrecognized compensation cost related to nonvested stock options granted and outstanding; that cost is expected to be recognized through fiscal year 2009, with a weighted average remaining period of less than one year. Cash received from stock option exercises was \$3.2 million and \$6.7 million during the three months ended September 28, 2008 and September 23, 2007, respectively.

Table of Contents

A summary of the status of the Company's restricted stock units as of September 28, 2008, and changes during the three months then ended is presented below:

| Nonvested Restricted Stock Units | Shares (in thousands) | Average Grant- Date Fair Value |
|---|--------------------------------------|---|
| Nonvested at June 29, 2008 | 1,696 | \$ 46.51 |
| Granted | 369 | 37.34 |
| Vested | (281) | 32.77 |
| Forfeited | (78) | 47.68 |
| Nonvested at September 28, 2008 | 1,706 | \$ 43.72 |

The fair value of the Company's restricted stock units was calculated based upon the fair market value of the Company's stock at the date of grant. As of September 28, 2008, there was \$48.1 million of total unrecognized compensation cost related to nonvested restricted stock units granted; that cost is expected to be recognized over a weighted average remaining period of 0.9 years.

ESPP

The 1999 Employee Stock Purchase Plan (the 1999 ESPP) allows employees to designate a portion of their base compensation to be used to purchase the Company's Common Stock at a purchase price per share of the lower of 85% of the fair market value of the Company's Common Stock on the first or last day of the applicable offering period. Typically, each offering period lasts 12 months and comprises three interim purchase dates. As of September 28, 2008, there were a total of 6,141,631 shares available for issuance under the 1999 ESPP.

ESPP awards were valued using the Black-Scholes model with expected volatility calculated using implied volatility. ESPP awards were valued assuming no expected dividends and the following weighted-average assumptions for the three months ended September 28, 2008:

| | |
|---------------------------------|-------|
| Expected life (years) | 0.68 |
| Expected stock price volatility | 45.0% |
| Risk-free interest rate | 1.9% |

As of September 28, 2008, there was \$7.4 million of total unrecognized compensation cost related to the 1999 ESPP that is expected to be recognized over a remaining period of 0.9 years.

NOTE 4 FINANCIAL INSTRUMENTS

The Company adopted the required portions of the fair value measurement and disclosure provisions of SFAS No. 157 on June 30, 2008. SFAS No. 157 establishes specific criteria for the fair value measurements of financial and nonfinancial assets and liabilities that are already subject to fair value measurements under current accounting rules. SFAS No. 157 also requires expanded disclosures related to fair value measurements.

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. An asset or liability's level is based on the lowest level of input that is significant to the fair value measurement. This Statement requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities.

The Company's Level 1 assets consist of money market fund deposits, Treasury securities, and equity instruments, all of which are traded in an active market with sufficient volume and frequency of transactions.

Level 2: Valuations based on quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of

the assets or liabilities.

The Company's Level 2 assets and liabilities include U.S. agency securities, bank time deposits, government sponsored entities, bank and corporate notes, municipal notes and bonds, mortgage and asset-backed securities, equity securities, derivative assets and liability contracts, which are priced using inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Table of Contents

Level 3: Valuations based on unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities

The Company has no Level 3 assets or liabilities as of September 28, 2008.

The following table sets forth the Company's financial assets and liabilities that were recorded at fair value on a recurring basis during the quarter, by level, within the fair value hierarchy at September 28, 2008:

| | Total | Fair Value Measurement at September 28, 2008 Using | | |
|----------------------------------|--------------|---|---|--|
| | | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| (in thousands) | | | | |
| Assets | | | | |
| Fixed Income | | | | |
| Cash equivalents | \$ 651,692 | \$ 651,692 | \$ | \$ |
| U.S. Treasuries and Agencies | 41,507 | 38,472 | 3,035 | |
| Government Sponsored Enterprises | 28,078 | | 28,078 | |
| Bank and Corporate Notes | 227,965 | | 227,965 | |
| Municipal Notes and Bonds | 155,364 | | 155,364 | |
| Total fixed income | 1,104,606 | 690,164 | 414,442 | |
| Equities | 3,141 | 2,339 | 802 | |
| Derivatives assets | 1,453 | | 1,453 | |
| Total | \$ 1,109,200 | \$ 692,503 | \$ 416,697 | \$ |
| Liabilities | | | | |
| Derivatives liabilities | \$ 151 | \$ | \$ 151 | \$ |

The amounts in the table above are reported in the consolidated balance sheet as of September 28, 2008 as follows:

| | Total | Level 1 | Level 2 | Level 3 |
|---|--------------|------------|------------|---------|
| (in thousands) | | | | |
| Cash and cash equivalents | \$ 635,555 | \$ 635,555 | \$ | \$ |
| Short-term investments | 313,803 | 38,472 | 275,331 | |
| Restricted cash and investments | 156,051 | 16,138 | 139,913 | |
| Prepaid expenses and other current assets | 1,453 | | 1,453 | |
| Other assets | 2,338 | 2,338 | | |
| Total | \$ 1,109,200 | \$ 692,503 | \$ 416,697 | |

| | | | | | | |
|--|----|-----|----|----|-----|----|
| Accrued expenses and other current liabilities | \$ | 151 | \$ | \$ | 151 | \$ |
|--|----|-----|----|----|-----|----|

NOTE 5 INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market. Shipments to Japanese customers are classified as inventory and carried at cost until title transfers. Inventories consist of the following:

| | September 28, 2008 | June 29, 2008 |
|-----------------|-----------------------------------|--------------------------|
| | (in thousands) | |
| Raw materials | \$ 152,971 | \$ 157,135 |
| Work-in-process | 48,977 | 54,684 |
| Finished goods | 70,267 | 70,399 |
| | \$ 272,215 | \$ 282,218 |

Table of Contents**NOTE 6 PROPERTY AND EQUIPMENT, NET**

Property and equipment, net, consists of the following:

| | September 28, 2008 | June 29, 2008 |
|---|-----------------------------------|--------------------------|
| | (in thousands) | |
| Manufacturing, engineering and office equipment | \$ 247,300 | \$ 244,378 |
| Computer equipment and software | 73,767 | 73,237 |
| Land | 15,556 | 16,785 |
| Buildings | 58,526 | 59,102 |
| Leasehold improvements | 47,107 | 46,300 |
| Furniture and fixtures | 11,860 | 12,104 |
| | 454,116 | 451,906 |
| Less: accumulated depreciation and amortization | (223,739) | (216,171) |
| | \$ 230,377 | \$ 235,735 |

NOTE 7 GOODWILL AND INTANGIBLE ASSETS*Goodwill*

Changes in the balance of goodwill during the three months ended September 28, 2009 were as follows:

| | (in thousands) |
|--|---------------------------|
| Balance as of June 29, 2008 | \$ 281,298 |
| Other tax adjustments | 2,935 |
| Effect of changes in foreign currency exchange rates | (19,827) |
| Balance as of September 28, 2008 | \$ 264,406 |

Goodwill attributable to the SEZ acquisition of approximately \$204 million is not tax deductible. The remaining goodwill balance of approximately \$60 million is tax deductible.

Intangible Assets

The following table provides details of the Company's intangible assets subject to amortization as of September 28, 2008 (in thousands, except years):

| | Gross | Accumulated Amortization | Changes in Foreign Currency Exchange Rates | Net | Weighted- Average Useful Life (years) |
|-------------------------|--------------|-------------------------------------|---|------------|--|
| Customer relationships | \$ 35,226 | \$ (9,807) | \$ | \$ 25,419 | 6.90 |
| Existing technology | 61,598 | (6,278) | (4,349) | 50,971 | 6.70 |
| Other intangible assets | 35,216 | (12,550) | (793) | 21,873 | 4.10 |
| Patents | 17,710 | (5,841) | | 11,869 | 7.40 |
| | \$ 149,750 | \$ (34,476) | \$ (5,142) | \$ 110,132 | 6.20 |

Table of Contents

The following table provides details of the Company's intangible assets subject to amortization as of June 29, 2008 (in thousands, except years):

| | Gross | Accumulated Amortization | Net | Weighted- Average Useful Life (years) |
|-------------------------|--------------|-------------------------------------|------------|--|
| Customer relationships | \$ 35,226 | \$ (8,501) | \$ 26,725 | 6.90 |
| Existing technology | 61,598 | (4,008) | 57,590 | 6.70 |
| Other intangible assets | 35,216 | (10,157) | 25,059 | 4.10 |
| Patents | 17,710 | (5,195) | 12,515 | 7.40 |
| | \$ 149,750 | \$ (27,861) | \$ 121,889 | 6.20 |

The Company recognized \$6.6 million and \$3.6 million in intangible asset amortization expense during the three months ended September 28, 2008 and September 23, 2007, respectively.

The estimated future amortization expense of purchased intangible assets as of September 28, 2008 is as follows (in thousands):

| Fiscal Year | Amount |
|--------------------|---------------|
| 2009 (nine months) | \$ 18,909 |
| 2010 | 23,376 |
| 2011 | 20,396 |
| 2012 | 17,385 |
| 2013 | 17,449 |
| Thereafter | 12,617 |
| | \$ 110,132 |

NOTE 8 ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

| | September 28, 2008 | June 29, 2008 |
|--------------------------------|-----------------------------------|--------------------------|
| | (in thousands) | |
| Accrued compensation | \$ 205,466 | \$ 225,227 |
| Warranty reserves | 46,067 | 61,308 |
| Income and other taxes payable | 39,906 | 32,589 |
| Other | 73,500 | 70,938 |
| | \$ 364,939 | \$ 390,062 |

As a result of determinations made in connection with the Company's voluntary independent stock option review, the Company considered the application of Section 409A of the Internal Revenue Code of 1986 (Section 409A), as amended (IRC) and similar provisions of state law to certain stock option grants where, under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, intrinsic value existed at the time of grant. In the event such stock option grants are not considered as issued at fair market value at the original grant date under the IRC and applicable regulations thereunder, these options are subject to Section 409A. On March 30, 2008, the Board of

Directors of the Company authorized the Company to assume the tax liability of certain employees, including the Company's Chief Executive Officer and certain other executive officers, with options subject to Section 409A. The assumed 409A liability was \$51.7 million and \$50.9 million as of September 28, 2008 and June 29, 2008, respectively, and is included in accrued compensation in the table above. The determinations from the voluntary independent stock option review are more fully described in Note 3, Restatement of Consolidated Financial Statements to Consolidated Financial Statements in Item 8 of the Company's 2007 Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of the Company's 2007 Form 10-K.

Table of Contents**NOTE 9 OTHER INCOME (EXPENSE), NET**

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

| | Three Months Ended | |
|---------------------------------|---------------------------|------------------|
| | September | September |
| | 28, | 23, |
| | 2008 | 2007 |
| | (in thousands) | |
| Interest income | \$ 7,796 | \$ 13,287 |
| Interest expense | (2,553) | (3,436) |
| Foreign exchange gains (losses) | 3,266 | (1,367) |
| Charitable contributions | | (500) |
| Other, net | 508 | (351) |
| | \$ 9,017 | \$ 7,633 |

NOTE 10 INCOME TAX EXPENSE

The Company's effective tax rate for the three months ended September 28, 2008 was approximately 65.3%. This rate differs significantly from the statutory rate due to the geographical mix of income in higher and lower tax jurisdictions and the implementation of a tax strategy to align the future revenue and profit of SEZ with the Company's current tax operating structure. The Company recorded the following material discrete events during the September 2008 quarter: (1) a tax expense of \$1.5 million of FIN 48 interest, (2) a tax benefit of \$1.4 million of annual tax return filing reconciliations, and (3) a tax benefit of \$5.1 million related to one-time restructuring cost.

As of September 28, 2008, the total gross unrecognized tax benefits was \$151.4 million compared to \$143.8 million as of June 29, 2008, representing an increase of approximately \$7.6 million for the three month period. If the remaining balance of \$151.4 million of gross unrecognized tax benefits were realized in a future period, it would result in a tax benefit of \$106.2 million and a reduction of the effective tax rate. Approximately \$13.6 million of gross unrecognized tax benefits are related to the SEZ pre-acquisition period and would result in an adjustment to goodwill of \$0.7 million. The Company estimates that its uncertain tax positions will change by approximately \$17 million related to implementation of tax strategy in connection with SEZ in the next twelve months.

