

LAM RESEARCH CORP  
Form 10-Q  
January 30, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

*(Mark One)*

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

**For the quarterly period ended December 24, 2006 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act). Check one:

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

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 January 23, 2007, there were 141,772,632 shares of Registrant's Common Stock outstanding.

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

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

|                                                                                                                                                                            | <b>December<br/>24,<br/>2006<br/>(unaudited)</b> | <b>June 25,<br/>2006</b> |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------|--------------------------|
| <b>ASSETS</b>                                                                                                                                                              |                                                  |                          |
| Cash and cash equivalents                                                                                                                                                  | \$ 629,117                                       | \$ 910,815               |
| Short-term investments                                                                                                                                                     | 574,845                                          | 139,524                  |
| Accounts receivable, less allowance for doubtful accounts of \$3,839 as of December 24, 2006 and \$3,822 as of June 25, 2006                                               | 456,427                                          | 407,347                  |
| Inventories                                                                                                                                                                | 212,299                                          | 168,714                  |
| Deferred income taxes                                                                                                                                                      | 40,799                                           | 53,625                   |
| Prepaid expenses and other current assets                                                                                                                                  | 43,169                                           | 26,344                   |
| <br>Total current assets                                                                                                                                                   | <br>1,956,656                                    | <br>1,706,369            |
| Property and equipment, net                                                                                                                                                | 97,034                                           | 49,893                   |
| Restricted cash and investments                                                                                                                                            | 415,038                                          | 470,038                  |
| Deferred income taxes                                                                                                                                                      | 37,516                                           | 38,533                   |
| Goodwill                                                                                                                                                                   | 55,892                                           |                          |
| Intangible assets, net                                                                                                                                                     | 64,641                                           |                          |
| Other assets                                                                                                                                                               | 52,929                                           | 48,511                   |
| <br>Total assets                                                                                                                                                           | <br>\$ 2,679,706                                 | <br>\$ 2,313,344         |
| <br><b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                            |                                                  |                          |
| Trade accounts payable                                                                                                                                                     | \$ 111,429                                       | \$ 108,504               |
| Accrued expenses and other current liabilities                                                                                                                             | 350,140                                          | 317,637                  |
| Deferred profit                                                                                                                                                            | 176,794                                          | 140,085                  |
| <br>Total current liabilities                                                                                                                                              | <br>638,363                                      | <br>566,226              |
| Long-term debt                                                                                                                                                             | 300,000                                          | 350,000                  |
| Other long-term liabilities                                                                                                                                                | 833                                              | 969                      |
| <br>Total liabilities                                                                                                                                                      | <br>939,196                                      | <br>917,195              |
| Commitments and contingencies                                                                                                                                              |                                                  |                          |
| Stockholders' equity:                                                                                                                                                      |                                                  |                          |
| Preferred stock, at par value of \$0.001 per share; authorized 5,000 shares, none outstanding                                                                              |                                                  |                          |
| Common stock, at par value of \$0.001 per share; authorized 400,000 shares; issued and outstanding 141,899 shares at December 24, 2006 and 141,785 shares at June 25, 2006 | 142                                              | 142                      |
| Additional paid-in capital                                                                                                                                                 | 1,032,946                                        | 973,391                  |
|                                                                                                                                                                            | (486,003)                                        | (416,447)                |

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Treasury stock, at cost, 14,784 shares at December 24, 2006 and 13,532 shares at June 25, 2006

|                                            |              |              |
|--------------------------------------------|--------------|--------------|
| Accumulated other comprehensive loss       | (6,900)      | (11,205)     |
| Retained earnings                          | 1,200,325    | 850,268      |
| Total stockholders' equity                 | 1,740,510    | 1,396,149    |
| Total liabilities and stockholders' equity | \$ 2,679,706 | \$ 2,313,344 |

See Notes to Condensed Consolidated Financial Statements

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

|                                                  | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|--------------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                                  | <b>December</b>           | <b>December</b> | <b>December</b>         | <b>December</b> |
|                                                  | <b>24,</b>                | <b>25,</b>      | <b>24,</b>              | <b>25,</b>      |
|                                                  | <b>2006</b>               | <b>2005</b>     | <b>2006</b>             | <b>2005</b>     |
| Total revenue                                    | \$ 633,400                | \$ 358,245      | \$ 1,237,787            | \$ 679,152      |
| Cost of goods sold                               | 310,484                   | 180,735         | 601,707                 | 345,563         |
| Gross margin                                     | 322,916                   | 177,510         | 636,080                 | 333,589         |
| Research and development                         | 69,060                    | 55,742          | 130,683                 | 106,984         |
| Selling, general and administrative              | 59,351                    | 44,859          | 116,059                 | 90,014          |
| Total operating expenses                         | 128,411                   | 100,601         | 246,742                 | 196,998         |
| Operating income                                 | 194,505                   | 76,909          | 389,338                 | 136,591         |
| Other income, net                                | 13,092                    | 9,308           | 43,440                  | 17,796          |
| Income before income taxes                       | 207,597                   | 86,217          | 432,778                 | 154,387         |
| Income tax expense                               | 40,271                    | 8,439           | 81,934                  | 27,118          |
| Net income                                       | \$ 167,326                | \$ 77,778       | \$ 350,844              | \$ 127,269      |
| Net income per share:                            |                           |                 |                         |                 |
| Basic net income per share                       | \$ 1.18                   | \$ 0.57         | \$ 2.47                 | \$ 0.93         |
| Diluted net income per share                     | \$ 1.15                   | \$ 0.55         | \$ 2.42                 | \$ 0.89         |
| Number of shares used in per share calculations: |                           |                 |                         |                 |
| Basic                                            | 142,306                   | 136,572         | 142,120                 | 136,499         |
| Diluted                                          | 145,346                   | 142,525         | 145,102                 | 142,209         |

See Notes to Condensed Consolidated Financial Statements

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

|                                                                                   | <b>Six Months Ended</b> |                 |
|-----------------------------------------------------------------------------------|-------------------------|-----------------|
|                                                                                   | <b>December</b>         | <b>December</b> |
|                                                                                   | <b>24,</b>              | <b>25,</b>      |
|                                                                                   | <b>2006</b>             | <b>2005</b>     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                      |                         |                 |
| Net income                                                                        | \$ 350,844              | \$ 127,269      |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |                 |
| Depreciation and amortization                                                     | 15,287                  | 11,027          |
| Deferred income taxes                                                             | 13,843                  | 14,727          |
| Amortization of premiums/discounts on securities                                  | (1,054)                 | 1,599           |
| Equity-based compensation expense                                                 | 12,915                  | 11,290          |
| Income tax benefit on equity-based compensation plans                             | 22,239                  |                 |
| Excess tax benefit on equity-based compensation plans                             | (15,350)                |                 |
| Other, net                                                                        | (77)                    | 352             |
| Changes in working capital accounts                                               | (19,982)                | (7,478)         |
| Net cash provided by operating activities                                         | 378,665                 | 158,786         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                      |                         |                 |
| Capital expenditures and intangible assets                                        | (26,886)                | (9,694)         |
| Payments made for the acquisition of Bullen Ultrasonics, Inc. assets              | (177,108)               |                 |
| Transfer of restricted cash and investments                                       | 55,000                  |                 |
| Purchases of available-for-sale securities                                        | (638,817)               | (28,715)        |
| Sales and maturities of available-for-sale securities                             | 207,120                 | 94,504          |
| Net cash provided by / (used for) investing activities                            | (580,691)               | 56,095          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                      |                         |                 |
| Principal payments on long-term debt and capital lease obligations                | (50,072)                |                 |
| Excess tax benefit on equity-based compensation plans                             | 15,350                  |                 |
| Treasury stock purchases                                                          | (76,333)                | (140,607)       |
| Reissuances of treasury stock                                                     | 5,990                   | 5,137           |
| Proceeds from issuance of common stock                                            | 24,401                  | 74,100          |
| Net cash used for financing activities                                            | (80,664)                | (61,370)        |
| Effect of exchange rate changes on cash                                           | 992                     | (1,979)         |
| Net increase (decrease) in cash and cash equivalents                              | (281,698)               | 151,532         |
| Cash and cash equivalents at beginning of year                                    | 910,815                 | 482,250         |
| Cash and cash equivalents at end of period                                        | \$ 629,117              | \$ 633,782      |



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**LAM RESEARCH CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**December 24, 2006**  
**(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 (the Company or Lam) for the fiscal year ended June 25, 2006, which are included in the Annual Report on Form 10-K, File Number 0-12933. 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 <http://www.sec.gov>. The Company also posts the Forms 10-K, Forms 10-Q and Forms 8-K on the corporate website at <http://www.lamresearch.com>.

