LATTICE SEMICONDUCTOR CORP
Form 10-Q
November 05, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED October 2, 2010
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 000-18032
LATTICE SEMICONDUCTOR CORPORATION
(Exact name of Registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period as the registrant was required to submit and post such files). Yes [ ] No [ ]

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

Large accelerated filer[ ]	Accelerated filer [X]
Non-accelerated filer [ ]	Smaller reporting company [ ]

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

Number of shares of common stock outstanding as of November 4, 2010 117,835,443

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. We use words or phrases such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “may,” “will,” “should,” “continue,” “ongoing,” “future,” “potential” and phrases to identify forward-looking statements. Examples of forward-looking statements include, but are not limited to, statements about our fiscal 2010 revenues from sell-through distributors; changes to our unrecognized tax benefits and expectations regarding taxes and tax adjustments; the timing of completion of our 2009 restructuring plan; our expectations that a significant portion of our revenue will continue to be dependent on the communications end market; the Asian Pacific market being the primary source of our revenue; the impact of new accounting pronouncements; our benefiting from our cost reduction actions; our expectations regarding research and development investments and increases in capital expenditures; and our beliefs concerning the adequacy of our liquidity and ability to meet our operating and capital requirements and obligations.

Forward-looking statements involve estimates, assumptions, risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. The key factors that could cause our actual results to differ materially from the forward-looking statements include global economic conditions and uncertainty, the concentration of our sales in the communications equipment end market, particularly as it relates to the concentration of our sales in the Asia Pacific region, market acceptance and demand for our new products, the effect of the downturn in the economy on capital markets and credit markets, the impact of competitive products and pricing, unanticipated taxation requirements, or positions of the IRS, unexpected impacts of recent accounting guidance and the other risks that are described herein and that are otherwise described from time to time in our filings with the Securities and Exchange Commission, including but not limited to, the items discussed in “Risk Factors” in Item 1A of Part II of this Report. You should not unduly rely on forward-looking statements because our actual results could differ materially from those expressed in any forward-looking statements made by us. In addition, any forward-looking statement applies only as of the date on which it is made. We do not plan to, and undertake no obligation to, update any forward-looking statements to reflect events or circumstances that occur after the date on which such statements are made or to reflect the occurrence of unanticipated events.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LATTICE SEMICONDUCTOR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Revenue	$77,137	$49,097	$224,688	$139,333
Costs and expenses:				
Cost of products sold	31,551	22,478	90,704	65,450
Research and development	14,814	14,789	44,654	43,491
Selling, general and administrative	15,818	12,739	47,621	39,255
Amortization of intangible assets	—	—	—	228
Restructuring	79	2,544	41	2,504
	62,262	52,550	183,020	150,928
Income (loss) from operations	14,875	(3,453)	41,668	(11,595)
Other income (expense), net	669	(536)	1,916	(859)
Income (loss) before provision for income taxes	15,544	(3,989)	43,584	(12,454)
Provision for income taxes	176	125	391	129
Net income (loss)	$15,368	$(4,114)	$43,193	$(12,583)
Net income (loss) per share:				
Basic	$0.13	$(0.04)	$0.37	$(0.11)
Diluted	$0.13	$(0.04)	$0.36	$(0.11)
Shares used in per share calculations:				
Basic	117,257	115,321	116,332	115,356
Diluted	121,052	115,321	119,624	115,356

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and par value data)
(unaudited)

	October 2, 2010	January 2, 2010
Assets		
Current assets:		
Cash and cash equivalents	$166,634	$156,069
Short-term marketable securities	62,448	8,471
Accounts receivable, net	49,217	33,551
Inventories	31,681	25,925
Current portion of foundry advances	29	11,475
Prepaid expenses and other current assets	9,521	7,980
Total current assets	319,530	243,471
Property and equipment, less accumulated depreciation	36,883	36,507
Long-term marketable securities	9,719	12,939
Other long-term assets	2,785	3,640
Total assets	$368,917	$296,557
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$29,370	$22,679
Accrued payroll obligations	11,861	5,118
Deferred income and allowances on sales to sell-through distributors	18,177	10,160
Total current liabilities	59,408	37,957
Long-term liabilities	5,185	5,240
Total liabilities	64,593	43,197
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value, 10,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $.01 par value, 300,000,000 shares authorized, 117,805,000 and 115,592,000 shares issued and outstanding	1,178	1,156
Paid-in capital	630,012	622,584
Treasury stock	—	(326)
Accumulated other comprehensive income	153	158
Accumulated deficit	(327,019)	(370,212)
Total stockholders' equity	304,324	253,360
Total liabilities and stockholders' equity	$368,917	$296,557

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(unaudited)