As of September 28, 2008, the Company had accrued approximately \$12.0 million for the payment of interest and penalties, net of tax benefit, relating to unrecognized tax benefits compared to \$9.3 million as of June 29, 2008. During the quarter ended September 28, 2008, interest and penalties related to unrecognized tax benefits increased by \$2.7 million, of which \$1.5 million was recognized in the provision for income tax and the remaining balance of approximately \$1.2 million related to the SEZ acquisition and was recorded to goodwill.

The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Realization of the Company's net tax deferred assets is dependent on future taxable income. The Company believes it is more likely than not those assets will be realized. However, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. In the event that the Company determines that it would not be able to realize all or part of its net deferred tax assets, an adjustment would be charged to earnings in the period such determination is made. Likewise, if the Company later determines that it is more likely than not that the deferred tax assets would be realized, the previously provided valuation allowance would be reversed. The Company's current valuation allowance of \$3.4 million recorded relates to certain deferred tax assets acquired in the SEZ acquisition. Any subsequently recognized tax benefits associated with valuation allowances recorded in the SEZ acquisition will be recorded as an adjustment to goodwill. The Company evaluates the realizability of the deferred tax assets quarterly and will continue to assess the need for additional valuation allowances, if any.

The Company files U.S. federal, U.S. state, and foreign income tax returns. As of September 28 2008, tax years 2000-2007 remain subject to examination in the U.S., and tax years 2002-2007 remain subject to examination in

various foreign jurisdictions.

The Emergency Economic Stabilization Act of 2008, which contains the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, was enacted on October 3, 2008 by the U.S. government. Under the Act, the research credit was retroactively extended for amounts paid or incurred after December 31, 2007 and before January 1, 2010. The effects of the change in the tax law will be recognized in the Company's quarter ending December 28, 2008, which is the quarter in which the law was enacted. The Company estimates the tax benefit to be between approximately \$14 million to \$18 million.

Assembly Bill 1452, which was enacted on September 30, 2008 by the State of California, limits the amount of tax credits that can be utilized on the tax return. This change will be effective in the Company's quarter ending December 28, 2008, which is the quarter in which the law was enacted. This change is not expected to have any impact on the Company's effective tax rate since the tax credits not utilized in the current year can be used to offset future tax liability.

Table of Contents**NOTE 11 NET INCOME PER SHARE**

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed, using the treasury stock method, as though all potential common shares that are dilutive were outstanding during the period. The following table provides a reconciliation of the numerators and denominators of the basic and diluted computations for net income per share.

| | Three Months Ended | |
|--|--|-----------------------------------|
| | September 28, 2008 | September 23, 2007 |
| | (in thousands, except per share data) | |
| Numerator: | | |
| Net income | \$ 8,873 | \$ 148,588 |
| Denominator: | | |
| Basic average shares outstanding | 125,527 | 124,057 |
| Effect of potential dilutive securities: | | |
| Employee stock plans | 1,292 | 2,301 |
| Diluted average shares outstanding | 126,819 | 126,358 |
| Net income per share Basic | \$ 0.07 | \$ 1.20 |
| Net income per share Diluted | \$ 0.07 | \$ 1.18 |

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

| | Three Months Ended | |
|--|-----------------------------------|-----------------------------------|
| | September 28, 2008 | September 23, 2007 |
| | (in thousands) | |
| Number of potential dilutive securities excluded | 243 | 19 |

NOTE 12 COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss) are as follows:

| | Three Months Ended | |
|--|-----------------------------------|-----------------------------------|
| | September 28, 2008 | September 23, 2007 |
| | (in thousands) | |
| Net income | \$ 8,873 | \$ 148,588 |
| Foreign currency translation adjustment | (48,229) | 2,442 |
| Unrealized loss on fair value of derivative financial instruments, net | (4,730) | (6,110) |
| Unrealized gain (loss) on financial instruments, net | (2,836) | 1,418 |

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| | | |
|--|-------------|------------|
| Reclassification adjustment for loss (gain) included in earnings | 607 | (532) |
| SFAS No. 158 adjustment | 35 | 17 |
| Comprehensive income (loss) | \$ (46,280) | \$ 145,823 |

Table of Contents

The balance of accumulated other comprehensive income (loss) is as follows:

| | September 28, 2008 | June 29, 2008 |
|---|-----------------------------------|--------------------------|
| | (in thousands) | |
| Accumulated foreign currency translation adjustment | \$ (41,617) | \$ 6,612 |
| Accumulated unrealized gain on derivative financial instruments | 1,760 | 5,895 |
| Accumulated unrealized loss on financial instruments | (3,558) | (734) |
| SFAS No. 158 adjustment | (1,118) | (1,153) |
| Accumulated other comprehensive gain (loss) | \$ (44,533) | \$ 10,620 |

NOTE 13 ACQUISITIONS

During fiscal year 2008, the Company acquired approximately 99% of the outstanding shares of SEZ, a major supplier of single-wafer wet clean technology and products to the global semiconductor manufacturing industry. The acquisition was an all-cash transaction. The Company expects to take additional steps as necessary to acquire the SEZ shares that remain outstanding. The acquisition of these shares was conducted pursuant to the terms of a Transaction Agreement entered into on December 10, 2007 by and between the Company and SEZ. SEZ's Spin-Process single-wafer technology forms part of a broad equipment solution portfolio for wafer cleaning and decontamination, a key process adjacent to etch.

The acquisition was accounted for as a business combination in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations and the preliminary purchase price at the time of acquisition was allocated based on the estimated fair value of net tangible and intangible assets acquired, and liabilities assumed. The purchase price allocation is preliminary pending further information on tax contingencies.

The purchase price was preliminarily allocated to the fair value of assets acquired and liabilities assumed as follows, in thousands:

| | |
|--|-------------------|
| Cash consideration | \$ 619,329 |
| Transaction costs | 11,115 |
| | \$ 630,444 |
| ASSETS | |
| Cash and cash equivalents | \$ 147,870 |
| Short-term investments | 5,492 |
| Accounts receivable | 103,794 |
| Inventories | 80,336 |
| Prepaid expenses and other current assets | 24,201 |
| Property and equipment | 86,096 |
| Restricted cash and investments | 40,038 |
| Deferred income taxes | 739 |
| Goodwill | 220,732 |
| Intangible assets | 67,743 |
| Other assets | 2,527 |
| LIABILITIES | |
| Accounts payable | 11,700 |
| Accrued expenses and other accrued liabilities | 56,007 |
| Long-term debt and capital leases | 55,088 |

| | |
|-----------------------------|------------|
| Other long-term liabilities | 19,869 |
| Minority interest | 6,460 |
| | \$ 630,444 |

Table of Contents**NOTE 14 LONG-TERM DEBT AND GUARANTEES**

The Company's contractual cash obligations relating to its existing capital leases and debt as of September 28, 2008 are as follows:

| | Capital Leases | Long-term Debt (in thousands) | Total |
|--|---------------------------|--|--------------|
| Payments due by period: | | | |
| One year | \$ 1,954 | \$ 29,301 | \$ 31,255 |
| Two years | 2,133 | 234,595 | 236,728 |
| Three years | 3,226 | 8,490 | 11,716 |
| Four years | 2,087 | 5,820 | 7,907 |
| Five years | 2,085 | 1,798 | 3,883 |
| Over 5 years | 14,488 | | 14,488 |
| Total | 25,973 | 280,004 | 305,977 |
| Interest on capital leases | 6,602 | | 6,602 |
| Current portion of long-term debt and capital leases | 818 | 29,301 | 30,119 |
| Long-term debt and capital leases | \$ 18,553 | \$ 250,703 | \$ 269,256 |

Capital Leases

Capital leases reflect building lease obligations assumed from the Company's acquisition of SEZ. The amounts in the table above include the interest portion of payment obligations. The Company's total capital lease obligations were \$19.4 million as of September 28, 2008.

Long-Term Debt

On March 3, 2008, and as amended on September 29, 2008, the Company, as borrower, entered into the Credit Agreement with ABN AMRO BANK N.V. (the Agent), as administrative agent for the lenders party to the Credit Agreement, and such lenders. Bullen Semiconductor Corporation entered into the Bullen Guarantee to guarantee the obligations of the Company under the Credit Agreement. In connection with the Credit Agreement, the Company and Bullen entered into the Collateral Documents including the Security Agreement, the Bullen Security Agreement, the Pledge Agreement and other Collateral Documents to secure its obligations under the Credit Agreement. The Collateral Documents encumber current and future accounts receivables, inventory, equipment and related assets of the Company and Bullen, as well as 100% of the Company's ownership interest in Bullen and 65% of the Company's ownership interest in Lam Research International BV, a wholly-owned subsidiary of the Company. In addition, any future domestic subsidiaries of the Company will also enter into a similar guarantee and collateral documents to encumber the foregoing type of assets.

Under the Credit Agreement, the Company borrowed \$250 million in principal amount for general corporate purposes. The loan under the Credit Agreement is a non-revolving term loan with the following repayment terms: (a) \$12.5 million of the principal amount due in each of the December 2008, June 2009, and December 2009 quarters, and (b) the payment of the remaining principal amount on March 6, 2010. The outstanding principal amount bears interest at LIBOR plus 0.75% per annum or, alternatively, at the Agent's prime rate. The Company may prepay the loan under the Credit Agreement in whole or in part at any time without penalty. The Credit Agreement contains customary representations, warranties, affirmative covenants and events of default, as well as various negative covenants (including maximum leverage ratio, minimum liquidity and minimum EBITDA).

The Company's total long-term debt of \$280.0 million as of September 28, 2008 includes the \$250.0 million discussed above and \$30.0 million assumed in connection with the acquisition of SEZ, consisting of various bank loans and government subsidized technology loans supporting operating needs.

Guarantees

The Company accounts for its guarantees in accordance with FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN 45 also requires a company (the guarantor) to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee.

Table of Contents

On December 18, 2007, and as amended on April 3, 2008 and July 9, 2008, the Company entered into a series of two operating leases (the Livermore Leases) regarding certain improved properties in Livermore, California. On December 21, 2007, the Company entered into a series of four amended and restated operating leases (the New Fremont Leases, and collectively with the Livermore Leases, the Operating Leases) with regard to certain improved properties at its headquarters in Fremont, California. Each of the Operating Leases is an off-balance sheet arrangement. The Operating Leases (and associated documents for each Operating Lease) were entered into by the Company and BNP Paribas Leasing Corporation (BNPPLC).

Each Livermore Lease facility has an approximately seven-year term (inclusive of an initial construction period during which BNPPLC's and the Company's obligations will be governed by the Construction Agreement entered into with regard to such Livermore Lease facility) ending on the first business day in January, 2015. Each New Fremont Lease has an approximately seven-year term ending on the first business day in January, 2015.

Under each Operating Lease, the Company may, at its discretion and with 30 days' notice, elect to purchase the property that is the subject of the Operating Lease for an amount approximating the sum required to prepay the amount of BNPPLC's investment in the property and any accrued but unpaid rent. Any such amount may also include an additional make-whole amount for early redemption of the outstanding investment, which will vary depending on prevailing interest rates at the time of prepayment.

The Company will be required, pursuant to the terms of the Operating Leases and associated documents, to maintain collateral in an aggregate of approximately \$168.6 million (upon completion of the Livermore construction) in separate interest-bearing accounts and/or eligible short-term investments as security for its obligations under the Operating Leases. As of September 28, 2008, the Company had \$139.9 million recorded as restricted cash and short-term investments in its consolidated balance sheet as collateral required under the lease agreements related to the amounts currently outstanding on the facility.

Upon expiration of the term of an Operating Lease, the property subject to that Operating Lease may be remarketed. The Company has guaranteed to BNPPLC that each property will have a certain minimum residual value, as set forth in the applicable Operating Lease. The aggregate guarantee made by the Company under the Operating Leases is no more than approximately \$144.9 million (although, under certain default circumstances, the guarantee with regard to an Operating Lease may be 100% of BNPPLC's investment in the applicable property; in the aggregate, the amounts payable under such guarantees will be no more than \$168.6 million plus related indemnification or other obligations).