The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 24, 2007 and includes 52 weeks. The quarter ended December 24, 2006 and the quarter ended December 25, 2005 both included 13 weeks.

**NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (SFAS No. 157) which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including interim periods, for that fiscal year. The Company is currently evaluating the impact, if any, of adopting the provisions of SFAS No. 157 on its financial position, results of operations and liquidity.

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.

FIN 48 is effective for fiscal years beginning after December 15, 2006. Any differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is currently in the process of determining the impact, if any, of adopting the provisions of FIN 48 on its financial position, results of operations and liquidity.

**NOTE 3 EQUITY-BASED COMPENSATION PLANS**

The Company has adopted stock plans that provide for the grant to employees of equity-based awards, including stock options and restricted stock units, of Lam common stock. In addition, these plans permit the grant of nonstatutory equity-based awards to paid consultants and outside directors. 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), which the Company adopted as of June 27, 2005 using the modified prospective method. The Company recognized equity-based compensation expense of \$6.6 million and \$12.9 million during the three and six months ended December 24, 2006 and \$6.0 million and \$11.3 million during the three and six months ended December 25, 2005, respectively. The income tax benefit

recognized in the condensed consolidated statements of operations related to equity-based compensation expense was \$1.0 million and \$2.1 million during the three and six months ended December 24, 2006 and \$1.0 million and \$1.9 million during the three and six months ended December 25, 2005, 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.

**Table of Contents****Stock Options and Restricted Stock Units**

The 2007 Stock Incentive Plan, 1997 Stock Incentive Plan and the 1999 Stock Option Plan (Plans) provide for the grant of non-qualified equity-based awards to eligible employees, consultants and advisors, and non-employee directors of the Company and its subsidiaries. As of December 24, 2006, there were a total of 30,154,353 shares reserved for future issuance under these Plans.

The Company did not grant any stock options during the six months ended December 24, 2006 and December 25, 2005. The fair value of the Company's stock options issued prior to the adoption of SFAS No. 123R was estimated using a Black-Scholes option valuation model. This model requires the input of highly subjective assumptions, including expected stock price volatility and the estimated life of each award. The fair value of these stock options was estimated assuming no expected dividends and estimates of expected life, volatility and risk-free interest rate at the time of grant. Prior to the adoption of SFAS No. 123R, the Company used historical volatility as a basis for calculating expected volatility.

A summary of stock option activity under the Plans as of December 24, 2006 and changes during the six months then ended is presented below:

| <b>Options</b>                   | <b>Shares<br/>(in<br/>thousands)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>as of<br/>December<br/>24, 2006<br/>(in<br/>thousands)</b> |
|----------------------------------|--------------------------------------|----------------------------------------------------|---------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| Outstanding at June 25, 2006     | 5,528                                | \$ 20.04                                           | 3.55                                                                            |                                                                                                     |
| Granted                          |                                      |                                                    |                                                                                 |                                                                                                     |
| Exercised                        | (1,243)                              | 19.80                                              |                                                                                 |                                                                                                     |
| Forfeited or expired             | (26)                                 | 22.92                                              |                                                                                 |                                                                                                     |
| Outstanding at December 24, 2006 | 4,259                                | \$ 20.10                                           | 3.08                                                                            | \$ 126,515                                                                                          |
| Exercisable at December 24, 2006 | 3,919                                | \$ 20.02                                           | 2.96                                                                            | \$ 116,682                                                                                          |

The total intrinsic value of options exercised during the three and six months ended December 24, 2006 was \$36.4 million and \$39.1 million, respectively. The total intrinsic value of options exercised during the three and six months ended December 25, 2005 was \$64.8 million and \$74.2 million, respectively. As of December 24, 2006, there was \$0.8 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 0.4 years. Cash received from stock option exercises was \$22.7 million and \$24.4 million during the three and six months ended December 24, 2006.

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A summary of the status of the Company's restricted stock units as of December 24, 2006, and changes during the six months then ended is presented below:

|                                         | <b>Shares<br/>(in<br/>thousands)</b> | <b>Weighted<br/>Average<br/>Grant-<br/>Date Fair<br/>Value</b> |
|-----------------------------------------|--------------------------------------|----------------------------------------------------------------|
| <b>Nonvested Restricted Stock Units</b> |                                      |                                                                |
| Nonvested at June 25, 2006              | 1,046                                | \$33.60                                                        |
| Granted                                 | 160                                  | 46.66                                                          |
| Vested                                  | (124)                                | 29.08                                                          |
| Forfeited                               | (28)                                 | 36.95                                                          |
| Nonvested at December 24, 2006          | 1,054                                | \$36.09                                                        |

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 December 24, 2006, there was \$20.5 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 1.5 years.

**ESPP**

The 1999 Employee Stock Purchase Plan (the 1999 ESPP Plan) 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 December 24, 2006, there were a total of 12,993,828 shares reserved for issuance and 3,087,100 shares were available for issuance under the 1999 ESPP Plan.

ESPP awards were valued using the Black-Scholes model with expected volatility calculated using implied volatility. ESPP was valued assuming no expected dividends and the following weighted-average assumptions:

|                                 | <b>Six Months Ended<br/>December<br/>24,<br/>2006</b> | <b>December<br/>25,<br/>2005</b> |
|---------------------------------|-------------------------------------------------------|----------------------------------|
| Expected life (years)           | 0.69                                                  | 0.68                             |
| Expected stock price volatility | 44.5%                                                 | 34.5%                            |
| Risk-free interest rate         | 5.0%                                                  | 3.4%                             |

As of December 24, 2006, there was \$4.4 million of total unrecognized compensation cost related to the ESPP that is expected to be recognized over a remaining period of 0.7 years.

**Table of Contents****NOTE 4 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:

|                 | <b>December<br/>24,<br/>2006</b> | <b>June 25,<br/>2006</b> |
|-----------------|----------------------------------|--------------------------|
|                 | <b>(in thousands)</b>            |                          |
| Raw materials   | \$ 111,388                       | \$ 78,038                |
| Work-in-process | 34,470                           | 29,980                   |
| Finished goods  | 66,441                           | 60,696                   |
|                 | <b>\$ 212,299</b>                | <b>\$ 168,714</b>        |

Included in the table above is inventory of \$12.7 million acquired from Bullen Ultrasonics, Inc. during the quarter ended December 24, 2006.

**NOTE 5 PROPERTY AND EQUIPMENT, NET**

Property and equipment, net, consist of the following:

|                                                 | <b>December<br/>24,<br/>2006</b> | <b>June 25,<br/>2006</b> |
|-------------------------------------------------|----------------------------------|--------------------------|
|                                                 | <b>(in thousands)</b>            |                          |
| Manufacturing, engineering and office equipment | \$ 145,094                       | \$ 106,172               |
| Computer equipment and software                 | 65,713                           | 61,419                   |
| Land                                            | 1,290                            |                          |
| Buildings                                       | 8,653                            |                          |
| Leasehold improvements                          | 39,216                           | 38,950                   |
| Furniture and fixtures                          | 8,103                            | 6,599                    |
|                                                 | <b>268,069</b>                   | <b>213,140</b>           |
| Less: accumulated depreciation and amortization | <b>(171,035)</b>                 | <b>(163,247)</b>         |
|                                                 | <b>\$ 97,034</b>                 | <b>\$ 49,893</b>         |

Included in the table above is \$33.1 million of property and equipment acquired from Bullen Ultrasonics during the quarter ended December 24, 2006.

**NOTE 6 ACQUISITION**

During the quarter ended December 24, 2006, the Company acquired the U.S. silicon growing and silicon fabrication assets of Bullen Ultrasonics, Inc. The Company was the largest customer of the Bullen Ultrasonics silicon business. The silicon business has become a division of the Company post-acquisition while Bullen Ultrasonics retains assets unrelated to the silicon growing and silicon fabrication business which the Company believes Bullen Ultrasonics will continue to conduct such unrelated businesses as a separate, independently-held entity.

The acquisition includes assets related to Bullen Ultrasonics' silicon growing and silicon fabrication business, including assets of Bullen Ultrasonics and Bullen Semiconductor (Suzhou) Co., Ltd., a wholly foreign-owned enterprise established in Suzhou, Jiangsu, People's Republic of China (PRC). The closing of the U.S. assets occurred on November 13, 2006. The acquisition of the Suzhou assets has not yet occurred as of the date of this filing. The assets acquired consist of fixtures, intellectual property, equipment, inventory, material and supplies, contracts relating to the conduct of the business, certain licenses and permits issued by government authorities for use in connection

with the operations of Eaton, Ohio and Suzhou manufacturing facilities, real property and leaseholds connected with such facilities, data and records related to the operation of the silicon growing and silicon fabrication business and certain proprietary rights.