	Nine Months Ended	
	October 2, 2010	October 3, 2009
Cash flows from operating activities:		
Net income (loss)	$43,193	$(12,583)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	10,642	10,928
Gain on sale of marketable securities	(416)	(163)
Impairment of Long-term marketable securities	—	2,267
Gain on sale of excess real estate	(720)	—
Stock-based compensation	3,505	3,363
Changes in assets and liabilities:		
Accounts receivable, net	(15,666)	(1,839)
Inventories	(5,756)	5,639
Prepaid expenses and other current assets	(3,525)	392
Foundry advances (includes advance credits and Other receivable)	11,446	43,147
Accounts payable and accrued expenses (includes restructuring)	6,488	6,168
Accrued payroll obligations	6,743	(820)
Deferred income and allowances on sales to sell-through distributors	8,017	(209)
Other liabilities	337	(2,546)
Net cash provided by operating activities	64,288	53,744
Cash flows from investing activities:		
Proceeds from sales or maturities of marketable securities	40,813	13,262
Purchase of marketable securities	(91,150)	—
Proceeds from sale of excess real estate	874	—
Capital expenditures	(8,531)	(4,323)
Net cash (used in) provided by investing activities	(57,994)	8,939
Cash flows from financing activities:		
Payment on yen line of credit	—	(805)
Treasury stock	—	(329)
Net proceeds from issuance of common stock	4,926	8
Net share settlement upon issuance of RSUs	(655)	(161)
Net cash provided by (used in) financing activities	4,271	(1,287)
Net increase in cash and cash equivalents	10,565	61,396
Beginning cash and cash equivalents	156,069	53,668
Ending cash and cash equivalents	$166,634	$115,064
Supplemental disclosures of non-cash investing and financing activities:		
Unrealized gain on assets measured at fair value, net, included in Accumulated other comprehensive income	$4	$1,333
Distribution of deferred compensation from trust assets	$227	$589
Retirement of Treasury stock	$(326)	$—

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation and Significant Accounting Policies:

The accompanying Condensed Consolidated Financial Statements are unaudited and have been prepared by Lattice Semiconductor Corporation (the “Company”, “we”, “us” or “our”) pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and in our opinion include all adjustments, consisting of normal recurring adjustments, necessary for the fair statement of results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These Condensed Consolidated Financial Statements should be read in conjunction with our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 2, 2010.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and classification of assets, such as marketable securities, accounts receivable, inventory, auction rate securities, deferred income taxes and liabilities, accrued expenses (including restructuring charges), income taxes, deferred income and allowances on sales to certain sell-through distributors, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the fiscal periods presented. Actual results could differ from these estimates.

We report based on a 52 or 53-week fiscal year ending on the Saturday closest to December 31. Our third quarter of fiscal 2010 and third quarter of fiscal 2009 ended on October 2, 2010 and October 3, 2009, respectively. All references to quarterly or three and nine months ended financial results are references to the results for the relevant fiscal period.

Cash Equivalents and Marketable Securities

We consider all investments that are readily convertible into cash and have original maturities of three months or less, to be cash equivalents. Cash equivalents consist primarily of highly liquid investments in time deposits or money market accounts and are carried at cost. We account for marketable securities as available for sale with unrealized gains or losses recorded as Other comprehensive income, unless losses are considered other-than-temporary, in which case, losses are charged to the Condensed Consolidated Statements of Operations.

Concentration Risk

Potential exposure to concentration risk consists primarily of cash equivalents, marketable securities, trade receivables and supply of wafers for our new products. We place our investments primarily through four financial institutions and mitigate the concentration of credit risk by placing percentage limits on the maximum portion of the investment portfolio which may be invested in any one investment instrument. The Company’s investment policy defines approved credit ratings for investment securities. Purchased securities must meet or exceed the ratings; however, due to liquidity issues in global credit and capital markets, some of our auction rate securities have fallen below our required credit ratings. Investments consisted primarily of money market instruments, “AA” or better corporate notes and bonds, “AA” or better rated U.S. municipal notes, U.S. government agency obligations and “C” or better rated auction rate securities. See Note 4 for a discussion of the liquidity attributes of our marketable securities.

Concentration of credit risk with respect to trade receivables are mitigated by a geographically diverse customer base consisting primarily of four large distributors, a large number of OEM customers and several contract manufacturers, as well as by our credit and collection process. Accounts receivable are recorded at the invoice amount, do not bear interest, and are shown net of allowances for doubtful accounts of $0.9 million and $1.0 million at October 2, 2010 and January 2, 2010, respectively. We perform credit evaluations for essentially all customers and secure transactions with letters of credit or advance payments where appropriate. We regularly review our allowance for doubtful accounts and the aging of our accounts receivable. Write-offs for uncollected trade receivables have not been significant to date.

We enter into arrangements with certain sell-through distributors under which we issue accounts receivable credit adjustments (“distributor advances”) to reduce the distributors' working capital requirements for servicing our end customers. Distributor advances are recorded as a reduction of Deferred income and allowances on sales to sell-through distributors. These arrangements are unsecured, bear no interest, are settled on a quarterly basis and are due upon demand. Distributor advances, which have no impact on revenue recognition, totaled $28.3 million and $16.5 million at October 2, 2010 and January 2, 2010, respectively.

Current portion of foundry advances was less than $0.1 million and was $11.5 million at October 2, 2010 and January 2, 2010, respectively, pursuant to an agreement with Fujitsu Semiconductor Limited (“Fujitsu”) in which we agreed to advance $125.0 million to Fujitsu for future wafer purchases. Under the terms of a letter agreement between the Company and Fujitsu, Fujitsu agreed to repay $60.0 million in cash to the Company, plus interest, in two installments. $30.0 million was received on April 15, 2009 and the remaining $30.0 million was received on October 15, 2009. We expect to receive the remaining advance of less than $0.1 million in the form of advance credits, including engineering mask set charges, during the fourth quarter of the Company's fiscal 2010. We rely on Fujitsu for essentially all wafer purchases for our new products.