The lessor under the lease agreements is a substantive independent leasing company that does not have the characteristics of a variable interest entity (VIE) as defined by FASB Interpretation No. 46, Consolidation of Variable Interest Entities and is therefore not consolidated by the Company.

The Company has issued certain indemnifications to its lessors under some of its agreements. The Company has entered into certain insurance contracts which may limit its exposure to such indemnifications. As of September 28, 2008, the Company has not recorded any liability on its financial statements in connection with these indemnifications, as it does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

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

The Company offers standard warranties on its systems that run generally for a period of 12 months from system acceptance. 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.

Table of Contents

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

| | Three Months Ended | |
|---|-----------------------------------|-----------------------------------|
| | September 28, 2008 | September 23, 2007 |
| | (in thousands) | |
| Balance at beginning of period | \$ 61,308 | \$ 52,186 |
| Warranties issued during the period | 5,216 | 14,632 |
| Settlements made during the period | (10,271) | (15,744) |
| Expirations and change in liability for pre-existing warranties during the period | (8,915) | 561 |
| Changes in foreign currency exchange rates | (1,271) | |
| Balance at end of period | \$ 46,067 | \$ 51,635 |

NOTE 15 DERIVATIVE INSTRUMENTS AND HEDGING

The Company carries derivative financial instruments (derivatives) on the balance sheet at their fair values in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133) and Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (SFAS No. 149). The Company enters into foreign exchange forward contracts with financial institutions with the primary objective of reducing volatility of earnings and cash flows related to foreign currency exchange rate fluctuations. The counterparties to these foreign exchange forward contracts are creditworthy multinational financial institutions; therefore, the risk of counterparty nonperformance is not considered to be material.

Cash Flow Hedges

The Company's policy is to attempt to minimize short-term business exposure to foreign currency exchange rate fluctuations using an effective and efficient method to eliminate or reduce such exposures. In the normal course of business, the Company's financial position is routinely subjected to market risk associated with foreign currency exchange rate fluctuations. To protect against the reduction in value of forecasted Japanese yen-denominated revenues, the Company has instituted a foreign currency cash flow hedging program. The Company enters into foreign exchange forward contracts that generally expire within 12 months, and no later than 24 months. These foreign exchange forward contracts are designated as cash flow hedges and are carried on the Company's balance sheet at fair value with the effective portion of the contracts' gains or losses included in accumulated other comprehensive income (loss) and subsequently recognized in revenue in the same period the hedged revenue is recognized.

At inception and at each quarter end, hedges are tested for effectiveness using regression testing. Changes in the fair value of foreign exchange forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in revenue in the current period. The change in forward time value was not material for all reported periods. There were no gains or losses during the three months ended September 28, 2008 and September 23, 2007 associated with ineffectiveness or forecasted transactions that failed to occur. 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.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. When derivative instruments are designated and qualify as effective cash flow hedges, the Company is able to defer effective changes in the fair value of the hedging instrument within accumulated other comprehensive income (loss) until the hedged exposure is realized. Consequently, with the exception of excluded time value and hedge ineffectiveness recognized, the Company's results of operations are not subject to fluctuation as a result of changes in

the fair value of the derivative instruments. If hedges are not highly effective or if the Company does not believe that the underlying hedged forecasted transactions would 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 without the benefits of offsets or deferrals of changes in fair value arising from hedge accounting treatment. At September 28, 2008, the Company expects to reclassify the entire amount associated with the \$1.8 million of gains accumulated in other comprehensive income to earnings during the next 12 months due to the recognition in earnings of the hedged forecasted transactions.

Table of Contents*Balance Sheet Hedges*

The Company also enters into foreign exchange forward contracts to hedge the effects of foreign currency fluctuations associated with foreign currency denominated assets and liabilities, primarily intercompany receivables and payables. Under SFAS No. 133 and SFAS No. 149, these foreign exchange forward contracts are not designated for hedge accounting treatment. Therefore, the change in fair value of these derivatives is recorded into earnings as a component of other income and expense and offsets the change in fair value of the foreign currency denominated intercompany and trade receivables, recorded in other income and expense, assuming the hedge contract fully covers the intercompany and trade receivable balances.

NOTE 16 RESTRUCTURING AND ASSET IMPAIRMENTS

During the June 2008 quarter the Company incurred expenses for restructuring and asset impairment charges related to the integration of SEZ and overall streamlining of the Company's combined Clean Product Group (June 2008 Plan). The Company incurred additional expenses under the June 2008 Plan during the quarter ended September 28, 2008. The charges during the June 2008 quarter included severance and related benefits costs, excess facilities-related costs and certain asset impairments associated with the Company's initial product line integration road maps. The charges during the September 2008 quarter primarily included severance and related benefits costs and certain asset impairments associated with the Company's product line integration road maps.

Prior to the end of the June and September 2008 quarters, the Company initiated the announced restructuring activities and management with the proper level of authority approved specific actions under the June 2008 Plan. Severance packages to affected employees were communicated in enough detail such that the employees could determine their type and amount of benefit. The termination of the affected employees occurred as soon as practical after the restructuring plans were announced. The amount of remaining future lease payments for facilities the Company ceased to use and included in the restructuring charges is based on management's estimates using known prevailing real estate market conditions at that time based, in part, on the opinions of independent real estate experts. Leasehold improvements relating to the vacated buildings were written off, as these items will have no future economic benefit to the Company and have been abandoned.

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

The Company recorded net restructuring charges and asset impairments during fiscal year 2008 of approximately \$19.0 million, consisting of severance and benefits for involuntarily terminated employees of \$5.5 million, charges for the present value of remaining lease payments on vacated facilities of \$0.9 million, and the write-off of related fixed assets of \$1.9 million. The Company also recorded asset impairments related to initial product line integration road maps of \$10.7 million. Of the total \$19.0 million in charges, \$12.6 million was recorded in cost of goods sold and \$6.4 million was recorded in operating expenses in the Company's fiscal year 2008 consolidated statement of operations.

The Company recorded net restructuring charges and asset impairments during the September 2008 quarter of approximately \$19.0 million, consisting of severance and benefits for involuntarily terminated employees of \$12.5 million. The Company also recorded additional asset impairments related to product line integration road maps of \$6.5 million. Of the total \$19.0 million in charges, \$3.0 million was recorded in cost of goods sold and \$16.0 million was recorded in operating expenses in the Company's consolidated statement of operations for the three months ended September 28, 2008.

Below is a table summarizing activity relating to the June 2008 Plan:

| Severance and Benefits | Facilities | Abandoned Assets (in thousands) | Inventory | Total |
|---------------------------------------|-------------------|--|------------------|--------------|
|---------------------------------------|-------------------|--|------------------|--------------|

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| | | | | | |
|--------------------------------|-----------|--------|----------|-----------|-----------|
| June 2008 quarter expense | \$ 5,513 | \$ 899 | \$ 1,893 | \$ 10,671 | \$ 18,976 |
| Cash payments | (927) | | | | (927) |
| Non-cash charges | | | (1,893) | (10,671) | (12,564) |
| Balance at June 29, 2008 | 4,586 | 899 | | | 5,485 |
| September 2008 quarter expense | 12,554 | | 3,395 | 3,067 | 19,016 |
| Cash payments | (1,098) | (215) | | | (1,313) |
| Non-cash charges | | | (3,395) | (3,067) | (6,462) |
| Balance at September 28, 2008 | \$ 16,042 | \$ 684 | \$ | \$ | \$ 16,726 |

The severance and benefits-related costs are anticipated to be utilized by the end of fiscal year 2009. The facilities balance consists primarily of lease payments on vacated buildings and is expected to be utilized by the end of fiscal year 2009.

Table of Contents**NOTE 17 STOCK REPURCHASE PROGRAM**

On September 8, 2008, the Company announced that its Board of Directors had authorized the repurchase of up to \$250 million of Company common stock from the public market or in private purchases. While the repurchase program does not have a defined termination date, it may be suspended or discontinued at any time, and will be funded using the Company's available cash. Share repurchases under the authorizations were as follows:

| Period | Total Number of Shares Repurchased | Total Cost of Repurchase (in thousands, except per share data) | Average Price Paid Per Share | Amount Available Under Repurchase Program |
|--|--|---|---------------------------------------|---|
| Authorization of up to \$250 million - September 2008 | | | | \$ 250,000 |
| Quarter ended September 28, 2008 | 1 | \$ 15 | \$ 30.00 | \$ 249,985 |

In addition to shares repurchased under Board authorized repurchase programs shown above, during the three months ended September 28, 2008, the Company withheld 83,047 shares through net share settlements upon the vesting of restricted stock unit awards under the Company's equity compensation plans to cover tax withholding obligations.

NOTE 18: LEGAL PROCEEDINGS

From time to time, the Company has received notices from third parties alleging infringement of such parties patent or other intellectual property rights by the Company's products. In such cases it is the Company's policy to defend the claims, or if considered appropriate, negotiate licenses on commercially reasonable terms. However, no assurance can be given that the Company will be able in the future to negotiate necessary licenses on commercially reasonable terms, or at all, or that any litigation resulting from such claims would not have a material adverse effect on the Company's consolidated financial position or operating results.

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. 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 our future revenue, shipments, cost and margins, product development, demand, acceptance and market share, competitiveness, market opportunities, levels of research and development (R&D), outsourced activities and operating expenses, anticipated manufacturing, customer and technical requirements, the ongoing viability of the solutions that we offer and our customer's success, tax expenses, our management's plans and objectives for our current and future operations and business focus, the levels of customer spending or R&D activities, the sufficiency of financial resources to support future operations, capital expenditures, and general economic conditions. 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 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 reports on 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 herein and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known to us. We undertake no obligation to release the results of any revisions to these forward-looking statements, which may be made to reflect events or circumstances that occur after the date hereof or to reflect the occurrence or effect of anticipated or unanticipated events.

Documents To Review In Connection With Management's 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 28, 2008, this discussion should be read in conjunction with the condensed consolidated financial statements and notes presented in this Form 10-Q and the financial statements and notes in our Annual Report on Form 10-K for the fiscal year ended June 29, 2008.

The semiconductor industry is cyclical in nature and has historically experienced periodic downturns and upturns. Today's leading indicators of changes in customer investment patterns may not be any more reliable than in prior years. Demand for our equipment can vary significantly from period to period as a result of various factors, including, but not limited to, economic conditions, supply, demand, and prices for semiconductors, customer capacity requirements, and our ability to develop and market competitive products. For these and other reasons, our results of operations for the three months ended September 28, 2008 may not necessarily be indicative of future operating results.

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

Executive Summary provides a summary of key highlights of our results of operations

Results of Operations provides an analysis of operating results

Critical Accounting Policies and Estimates discusses accounting policies that reflect the more significant judgments and estimates used in the preparation of our condensed consolidated financial statements

Liquidity and Capital Resources provides an analysis of cash flows, contractual obligations and financial position

Table of Contents**EXECUTIVE SUMMARY**

We design, manufacture, market, and service semiconductor processing equipment used in the fabrication of integrated circuits and are recognized as a major provider of such equipment to the worldwide semiconductor industry. Semiconductor wafers are subjected to a complex series of process and preparation steps that result in the simultaneous creation of many individual integrated circuits. We leverage our expertise in these areas to develop integrated and standalone processing solutions which typically benefit our customers through reduced cost, lower defect rates, enhanced yields, or faster processing time as well as by facilitating their ability to meet more stringent performance and design standards.

The following summarizes certain key quarterly financial information for the periods indicated below (in thousands, except percentages and per share amounts):

| | Three Months Ended | | |
|--|-----------------------------------|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |
| Revenue | \$440,361 | \$566,160 | \$684,621 |
| Gross margin | 183,110 | 234,650 | 343,887 |
| Gross margin as a percent of total revenue | 41.6% | 41.4% | 50.2% |
| Net income | 8,873 | 72,178 | 148,588 |
| Diluted net earnings per share | \$ 0.07 | \$ 0.57 | \$ 1.18 |

Our results during the quarter ended September 28, 2008 were adversely affected by a decline in customer demand consistent with the deteriorating general economic outlook. September 2008 quarter revenue was in line with our expectations and decreased 22% compared with the June 2008 quarter.