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Pursuant to the First Amendment to the Asset Purchase Agreement dated October 5, 2006, the parties to the Asset Purchase Agreement agreed that the closing of the sale of the Suzhou assets would take place within 5 business days following receipt by the parties of all necessary approvals, consents and authorizations of governmental and provincial authorities in the PRC and satisfaction of other customary conditions and covenants. The Company will pay the \$2.5 million purchase price for the Suzhou assets upon the receipt of the approvals and satisfaction of conditions noted above.

\$17.5 million of the consideration has been placed in escrow for a period of 12 months following the U.S. closing date to secure indemnification obligations of Bullen Ultrasonics and its shareholders relating to the accuracy of representations and warranties and the satisfaction of covenants.

The acquisition supports the competitive position and capability primarily of the Company's dielectric Etch products by providing access to and control of critical intellectual property and manufacturing technology related to the production of silicon parts in the Company's processing chambers. The Company funded the purchase price of the acquisition with existing cash resources.

The acquisition was accounted for as a business combination in accordance with Statement of Financial Accounting Standards Number 141, "Business Combinations" and all amounts were recorded at their estimated fair value. The Condensed Consolidated Financial Statements include the operating results from the date of acquisition. Pro forma results of operations have not been presented because the effects of the acquisition were not material to the Company's results.

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

|                                                |            |
|------------------------------------------------|------------|
| Cash consideration                             | \$ 173,893 |
| Estimated transaction costs                    | 3,215      |
|                                                | \$ 177,108 |
| Inventories                                    | \$ 12,656  |
| Property and equipment, net                    | 33,060     |
| Prepaid expenses and other current assets      | 4,392      |
| Other assets                                   | 5,731      |
| Accrued expenses and other current liabilities | (42)       |
| Customer relationships                         | 35,226     |
| Other intangible assets                        | 30,193     |
| Goodwill                                       | 55,892     |
|                                                | \$ 177,108 |

The amounts above are preliminary and may be subject to change as a result of finalization of asset values.

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

Total goodwill recorded as a result of the Bullen acquisition was \$55.9 million.

*Intangible Assets*

The following table provides details of the Company's intangible assets subject to amortization related to the Bullen acquisition (in thousands) as of December 24, 2006:

|                         | <b>Gross</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b> | <b>Weighted-<br/>Average<br/>Useful<br/>Life<br/>(years)</b> |
|-------------------------|--------------|-------------------------------------|------------|--------------------------------------------------------------|
| Customer relationships  | \$ 35,226    | \$ (663)                            | \$ 34,563  | 6.9                                                          |
| Other intangible assets | 30,193       | (115)                               | 30,078     | 4.6                                                          |
|                         | \$ 65,419    | \$ (778)                            | \$ 64,641  | 5.9                                                          |

The Company accounts 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. The Company reviews goodwill for impairment at least annually. In addition, the Company reviews goodwill and other intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable.

The estimated future amortization expense of purchased intangible assets as of December 24, 2006 is as follows (in thousands):

| <b>Fiscal Year</b>          | <b>Amount</b> |
|-----------------------------|---------------|
| 2007 (remaining six months) | \$ 6,054      |
| 2008                        | 12,108        |
| 2009                        | 11,938        |
| 2010                        | 11,837        |
| 2011                        | 8,856         |
| Thereafter                  | 13,848        |
|                             | \$ 64,641     |

**Table of Contents****NOTE 8 ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

|                                | <b>December<br/>24,<br/>2006</b> | <b>June 25,<br/>2006</b> |
|--------------------------------|----------------------------------|--------------------------|
|                                | <b>(in thousands)</b>            |                          |
| Accrued compensation           | \$ 150,439                       | \$ 116,455               |
| Warranty reserves              | 46,054                           | 34,701                   |
| Income and other taxes payable | 81,875                           | 83,955                   |
| Other                          | 71,772                           | 82,526                   |
|                                | <b>\$ 350,140</b>                | <b>\$ 317,637</b>        |

**NOTE 9 OTHER INCOME, NET**

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

|                                 | <b>Three Months Ended</b>        |                                  | <b>Six Months Ended</b>          |                                  |
|---------------------------------|----------------------------------|----------------------------------|----------------------------------|----------------------------------|
|                                 | <b>December<br/>24,<br/>2006</b> | <b>December<br/>25,<br/>2005</b> | <b>December<br/>24,<br/>2006</b> | <b>December<br/>25,<br/>2005</b> |
|                                 | <b>(in thousands)</b>            |                                  |                                  |                                  |
| Interest income                 | \$ 20,440                        | \$ 8,383                         | \$ 39,809                        | \$ 15,097                        |
| Interest expense                | (5,000)                          | (88)                             | (10,160)                         | (167)                            |
| Foreign exchange gains (losses) | (2,437)                          | 1,125                            | (2,106)                          | 3,152                            |
| Favorable legal judgment        |                                  |                                  | 15,834                           |                                  |
| Other, net                      | 89                               | (112)                            | 63                               | (286)                            |
|                                 | <b>\$ 13,092</b>                 | <b>\$ 9,308</b>                  | <b>\$ 43,440</b>                 | <b>\$ 17,796</b>                 |

The legal judgment of \$15.8 million during the six months ended December 24, 2006 was obtained in a lawsuit filed by the Company alleging breach of purchase order contracts by one of its customers. The Supreme Court of California denied review of lower and appellate court judgments in favor of Lam during the quarter ended September 24, 2006.

**NOTE 10 INCOME TAX EXPENSE**

The Company's effective tax rate is based on its current profitability outlook and its expectations of earnings from operations in various tax jurisdictions throughout the world. The Company has implemented strategies to, in the longer term, limit its tax liability on the sale of its products worldwide. These tax strategies are structured to align the asset ownership and functions of the Company's various legal entities around the world, with its forecasts of the level, timing and sources of future revenues and profits.

Income tax expense was \$40.3 million and \$81.9 million for the three and six months ended December 24, 2006. Included in the tax expense for the quarter ended December 24, 2006 was a discrete event of a net tax benefit of \$4.8 million related to the extension of the federal research tax credit as it pertains to the Company's fiscal year 2006. Tax expense for the six months ended December 24, 2006 includes the item noted above and tax expense of \$6.1 million related to the favorable legal judgment of \$15.8 million reached during the quarter ended September 24, 2006. The Company also recorded a net tax benefit of \$10.0 million during the six months ended December 24, 2006 for the following discrete events: (1) the Company finalized negotiations on certain transfer pricing items; as a result, the Company reversed its related tax reserve and increased its net operating loss carryforward balance, which resulted in a net tax benefit of \$39.5 million, and (2) the Company recorded tax expense of \$29.5 million related to the

application of foreign tax rulings.

**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.

|                                          | <b>Three Months Ended</b>                    |                 | <b>Six Months Ended</b> |                 |
|------------------------------------------|----------------------------------------------|-----------------|-------------------------|-----------------|
|                                          | <b>December</b>                              | <b>December</b> | <b>December</b>         | <b>December</b> |
|                                          | <b>24,</b>                                   | <b>25,</b>      | <b>24,</b>              | <b>25,</b>      |
|                                          | <b>2006</b>                                  | <b>2005</b>     | <b>2006</b>             | <b>2005</b>     |
|                                          | <b>(in thousands, except per share data)</b> |                 |                         |                 |
| Numerator:                               |                                              |                 |                         |                 |
| Net income                               | \$ 167,326                                   | \$ 77,778       | \$ 350,844              | \$ 127,269      |
| Denominator:                             |                                              |                 |                         |                 |
| Basic average shares outstanding         | 142,306                                      | 136,572         | 142,120                 | 136,499         |
| Effect of potential dilutive securities: |                                              |                 |                         |                 |
| Employee stock plans                     | 3,040                                        | 5,953           | 2,982                   | 5,710           |
| Diluted average shares outstanding       | 145,346                                      | 142,525         | 145,102                 | 142,209         |
| Net income per share Basic               | \$ 1.18                                      | \$ 0.57         | \$ 2.47                 | \$ 0.93         |
| Net income per share Diluted             | \$ 1.15                                      | \$ 0.55         | \$ 2.42                 | \$ 0.89         |