Revenue Recognition and Deferred Income

Revenue from sales to customers is recognized upon shipment, or in the case of sales by our sell-through distributors, at the time of reported resale, provided that persuasive evidence of an arrangement exists, the price is fixed or determinable, title has transferred, collection of resulting receivables is probable, there are no customer remaining acceptance requirements and no remaining significant obligations. We sell our products directly to end customers or through a network of independent manufacturers' representatives and indirectly through a network of independent sell-in and sell-through distributors. Distributors provide us periodic data regarding the product, price, quantity, and end customer when products are resold as well as the quantities of our products they still have in stock. We must use estimates and apply judgment to reconcile sell-through distributors' reported inventories to their activities. Any error in our judgment could lead to inaccurate reporting of our Revenue, Cost of products sold, Deferred income and allowances on sales to sell-through distributors, and Net income (loss).

At the time of shipment to a sell-through distributor amounts are invoiced at published list price. The final price is set at the time of resale and is determined in accordance with a distributor price agreement. Amounts invoiced are recorded in Accounts receivable, net and inventory is transferred from Inventories to Deferred income and allowances on sales to sell-through distributors. Revenue and cost of products sold to sell-through distributors are deferred until either the product is resold by the distributor or, in certain cases, return privileges terminate, at which time Revenue and Cost of products sold are reflected in Net income (loss). Our estimate of inventory valued at published list price and held by sell-through distributors with right of return totaled $54.8 million and $31.7 million at October 2, 2010 and January 2, 2010, respectively. Distributor advances totaled $28.3 million and $16.5 million at October 2, 2010 and January 2, 2010, respectively and are recorded in Deferred income and allowances to sell-through distributors. Deferred costs of sales related to inventory held by sell-through distributors totaled $8.3 million and $5.0 million at October 2, 2010 and January 2, 2010, respectively.

During fiscal 2009, the Company completed a program to restructure our distribution channels primarily in the Asia Pacific region from a sell-in to a sell-through distribution model. As a result, we expect the majority of our revenue in fiscal 2010 will be from reported resale from our sell-through distributors. Resale of product by sell-through distributors as a percentage of our total revenue was 38%, 33% and 36% in fiscal years 2009, 2008 and 2007, respectively, and 55% and 56% for the third quarter and nine months ended October 2, 2010, respectively.

Revenue from software licensing was not material for the periods presented.

New Accounting Pronouncements

In September 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2009-13, “Revenue Recognition (Topic 605): Multiple Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force),” (“ASU 2009-13”). ASU 2009-13 provides principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated and the consideration allocated. Additionally, ASU 2009-13 requires an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence or third-party evidence of selling price, eliminates the residual method and requires an entity to allocate revenue using the relative selling price method. This update is effective for the Company beginning January 1, 2011 and can be applied prospectively or retrospectively. The Company is currently assessing the impact of the adoption on its financial statements.

In October 2009, the FASB issued Accounting Standards Update 2009-14, "Software (Topic 985): Certain Revenue Arrangements That Include Software Elements," ("ASU 2009-14"). ASU 2009-14 clarifies which revenue allocation and measurement guidance should be used for arrangements that contain both tangible products and software, in cases where the software is more than incidental to the tangible product as a whole. More specifically, if the software sold with or embedded within the tangible product is essential to the functionality of the tangible product, then this software as well as undelivered

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software elements that relate to this software are excluded from the scope of existing software revenue guidance. This guidance is to be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently assessing the impact of the adoption on its financial statements.

In January 2010, the FASB issued Accounting Standards Update No. 2010-06, “Fair Value Measurements Disclosures,” which amends Subtopic 820-10 of the FASB Accounting Standards Codification to require new disclosures for fair value measurements and provides clarification for existing disclosures requirements ("ASU No. 2010-06"). More specifically, this update will require (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009 with the exception of revised Level 3 disclosure requirements, which are effective for interim and annual reporting periods beginning after December 15, 2010. The Company has adopted part (a) of this ASU in full with respect to the interim period ended July 3, 2010, and part (b) will be adopted in fiscal year 2011.

Note 2 - Net Income (Loss) Per Share:

Net income (loss) per share is computed based on the weighted average number of shares of common stock and potentially dilutive securities assumed to be outstanding during the period using the treasury stock method. Potentially dilutive securities consist of stock options, restricted stock units (“RSUs”), employee stock purchase plan ("ESPP") shares, and warrants to purchase shares of common stock. There were no outstanding warrants as of October 2, 2010 or January 2, 2010.

The computation of diluted net income per share for the third quarter and nine months ended October 2, 2010, includes the effects of stock options, RSUs and ESPP shares aggregating 3.8 million and 3.3 million shares, respectively, as they are dilutive, and excludes the effects of stock options and RSUs aggregating 1.9 million and 3.0 million shares, respectively, as they are antidilutive. The computation of diluted net loss per share for the third quarter and nine months ended October 3, 2009, excludes the effects of stock options, RSUs, ESPP shares and warrants aggregating 10.1 million and 11.7 million shares, because the effect was antidilutive. Stock options, RSUs, ESPP shares and warrants are antidilutive when the aggregate of exercise price, unrecognized stock-based compensation expense and excess tax benefit are greater than the average market price for our common stock during the period or when the Company is in a net loss position. Stock options and RSUs that are antidilutive in the third quarter and first nine months of fiscal 2010 could become dilutive in the future.