Gross margin as a percent of revenues for the September 2008 quarter increased slightly to 41.6%. Included in gross margin during the September 2008 and June 2008 quarters are restructuring and asset impairment charges of \$3.0 million and \$12.6 million, respectively. Gross margin levels in the September 2008 quarter were impacted by reduced factory utilization levels consistent with reduced business activity.

Operating expenses during the September 2008 quarter decreased \$4 million sequentially and included \$16.0 million of restructuring and asset impairments compared to \$6.4 million in the June 2008 quarter. The decrease in operating expenses in the September 2008 quarter compared with the June 2008 quarter was primarily due to a series of management actions including the Clean Product Group restructuring (as described below under

Restructuring and Asset Impairments), a significant reduction in all-employee and senior executive variable compensation, and a commitment to cost containment across the company.

Equity-based compensation expense recognized during the September 2008 quarter in cost of goods sold and operating expenses was \$3.3 million and \$12.1 million, respectively.

Operating income for the September 2008 quarter included restructuring and asset impairment charges of \$19.0 million and was 3.8% of revenues with cash flows from operating activities during the three months ended September 28, 2008 of \$43.1 million, or approximately 10% of revenues.

RESULTS OF OPERATIONS**Shipments**

| | Three Months Ended | | |
|-------------------------|-----------------------------------|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |
| Shipments (in millions) | \$345 | \$495 | \$ 621 |
| North America | 15% | 13% | 18% |
| Europe | 11% | 9% | 7% |

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| | | | |
|--------------|-----|-----|-----|
| Asia Pacific | 11% | 15% | 12% |
| Taiwan | 16% | 15% | 26% |
| Korea | 29% | 22% | 20% |
| Japan | 18% | 26% | 17% |

Shipments for the September 2008 quarter decreased sequentially by 30% and year-over-year by 44%, consistent with the reduced spending commitments of our customers in the semiconductor industry. During the September 2008 quarter, 300 millimeter applications represented approximately 91% of total systems shipments and 91% of total systems shipments were for applications at less than or equal to

Table of Contents

the 90 nanometer technology node. Total systems shipments market segmentation for the September quarter was as follows: Memory at approximately 72%, IDM Logic at 20% and Foundry at 8%.

Revenue

| | Three Months Ended | | |
|------------------------|-----------------------------------|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |
| Revenue (in thousands) | \$440,361 | \$566,160 | \$684,621 |
| North America | 15% | 13% | 17% |
| Europe | 10% | 9% | 9% |
| Asia Pacific | 17% | 14% | 14% |
| Taiwan | 14% | 16% | 21% |
| Korea | 27% | 22% | 25% |
| Japan | 17% | 26% | 14% |

Revenue for the three months ended September 28, 2008 decreased 22% sequentially and 36% year over year and reflects a decrease in demand for our products due to our customers' response to balancing supply and demand in light of the deteriorating economic outlook. Our revenue levels are correlated to the amount of shipments and our installation and acceptance timelines. The overall Asia region continued to account for a significant portion of our revenues as a substantial amount of the worldwide capacity additions for semiconductor manufacturing continues to occur in that region. Our deferred revenue balance decreased to \$103.5 million as of September 28, 2008 compared to \$193.6 million at June 29, 2008, consistent with the decline in customer spending levels. The anticipated future revenue value of orders shipped from backlog to Japanese customers that are not recorded as deferred revenue was approximately \$41 million as of September 28, 2008; these shipments are classified as inventory at cost until title transfers.

Gross Margin

| | Three Months Ended | | |
|--------------------------|---|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |
| | (in thousands, except percentages) | | |
| Gross Margin | \$183,110 | \$234,650 | \$343,887 |
| Percent of total revenue | 41.6% | 41.4% | 50.2% |

Gross margin as a percent of revenue for the September 2008 quarter was 41.6% and was within our expectations. Included in gross margin during the September 2008 and June 2008 quarters are restructuring and asset impairment charges of \$3.0 million and \$12.6 million, respectively. The increase in gross margin percentage during the September 2008 quarter compared to the June 2008 quarter was primarily due to reduced restructuring and asset impairments charges related to the integration of SEZ, partially offset by reduced factory utilization levels consistent with reduced business activity. The reduction in gross margin in the three months ended September 28, 2008 compared with the same period in the prior year was primarily due to a change in our customer mix, lower factory utilization consistent with reduced business activity, and the inclusion of SEZ.

Research and Development

| | Three Months Ended | | |
|--|-----------------------------------|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |

| | (in thousands, except percentages) | | |
|------------------------------|---|----------|-----------|
| Research & Development (R&D) | \$81,563 | \$86,652 | \$ 76,288 |
| Percent of total revenue | 18.5% | 15.3% | 11.1% |

We continue to invest significantly in research and development focused on leading-edge plasma etch, single-wafer clean, and new products and technologies. The decrease in R&D expenses during the September 2008 quarter of \$5.1 million compared to the June 2008 quarter is mainly due to savings associated with our June 2008 restructuring activities, including decreases of approximately \$5 million in salaries and benefits as well as \$3 million in depreciation and amortization. These reductions were partially offset by increases of approximately \$2 million in equity-based compensation, primarily due to the timing of our Company-wide RSU grant in May, 2008. The increase in R&D expenses in the September 2008 quarter compared with the September 2007 quarter was due to an increase of approximately \$5 million in salaries and benefits and \$2 million in depreciation and amortization as the result of the inclusion of SEZ as well as increases in equity-based compensation of approximately \$2 million. These increases were partially offset by a reduction of approximately \$6 million in incentive-based compensation on lower profits.

Table of Contents***Selling, General and Administrative***

| | Three Months Ended | | |
|--|---|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |
| | (in thousands, except percentages) | | |
| Selling, General & Administrative (SG&A) | \$69,060 | \$77,704 | \$ 69,713 |
| Percent of total revenue | 15.7% | 13.7% | 10.2% |

The sequential decrease of approximately \$9 million in SG&A expenses during the September 2008 quarter compared to the June 2008 quarter included reductions of approximately \$4 million in outside services, \$3 million in incentive-based compensation on lower profits, and \$3 million in cost incurred as a result of the voluntary internal stock option review.

The slight decrease in SG&A expenses during the three months ended September 28, 2008 compared to the same period in the prior year of \$0.6 million was driven by reductions of approximately \$12 million in incentive-based compensation on lower profit levels partially offset by growth of approximately \$10 million in salary and benefit costs for increases of headcount and employee base compensation including SEZ.

Restructuring and Asset Impairments

During the June 2008 quarter we incurred expenses for restructuring and asset impairment charges related to the integration of SEZ and overall streamlining of our combined clean product group (June 2008 Plan). We incurred additional expenses under the June 2008 Plan during the quarter ended September 28, 2008. The charges during the June 2008 quarter included severance and related benefits costs, excess facilities-related costs and certain asset impairments associated with our initial product line integration road maps. The charges during the September 2008 quarter primarily included severance and related benefits costs and certain asset impairments associated with our product line integration road maps.

Prior to the end of the June and September 2008 quarters, we initiated the announced restructuring activities with the appropriate level of management authority and specificity under the June 2008 Plan. Severance packages to affected employees were communicated in enough detail such that the employees could determine their type and amount of benefit. The termination of the affected employees occurred as soon as practical after the restructuring plans were announced. The amount of remaining future lease payments for facilities we ceased to use was included in the restructuring charges. These amounts are based on management's estimates using known prevailing real estate market conditions at that time based, in part, on the opinions of independent real estate experts. Leasehold improvements relating to the vacated buildings were written off, as these items will have no future economic benefit to the Company and have been abandoned.

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

We recorded net restructuring charges and asset impairments during fiscal year 2008 of approximately \$19.0 million, consisting of severance and benefits for involuntarily terminated employees of \$5.5 million, charges for the present value of remaining lease payments on vacated facilities of \$0.9 million, and the write-off of related fixed assets of \$1.9 million. We also recorded asset impairments related to initial product line integration road maps of \$10.7 million. Of the total of \$19.0 million in charges, \$12.6 million was recorded in cost of goods sold and \$6.4 million was recorded in operating expenses in our fiscal year 2008 consolidated statement of operations.

We recorded net restructuring charges and asset impairments during the September 2008 quarter of approximately \$19.0 million, consisting of severance and benefits for involuntarily terminated employees of \$12.5 million. We also recorded additional asset impairments related to product line integration road maps of \$6.5 million. Of the total \$19.0 million in charges, \$3.0 million was recorded in cost of goods sold and \$16.0 million was recorded in operating

expenses in our consolidated statement of operations.

As a result of the June 2008 and September 2008 quarters restructuring activity, we expect annual savings, relative to the cost structure immediately preceding the activities, in total expenses of approximately \$34 million. These estimated savings from the June 2008 Plan's discrete actions are primarily related to lower employee payroll, facilities, and depreciation expenses. Actual savings may vary from these forecasts, depending upon future events and circumstances.

Table of Contents

Below is a table summarizing activity relating to the June 2008 Plan:

| | Severance and Benefits | Facilities | Abandoned Assets (in thousands) | Inventory | Total |
|--------------------------------|---------------------------------------|-------------------|--|------------------|--------------|
| June 2008 quarter expense | \$ 5,513 | \$ 899 | \$ 1,893 | \$ 10,671 | \$ 18,976 |
| Cash payments | (927) | | | | (927) |
| Non-cash charges | | | (1,893) | (10,671) | (12,564) |
| Balance at June 29, 2008 | 4,586 | 899 | | | 5,485 |
| September 2008 quarter expense | 12,554 | | 3,395 | 3,067 | 19,016 |
| Cash payments | (1,098) | (215) | | | (1,313) |
| Non-cash charges | | | (3,395) | (3,067) | (6,462) |
| Balance at September 28, 2008 | \$ 16,042 | \$ 684 | \$ | \$ | \$ 16,726 |

The severance and benefits-related costs are anticipated to be utilized by the end of fiscal year 2009. The facilities balance consists primarily of lease payments on vacated buildings and is expected to be utilized by the end of fiscal year 2009.

Other Income (Expense), Net

Other income (expense), net consisted of the following:

| | Three Months Ended | | |
|------------------------------|-----------------------------------|--------------------------|-----------------------------------|
| | September 28, 2008 | June 29, 2008 | September 23, 2007 |
| | (in thousands) | | |
| Interest income | \$ 7,796 | \$ 10,796 | \$ 13,287 |
| Interest expense | (2,553) | (3,015) | (3,436) |
| Foreign exchange gain (loss) | 3,266 | 2,564 | (1,367) |
| Charitable contributions | | | (500) |
| Other, net | 508 | (1) | (351) |
| | \$ 9,017 | \$ 10,344 | \$ 7,633 |

Interest income decreased \$3.0 million during the quarter ended September 28, 2008 as compared with the quarter ended June 29, 2008 and was primarily attributable to portfolio gains realized in the June quarter and to a lesser extent decreases in interest rate yields over the period. The decrease in interest income for the three months ending September 28, 2008, as compared with the same period in the prior year, is primarily due to decreases in interest rate yields.

During the three months ending September 28, 2008, our interest expense decreased compared with the corresponding periods of June 29, 2008 and September 23, 2007 as a result of decreases in interest rate yields.

The foreign exchange gains during the three months ended September 28, 2008 are primarily due to our foreign currency denominated liabilities with non-U.S. dollar functional subsidiaries where the U.S. dollar strengthened against certain currencies, primarily the Euro and Taiwan dollar. A description of our exposure to foreign currency exchange rates can be found in the Risk Factors section of this Quarterly Report on Form 10-Q under the heading **Our Future Success Depends on International Sales and Management of Global Operations.**

Table of Contents***Income Tax Expense***

Our effective tax rate for the three months ended September 28, 2008 was 65.3%. Our effective tax rate for the three months ended September 23, 2007 was 27.7%. We recorded the following material discrete events during the September 2008 quarter: (1) a tax expense of \$1.5 million of FIN 48 interest, (2) a benefit of \$1.4 million of annual tax return filing reconciliations, and (3) a tax benefit of \$5.1 million related to one-time restructuring cost. The overall change in the effective tax rate in all periods is impacted by the jurisdictional mix of income.