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:

|                                                  | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|--------------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                                  | <b>December</b>           | <b>December</b> | <b>December</b>         | <b>December</b> |
|                                                  | <b>24,</b>                | <b>25,</b>      | <b>24,</b>              | <b>25,</b>      |
|                                                  | <b>2006</b>               | <b>2005</b>     | <b>2006</b>             | <b>2005</b>     |
|                                                  | <b>(in thousands)</b>     |                 |                         |                 |
| Number of potential dilutive securities excluded | 39                        | 315             | 153                     | 874             |

**NOTE 12 COMPREHENSIVE INCOME**

The components of comprehensive income are as follows:

|                                         | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|-----------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                         | <b>December</b>           | <b>December</b> | <b>December</b>         | <b>December</b> |
|                                         | <b>24,</b>                | <b>25,</b>      | <b>24,</b>              | <b>25,</b>      |
|                                         | <b>2006</b>               | <b>2005</b>     | <b>2006</b>             | <b>2005</b>     |
|                                         | <b>(in thousands)</b>     |                 |                         |                 |
| Net income                              | \$ 167,326                | \$ 77,778       | \$ 350,844              | \$ 127,269      |
| Foreign currency translation adjustment | 2,144                     | (584)           | 2,009                   | (2,378)         |
|                                         | (906)                     | 2,323           | 1,712                   | 4,737           |

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|                                                                               |            |           |            |            |
|-------------------------------------------------------------------------------|------------|-----------|------------|------------|
| Unrealized gain (loss) on fair value of derivative financial instruments, net |            |           |            |            |
| Unrealized gain (loss) on financial instruments, net                          | (1,104)    | (610)     | 1,090      | (1,331)    |
| Reclassification adjustment for gain included in earnings                     | (551)      | (2,814)   | (506)      | (4,306)    |
| Comprehensive income                                                          | \$ 166,909 | \$ 76,093 | \$ 355,149 | \$ 123,991 |

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The balance of accumulated other comprehensive loss is as follows:

|                                                                 | <b>December<br/>24,<br/>2006</b> | <b>June 25,<br/>2006</b> |
|-----------------------------------------------------------------|----------------------------------|--------------------------|
|                                                                 | <b>(in thousands)</b>            |                          |
| Accumulated foreign currency translation adjustment             | \$ (5,691)                       | \$ (7,700)               |
| Accumulated unrealized loss on derivative financial instruments | (434)                            | (1,177)                  |
| Accumulated unrealized loss on financial instruments            | (775)                            | (2,328)                  |
| Accumulated other comprehensive loss                            | \$ (6,900)                       | \$ (11,205)              |

**NOTE 13 GUARANTEES**

The Company accounts for its guarantees in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 45 Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN No. 45). FIN No. 45 requires a company that is a guarantor to make specific disclosures about its obligations under certain guarantees that it has issued. FIN No. 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.

The Company leases several facilities at its headquarters location in Fremont, California. As part of certain of the lease agreements, the Company has the option to purchase the remaining buildings at any time for a total purchase price for all remaining properties related to these leases of approximately \$85.0 million. The Company is required to guarantee the lessor a residual value on the properties of up to \$75.0 million at the end of the lease terms in fiscal year 2008 (in the event that the leases are not renewed, the Company does not exercise the purchase options, the lessor sells the properties and the sale price is less than the lessor's costs). The Company maintains cash collateral of \$85.0 million as part of the lease agreements as of December 24, 2006 in separate, specified certificates of deposit and interest-bearing accounts which are recorded as restricted cash and investments in its Condensed Consolidated Balance Sheet. 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 December 24, 2006, 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.

On June 16, 2006, the Company's wholly-owned subsidiary, Lam Research International SARL (LRI), as borrower, entered into a \$350 million Credit Agreement (the Credit Agreement). In connection with the Credit Agreement, the Company entered into a Guarantee Agreement (the Guarantee Agreement) guaranteeing the obligations of LRI under the Credit Agreement. The Company's obligations under the Guarantee Agreement are collateralized by readily marketable securities in an amount equal to 110% of the outstanding balance of its obligations under the Guarantee Agreement, representing \$330.0 million at December 24, 2006 as the Company had paid down \$50.0 million of the existing debt during the quarter ended December 24, 2006. This collateral is reflected in the balance of restricted cash and investments in the Company's Condensed Consolidated Balance Sheet.

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, not to exceed 14 months from the date of shipment of the system to the customer. 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.

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

|                                                                                   | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|-----------------------------------------------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                                                                                   | <b>December</b>           | <b>December</b> | <b>December</b>         | <b>December</b> |
|                                                                                   | <b>24,</b>                | <b>25,</b>      | <b>24,</b>              | <b>25,</b>      |
|                                                                                   | <b>2006</b>               | <b>2005</b>     | <b>2006</b>             | <b>2005</b>     |
|                                                                                   | <b>(in thousands)</b>     |                 |                         |                 |
| Balance at beginning of period                                                    | \$ 41,643                 | \$ 29,758       | \$ 34,701               | \$ 35,802       |
| Warranties issued during the period                                               | 14,245                    | 9,793           | 30,339                  | 16,355          |
| Settlements made during the period                                                | (8,027)                   | (5,278)         | (14,299)                | (10,732)        |
| Expirations and change in liability for pre-existing warranties during the period | (1,807)                   | (4,042)         | (4,687)                 | (11,194)        |
| Balance at end of period                                                          | \$ 46,054                 | \$ 30,231       | \$ 46,054               | \$ 30,231       |

**NOTE 14 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). The Company has a policy that allows the use of derivative financial instruments, specifically foreign currency forward exchange rate contracts, to hedge foreign currency exchange rate fluctuations on forecasted revenue transactions denominated in Japanese Yen and other foreign currency denominated assets. The Company does not use derivatives for trading or speculative purposes.

The Company's policy is to attempt to minimize short-term business exposure to foreign currency exchange rate risks 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 currency forward exchange rate contracts that generally expire within 12 months, and no later than 24 months. These foreign currency forward exchange 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 earnings in the same period the hedged revenue is recognized.

Each period, hedges are tested for effectiveness, using the dollar offset method, by comparing the change in value of the derivative with the change in the value of the anticipated sales transactions. There were no gains or losses during the three and six months ended December 24, 2006 and December 25, 2005 associated with 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 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 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 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 investments in derivative instruments as cash flow hedges. If this were to occur in a future period, 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 December 24, 2006, the Company expects to reclassify the entire amount of \$0.4 million of losses accumulated in other comprehensive income to earnings during the next 12 months due to the recognition in earnings of the hedged forecasted transactions.

The Company also enters into foreign currency forward exchange rate contracts to hedge the gains and losses generated by the remeasurement of Japanese Yen-denominated receivable balances. Under SFAS No. 133, these 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.

**Table of Contents****NOTE 15 STOCK REPURCHASE PROGRAM**

In October 2004, 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. The terms of the repurchase program permitted the Company to repurchase shares through September 30, 2007. In August 2005, the Company announced that its Board of Directors had authorized the repurchase of an additional \$500 million of the Company's common stock from the public market or private purchase. The terms of the repurchase program permit the Company to repurchase shares through September 30, 2008. The Company does plan to continue to execute the authorized repurchases in future periods. Share repurchases under the authorizations were as follows:

| Period                            | Total<br>Number<br>of<br>Shares<br>Repurchased | Total Cost<br>of<br>Repurchase<br><br>(in thousands, except per share data) | Average Price<br>Paid<br><br>Per Share | Remaining<br>Amount                              |
|-----------------------------------|------------------------------------------------|-----------------------------------------------------------------------------|----------------------------------------|--------------------------------------------------|
|                                   |                                                |                                                                             |                                        | Available Under<br>the<br>Repurchase<br>Programs |
| As of June 25, 2006               | 12,833                                         | \$ 418,292                                                                  | \$ 32.59                               | \$ 331,708                                       |
| Quarter Ending September 24, 2006 |                                                |                                                                             |                                        |                                                  |
| Quarter Ending December 24, 2006  | 1,447                                          | 75,012                                                                      | 51.83                                  | \$ 256,696                                       |
| Total                             | 14,280                                         | \$ 493,304                                                                  | \$ 34.55                               |                                                  |

**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, product development, demand, acceptance and market share, competitiveness, gross margins, levels of research and development (R&D), outsourcing plans and operating expenses, tax expenses, our management's plans and objectives for our current and future operations, management's plans for repurchasing Company stock pursuant to the authorization of our Board, the levels of customer spending or R&D activities, general economic conditions, our ability to scale up our operations to meet increased customer demand and to efficiently integrate and manage our new silicon growing and fabrication assets following completion of its acquisition, and the sufficiency of financial resources to support future operations, and capital expenditures. Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value and effect, including those discussed below under the heading Risk Factors within Item 1A of this report and other documents we file from time to time with the Securities and Exchange Commission (SEC), such as our last filed Annual Report on Form 10-K for the fiscal year ended June 25, 2006, our quarterly reports on Form 10-Q, 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 which 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 and six months ended December 24, 2006, 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 last filed Annual Report on Form 10-K as of June 25, 2006 and Form 10-Q for the three months ended September 24, 2006.