Note 3 - Marketable Securities:

The following table summarizes the contractual maturities of our marketable securities (at fair value and in thousands):

	October 2, 2010	January 2, 2010
Short-term marketable securities:	$62,448	$8,471
Long-term marketable securities:		
Due after ten years	9,523	12,743

No contractual maturity date	196	196
	9,719	12,939
Total marketable securities	$72,167	$21,410

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The following table summarizes the composition of our marketable securities (at fair value and in thousands):

	October 2, 2010	January 2, 2010
Short-term marketable securities:		
Corporate and government bonds and notes	$62,448	$8,471
Long-term marketable securities:		
Auction Rate Securities (by type of underlying asset):		
Federally-insured or FFELP guaranteed student loans	9,523	12,743
Auction market preferred shares	196	196
	9,719	12,939
Total marketable securities	$72,167	$21,410

The following table summarizes the composition of our auction rate securities (in thousands):

	October 2, 2010			January 2, 2010		
	Par Value	Fair Value	S&P Credit rating	Par Value	Fair Value	S&P Credit rating
Long-term marketable securities:						
Federally-insured or FFELP guaranteed student loans	$11,600	$9,523	AAA	$15,725	$12,743	AAA
Auction market preferred shares	8,325	196	C	8,325	196	C
Total Long-term marketable securities	$19,925	$9,719		$24,050	$12,939	

During the first nine months of fiscal 2010, the Company accepted 13 partial redemptions at 100% of par value ($0.3 million) of auction rate securities. On July 29, 2010, the Company sold student loan auction rate securities, with a par value of $3.8 million and fair value of $2.9 million for $3.3 million and reported a gain of $0.4 million in the third quarter of fiscal 2010. The Company intends to sell its auction rate securities as markets for these securities resume or reasonable offers become available. At October 2, 2010, due to continued multiple failed auctions and a determination of illiquidity, the auction rate securities held by the Company are classified as Long-term marketable securities.

Student loan asset-backed notes are insured by the federal government or guaranteed by the Federal Family Educational Loan Program (“FFELP”). Auction market preferred shares are issued by Ambac Assurance Corporation (“AMBAC”).

While the auctions for auction rate securities have historically provided a liquid market for these securities, due to liquidity issues in global credit and capital markets, auction rate securities held by us have experienced multiple failed auctions (a portion beginning in October 2007). These instruments are considered illiquid and have been reclassified as Long-term marketable securities on the Condensed Consolidated Balance Sheets. No additional impairment charges were recognized in the first nine months of fiscal 2010. If we were to liquidate our position in these securities, the amount realized could be materially different than the estimated fair value amounts at which we are carrying these securities and there could be a materially detrimental effect on our financial results.

Note 4 - Fair Value of Financial Instruments:

	Fair value measurements as of October 2, 2010			
	Total	Level 1	Level 2	Level 3
Short-term marketable securities	$62,448	$62,448	$—	$—
Long-term marketable securities	9,719	—	—	9,719

Total assets measured at fair value	$72,167	$62,448	$—	$9,719

We invest in various financial instruments including corporate and government bonds and notes, commercial paper and auction rate securities. The Company carries these instruments at their fair value in accordance with ASC 820. The framework under the provisions of ASC 820 establishes three levels of inputs that may be used to measure fair value. Each level of input has different levels of subjectivity and difficulty involved in determining fair value.

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Level 1 instruments generally represent quoted prices in active markets. Therefore, determining fair value for Level 1 instruments generally does not require significant management judgment, and the estimation is not difficult. Our Level 1 instruments consist of federal agency, municipal or corporate notes and bonds that are traded in active markets and are classified as Short-term marketable securities on our Condensed Consolidated Balance Sheet.

Level 2 instruments include inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices for identical instruments in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. We have no investments in Level 2 instruments.

Level 3 instruments include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Our auction rate securities are classified as Level 3 instruments. Management uses a combination of the market and income approach to derive the fair value of auction rate securities, which include third party valuation results, investment broker provided market information and available information on the credit quality of the underlying collateral. As a result, the determination of fair value for Level 3 instruments requires significant management judgment and subjectivity. Our Level 3 instruments are classified as Long-term marketable securities on our Condensed Consolidated Balance Sheet.

During the nine months ended October 2, 2010 and October 3, 2009, the following changes occurred in our Level 3 instruments (in thousands):

	Nine Months Ended	
	October 2, 2010	October 3, 2009
Beginning fair value of Long-term marketable securities	$12,939	$19,485
Fair value of securities sold or redeemed	(3,220)	(925)
Temporary or other-than-temporary fluctuations in fair value	—	(904)
Ending fair value of Long-term marketable securities	$9,719	$17,656

In accordance with ASC 320, “Investments-Debt and Equity Securities,” the Company recorded an unrealized gain of less than $0.1 million during the nine months ended October 2, 2010 on certain Short-term marketable securities (Level 1 instruments), which has been recorded in Accumulated other comprehensive income. Future fluctuations in fair value related to these instruments that the Company deems to be temporary, including any recoveries of previous write-downs, would be recorded to Accumulated other comprehensive income. In addition, during the three and nine months ended October 2, 2010, the Company realized a gain of $0.4 million and $0.5 million, respectively, related to the sale of a portion of its Long-term marketable securities portfolio.