The increase in the effective tax rate is primarily due to the geographical mix of income in lower and higher tax jurisdictions, the application of certain foreign tax rulings, the expiration of the U.S. federal research tax credit (which expired on December 31, 2007), and the implementation of a tax strategy to align the future revenue and profit of SEZ with the Company's current tax operating structure.

The Emergency Economic Stabilization Act of 2008, which contains the Tax Extenders and Alternative Minimum Tax Relief Act of 2008, was enacted on October 3, 2008 by the U.S. government. Under the Act, the research tax credit was retroactively extended for amounts paid or incurred after December 31, 2007 and before January 1, 2010. The effects of the change in the tax law will be recognized in our second quarter, which is the quarter in which the law was enacted. We estimate the tax benefit to be between \$14 and \$18 million.

Assembly Bill 1452, which was enacted on September 30, 2008 by the State of California, limits the amount of tax credits that can be utilized on the tax return. This change will be effective in our second quarter, which is the quarter in which the law was enacted. This change is not expected to have any impact on our effective tax rate since the tax credits not utilized in the current year can be used to offset future tax liability.

Our effective tax rate is based on our current profitability outlook and our expectations of earnings from operations in various tax jurisdictions throughout the world. We have implemented strategies intended to limit our tax liability on the sale of our products worldwide. These tax strategies are intended to align the asset ownership and functions of our various legal entities around the world with our forecasts of the level, timing and sources of future revenues and profits.

Deferred Income Taxes

We had gross deferred tax assets, related primarily to reserves and accruals that are not currently deductible and tax credit carryforwards, of \$185.4 million and \$173.0 million as of September 28, 2008 and June 29, 2008, respectively. The gross deferred tax assets were offset by deferred tax liabilities of \$53.1 million and a valuation allowance of \$3.4 million as of September 28, 2008 and June 29, 2008, respectively.

Deferred tax assets increased from June 29, 2008 to September 28, 2008 by approximately \$12.4 million primarily related to the increase in foreign net operating losses.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more likely than not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more likely than not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed. Our current valuation allowance of \$3.4 million relates to deferred tax assets acquired in the SEZ acquisition. Any subsequently recognized tax benefits associated with valuation allowances recorded in the SEZ acquisition will be recorded as an adjustment to goodwill. We evaluate the realizability of the deferred tax assets quarterly and will continue to assess the need for additional valuation allowances, if any.

Table of Contents**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make certain judgments, estimates and assumptions that could affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We based our estimates and assumptions on historical experience and on various other assumptions believed to be applicable and evaluate them on an ongoing basis to ensure they remain reasonable under current conditions. Actual results could differ significantly from those estimates.

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

Revenue Recognition: We recognize all revenue when persuasive evidence of an arrangement exists, delivery has occurred and title has passed or services have been rendered, the selling price is fixed or determinable, collection of the receivable is reasonably assured, and we have completed our system installation obligations, received customer acceptance or are otherwise released from our installation or customer acceptance obligations. In the event that 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. In circumstances where 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 where it can be reliably demonstrated that the delivered system meets all of the agreed-to customer specifications. In situations with multiple deliverables, revenue is recognized 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. Revenue from multiple-element arrangements is allocated among the separate elements based on their relative fair values, provided the elements have value on a stand-alone basis, there is objective and reliable evidence of fair value, the arrangement does not include a general right of return relative to the delivered item and delivery or performance of the undelivered item(s) is considered probable and substantially in our control. The maximum revenue recognized on a delivered element is limited to the amount that is not contingent upon the delivery of additional items. Revenue related to sales of spare parts and system upgrade kits is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services requested by a customer order. Revenue for extended maintenance service contracts with a fixed payment amount is recognized on a straight-line basis over the term of the contract.

Inventory Valuation: Inventories are stated at the lower of cost or market using standard costs which generally approximate actual costs on a first-in, first-out basis. We maintain a perpetual inventory system and continuously record the quantity on-hand and standard cost for each product, including purchased components, subassemblies, and finished goods. We maintain the integrity of perpetual inventory records through periodic physical counts of quantities on hand. Finished goods are reported as inventories until the point of title transfer to the customer. Generally, title transfer is documented in the terms of sale. When the terms of sale do not specify, we assume title transfers when we complete physical transfer of the products to the freight carrier unless other customer practices prevail. Transfer of title for shipments to Japanese customers generally occurs at time of customer acceptance.

Standard costs are reassessed as needed but annually at a minimum, and reflect achievable acquisition costs, generally the most recent vendor contract prices for purchased parts, normalized assembly and test labor utilization levels, methods of manufacturing, and overhead for internally manufactured products. Manufacturing labor and overhead costs are attributed to individual product standard costs at a level planned to absorb spending at average utilization volumes. All intercompany profits related to the sales and purchases of inventory between our legal entities are eliminated from our consolidated financial statements.

Management evaluates the need to record adjustments for impairment of inventory at least quarterly. Our policy is to assess the valuation of all inventories including manufacturing raw materials, work-in-process, finished goods, and spare parts in each reporting period. Obsolete inventory or inventory in excess of management's estimated usage requirements over the next 12 to 36 months is written down to its estimated market value if less than cost. Inherent in the estimates of market value are management's forecasts related to our future manufacturing schedules, customer

demand, technological and/or market obsolescence, general semiconductor market conditions, possible alternative uses, and ultimate realization of excess inventory. 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 sales in the period the revision is made.

Warranty: Typically, the sale of semiconductor capital equipment includes providing parts and service warranty to customers as part of the overall price of the system. We offer standard warranties for our systems that run generally for a period of 12 months from system acceptance. When appropriate, we record a provision for estimated warranty expenses to cost of sales for each system upon revenue recognition. The amount recorded is based on an analysis of historical activity which uses factors such as type of system, customer, geographic region, and any known factors such as tool reliability trends. All actual or estimated parts and labor costs incurred in subsequent periods are charged to those established reserves on a system-by-system basis.

Actual warranty expenses are accounted for on a system-by-system basis, and may differ from our original estimates. While we periodically monitor the performance and cost of warranty activities, if actual costs incurred are different than our estimates, we may

Table of Contents

recognize adjustments to provisions in the period in which those differences arise or are identified. We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems.

In addition to the provision of standard warranties, we offer customer-paid extended warranty services. Revenues for extended maintenance and warranty services with a fixed payment amount are recognized on a straight-line basis over the term of the contract. Related costs are recorded either as incurred or when related liabilities are determined to be probable and estimable.

Equity-based Compensation Employee Stock Purchase Plan and Employee Stock Plans: We account for our employee stock purchase plan (ESPP) and stock plans under the provisions of Statement of Financial Accounting Standards No. 123R (SFAS No. 123R). SFAS No. 123R requires the recognition of the fair value of equity-based compensation in net income. The fair value of our restricted stock units was calculated based upon the fair market value of Company stock at the date of grant. The fair value of our stock options and ESPP awards was estimated using a Black-Scholes option valuation model. This model requires the input of highly subjective assumptions and elections in adopting and implementing SFAS No. 123R, including expected stock price volatility and the estimated life of each award. The fair value of equity-based awards is amortized over the vesting period of the award and we have elected to use the straight-line method for awards granted after the adoption of SFAS No. 123R and continue to use a graded vesting method for awards granted prior to the adoption of SFAS No. 123R.

We make quarterly assessments of the adequacy of our tax credit pool related to equity-based compensation to determine if there are any deficiencies that require recognition in our consolidated statements of operations. As a result of the adoption of SFAS No. 123R, we will only recognize a benefit from stock-based compensation in paid-in-capital if an incremental tax benefit is realized after all other tax attributes currently available to us have been utilized. In addition, we have elected to account for the indirect benefits of stock-based compensation on the research tax credit through the income statement (continuing operations) rather than through paid-in-capital. We have also elected to net deferred tax assets and the associated valuation allowance related to net operating loss and tax credit carryforwards for the accumulated stock award tax benefits determined under Accounting Principles Board No. 25 for income tax footnote disclosure purposes. We will track these stock award attributes separately and will only recognize these attributes through paid-in-capital in accordance with Footnote 82 of SFAS No. 123R.

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

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

We provide for income taxes on the basis of annual estimated effective income tax rates. Our estimated effective income tax rate reflects our underlying profitability, the level of R&D spending, the regions where profits are recorded and the respective tax rates imposed. We carefully monitor these factors and adjust the effective income tax rate, if necessary. If actual results differ from estimates, we could be required to record an additional valuation allowance on deferred tax assets or adjust our effective income tax rate, which could have a material impact on our business, results of operations, and financial condition.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws. Our estimate for the potential outcome of any uncertain tax issue is highly judgmental. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material impact on our results of operations and financial condition.

In July 2006, the FASB issued FASB Interpretation 48, Accounting for Income Tax Uncertainties (FIN 48). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties.

We must make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of tax credits, benefits, and deductions, and in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as the interest and penalties relating to these uncertain tax positions. Significant changes to these estimates may result in an increase or decrease to our tax provision in a subsequent period.

Table of Contents

We must assess the likelihood that we will be able to recover our deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. We believe that we will ultimately recover a substantial majority of the deferred tax assets recorded on our consolidated balance sheets. However, should there be a change in our ability to recover our deferred tax assets, our tax provision would increase in the period in which we determined that the recovery was not probable.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. As a result of the implementation of FIN 48, we recognize liabilities for uncertain tax positions based on the two-step process prescribed within the interpretation. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more than 50% likely to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as this requires us to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision in the period.

Goodwill and Intangible Assets: We account for goodwill and other intangible assets in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, (SFAS No. 142). SFAS No. 142 requires that goodwill and identifiable intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values and reviewed for impairment in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

We review goodwill at least annually for impairment. Should certain events or indicators of impairment occur between annual impairment tests, we perform the impairment test of goodwill at that date. In testing for a potential impairment of goodwill, we: (1) allocate goodwill to our various reporting units to which the acquired goodwill relates; (2) estimate the fair value of our reporting units; and (3) determine the carrying value (book value) of those reporting units, as some of the assets and liabilities related to those reporting units are not held by those reporting units but by corporate headquarters. 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 research and development and developed technology. Only after this process is completed can the amount of goodwill impairment, if any, be determined.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. In estimating the fair value of a reporting unit for the purposes of our annual or periodic analyses, we make estimates and judgments about the future cash flows of that reporting unit. Although our cash flow forecasts are based on assumptions that are consistent with our plans and estimates we are using to manage the underlying businesses, there is significant exercise of judgment involved in determining the cash flows attributable to a reporting unit over its estimated remaining useful life. In addition, we make certain judgments about allocating shared assets to the estimated balance sheets of our reporting units. We also consider our and our competitor's market capitalization on the date we perform the analysis. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge.

The value assigned to intangible assets 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.

Recent Accounting Pronouncements

On June 30, 2008, we adopted the required portions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS No. 157). There was no material impact from the adoption of SFAS No. 157 to our consolidated financial statements. This Statement defines fair value, establishes a framework for

measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements. SFAS No. 157 currently applies to all financial assets and liabilities, and nonfinancial assets and liabilities that are recognized or disclosed at fair value on a recurring basis. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. 157-2, delaying the effective date of SFAS No. 157 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value on a recurring basis. The delayed portions of SFAS No. 157 will be adopted by us beginning in our fiscal year ending June 27, 2010. In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active*, which clarifies the application of Statement 157 when the market for a financial asset is inactive. Specifically, FSP FAS 157-3 clarifies how (1) management's internal assumptions should be considered in measuring fair value when observable data are not present, (2) observable market information from an inactive market should be taken into account, and (3) the use of broker quotes or pricing services should be considered in assessing the relevance of observable and unobservable data to measure fair value. The guidance of FSB FAS 157-3 is effective immediately and we have adopted its provisions with respect to our financial assets

Table of Contents

and liabilities as of September 28, 2008. The impact of adopting the non delayed portions of SFAS No. 157 is more fully described in Note 4 of Notes to Condensed Consolidated Financial Statements.