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 and six months ended December 24, 2006 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*

Lam Research Corporation (Lam or the Company) is a major provider of wafer fabrication equipment and services to the world's semiconductor industry. We actively market and sell product offerings that include single-wafer plasma etch systems with a wide range of applications, and an array of services designed to optimize the utilization of these systems by our customers.

The following summarizes certain key quarterly financial information for the periods indicated below:

|                                            | <b>Three Months Ended</b>                                    |             |                     |
|--------------------------------------------|--------------------------------------------------------------|-------------|---------------------|
|                                            | <b>September</b>                                             |             |                     |
|                                            | <b>December 24,</b>                                          | <b>24,</b>  | <b>December 25,</b> |
|                                            | <b>2006</b>                                                  | <b>2006</b> | <b>2005</b>         |
|                                            | <b>(in thousands, except per share data and percentages)</b> |             |                     |
| Revenue                                    | \$ 633,400                                                   | \$ 604,387  | \$ 358,245          |
| Gross margin                               | 322,916                                                      | 313,164     | 177,510             |
| Gross margin as a percent of total revenue | 51.0%                                                        | 51.8%       | 49.5%               |
| Net income                                 | 167,326                                                      | 183,518     | 77,778              |
| Diluted earnings per share                 | \$ 1.15                                                      | \$ 1.27     | \$ 0.55             |

December 2006 quarter new orders entered into backlog increased to \$779 million, or 7% sequentially. In absolute dollars, regions accounting for the sequential growth included Taiwan, Europe, Korea, and China. We classify total systems new orders market segmentation for Memory at approximately 74%, of which approximately 29% was attributable to NAND applications.

December 2006 quarter revenues, impacted by our shipment levels and installation and acceptance timelines, increased 5% sequentially to \$633.4 million and 77% year over year.

Gross margin as a percent of revenues of 51% met our guidance.

Operating margins exceeded 30 percent for the third consecutive quarter. Total operating expenses increased as planned by approximately \$10 million sequentially. Approximately 74% of this increase was in research and development, due to increases in discretionary investments targeting new and etch adjacent product growth opportunities. The year over year increase in operating expenses of \$27.8 million, or 28%, was a function of our r & d investment and the infrastructure necessary to support our market share and product growth objectives, as well as increases in incentive-based compensation of approximately \$7 million driven by higher profit levels.

Equity-based compensation expense recognized during the December 2006 quarter in cost of goods sold and operating expenses was \$1.1 million and \$5.5 million, respectively.

Operating income as a percent of revenues for the December 2006 quarter was 30.7% with cash flows from operating activities during the six months ended December 24, 2006 of \$378.7 million, or approximately 31% of revenues.

**Table of Contents****RESULTS OF OPERATIONS*****New Orders and Backlog***

New orders recorded into backlog are presented in the table below.

Unshipped orders in backlog as of December 24, 2006 were approximately \$719 million. More than 90% of the systems backlog balance at December 24, 2006 is scheduled for delivery through June of 2007. The basis for recording new orders is defined in our backlog policy. Our unshipped orders backlog includes orders for systems, spares, and services where written customer requests have been accepted and the delivery of products or provision of services is anticipated within the next 12 months. Our policy is to revise our backlog for order cancellations and to make adjustments to reflect, among other things, spares volume estimates and customer delivery date changes. Please refer to Backlog in Part I Item 1, Business of our Annual Report on Form 10-K for the fiscal year ended June 25, 2006 for additional information on our backlog policy.

|                          | Three Months Ended      |                          |                         |
|--------------------------|-------------------------|--------------------------|-------------------------|
|                          | December<br>24,<br>2006 | September<br>24,<br>2006 | December<br>25,<br>2005 |
| New orders (in millions) | \$ 779                  | \$ 725                   | \$ 403                  |
| North America            | 16%                     | 26%                      | 13%                     |
| Europe                   | 10%                     | 5%                       | 12%                     |
| Asia Pacific             | 42%                     | 33%                      | 29%                     |
| Korea                    | 21%                     | 19%                      | 23%                     |
| Japan                    | 11%                     | 17%                      | 23%                     |

New orders recorded for the December 2006 quarter increased 7% sequentially. We believe the trend in orders is due to increased capital investments by our customers and our market share gains. During the December 2006 quarter, 300 millimeter applications represented approximately 90% of total systems new orders and 93% of total systems new orders were for applications at less than or equal to the 90 nanometer technology node. We classify total systems new orders market segmentation for the December quarter as Memory at approximately 74%, IDM Logic/Other at 14% and Foundry at 12%.

***Revenue***

|               | Three Months Ended      |                          |                         | Six Months Ended     |                         |
|---------------|-------------------------|--------------------------|-------------------------|----------------------|-------------------------|
|               | December<br>24,<br>2006 | September<br>24,<br>2006 | December<br>25,<br>2005 | December 24,<br>2006 | December<br>25,<br>2005 |
|               | (in thousands)          |                          |                         | (in thousands)       |                         |
| Revenue       | \$633,400               | \$604,387                | \$358,245               | \$1,237,787          | \$679,152               |
| North America | 17%                     | 15%                      | 13%                     | 16%                  | 14%                     |
| Europe        | 10%                     | 14%                      | 13%                     | 11%                  | 12%                     |
| Asia Pacific  | 37%                     | 38%                      | 29%                     | 38%                  | 29%                     |
| Korea         | 20%                     | 15%                      | 20%                     | 18%                  | 19%                     |
| Japan         | 16%                     | 18%                      | 25%                     | 17%                  | 26%                     |

Revenue for the December 2006 quarter slightly exceeded our expectations and increased 5% sequentially. The increase in revenues both sequentially and year over year is impacted by the amounts of previously reported new orders, shipment levels, and our acceptance timelines. The overall Asia region continues 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 this region. Our deferred revenue balance increased to \$284.4 million as of December 24, 2006

compared to \$258.2 million at September 24, 2006. The anticipated future revenue value of orders shipped from backlog to Japanese customers that are not recorded as deferred revenue was approximately \$64 million as of December 24, 2006; these shipments are classified as inventory at cost until title transfers.

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Our current estimate for revenues for the March 2007 quarter ranges from \$635 million to \$650 million. This expectation is a forward-looking statement and actual results could differ materially as a result of certain factors as referred to on page 17 of this Quarterly Report on Form 10-Q.

***Gross Margin***

|                          | <b>Three Months Ended</b>                 |                  |                 | <b>Six Months Ended</b>                   |                 |
|--------------------------|-------------------------------------------|------------------|-----------------|-------------------------------------------|-----------------|
|                          | <b>December</b>                           | <b>September</b> | <b>December</b> | <b>December</b>                           | <b>December</b> |
|                          | <b>24,</b>                                | <b>24,</b>       | <b>25,</b>      | <b>24,</b>                                | <b>25,</b>      |
|                          | <b>2006</b>                               | <b>2006</b>      | <b>2005</b>     | <b>2006</b>                               | <b>2005</b>     |
|                          | <b>(in thousands, except percentages)</b> |                  |                 | <b>(in thousands, except percentages)</b> |                 |
| Gross Margin             | \$322,916                                 | \$313,164        | \$177,510       | \$636,080                                 | \$333,589       |
| Percent of total revenue | 51.0%                                     | 51.8%            | 49.5%           | 51.4%                                     | 49.1%           |

Gross margin as a percent of revenue was 51% and met our guidance. The sequential reduction in gross margin of 80 basis points reflects the later stages of our consumable spare parts price reduction activity and certain costs associated with installed base upgrades to support our customers, which we believe will position us for continued market share expansion. The increase in gross margin as a percent of revenue for the three and six months ended December 24, 2006 as compared to the same periods in the prior year was primarily driven by improved utilization of factory and field resources on higher business volumes.

We expect gross margin as a percent of revenue will be approximately 50% in the March 2007 quarter. This expectation is a forward-looking statement and actual results could differ materially as a result of certain factors as referred to on page 17 of this Quarterly Report on Form 10-Q.