If the Company were to determine in the future that any further decline in fair value is other-than-temporary, we would record an impairment charge, which could have a materially detrimental impact on our operating results. If we were to liquidate our position in these securities, it is likely that the amount of any future realized gain or loss would be different from the unrealized gain or loss reported in Accumulated other comprehensive income or the previously reported other-than-temporary impairment charge.

Note 5 - Inventories (in thousands):

	October 2, 2010	January 2, 2010
Work in progress	$21,524	$15,046

Finished goods	10,157	10,879
	$31,681	$25,925

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Note 6 - Changes in Stockholders' Equity and Comprehensive Income (in thousands):

	Common stock	Paid-in capital	Treasury stock	Accumu-lated deficit	Accumu-lated other compre-hensive income	Total
Balances, January 2, 2010	$1,156	$622,584	$(326)	$(370,212)	$158	$253,360
Net income for the nine months ended October 2, 2010	—	—	—	43,193	—	43,193
Unrealized gain, net, related to marketable securities	—	—	—	—	4	4
Translation adjustments	—	—	—	—	(9)	(9)
Comprehensive income	—	—	—	—	—	43,188
Common stock issued in connection with the exercise of stock options, ESPP and vested RSUs (net of taxes)	22	4,249	—	—	—	4,271
Retirement of repurchased stock	—	(326)	326	—	—	—
Stock-based compensation expense related to stock options, ESPP and RSUs	—	3,505	—	—	—	3,505
Balances, October 2, 2010	$1,178	$630,012	$—	$(327,019)	$153	$304,324

On December 13, 2008, the Company’s Board of Directors approved a stock repurchase program pursuant to which up to $20.0 million of outstanding common stock may be repurchased from time to time. The duration of the repurchase program was twelve months, and expired on December 13, 2009. During fiscal year 2009, approximately 263,000 shares were repurchased for $0.3 million, all of which were open market transactions and were funded from available working capital. On May 4, 2010, the Board of Directors approved the retirement of repurchased shares.

On October 21, 2010, the Company's Board of Directors approved a stock repurchase program pursuant to which up to $20.0 million of outstanding common stock may be repurchased from time to time. The duration of the repurchase program is twelve months. Under the program, the Company may purchase shares of common stock through open market and privately negotiated transaction at prices deemed appropriate by management. The timing and amount of repurchase transactions under this program will depend on market conditions and corporate and regulatory considerations. The purchases will be funded from available working capital.

Note 7 - Income Taxes:

We are subject to federal income tax as well as income tax of multiple state and foreign jurisdictions. We are no longer subject to federal, state and local, or foreign income tax examinations for years before 2001. We have federal net operating loss carryforwards that expire at various dates between 2021 and 2029. We have state net operating loss carryforwards that expire at various dates from 2010 through 2029. We also have federal and state credit carryforwards, some of which do not expire, with the remainder expiring at various dates from 2010 through 2030. We have provided a valuation allowance equal to our net federal and state deferred tax assets as we have not met the more likely than not realization threshold for deferred tax asset recognition. We evaluate both positive and negative evidence to determine if some or all of our deferred tax assets should be recognized on a quarterly basis. As of

October 2, 2010, the negative evidence, which includes a three year cumulative pretax loss, outweighs the positive evidence available. In future periods, if we determine that the positive evidence is sufficient to conclude that we are more-likely-than-not to realize some or all of our deferred tax assets, we will recognize a deferred tax asset and a benefit in the period in which such determination is made. As of October 2, 2010, the net deferred tax asset relates to foreign jurisdictions where we have concluded it is more-likely-than-not-that we will realize the net deferred tax assets in future periods.

The Internal Revenue Service (“IRS”) has examined our income tax returns for 2001 and 2002, and has issued proposed adjustments of $1.4 million, plus interest. These adjustments relate to the treatment of acquisition costs and a tax accounting method change for prepaid expenses. Although we do not agree with the proposed adjustment related to the prepaid expense matter, we believe that we have reached a tentative agreement concerning the acquisition costs. During the three months ended March 29, 2008, we made a payment of $0.3 million related to this tentative agreement. On May 23, 2008, the Company filed a petition with the Tax Court seeking a redetermination of the prepaid expense adjustment. Although the final resolution of this matter is uncertain, we believe that adequate amounts have been provided for as unrecognized tax benefits. There is the possibility of either a favorable or unfavorable effect on our results of operations in the period in which these matters are effectively settled. We will recognize any uncertain tax benefit in the period settled.

We are subject to state and local income tax examinations for the years 2001 through 2003. To date, there are no proposed adjustments that are expected to have a material adverse effect on our results of operations. We are currently under examination in Taiwan related to the 2007 and 2008 tax years. The 2007 exam has been settled with no material adjustments. The 2008 exam has not been settled but there are no proposed adjustments that are expected to have a material adverse effect on our results of operations. We are not currently under examination in any other foreign jurisdictions.

We believe that it is reasonably possible that $1.5 million of unrecognized tax benefits and $0.9 million of associated interest and penalties could significantly change during the next twelve months. The $2.4 million potential change would represent a decrease in unrecognized tax benefits, comprised of items related to matters currently being litigated with the IRS, certain federal and state credits and uncertain income tax positions related to foreign tax filings for years that will no longer be subject to examination under expiring statutes of limitations.