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This Statement permits entities to choose to measure many financial instruments and certain other items at fair value. This Statement was effective for us beginning June 30, 2008. We have not applied the fair value option to any items; therefore, the Statement did not have an impact on the consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R). SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. We expect to adopt SFAS No. 141R in the beginning of fiscal year 2010 and are currently evaluating the potential impact, if any, of the adoption of SFAS No. 141R on our consolidated results of operations and financial condition.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for the treatment of noncontrolling interests in a subsidiary. Noncontrolling interests in a subsidiary will be reported as a component of equity in the consolidated financial statements and any retained noncontrolling equity investment upon deconsolidation of a subsidiary is initially measured at fair value. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 will result in the reclassification of minority interests to stockholders' equity. We are currently assessing any further impacts of SFAS 160 on our results of operations and financial condition.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities - An Amendment of FASB Statement 133* (SFAS 161). SFAS 161 requires expanded and enhanced disclosure for derivative instruments, including those used in hedging activities. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently assessing the impact of the adoption of SFAS 161 on our consolidated financial statement disclosures.

In April 2008, the FASB issued FASB Staff Position Statement of Financial Accounting Standards 142-3, *Determination of the Useful Life of Intangible Assets* (FSP SFAS 142-3). FSP SFAS 142-3 provides guidance with respect to estimating the useful lives of recognized intangible assets acquired on or after the effective date and requires additional disclosure related to the renewal or extension of the terms of recognized intangible assets. FSP SFAS 142-3 is effective for fiscal years and interim periods beginning after December 15, 2008. We are currently assessing the impact of the adoption of FSP SFAS 142-3 on our results of operations and financial condition.

LIQUIDITY AND CAPITAL RESOURCES

As of September 28, 2008, we had \$1.2 billion in gross cash and cash equivalents, short-term investments, and restricted cash and investments (total cash and investments) which is consistent with the total balance as of June 29, 2008. Cash provided from operating activities was \$43.1 million for the three months ended September 28, 2008, representing 10% of revenues. On September 8, 2008, we announced that our Board of Directors had authorized the repurchase of up to \$250 million of Company common stock from the public market or in private purchases. While the repurchase program does not have a defined termination date, it may be suspended or discontinued at any time, and will be funded using our available cash. Approximately \$250 million remains available for repurchase under the authorization as of September 28, 2008.

Cash Flows From Operating Activities

Net cash provided by operating activities of \$43.1 million during the three months ended September 28, 2008, consisted of (in millions):

| | |
|-------------------------------|--------|
| Net income | \$ 8.9 |
| Non-cash charges: | |
| Depreciation and amortization | 17.9 |

| | |
|--|---------|
| Equity-based compensation | 15.4 |
| Restructuring charges, net | 19.0 |
| Net tax benefit on equity-based compensation plans | 0.7 |
| Deferred income taxes | (12.4) |
| Changes in operating asset accounts | (9.1) |
| Other | 2.7 |
| | \$ 43.1 |

Significant changes in operating accounts included above during the three months ended September 28, 2008 included the following uses of cash: decreases in accounts payable of \$27 million, \$52 million in deferred profit, and \$42 million in accrued expenses and other

Table of Contents

liabilities. These uses of cash were partially offset by a decrease in accounts receivable of approximately \$101 million. These changes in operating accounts are consistent with decreased business volumes.

Cash Flows from Investing Activities

Net cash used for investing activities during the three months ended September 28, 2008 was \$26.7 million and included the transfer of restricted cash and investments of approximately \$16 million, capital expenditures of \$15 million, partially offset by approximately \$7 million in net sales of available-for-sale securities. We completed the acquisition of assets related to Bullen Semiconductor (Suzhou) Co., Ltd. during the quarter ended September 28, 2008 at a cost of approximately \$2.5 million.

Cash Flows from Financing Activities

Net cash provided by financing activities during the three months ended September 28, 2008 was \$10.0 million, and included net proceeds from issuance of common stock related to employee equity-based plans of \$11 million, excess tax benefit on equity-based compensation plans of approximately \$4 million which represents the benefits of tax deductions in excess of the compensation cost recognized, all partially offset by \$3 million in share repurchases primarily related to shares withheld through net share settlements upon the vesting of restricted stock unit awards under the Company's equity compensation plans and \$2 million in principal payments on long-term debt and capital lease obligations.

Given the cyclical nature of the semiconductor equipment industry, we believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in R&D and capital infrastructure. Based upon our current business outlook, our levels of cash, cash equivalents, and short-term investments at September 28, 2008 are expected to be sufficient to support our presently anticipated levels of operations, investments, debt service requirements, and capital expenditures, through at least the next 12 months.

In the longer term, liquidity will depend to a great extent on our future revenues and our ability to appropriately manage our costs based on demand for our products and services. Should additional funding be required, we may need to raise the required funds through borrowings or public or private sales of debt or equity securities. We believe that, in the event of such requirements, 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.

Off-Balance Sheet Arrangements and Contractual Obligations

We have certain obligations to make future payments under various contracts, some of which are recorded on our balance sheet and some of which are not. Obligations are recorded on our balance sheet in accordance with U.S. generally accepted accounting principles and include our long-term debt which is outlined in the following table and discussed below. Our off-balance sheet arrangements include contractual relationships and are presented as operating leases and purchase obligations in the table below. Our contractual cash obligations and commitments relating to these agreements and our guarantees are included in the following table. The amounts in the table below exclude \$115 million of liabilities under FIN 48 as we are unable to reasonably estimate the ultimate amount or time of settlement.

| | Operating Leases | Capital Leases | Purchase Obligations (in thousands) | Long-term Debt and Interest Expense | Total |
|-------------------------|-----------------------------|---------------------------|--|--|-------------------|
| Payments due by period: | | | | | |
| Less than 1 year | \$ 12,129 | \$ 1,954 | \$ 137,888 | \$ 41,119 | \$ 193,090 |
| 1-3 years | 21,896 | 5,359 | 73,468 | 248,290 | 349,013 |
| 3-5 years | 14,018 | 4,172 | 59,016 | 7,709 | 84,915 |
| Over 5 years | 148,903 | 14,488 | 31,950 | | 195,341 |
| Total | \$ 196,946 | \$ 25,973 | \$ 302,322 | \$ 297,118 | \$ 822,359 |

Operating Leases

We lease most of our administrative, R&D and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases, which expire at various dates through 2016. Certain of our facility leases for buildings located at our Fremont, California headquarters and certain other facility leases provide us with an option to extend the leases for additional periods or to purchase the facilities. Certain of our facility leases provide for periodic rent increases based on the general rate of inflation.

Included in the Operating Leases Over 5 years section of the table above is \$144.9 million in guaranteed residual values for lease agreements relating to certain properties at our Fremont, California campus and properties in Livermore, California.

Table of Contents

On December 18, 2007, and as amended on April 3, 2008 and July 9, 2008, we entered into a series of two operating leases (the Livermore Leases) regarding certain improved properties in Livermore, California. On December 21, 2007, we entered into a series of four amended and restated operating leases (the New Fremont Leases, and collectively with the Livermore Leases, the Operating Leases) with regard to certain improved properties at our headquarters in Fremont, California. Each of the Operating Leases is an off-balance sheet arrangement. The Operating Leases (and associated documents for each Operating Lease) were entered into by us and BNP Paribas Leasing Corporation (BNPPLC).

Each Livermore Lease facility has an approximately seven-year term (inclusive of an initial construction period during which BNPPLC's and our obligations will be governed by the Construction Agreement entered into with regard to such Livermore Lease facility) ending on the first business day in January, 2015. Each New Fremont Lease has an approximately seven-year term ending on the first business day in January, 2015.

Under each Operating Lease, we may, at our discretion and with 30 days' notice, elect to purchase the property that is the subject of the Operating Lease for an amount approximating the sum required to prepay the amount of BNPPLC's investment in the property and any accrued but unpaid rent. Any such amount may also include an additional make-whole amount for early redemption of the outstanding investment, which will vary depending on prevailing interest rates at the time of prepayment.

We will be required, pursuant to the terms of the Operating Leases and associated documents, to maintain collateral in an aggregate of approximately \$168.6 million (upon completion of the Livermore construction) in separate interest-bearing accounts and/or eligible short-term investments as security for our obligations under the Operating Leases. As of September 28, 2008, we had \$139.9 million recorded as restricted cash and short-term investments in our consolidated balance sheet as collateral required under the lease agreements related to the amounts currently outstanding on the facility.

Upon expiration of the term of an Operating Lease, the property subject to that Operating Lease may be remarketed. We have guaranteed to BNPPLC that each property will have a certain minimum residual value, as set forth in the applicable Operating Lease. The aggregate guarantee made by us under the Operating Leases is no more than approximately \$144.9 million (although, under certain default circumstances, the guarantee with regard to an Operating Lease may be 100% of BNPPLC's investment in the applicable property; in the aggregate, the amounts payable under such guarantees will be no more than \$168.6 million plus related indemnification or other obligations).

The lessor under the lease agreements is a substantive independent leasing company that does not have the characteristics of a variable interest entity (VIE) as defined by FASB Interpretation No. 46, Consolidation of Variable Interest Entities, and is therefore not consolidated by us.

The remaining operating lease balances primarily relate to non-cancelable facility-related operating leases.

Capital Leases

Capital leases reflect building lease obligations assumed from our acquisition of SEZ. The amounts in the table above include the interest portion of payment obligations.

Purchase Obligations

Purchase obligations consist of significant contractual obligations either on an annual basis or over multi-year periods related to our outsourcing activities or other material commitments, including vendor-consigned inventories. We continue to enter into new agreements and maintain existing agreements to outsource certain activities, including elements of our manufacturing, warehousing, logistics, facilities maintenance, certain information technology functions, and certain transactional general and administrative functions. The contractual cash obligations and commitments table presented above contains our obligations at September 28, 2008 under these arrangements and others. Actual expenditures will vary based on the volume of transactions and length of contractual service provided. In addition to these obligations, certain of these agreements include early termination provisions and/or cancellation penalties which could increase or decrease amounts actually paid.

Consignment inventories, which are owned by vendors but located in our storage locations and warehouses, are not reported as our inventory until title is transferred to us or our purchase obligation is determined. At September 28, 2008, vendor-owned inventories held at our locations and not reported as our inventory were \$31.8 million.

Long-Term Debt

On March 3, 2008, and as amended on September 29, 2008, we, as borrower, entered into the Credit Agreement with ABN AMRO BANK N.V (the Agent), as administrative agent for the lenders party to the Credit Agreement, and such lenders. Bullen Semiconductor

Table of Contents

Corporation entered into the Bullen Guarantee to guarantee the obligations of the Company under the Credit Agreement. In connection with the Credit Agreement, the Company and Bullen entered into the Collateral Documents, including the Security Agreement, the Bullen Security Agreement, the Pledge Agreement and other related documents to secure its obligations under the Credit Agreement. The Collateral Documents encumber current and future accounts receivables, inventory, equipment and related assets of the Company and Bullen, as well as 100% of our ownership interest in Bullen and 65% of our ownership interest in Lam Research International BV, a wholly-owned subsidiary of the Company. In addition, any future domestic subsidiaries of the Company will also enter into a similar guarantee and collateral documents to encumber the foregoing type of assets.

Under the Credit Agreement, we borrowed \$250 million in principal amount for general corporate purposes. The loan under the Credit Agreement is a non-revolving term loan with the following repayment terms: (a) \$12.5 million of the principal amount due in each of the December 2008, June 2009, and December 2009 quarters, and (b) the payment of the remaining principal amount on March 6, 2010. The outstanding principal amount bears interest at LIBOR plus 0.75% per annum or, alternatively, at the Agent's prime rate. We may prepay the loan under the Credit Agreement in whole or in part at any time without penalty. The Credit Agreement contains customary representations, warranties, affirmative covenants and events of default, as well as various negative covenants (including maximum leverage ratio, minimum liquidity and minimum EBITDA).

Our total long-term debt of \$280.0 million as of September 28, 2008 includes the \$250.0 million discussed above and \$30.0 million from SEZ, consisting of various bank loans and government subsidized technology loans supporting operating needs. The current portion of long-term debt was \$29.3 million as of September 28, 2008.