***Research and Development***

|                              | <b>Three Months Ended</b>                 |                  |                 | <b>Six Months Ended</b>                   |                 |
|------------------------------|-------------------------------------------|------------------|-----------------|-------------------------------------------|-----------------|
|                              | <b>December</b>                           | <b>September</b> | <b>December</b> | <b>December</b>                           | <b>December</b> |
|                              | <b>24,</b>                                | <b>24,</b>       | <b>25,</b>      | <b>24,</b>                                | <b>25,</b>      |
|                              | <b>2006</b>                               | <b>2006</b>      | <b>2005</b>     | <b>2006</b>                               | <b>2005</b>     |
|                              | <b>(in thousands, except percentages)</b> |                  |                 | <b>(in thousands, except percentages)</b> |                 |
| Research & Development (R&D) | \$69,060                                  | \$61,623         | \$55,742        | \$130,683                                 | \$106,984       |
| Percent of total revenue     | 10.9%                                     | 10.2%            | 15.6%           | 10.6%                                     | 15.8%           |

We continue to invest significantly in research and development focused on leading-edge plasma etch and new products, including clean. The growth in R&D expenses during the December 2006 quarter compared to the September 2006 quarter includes an increase of \$4 million in engineering material supplies which reflects the expensing of the majority of materials associated with evaluation units for our customers, and \$1 million in increased salary and benefits primarily due to planned increases in headcount. The growth in R&D expenses during the three months ended December 24, 2006 compared with the same period in the prior year reflects our planned investment level and includes an increase of approximately \$4 million in engineering material supplies and outside services targeting new and etch adjacent product growth opportunities, approximately \$5 million in increased salary and benefit costs for planned increases in headcount and employee base compensation, and approximately \$1 million in incentive-based compensation driven by higher profit levels. The increase in R&D expenses during the six months ended December 24, 2006 compared with the same period in the prior year reflects our planned investment level and includes an increase of approximately \$7 million in engineering material supplies and outside services which are targeted at our continuing support of our existing and new product growth objectives, approximately \$9 million in increased salary and benefit costs for planned increases in headcount and employee base compensation, and approximately \$4 million in incentive-based compensation driven by higher profit levels.



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

|  | Three Months Ended                 |           |          | Six Months Ended                   |          |
|--|------------------------------------|-----------|----------|------------------------------------|----------|
|  | December                           | September | December | December                           | December |
|  | 24,                                | 24,       | 25,      | 24,                                | 25,      |
|  | 2006                               | 2006      | 2005     | 2006                               | 2005     |
|  | (in thousands, except percentages) |           |          | (in thousands, except percentages) |          |

|                                          |          |           |          |            |           |
|------------------------------------------|----------|-----------|----------|------------|-----------|
| Selling, General & Administrative (SG&A) | \$59,351 | \$ 56,708 | \$44,859 | \$ 116,059 | \$ 90,014 |
| Percent of total revenue                 | 9.4%     | 9.4%      | 12.5%    | 9.4%       | 13.3%     |

The sequential growth in SG&A expenses during the December 2006 quarter included an increase of approximately \$2 million in salary and benefit cost for planned increases in headcount targeted at providing the necessary infrastructure and bandwidth to support our growth. The increase in SG&A expenses during the three months ended December 24, 2006 compared to the same period in the prior year was driven by growth in salary and benefit costs of approximately \$6 million for planned increases of headcount and employee base compensation as well as approximately \$6 million in incentive-based compensation triggered by higher profits. The increase in SG&A expenses during the six months ended December 24, 2006 compared to the same period in the prior year was driven by increases in salary and benefit costs of approximately \$7 million for planned increases of headcount and employee base compensation, and approximately \$14 million in incentive-based compensation triggered by higher profits.

***Other Income, net***

Other income, net consisted of the following:

|                                 | Three Months Ended |           |          | Six Months Ended |           |
|---------------------------------|--------------------|-----------|----------|------------------|-----------|
|                                 | December           | September | December | December         | December  |
|                                 | 24,                | 24,       | 25,      | 24,              | 25,       |
|                                 | 2006               | 2006      | 2005     | 2006             | 2005      |
|                                 | (in thousands)     |           |          | (in thousands)   |           |
| Interest income                 | \$ 20,440          | \$ 19,369 | \$ 8,383 | \$ 39,809        | \$ 15,097 |
| Interest expense                | (5,000)            | (5,160)   | (88)     | (10,160)         | (167)     |
| Foreign exchange gains (losses) | (2,437)            | 331       | 1,125    | (2,106)          | 3,152     |
| Favorable legal judgment        |                    | 15,834    |          | 15,834           |           |
| Other, net                      | 89                 | (26)      | (112)    | 63               | (286)     |
|                                 | \$ 13,092          | \$ 30,348 | \$ 9,308 | \$ 43,440        | \$ 17,796 |

The increase in interest income during the quarter ended December 24, 2006 as compared with the quarters ended September 24, 2006 and December 25, 2005 was due to increases in average cash and investment balances. The increase in interest expense from the quarter ended December 25, 2005 to the quarter ended September 24, 2006 was due to the \$350 million of long-term debt entered into by our wholly-owned subsidiary on June 16, 2006 to facilitate the repatriation of foreign earnings under the American Jobs Creation Act. The foreign exchange loss during the December 2006 quarter and the foreign exchange gain during the December 2005 quarter were primarily due to our foreign currency denominated liabilities with non-U.S. dollar functional subsidiaries where the U.S. dollar weakened against certain currencies, primarily the Euro, Taiwan dollar and Singapore Dollar during the December 2006 quarter and the U.S. dollar strengthened against certain foreign currencies, primarily the Euro and Taiwan dollar during the December 2005 quarter. A description of our exposure to foreign currency exchange rates can be found in the Risk Factors section of this Form 10-Q under the heading *Our future Success Depends on International Sales and Management of Global Operations*. The legal judgment of \$15.8 million during the quarter ended September 24, 2006 was obtained in a lawsuit filed by us alleging breach of purchase order contracts by one of our customers. The

Supreme Court of California denied review of lower and appellate court judgments in favor of Lam during the quarter ended September 24, 2006.

***Income Tax Expense***

Our effective tax rate for the three and six months ended December 24, 2006 was 19.4% and 18.9%, respectively. On December 20, 2006, the Tax Relief and Health Care Act of 2006 was signed into law, extending the research credit for eligible amounts paid or incurred in 2006 and 2007. As a result, during the quarter ended December 24, 2006, we recorded a \$4.8 million tax benefit related to the extension of the federal research credit as it pertains to the Company's fiscal year 2006. We also recorded the following discrete

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events during the September 2006 quarter: (1) we recognized a tax benefit of \$39.5 million from the reversal of tax reserves and an increase in net operating loss carryforward upon finalized negotiations on certain transfer pricing items, and (2) we recorded tax expense of \$29.5 million related to the application of foreign tax rulings. Our effective tax rates for the three and six months ended December 25, 2005 were 9.8% and 17.6%, respectively. During the quarter ended December 25, 2005, we recognized a one time tax benefit of \$6.1 million related to foreign tax rulings on prior year tax returns. The overall change in the effective tax rate in all periods is impacted by the jurisdictional mix of income.

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 to, in the longer term, limit our tax liability on the sale of our products worldwide. These tax strategies are structured 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 \$105.4 million and \$119.2 million as of December 24, 2006 and June 25, 2006, respectively. The gross deferred tax assets were offset by deferred tax liabilities of \$27.1 million, as of December 24, 2006 and June 25, 2006.

Deferred tax assets decreased from June 25, 2006 to December 24, 2006 by \$13.8 million primarily due to the utilization of net operating losses and tax credits. Other items impacting the net deferred tax assets included the impact of certain elections related to foreign tax rulings, the conclusion of negotiations on certain transfer pricing items during the September 2006 quarter, and the incremental tax benefit related to stock-based compensation deductions. 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 continue to evaluate the realizability of our deferred tax assets quarterly and will assess the need for additional valuation allowances, if any, in subsequent quarters.

### ***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 evaluated them on an on-going basis to ensure they remained reasonable under current conditions. Actual results could differ significantly from those estimates.

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

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*Inventory Valuation* : Inventories are stated at the lower of cost or market using standard costs, which 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 re-assessed at least annually and reflect achievable acquisition costs, generally the most recent vendor contract prices for purchased parts, currently obtainable assembly and test labor utilization levels, 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, not to exceed 14 months from shipment of the system to the customer. 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 parts and labor costs incurred in subsequent periods are charged to those established reserves through the application of detailed project record keeping.

Actual warranty expenses are incurred on a system-by-system basis, and may differ from our original estimates. While we periodically monitor the performance and cost of warranty activities, if actual costs incurred are different than our estimates, we may recognize adjustments to provisions in the period in which those differences arise or are identified. 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 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 to determine if there are any

deficiencies which 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 and the extraterritorial income deduction 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 APB 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 SFAS123(R).