We are paying foreign income taxes, which are reflected in the Provision for income taxes in the Condensed Consolidated Statements of Operations and are primarily related to the cost of operating an offshore research and development subsidiary and sales subsidiaries. We are not currently paying federal income taxes and do not expect to pay such taxes until the benefits of our tax net operating losses are fully utilized. We expect to pay a nominal amount of state income tax. We accrue interest and penalties related to uncertain tax positions in the Provision for income taxes.

Note 8 - Restructuring:

During fiscal 2009, we initiated a restructuring plan ("2009 restructuring plan") to lower operating expenses primarily by reducing headcount, reducing occupancy in certain leased facilities and to transfer inventory management, order fulfillment, and direct sales logistics from our headquarters in Oregon to a third party contractor in Singapore. In addition, the Company established an operations center in Singapore to transfer some of its supply chain activities from the Company’s headquarters in Oregon. The 2009 restructuring plan will be substantially completed by the fourth quarter of fiscal 2010.

During the third quarter of fiscal 2008, we initiated a restructuring plan (“2008 restructuring plan”) to better align operating expenses with near-term revenue expectations, primarily by reducing headcount. The 2008 restructuring plan was substantially complete by the end of fiscal 2008. During the third quarter of fiscal 2007, we approved and initiated a restructuring plan to lower operating expenses primarily by reducing headcount ("2007 restructuring plan").

The 2007 restructuring plan encompassed a reduction in work force, a voluntary separation program for certain employees and the closure of certain leased facilities. The 2007 restructuring plan was substantially complete by the end of fiscal 2009. During the fourth quarter of fiscal 2005, we initiated a restructuring plan ("2005 restructuring plan") to reduce operating expenses. The 2005 restructuring plan encompassed three major components - a streamlining of research and development sites, a voluntary separation program for certain employees and an organizational consolidation within the Company's largest design center.

At October 2, 2010, the Condensed Consolidated Balance Sheet included $1.1 million primarily related to operating lease commitments and severance and related expenses accrued under the provisions of the 2009 restructuring plan. In addition, the Condensed Consolidated Balance Sheet included $0.3 million related to operating lease commitments accrued under the provisions of the 2005 restructuring plan.

The following table displays the activity related to all the restructuring plans described above (in thousands):

	Balance at January 2, 2010	Charged to expense during nine months ended October 2, 2010	Paid or settled	Adjustments to reserve	Balance at October 2, 2010	Cumulative expense through January 2, 2010	Aggregate expense and adjustments
Severance and related costs	$715	$199	$(425)	$(196)	$293	$16,004	$16,007
Lease loss reserve and other	1,521	38	(466)	—	1,093	9,090	9,128
Total restructuring plans	$2,236	$237	$(891)	$(196)	$1,386	$25,094	$25,135

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Total Restructuring included in our Condensed Consolidated Statements of Operations was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Severance and related costs	$67	$1,313	$3	$1,307
Lease loss reserve and other	12	1,231	38	1,197
	$79	$2,544	$41	$2,504

We cannot be certain as to the actual amount of any remaining restructuring charges, changes in original estimates or the timing of their recognition for financial reporting purposes.

Note 9 - Stock-Based Compensation:

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

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Line item:				
Cost of products sold	$76	$75	$235	$264
Research and development	468	369	1,388	1,128
Selling, general and administrative	489	569	1,882	1,971
	$1,033	$1,013	$3,505	$3,363

Note 10 - Legal Matters:

On June 11, 2007, a patent infringement lawsuit was filed by Lizy K. John (“John”) against Lattice Semiconductor Corporation in the U.S. District Court for the Eastern District of Texas, Marshall Division. John seeks an injunction, unspecified damages, and attorneys' fees and expenses. The Company filed a request for re-examination of the patent by the United States Patent and Trademark Office (“PTO”), which was granted by the PTO, and the re-examination is in progress. The litigation has been stayed pending the results of the re-examination. Neither the likelihood nor the amount of any potential exposure to the Company can be estimated at this time.

On April 29, 2010, Stragent, LLC (“Stragent”) and SeeSaw Foundation (“SeeSaw”) filed a patent infringement lawsuit against Lattice Semiconductor Corporation in the U.S. District Court for the Eastern District of Texas, Tyler Division. Stragent and SeeSaw seek unspecified damages and attorneys' fees and expenses. Neither the likelihood nor the amount of any potential exposure to the Company can be estimated at this time.

On July 20, 2010, Intellitech Corporation (“Intellitech”) filed a patent infringement lawsuit against Lattice Semiconductor Corporation in the U.S. District Court for the District of Delaware. Intellitech seeks unspecified damages and attorneys' fees and expenses. Neither the likelihood nor the amount of any potential exposure to the Company can be estimated at this time.

We are also exposed to certain other asserted and unasserted potential claims. There can be no assurance that, with respect to potential claims made against us, we could resolve such claims under terms and conditions that would not have a material adverse effect on our business, our liquidity or our financial results.