Guarantees

We account for our guarantees in accordance with FASB Interpretation No. 45 *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN 45 also requires a company (the guarantor) to recognize, at the inception of a guarantee, a liability for the obligations it has undertaken in issuing the guarantee.

We have issued certain indemnifications to our lessors for taxes and general liability under some of our agreements. We have entered into certain insurance contracts which may limit our exposure to such indemnifications. As of September 28, 2008, we have not recorded any liability on our consolidated financial statements in connection with these indemnifications, as we do 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 offers standard warranties on its systems that run generally for a period of 12 months from system acceptance. 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.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

For financial market risks related to changes in interest rates and foreign currency exchange rates, refer to Part II, Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, in our 2008 Form 10-K.

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

We believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in our business activities. Based upon our current business outlook, our levels of cash, cash equivalents, and short-term investments at September 28, 2008 are expected to be sufficient to support our anticipated levels of operations, investments, debt service requirements, and capital expenditures, through at least the next 12 months. However, the current uncertainty in the global economic conditions and the recent disruption in credit markets pose a risk that could impact customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers, and creditors. If the current situation deteriorates further, our business could suffer further negative impacts.

Table of Contents

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Exchange Act Rule 13a-15(b), as of September 28, 2008, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer, along with our Chief Financial Officer, concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

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

Changes in Internal Control over Financial Reporting

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

Effectiveness of Controls

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

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

From time to time, we have received notices from third parties alleging infringement of such parties' patent or other intellectual property rights by our products. In such cases it is our policy to defend the claims, or if considered appropriate, negotiate licenses on commercially reasonable terms. However, no assurance can be given that we will be able in the future to negotiate necessary licenses on commercially reasonable terms, or at all, or that any litigation resulting from such claims would not have a material adverse effect on our consolidated financial position or operating results.

ITEM 1A. Risk Factors

In addition to the other information in this Quarterly Report on Form 10-Q, the following risk factors should be carefully considered in evaluating the Company and its business because such factors may significantly impact our business, operating results, and financial condition. As a result of these risk factors, as well as other risks discussed in our other SEC filings, our actual results could differ materially from those projected in any forward-looking statements. No priority or significance is intended, or should be attached, to the order in which the risk factors appear.

We Face Risks Related to the Current Credit Environment and Slowing in the General Economy

Current uncertainty in global economic conditions resulting from the recent disruption in credit markets poses a risk to the overall economy that could impact customer demand for our products and our ability to manage normal commercial relationships with our customers, suppliers, and creditors. The degree of the impact, if any, of the current credit and economic environment will depend on a number of factors, including whether the U.S. economy and the global economy, generally, enter into a prolonged recession.

Our Quarterly Revenues and Operating Results Are Unpredictable

Our revenues and operating results may fluctuate significantly from quarter to quarter due to a number of factors, not all of which are in our control. We manage our expense levels based in part on our expectations of future revenues. If revenue levels in a particular quarter do not meet our expectations, our operating results may be adversely affected. 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 single transaction 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 generally and the equipment industry specifically;

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

timing of customer acceptances of equipment;

the size and timing of orders from customers;

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

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;

changes in import/export regulations;

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

legislative, tax, accounting, or regulatory changes or changes in their interpretation;

procurement shortages;

manufacturing difficulties;

Table of Contents

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

changes in our estimated effective tax rate;

new or modified accounting regulations and practices; and

exchange rate fluctuations.

Further, because a significant amount of our R&D and administrative operations and capacity is located at our Fremont, California campus, natural, physical, logistical or other events or disruptions affecting these facilities (including labor disruptions, earthquakes, and power failures) could adversely impact our financial performance.

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

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

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

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

The Semiconductor Equipment Industry is Volatile and Reduced Product Demand Has a Negative Impact on Shipments

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 and products using integrated circuits. The semiconductor industry is cyclical in nature and historically experiences periodic downturns. Business conditions historically have changed rapidly and unpredictably.

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

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

Rapid technological changes in semiconductor manufacturing processes subject us to increased pressure to develop technological advances enabling such processes. We believe that our future success depends in part upon our ability to develop and offer new products with improved capabilities and to continue to enhance our existing products. If new products have reliability or quality problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may be unable to develop and manufacture new products successfully, or new products that we introduce may fail in the marketplace. Our failure to complete commercialization of these new products in a timely manner could result in unanticipated costs and inventory obsolescence, which would adversely affect our financial results.

In order to develop new products and processes, we expect to continue to make significant investments in R&D and to pursue joint development relationships with customers, suppliers or other members of the industry. We must manage product transitions and joint development relationships successfully, as introduction of new products could

adversely affect our sales of existing products. Moreover, future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both.

Table of Contents

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

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

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

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

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

increased pressure from competitors that offer broader product lines;

technological change 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 a more limited product line creates the risk that our customers may view us as less important to their business than our competitors that offer additional products as well. This may impact our ability to maintain or expand our business with certain customers. Such product concentration may also subject us to additional risks associated with technology changes. Since we are primarily a provider of etch equipment, our business is affected by our customers' use of etching steps in their processes. Should technologies change so that the manufacture of semiconductor chips requires fewer etching steps, this might have a larger impact on our business than it would on the business of our less concentrated competitors.

We Have a Limited Number of Key Customers

Sales to a limited number of large customers constitute a significant portion of our overall revenue, new orders and profitability. As a result, the actions of even one customer may subject us to revenue swings that are difficult to predict. 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.

Strategic Alliances May Have Negative Effects on Our Business

Increasingly, semiconductor companies are entering into strategic alliances with one another to expedite the development of processes and other manufacturing technologies. Often, one of the outcomes of such an alliance is the definition of a particular tool set for a certain function or a series of process steps that use a specific set of manufacturing equipment. While this could work to our advantage if Lam Research's equipment becomes the basis for the function or process, it could work to our disadvantage if a competitor's tools or equipment become the standard equipment for such function or process. In the latter case, even if Lam Research's equipment was previously used by a customer, that equipment may be displaced in current and future applications by the tools standardized by the alliance.

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

We are Dependent Upon a Limited Number of Key Suppliers

We obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. We have established long-term contracts with many of these suppliers. These long-term contracts can take a variety of forms. We may renew these contracts periodically. In some cases, these suppliers sold us products during at least the last four years, and we expect that we will continue to renew these contracts in the future

or that we will otherwise replace them with competent alternative suppliers. However, several of our suppliers are relatively new providers to us so that our experience with them and their performance is limited. Where practical, our intent is to establish alternative sources to mitigate the risk that the failure of any single supplier will adversely affect our business. Nevertheless, a prolonged inability to obtain certain components could impair our ability to ship products, lower our revenues and thus adversely affect our operating results and result in damage to our customer relationships.

Table of Contents

Our Outsource Providers May Fail to Perform as We Expect

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

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

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

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

We are Subject to Risks Associated with Our Competitors' Strategic Relationships and Their Introduction of New Products and We May Lack the Financial Resources or Technological Capabilities of Certain of Our Competitors Needed to Capture Increased Market Share

We expect to face significant competition from multiple current and future competitors. We believe that other companies are developing systems and products that are competitive to ours and are planning to 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 will require significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide, and to invest in product and process R&D. Certain of our competitors have substantially greater financial resources and more extensive engineering, manufacturing, marketing, and customer service and support resources than we do and therefore have the potential to increasingly dominate the semiconductor equipment industry. These competitors may deeply discount or give away products similar to those that we sell, challenging or even exceeding our ability to make similar accommodations and threatening our ability to sell those products. For these reasons, we may fail to continue to compete successfully worldwide.

In addition, our competitors may provide innovative technology that may have performance advantages over systems we currently, or expect to, offer. They 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 currently are developing additional 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, we may be unable to continue to compete in our markets, competition may intensify, or future competition may have a material adverse effect on our revenues, operating results, financial condition, and/or cash flows.

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

Non-U.S. sales accounted for approximately 83% in fiscal year 2008, 84% in fiscal year 2007 and 86% in fiscal year 2006 of our total revenue. We expect that international sales will continue to account for a significant portion of our total revenue in future years.

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

trade balance issues;

economic and political conditions;

changes in currency controls;

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

our ability to develop relationships with local suppliers;

37

Table of Contents

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

fluctuations in interest and currency exchange rates;

the need for technical support resources in different locations; and

our ability to secure and retain qualified people for the 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 between China, Taiwan, Japan, and the United States, that political and diplomatic influences might lead to trade disruptions which would adversely affect our business with China and/or Taiwan and perhaps the entire Asia region. A significant trade disruption in these areas could have a material, adverse impact on our future revenue and profits.

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

We currently enter into foreign exchange forward contracts to minimize the short-term impact of the exchange rate fluctuations on Japanese yen-denominated assets and forecasted Japanese yen-denominated revenue and also on U.S. dollar-denominated assets where the Euro is the functional currency. We also enter into foreign exchange forward contracts to minimize the short-term impact of exchange rate fluctuations on various other non U.S. dollar-denominated assets and liabilities. We currently believe these are our primary exposures to currency rate fluctuation. We expect to continue to enter into hedging transactions, for the purposes outlined, in the foreseeable future. However, these hedging transactions may not achieve their desired effect because differences between the actual timing of customer acceptances and our forecasts of those acceptances may leave us either over- or under-hedged on any given transaction. Moreover, by hedging these foreign currency denominated revenues, assets and liabilities with foreign exchange forward contracts, we may miss favorable currency trends that would have been advantageous to us but for the hedges. Additionally, we are exposed to short-term exchange rate fluctuations on non-U.S. dollar-denominated assets and liabilities other than those currency exposures previously discussed and currently do not enter into such foreign exchange forward contracts to hedge these other currency exposures, and we therefore are subject to both favorable and unfavorable exchange rate fluctuations to the extent that we transact business (including intercompany transactions) in other currencies.

Our Financial Results May be Adversely Impacted by Higher Than Expected Tax Rates or Exposure to Additional Income 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 both the United States and various foreign jurisdictions, and significant judgment is required to determine worldwide tax liabilities. Our effective tax rate could be adversely affected by changes in the split of earnings between countries with differing statutory tax rates, in the valuation of deferred tax assets, in tax laws or by material audit assessments, which could affect our profitability. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. In addition, the amount of income taxes we pay is subject to ongoing audits in various jurisdictions, and a material assessment by a governing tax authority could affect our profitability.

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

We are subject to a variety of governmental regulations related to the discharge or disposal of toxic, volatile or otherwise hazardous chemicals. We believe that we are in general compliance with these regulations and that we have

obtained (or will obtain or are otherwise addressing) all necessary environmental permits to conduct our business. These permits generally relate to the disposal of hazardous wastes. Nevertheless, the failure to comply with present or future regulations could result in fines being imposed on us, suspension of production, cessation of our operations or reduction in our customers' acceptance of our products. These regulations could require us to alter our current operations, to acquire significant equipment or to incur substantial other expenses to comply with environmental regulations. Our failure to control the use, sale, transport or disposal of hazardous substances could subject us to future liabilities.

If We are Unable to Adjust the Scale of Our Business in Response to Rapid Changes in Demand in the Semiconductor Equipment Industry, Our Operating Results and Our Ability to Compete Successfully May be Impaired

The business cycle in the semiconductor equipment industry has historically been characterized by frequent periods of rapid change in demand that challenge our management to adjust spending and 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,

Table of Contents

management processes, information systems and procedures and in training, managing, and appropriately sizing our supply chain, our work force, and other components of our business on a timely basis. 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. If we do not adequately meet these challenges, our gross margins and earnings may be impaired during periods of demand decline, and we may lack the infrastructure and resources to scale up our business to meet customer expectations and compete successfully during periods of demand growth.

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

An important element of our management strategy is to review acquisition prospects that would complement our existing products, augment our market coverage and distribution ability, or enhance our technological capabilities. As a result, we may make acquisitions of complementary companies, products or technologies, such as our March 2008 acquisition of SEZ, or we may reduce or dispose of certain product lines or technologies, that no longer fit our long-term strategies. Managing an acquired business, disposing of product technologies or reducing personnel entails 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 and potential loss of key employees or customers of acquired or disposed operations among others. We anticipate that our recent acquisition of SEZ will give rise to risks like these, as we integrate its operations with ours. There can be no assurance that we will be able to achieve and manage successfully any such integration of potential acquisitions, disposition of product lines or technologies, or reduction in personnel or that our management, personnel, or systems will be adequate to support continued operations. Any such inabilities or inadequacies could have a material adverse effect on our business, operating results, financial condition, and cash flows.