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*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 the underlying profitability of the Company, 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. We account for income tax contingencies in accordance with SFAS No. 5, *Accounting for Contingencies*.

*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 for impairment at least annually. In addition, we review goodwill and other intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable.

***Recent Accounting Pronouncements***

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, (SFAS No. 157), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including interim periods, for that fiscal year. We are currently evaluating the impact, if any, of the adopting the provisions of SFAS No. 157 on our financial position, results of operations and liquidity.

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.

FIN 48 is effective for fiscal years beginning after December 15, 2006. Any differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained

earnings. We are currently in the process of determining the impact, if any, of adopting the provisions of FIN 48 on our financial position, results of operations and liquidity.

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

As of December 24, 2006, we had \$1.6 billion in cash and cash equivalents, short-term investments, and restricted cash and investments which represents an increase of \$98.6 million compared to balances as of June 25, 2006. Cash provided by operating activities during the six months ended December 24, 2006 was \$378.7 million, representing 31% of revenues and proceeds from the issuance of common stock were \$30.4 million. Uses of cash include approximately \$177 million to fund the acquisition of the silicon growing and silicon fabrication assets of Bullen Ultrasonics, Inc. (Bullen). We also repaid \$50 million of our long-term debt during the quarter ended December 24, 2006. Share repurchases totaled \$76.3 million, and capital expenditures were \$26.9 million.

*Cash Flows From Operating Activities*

Net cash provided by operating activities of \$378.7 million during the six months ended December 24, 2006, consisted of (in millions):

|                                                    |          |
|----------------------------------------------------|----------|
| Net income                                         | \$ 350.8 |
| Non-cash charges:                                  |          |
| Depreciation and amortization                      | 15.3     |
| Equity-based compensation                          | 12.9     |
| Other, net                                         | (1.0)    |
| Net tax benefit on equity-based compensation plans | 6.9      |
| Decrease in deferred tax assets                    | 13.8     |
| Change in other working capital accounts           | (20.0)   |
|                                                    | \$ 378.7 |

Significant changes in working capital accounts during the six months ended December 24, 2006 included an increase in accounts receivable of \$49.1 million reflecting the growth of our business. Inventories, excluding \$12.7 million acquired from Bullen, grew \$30.9 million on increased business volume, and other current assets increased \$12.4 million, excluding \$4.4 million of assets acquired from Bullen. These changes were partially offset by an increase in deferred profit of \$36.7 million and accrued liabilities growth of \$32.5 million which was primarily driven by an increase in incentive-based compensation on higher profit levels and the disbursement cycle of this compensation.

*Cash Flows from Investing Activities*

Net cash used for investing activities during the six months ended December 24, 2006 was \$580.7 million and consisted of the acquisition of Bullen assets of \$177.1 million, net purchases of short-term investments of \$431.7 million as we reposition our portfolio subsequent to our fiscal year 2006 repatriation of foreign earnings, and capital expenditures of \$26.9 million. We also reclassified \$55.0 million out of restricted cash and investments due to the repayment of \$50.0 million during the December 2006 quarter of our long-term debt.

*Cash Flows from Financing Activities*

Net cash used for financing activities during the six months ended December 24, 2006 was \$80.7 million, driven by share repurchases of \$76.3 million and payments on long-term debt and capital leases of \$50.1 million. These uses were partially offset by net proceeds from issuance of common stock related to employee equity-based plans of \$30.4 million and the excess tax benefit on equity-based compensation plans of \$15.4 million, which is not added back to net income in the presentation of cash flows from operating activities.

During the six months ended December 24, 2006, we repurchased approximately 1.4 million shares of common stock for a total price of \$75.0 million under the Board authorized repurchase program which runs through September 30, 2008. As of December 24, 2006 the total amount remaining available for repurchase under Board authorization was \$256.7 million. We expect to continue to repurchase shares consistent with the Board authorization, the level of which will be determined by factors, including but not limited to, the needs of the business and the stock price and daily trading volumes of our stock.

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 December 24, 2006 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.

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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. 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.

***Commitments***

We have certain obligations, some of which are recorded on our balance sheet and some which are not, to make future payments under various contracts. Obligations are recorded on our balance sheet in accordance with U.S. generally accepted accounting principles. The obligations recorded on our condensed consolidated balance sheet include restructuring liabilities and long-term debt which are outlined in the following table and are 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:

|                         | <b>Operating<br/>Leases</b> | <b>Purchase<br/>Obligations</b> | <b>Restructuring<br/>Liabilities<br/>(in thousands)</b> | <b>Long-term<br/>Debt and<br/>Interest<br/>Expense</b> | <b>Total</b> |
|-------------------------|-----------------------------|---------------------------------|---------------------------------------------------------|--------------------------------------------------------|--------------|
| Payments due by period: |                             |                                 |                                                         |                                                        |              |
| Less than 1 year        | \$ 13,825                   | \$ 161,352                      | \$ 768                                                  | \$ 16,623                                              | \$ 192,568   |
| 1-3 years               | 83,492                      | 59,548                          |                                                         | 33,291                                                 | 176,331      |
| 4-5 years               | 1,934                       | 16,554                          |                                                         | 324,911                                                | 343,399      |
| Over 5 years            | 1,925                       | 2,322                           |                                                         |                                                        | 4,247        |
| Total                   | \$ 101,176                  | \$ 239,776                      | \$ 768                                                  | \$ 374,825                                             | \$ 716,545   |

***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 2021. 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 1-3 years section of the table above is \$75.0 million in guaranteed residual values for lease agreements relating to certain properties at our Fremont, California campus. As part of the lease agreements, we have the option to purchase the remaining buildings at any time for a total purchase price for all remaining properties related to these leases of approximately \$85.0 million. We are required to guarantee the lessor a residual value on the properties of up to \$75.0 million at the end of the lease terms in fiscal year 2008 (in the event that the leases are not renewed, we do not exercise the purchase options, the lessor sells the properties and the sale price is less than the lessor's costs). We maintain cash collateral of \$85.0 million as part of the lease agreements as of December 24, 2006 in separate, specified certificates of deposit and interest-bearing accounts which are recorded as restricted cash and investments in our Condensed Consolidated Balance Sheet. 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.



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### *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 minimum obligations at December 24, 2006 under these arrangements and others. Actual expenditures will vary based on the volume of transactions and length of contractual service provided. In addition to minimum spending commitments, certain of these agreements provide for potential cancellation charges.

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 December 24, 2006, vendor-owned inventories held at our locations and not reported as our inventory were \$25.9 million.

### *Restructuring Liabilities*

Our total restructuring reserves as of December 24, 2006 were \$0.8 million, which consists primarily of lease payments on vacated buildings. Through cash generated from operations, we expect the remaining balance to be paid over the next twelve months.

### *Long-Term Debt and Interest Expense*

On June 16, 2006, our wholly-owned subsidiary, Lam Research International SARL (LRI), as borrower, entered into a \$350 million Credit Agreement (the Credit Agreement). Under the Credit Agreement, on June 19, 2006, LRI borrowed \$350 million in principal amount. The loan under the Credit Agreement shall be fully repaid not later than five years following the closing date and will bear interest at LIBOR plus a spread ranging from 0.10% to 0.50%, depending upon a consolidated leverage ratio, as defined in the Credit Agreement. The initial spread under the Credit Agreement is 0.10%. LRI may prepay the loan under the Credit Agreement in whole or in part at any time without penalty, subject to reimbursement of lenders' breakage and redeployment costs in certain cases. The amounts in the table above include the remaining principal payment of \$300 million due on June 19, 2011 and interest payments estimated based on the current LIBOR rate of 5.365% and initial spread of ten basis points. \$50.0 million of the original \$350.0 million debt was repaid during the quarter ended December 24, 2006. The fair value of long-term debt approximates its carrying value due to the variable interest rate applicable to the debt.

We used the proceeds from the credit facility entered into by LRI to facilitate the repatriation of \$500 million of foreign earnings in the June 2006 quarter under the provisions of the American Jobs Creation Act of 2004 (AJCA).

## **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 Annual Report on Form 10-K for the year ended June 25, 2006.

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio 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 constantly positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to achieve portfolio liquidity and maintain a prudent amount of diversification.

## **ITEM 4. Controls and Procedures**

### *Disclosure Controls and Procedures*

As required by Exchange Act Rule 13a-15(b), as of December 24, 2006, 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.



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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.

## **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 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.

#### ***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 industry 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 and product mix;



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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;

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

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 typically range in price up to approximately \$6.0 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 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.

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***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.

***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 we participate in;

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'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'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.

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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 outsourced assembly 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.