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Note 11 - Segment and Geographic Information:

We operate in one industry segment comprising the design, development, manufacture and marketing of high performance programmable logic devices. Our revenue by major geographic area based on ship-to location was as follows (dollars in thousands):

	Three Months Ended						Nine Months Ended					
	October 2, 2010			October 3, 2009			October 2, 2010			October 3, 2009		
United States:	$8,884	12	%	$6,108	12	%	$26,772	12	%	$21,164	15	%
Export revenue:												
Asia Pacific (primarily China and Taiwan)	42,118	55		27,551	56		122,036	54		77,184	56	
Europe	13,691	17		8,414	17		40,465	18		25,135	18	
Japan	10,876	14		5,673	12		30,264	13		11,547	8	
Other Americas	1,568	2		1,351	3		5,151	3		4,303	3	
Total export revenue	68,253	88		42,989	88		197,916	88		118,169	85	
Total revenue	$77,137	100	%	$49,097	100	%	$224,688	100	%	$139,333	100	%

Our five largest customers make up a significant portion of our total revenue. In the first nine months of fiscal 2010 and fiscal 2009, combined revenue attributable to two large telecommunications equipment providers (one of which was supported through one of our distributors in prior years), accounted for approximately 12% and 20% of total revenue, respectively. Most of our property and equipment is located in the United States.

Note 12- Subsequent Events:

On October 12, 2010, the Company announced that effective November 8, 2010, Mr. Darin G. Billerbeck has been appointed to serve as President and Chief Executive Officer. In connection with Mr. Billerbeck's appointment, the Company entered into an offer letter with Mr. Billerbeck that sets forth certain terms related to Mr. Billerbeck's compensation package. The Company and Mr. Billerbeck entered into an employment agreement effective as of November 8, 2010 that included the compensation described in the offer letter and contains additional terms and conditions substantially similar to those set forth in the employment agreements of the Company's other executive officers.

On October 21, 2010, the Company's Board of Directors approved a stock repurchase program pursuant to which up to $20.0 million of outstanding common stock may be repurchased from time to time. The duration of the repurchase program is twelve months. Under the program, the Company may purchase shares of common stock through open market and privately negotiated transactions at prices deemed appropriate by management. The timing and amount of repurchase transactions under this program will depend on market conditions and corporate and regulatory considerations. The purchases will be funded from available working capital.

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

Overview

Lattice Semiconductor Corporation (“Lattice” or the “Company”) designs, develops and markets high performance programmable logic products and related software. Programmable logic products are widely used semiconductor components that can be configured by the end customer as specific logic circuits, and enable the end customer to shorten design cycle times and reduce development costs. Within the programmable logic market there are two groups of products - programmable logic devices (“PLD”) and field programmable gate arrays (“FPGA”) - each representing a distinct silicon architectural approach. Products based on the two alternative programmable logic architectures are generally optimal for different types of logic functions, although many logic functions can be implemented using either architecture. We believe that a substantial portion of programmable logic customers utilize both PLD and FPGA architectures. Our end customers are primarily original equipment manufacturers in the wired and wireless communications, computing, industrial, consumer, automotive, medical and military end markets.

Critical Accounting Policies and Estimates

Critical accounting policies are those that are both most important to the portrayal of a company's financial condition and results and require management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Management believes that there have been no significant changes during the nine months ended October 2, 2010 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the fiscal year ended January 2, 2010.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and classification of assets, such as marketable securities, accounts receivable, inventory, auction rate securities, deferred income taxes and liabilities, accrued liabilities (including restructuring charges), income taxes, deferred income and allowances on sales to certain sell-through distributors, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the fiscal periods presented. Actual results could differ from those estimates.

Recent Accounting Guidance

In September 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2009-13, “Revenue Recognition (Topic 605): Multiple Deliverable Revenue Arrangements (a consensus of the FASB Emerging Issues Task Force)”, (“ASU 2009-13”). ASU 2009-13 provides principles and application guidance on whether multiple deliverables exist, how the arrangement should be separated and the consideration allocated. Additionally, ASU 2009-13 requires an entity to allocate revenue in an arrangement using estimated selling prices of deliverables if a vendor does not have vendor-specific objective evidence or third-party evidence of selling price, eliminates the residual method and requires an entity to allocate revenue using the relative selling price method. This update is effective for the Company beginning January 1, 2011 and can be applied prospectively or retrospectively. The Company is currently assessing the impact of the adoption on its financial statements.

In October 2009, the FASB issued Accounting Standards Update 2009-14, "Software (Topic 985): Certain Revenue Arrangements That Include Software Elements," ("ASU 2009-14"). ASU 2009-14 clarifies which revenue allocation and measurement guidance should be used for arrangements that contain both tangible products and software, in cases where the software is more than incidental to the tangible product as a whole. More specifically, if the software sold with or embedded within the tangible product is essential to the functionality of the tangible product, then this software as well as undelivered software elements that relate to this software are excluded from the scope of existing software revenue guidance. This guidance is to be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. The Company is currently assessing the impact of the adoption on its financial statements.