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

The Market for Our Common Stock is Volatile, Which May Affect Our Ability to Raise Capital or Make Acquisitions

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 factors, including but not limited to the following:

- general market, semiconductor, or semiconductor equipment industry conditions;
- global economic fluctuations;
- variations in our quarterly operating results;
- variations in our revenues, earnings or other business and financial metrics from those experienced by other companies in our industry or forecasts by securities analysts;
- announcements of restructurings, technological innovations, reductions in force, departure of key employees, consolidations of operations, or introduction of new products;
- government regulations;
- developments in, or claims relating to, patent or other proprietary rights;
- success or failure of our new and existing products;
- liquidity of Lam Research;
- disruptions with key customers or suppliers; or
- political, economic, or environmental events occurring globally or in any of our key sales regions.

In addition, the stock market experiences significant price and volume fluctuations. Historically, we have witnessed significant volatility in the price of our Common Stock due in part to the actual or anticipated movement in interest rates and the price of and markets for semiconductors. These broad market and industry factors have and may again adversely affect the price of our Common Stock, regardless of our actual operating performance. In the past, following volatile periods in the price of stock, many companies became the object of

Table of Contents

securities class action litigation. If we are sued in a securities class action, we could incur substantial costs, and it could divert management's attention and resources and have an unfavorable impact on the price for our Common Stock.

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

We maintain and rely upon certain critical information systems for the effective operation of our business. These information systems include telecommunications, the internet, our corporate intranet, various computer hardware and software applications, network communications, and e-mail. These information systems may be owned by us or by our outsource providers or even third parties such as vendors and contractors and may be maintained by us or by such providers and third parties. 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. To the extent that these information systems are under our control, we have implemented security procedures, such as virus protection software and emergency recovery processes, to address the outlined risks. However, security procedures for information systems cannot be guaranteed to be failsafe and our inability to use or access these information systems at critical points in time could unfavorably impact the timely and efficient operation of our business.

Intellectual Property and Other Claims Against Us Can be Costly and Could Result in the Loss of Significant Rights Which are Necessary to Our Continued Business and Profitability

Third parties may assert infringement, unfair competition or other claims against us. From time to time, other parties send us notices alleging that our products infringe their patent or other intellectual property rights. In addition, our Bylaws and indemnity obligations provide that we will indemnify officers and directors against losses that they may incur in legal proceedings resulting from their service to Lam Research. 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. Moreover, although we seek to obtain insurance to protect us from claims and cover losses to our property, there is no guarantee that such insurance will fully indemnify us for any losses that we may incur.

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

Our success depends in part on our proprietary technology. While we attempt to protect our proprietary technology through patents, copyrights and trade secret protection, we believe that our success also depends on increasing our technological expertise, continuing our development of new systems, increasing market penetration and growth of our installed base, and providing comprehensive support and service to our customers. However, we may be unable to protect our technology in all instances, or our competitors may develop similar or more competitive technology independently. We currently hold a number of United States and foreign patents and pending patent applications. However, other parties may challenge or attempt to invalidate or circumvent any patents the United States or foreign governments issue to us or these governments may fail to issue patents for pending applications. In addition, the rights granted or anticipated under any of these patents or pending patent applications may be narrower than we expect or, in fact, provide no competitive advantages.

We are Subject to the Internal Control Evaluation and Attestation Requirements of Section 404 of the Sarbanes-Oxley Act of 2002

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we are required to include in our annual report our assessment of the effectiveness of our internal control over financial reporting and our audited financial statements as of the end of each fiscal year. Furthermore, our independent registered public accounting firm (the Independent Registered Public Accounting Firm) is required to report on whether it believes we maintained, in all material respects, effective internal control over financial reporting as of the end of each fiscal year. We have successfully completed our assessment and obtained our Independent Registered Public Accounting Firm's attestation as to the effectiveness of our internal control over financial reporting as of June 29, 2008. In future years, if we fail to timely complete this assessment, or if our Independent Registered Public Accounting Firm cannot timely attest to our assessment, we could be subject to regulatory sanctions and a loss of public confidence in our internal control. In

addition, any failure to implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results or cause us to fail to timely meet our regulatory reporting obligations.

Our Independent Registered Public Accounting Firm Must Confirm Its Independence in Order for Us to Meet Our Regulatory Reporting Obligations on a Timely Basis

Our Independent Registered Public Accounting Firm communicates with us at least annually regarding any relationships between the Independent Registered Public Accounting Firm and Lam Research that, in the Independent Registered Public Accounting Firm's professional judgment, might have a bearing on the Independent Registered Public Accounting Firm's independence with respect to us. If, for whatever reason, our Independent Registered Public Accounting Firm finds that it cannot confirm that it is independent of Lam Research based on existing securities laws and registered public accounting firm independence standards, we could experience delays or other failures to meet our regulatory reporting obligations.

Table of Contents***The Results of Our Independent Committee Review of Our Historical Stock Option Practices and Resulting Restatements May Continue to Have Adverse Effects on Our Financial Results***

The review by a special committee of our Board of Directors consisting of two independent Board members (the Independent Committee) of our historical stock option practices and the resulting restatement of our historical financial statements have required us to expend significant management time and incur significant accounting, legal, and other expenses during fiscal year 2008. The resulting restatements have had a material adverse effect on our results of operations. We have restated our historical results of operations to record additional non-cash, stock-based compensation expense of \$95.2 million in the aggregate for the periods from fiscal 1997 to fiscal 2006 (excluding the impact of related payroll and income taxes). We amortized less than \$0.1 million of compensation expense under Statement of Financial Accounting Standards No. 123R (SFAS No. 123R) in periods subsequent to fiscal year 2006 to properly account for previously issued stock options with deemed incorrect measurement dates. Furthermore, to address potential adverse tax consequences certain of our employees have incurred or may incur as a result of the issuance and/or exercise of misdated stock options, we have taken and will continue to take remedial actions to make such employees including our Chief Executive Officer and other affected executive officers, whole for any or all such additional tax liabilities which were approximately \$52 million as of September 28, 2008. Such actions have caused and in the future may cause us to incur additional cash or noncash compensation expense. See the Explanatory Note immediately preceding Part I, Item 1 and Note 3, Restatements of Consolidated Financial Statements, to Notes to Consolidated Financial Statements of our Annual Report on Form 10-K as of and for the year ended June 24, 2007 (2007 Form 10-K) for further discussion.

We May Be Subject to the Risks of Lawsuits in Connection With Our Historical Stock Option Practices, the Resulting Restatements, and the Remedial Measures We Have Taken

We, and our current and former directors and officers, may become the subject of shareholder derivative and/or class action lawsuits and other legal proceedings relating to our historical stock option practices and resulting restatements in the future. We may also be subject to other kinds of lawsuits. Should any of these events occur, they could require us to expend significant management time and incur significant accounting, legal and other expenses. This could divert attention and resources from the operation of our business and adversely affect our financial condition and results of operations. In addition, the ultimate outcome of these potential actions could have a material adverse effect on our business, financial condition, results of operations, cash flows and the trading price for our securities. Litigation may be time-consuming, expensive and disruptive to normal business operations, and the outcome of litigation is difficult to predict. The defense of these potential lawsuits could result in significant expenditures.

Subject to certain limitations, we are obliged to indemnify our current and former directors, officers and employees in connection with any government inquiry or litigation related to our historical stock option practices that may arise. We currently hold insurance policies for the benefit of our directors and officers, although there can be no assurance that the insurance would cover all of the expenses that would be associated with any proceedings.

Judgment and Estimates Utilized by Us in Determining Stock Option Grant Dates and Related Adjustments May Be Subject to Change due to Subsequent SEC Guidance or Other Disclosure Requirements

In determining the restatement adjustments in connection with the stock option review, management used all reasonably available relevant information to form conclusions it believes are appropriate as to the most likely option granting actions that occurred, the dates when such actions occurred, and the determination of grant dates for financial accounting purposes based on when the requirements of the accounting standards were met. We considered various alternatives throughout the course of the review and restatement, and we believe the approaches used were the most appropriate, and that the choices of measurement dates used in our review of stock option grant accounting and restatement of our financial statements were reasonable and appropriate in our circumstances. However, the SEC may issue additional guidance on disclosure requirements related to the financial impact of past stock option grant measurement date errors that may require us to amend this filing or other filings with the SEC to provide additional disclosures pursuant to such additional guidance. Any such circumstance could also lead to future delays in filing our subsequent SEC reports. Furthermore, if we are subject to adverse findings in any of these matters, we could be required to pay damages or penalties or have other remedies imposed upon us which could harm our business,

financial condition, and results of operations.

We Recently Regained Compliance with SEC Reporting Requirements. If We are Unable to Remain in Compliance, There May Be a Material Adverse Effect on our Business and Our Stockholders

As a consequence of the Independent Committee review of our historical stock option practices and resulting restatements of our financial statements, for several quarters, we were not able to file our periodic reports with the SEC on a timely basis and faced the possibility of delisting of our stock from the NASDAQ Global Select Market. We have filed all of our tardy filings, which remediated the Company's non-compliance with NASDAQ Marketplace Rule 4310(c) (14), and believe we are in compliance with all applicable reporting requirements. However, if the SEC disagrees with the manner in which the financial impact of past stock option grants has been accounted for and reported, or not reported, there could be delays in filing future SEC reports. See the Explanatory Note immediately preceding Part I, Item 1 and Note 3, Restatements of Consolidated Financial Statements, to Consolidated Financial Statements of our 2007 Form 10-K for further discussion. As a result of the delayed filings of our Quarterly Reports on Form 10-Q for the quarters ended

Table of Contents

September 23, 2007 and December 23, 2007, as well as of the 2007 Form 10-K, we are ineligible to register our securities on Form S-3 for sale by us or resale by others until one year from March 31, 2008, the date the last delinquent filing was made. We may use Form S-1 to raise capital or complete acquisitions, but doing so could increase transaction costs and adversely impact our ability to raise capital or complete acquisitions of other companies in a timely manner.

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

(c) On September 8, 2008, the Company announced that its Board of Directors had authorized the repurchase of up to \$250 million of Company common stock from the public market or in private purchases. While the repurchase program does not have a defined termination date, it may be suspended or discontinued at any time, and will be funded using the Company's available cash. Share repurchases under the authorizations were as follows:

| Period | Total Number of Shares Repurchased (1) | Average Price Paid Per Share (in thousands, except per share data) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Amount Available Under Repurchase Program |
|--|---|---|---|--|
| June 30 - July 27, 2008 | 4 | \$ 33.92 | | \$ |
| July 28 - August 24, 2008 | 72 | \$ 32.70 | | \$ |
| Authorization of up to \$250 million September 2008 | | | | \$ 250,000 |
| August 25 - September 28, 2008 | 8 | \$ 32.20 | 1 | \$ 249,985 |
| Total | 84 | \$ 32.71 | 1 | \$ 249,985 |

(1) In addition to shares repurchased under Board authorized repurchase programs and included in this column are 83,047 shares which the Company withheld through net share settlements during the three

months ended
September 28,
2008 upon the
vesting of
restricted stock
unit awards
under the
Company's
equity
compensation
plans to cover
tax withholding
obligations.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

(a) Exhibits

10.147 First Amendment to Credit Agreement, between Lam Research Corporation and ABN Amro Bank, N.V., dated September 29, 2008

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: November 7, 2008

LAM RESEARCH CORPORATION
(Registrant)

/s/ Ernest E. Maddock

Ernest E. Maddock
*Senior Vice President, Chief Financial
Officer*

43

Table of Contents

EXHIBIT INDEX

| Exhibit Number | Description |
|---------------------------|---|
| 10.147 | First Amendment to Credit Agreement, between Lam Research Corporation and ABN Amro Bank, N.V., dated September 29, 2008 |
| 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) |