### ***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.



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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 86% in fiscal year 2006, 84% in fiscal year 2005 and 82% in fiscal year 2004 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;

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 except for certain of our revenues in Japan that are denominated in Japanese Yen, certain of our spares and service contracts which are denominated in other currencies, 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 currency forward contracts to minimize the short-term impact of the exchange rate fluctuations on Japanese Yen-denominated assets and forecasted Japanese Yen-denominated revenue where we currently believe our primary exposure to currency rate fluctuation lies and will 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 our Yen-denominated assets with currency forward contracts, we may miss favorable currency trends, that would have been advantageous to us but for the hedges. Additionally, we currently do not enter into such forward contracts for currencies other than the Yen, 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.

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***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, or 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.

***Changes in Accounting Standards for Equity-Based Compensation May Adversely Affect our Operating Results, Our Stock Price, and Our Competitiveness in the Employee Marketplace***

The adoption of SFAS No. 123(R) required us to expense all equity-based compensation provided to employees and directors beginning with our quarter ending September 25, 2005. The environment for skilled employees that are knowledgeable about our products and services is a competitive one, and we believe that equity-based compensation is an important part of the overall compensation that we offer to attract and retain such employees. SFAS No. 123(R) has decreased and will continue to decrease our earnings based on its measure of the value of equity-based compensation. There is some risk that the design of our compensation plans is ineffective at balancing our profitability and employee retention objectives.

***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, 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, or we may reduce or dispose of certain product lines or technologies, which 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. 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 inability or inadequacies could have a material adverse effect on our business, operating results, financial condition, and cash flows.

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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 or earnings from levels 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;

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 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.

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***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. 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 Would 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 (Firm) is required to attest to whether our assessment of the effectiveness of our internal control over financial reporting is fairly stated in all material respects and separately 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 Firm's attestation as to the effectiveness of our internal control over financial reporting as of June 25, 2006. In future years, if we fail to timely complete this assessment, or if our 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 Firm and Lam that, in the Firm's professional judgment, might have a bearing on the 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 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.

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(c) In October, 2004, we announced that our Board of Directors had authorized the repurchase of up to \$250 million of our common stock from the public market or in private purchases. The terms of the repurchase program permitted us to repurchase shares through September 30, 2007. In August, 2005, we announced that our Board of Directors had authorized the repurchase of an additional \$500 million of our common stock from the public market or private purchase. The terms of the repurchase program permit us to repurchase shares through September 30, 2008. We plan to continue to execute the authorized repurchases going forward. Share repurchases under the authorizations were as follows:

| <b>Period</b>                         | <b>Total<br/>Number<br/>of<br/>Shares<br/>Repurchased</b> | <b>Average<br/>Price<br/>Paid<br/>per<br/>Share<br/>(in thousands, except per share data)</b> | <b>Total Number of<br/>Shares<br/>Purchased as Part<br/>of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>Remaining<br/>Amount<br/>Available<br/>Under<br/>the Repurchase<br/>Programs</b> |
|---------------------------------------|-----------------------------------------------------------|-----------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|
| As of September 24, 2006              | 12,833                                                    | \$ 32.59                                                                                      | 12,833                                                                                                              | \$ 331,708                                                                          |
| September 25, 2006 – October 22, 2006 | 151                                                       | 49.75                                                                                         | 151                                                                                                                 | \$ 324,204                                                                          |
| October 23, 2006 – November 19, 2006  | 591                                                       | 50.80                                                                                         | 591                                                                                                                 | \$ 294,184                                                                          |
| November 20, 2006 – December 24, 2006 | 705                                                       | 53.13                                                                                         | 705                                                                                                                 | \$ 256,696                                                                          |
| <b>Total</b>                          | <b>14,280</b>                                             | <b>\$ 34.55</b>                                                                               | <b>14,280</b>                                                                                                       |                                                                                     |

**ITEM 3. Defaults Upon Senior Securities**

None.

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

The Annual Meeting of Stockholders of Lam Research Corporation was held at the principal office of the Company at 4650 Cushing Parkway, Fremont, California 94538 on November 2, 2006.

Out of 142,206,849 shares of Common Stock (as of the record date of September 15, 2006) entitled to vote at the meeting, 121,711,995 shares were present in person or by proxy.

The results of voting on the following items were as set forth below:

The vote for nominated directors, to serve for the ensuing year, and until their successors are elected, was as follows:

| <b>NOMINEE</b>        | <b>IN FAVOR</b> | <b>WITHHELD</b> |
|-----------------------|-----------------|-----------------|
| James W. Bagley       | 118,633,539     | 3,078,456       |
| David G. Arscott      | 118,548,917     | 3,127,078       |
| Robert M. Berdahl     | 113,682,127     | 8,029,868       |
| Richard J. Elkus, Jr. | 113,679,706     | 8,032,289       |
| Jack R. Harris        | 112,385,779     | 9,326,216       |
| Grant M. Inman        | 118,523,646     | 3,188,349       |
| Catherine Lego        | 119,921,487     | 1,790,508       |
| Stephen G. Newberry   | 118,704,842     | 3,007,153       |
| Seiichi Watanabe      | 119,879,445     | 1,832,550       |
| Patricia Wolpert      | 114,401,356     | 7,310,639       |

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## Amendment of the Lam 2004 Executive Incentive Plan:

|                          | <b>IN FAVOR</b> | <b>AGAINST</b> | <b>ABSTAIN</b> | <b>Broker<br/>Non-Votes</b> |
|--------------------------|-----------------|----------------|----------------|-----------------------------|
| Beneficial Vote:         | 105,739,025     | 4,091,954      | 256,088        | 11,559,314                  |
| Registered Vote:         | 55,893          | 5,916          | 3,805          |                             |
| Total Shares Voted:      | 105,794,918     | 4,097,870      | 259,893        |                             |
| % of Voted Shares:       | 96.0%           | 3.7%           | .2%            |                             |
| % of Outstanding Shares: | 74.4%           | 2.9%           | .2%            |                             |

## Approval of Lam 2007 Stock Incentive Plan:

|                          | <b>IN FAVOR</b> | <b>AGAINST</b> | <b>ABSTAIN</b> | <b>Broker<br/>Non-Votes</b> |
|--------------------------|-----------------|----------------|----------------|-----------------------------|
| Beneficial Vote:         | 79,952,285      | 29,918,158     | 216,624        | 11,559,314                  |
| Registered Vote:         | 57,134          | 6,075          | 2,405          |                             |
| Total Shares Voted:      | 80,009,419      | 29,924,233     | 219,029        |                             |
| % of Voted Shares:       | 72.6%           | 27.2%          | .2%            |                             |
| % of Outstanding Shares: | 56.3%           | 21.0%          | .2%            |                             |

Ratification of Appointment of Ernst and Young LLP as Independent Registered Public Accounting Firm for the Company for the fiscal year ending June 24, 2007:

|                          | <b>IN FAVOR</b> | <b>AGAINST</b> | <b>ABSTAIN</b> |
|--------------------------|-----------------|----------------|----------------|
| Beneficial Vote:         | 120,151,227     | 1,453,468      | 41,685         |
| Registered Vote:         | 61,132          | 3,277          | 1,205          |
| Total Shares Voted:      | 120,212,359     | 1,456,745      | 42,890         |
| % of Voted Shares:       | 98.8%           | 1.2%           | 0%             |
| % of Outstanding Shares: | 84.5%           | 1.0%           | 0%             |

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits and Reports on Form 8-K**

(a) Exhibits

10.106 Form of Restricted Stock Unit Award Agreement (U.S. Agreement) - Lam Research Corporation 2007 Stock Incentive Plan

31.1 Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer)

31.2 Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer)

32.1 Section 1350 Certification (Principal Executive Officer)

32.2 Section 1350 Certification (Principal Financial Officer)

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**LAM RESEARCH CORPORATION  
SIGNATURES**

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

Date: January 29, 2007

LAM RESEARCH CORPORATION

(Registrant)

/s/ Martin B. Anstice

Martin B. Anstice

*Group Vice President, Chief Financial  
Officer and Chief Accounting Officer*

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**EXHIBIT INDEX**

**Exhibit**

**Number    Description**

|        |                                                                                                                     |
|--------|---------------------------------------------------------------------------------------------------------------------|
| 10.106 | Form of Restricted Stock Unit Award Agreement (U.S. Agreement) - Lam Research Corporation 2007 Stock Incentive Plan |
| 31.1   | Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer)                                                |
| 31.2   | Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer)                                                |
| 32.1   | Section 1350 Certification (Principal Executive Officer)                                                            |
| 32.2   | Section 1350 Certification (Principal Financial Officer)                                                            |