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In January 2010, the FASB issued Accounting Standards Update No. 2010-06, “Fair Value Measurements Disclosures,” which amends Subtopic 820-10 of the FASB Accounting Standards Codification to require new disclosures for fair value measurements and provides clarification for existing disclosures requirements ("ASU No. 2010-06"). More specifically, this update will require (a) an entity to disclose separately the amounts of significant transfers in and out of Levels 1 and 2 fair value measurements and to describe the reasons for the transfers; and (b) information about purchases, sales, issuances and settlements to be presented separately (i.e. present the activity on a gross basis rather than net) in the reconciliation for fair value measurements using significant unobservable inputs (Level 3 inputs). This update clarifies existing disclosure requirements for the level of disaggregation used for classes of assets and liabilities measured at fair value and requires disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements using Level 2 and Level 3 inputs. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009 with the exception of revised Level 3 disclosure requirements, which are effective for interim and annual reporting periods beginning after December 15, 2010. The Company has adopted part (a) of this ASU in full with respect to the interim period ended July 3, 2010, and part (b) will be adopted in fiscal year 2011.

Results of Operations

Revenue

Key elements of our Condensed Consolidated Statements of Operations (dollars in thousands) were as follows:

	Three Months Ended						Nine Months Ended					
	October 2, 2010			October 3, 2009			October 2, 2010			October 3, 2009		
Revenue	$77,137	100.0	%	$49,097	100.0	%	$224,688	100.0	%	$139,333	100.0	%
Gross margin	45,586	59.1		26,619	54.2		133,984	59.6		73,883	53.0	
Research and development	14,814	19.2		14,789	30.1		44,654	19.9		43,491	31.2	
Selling, general and administrative	15,818	20.5		12,739	25.9		47,621	21.2		39,255	28.1	
Amortization of intangible assets	—	—		—	—		—	—		228	0.2	
Restructuring	79	0.1		2,544	5.2		41	0.0		2,504	1.8	
Income (loss) from operations	$14,875	19.3	%	$(3,453)	(7.0	)%	$41,668	18.5	%	$(11,595)	(8.3	)%

Revenue in the third quarter and nine months ended October 2, 2010 increased to $77.1 million and $224.7 million, respectively, compared to $49.1 million and $139.3 million for the third quarter and nine months ended October 3, 2009. Revenue increased across all product lines, end markets, and product classifications (except for two of our mature product families).

Revenue by Product Line

FPGA and PLD revenue increased in the third quarter and first nine months of fiscal 2010 when compared to fiscal 2009. There was a 80% and 77% increase in FPGA units sold in the third quarter and first nine months of fiscal 2010 when compared to the third quarter and first nine months of fiscal 2009, respectively, primarily driven by an increase in demand for our New products. PLD revenue also increased across all product classifications (except for two of our mature product families) in the third quarter and first nine months of fiscal 2010 when compared to fiscal 2009, due primarily to an increase in units sold.

The composition of our revenue by product line for the third quarter and first nine months of fiscal 2010 and 2009 was as follows (dollars in thousands):

	Three Months Ended						Nine Months Ended					
	October 2, 2010			October 3, 2009			October 2, 2010			October 3, 2009		
FPGA	$24,715	32	%	$15,201	31	%	$72,737	32	%	$47,920	34	%
PLD	52,422	68		33,896	69		151,951	68		91,413	66	
Total revenue	$77,137	100	%	$49,097	100	%	$224,688	100	%	$139,333	100	%

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Revenue by End Market

Although units sold overall were up across all end markets, revenue from the Industrial and other end markets increased 171% when the quarter ended October 2, 2010 is compared to the quarter ended October 3, 2009. By contrast, the communications end market increased 46% over this same quarterly comparison and accounted for approximately 50% and 54% of our total revenue for the quarter ended October 2, 2010 and October 3, 2009, respectively, and 50% and 58% for the nine months ended October 2, 2010 and October 3, 2009, respectively. This is primarily due to strength in the wireless segment of the communications end market. We expect that a significant portion of our revenue will continue to be dependent on the health of the communications end market.

The composition of our revenue by end market for the third quarter and first nine months of fiscal 2010 and 2009 was as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 2, 2010		October 3, 2009		October 2, 2010		October 3, 2009	
Communications	$38,954	50 %	$26,670	54 %	$112,791	50 %	$80,436	58 %
Industrial and other	19,575	26	7,234	15	54,668	24	24,177	17
Computing	10,590	14	8,349	17	33,229	15	17,757	13
Consumer	8,018	10	6,844	14	24,000	11	16,963	12
Total revenue	$77,137	100 %	$49,097	100 %	$224,688	100 %	$139,333	100 %

Revenue by Product Classification

Revenue for New products increased 119% and 109% for the third quarter and first nine months of fiscal 2010, respectively, compared to the third quarter and first nine months of fiscal 2009. Revenue for Mainstream products increased 32% and 42% for the third quarter and first nine months of fiscal 2010 compared to the third quarter and first nine months of fiscal 2009. Mature product revenue increased 20% and 33% for the third quarter and first nine months of fiscal 2010, compared to the third quarter and first nine months of fiscal 2009. For all three product classifications (except for two of our mature product families) the revenue increase was related to an increase in unit sales partially offset by a decrease in average selling price.

The composition of our revenue by product classification for the third quarter and first nine months of fiscal 2010 and 2009 was as follows (dollars in thousands):

	Three Months Ended				Nine Months Ended			
	October 2, 2010		October 3, 2009		October 2, 2010		October 3, 2009	
New *	$35,304	46 %	$16,120	33 %	$95,174	42 %	$45,615	33 %
Mainstream *	25,099	32	18,985	39	76,284	34	53,731	38
Mature *	16,734	22	13,992	28	53,230	24	39,987	29
Total revenue	$77,137	100 %						