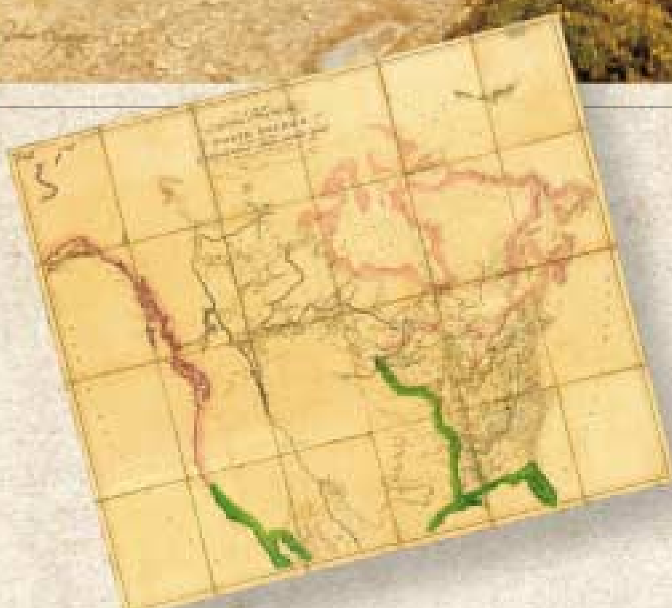
LATTICE SEMICONDUCTOR CORPORATION 2001 ANNUAL REPORT

THE JOURNEY



FINANCIAL HIGHLIGHTS

(unaudited)

(IN THOUSANDS, EXCEPT PER SHARE DATA)	2001	2000	FISCAL PERIOD 1999 (3)
Revenue	**$ 295,326**	$ 567,759	$ 269,699
Gross profit	**$ 183,828**	$ 349,929	$ 161,012
Operating income (1)	**$ 59,122**	$ 191,790	$ 64,433
(Loss) Earnings Before Goodwill ("EBG") (1)	**$ (40,990)** (2)	$ 233,167 (2)	$ 45,920
Basic (loss) EBG per share (4)	**$ (0.38)**	$ 2.29	$ 0.48
Diluted (loss) EBG per share (4)(5)	**$ (0.38)**	$ 2.02	$ 0.46
Cash and short-term investments	**$ 531,566**	$ 535,408	$ 214,140
Total assets	**$1,173,980**	$1,295,884	$ 916,155
Stockholders' equity	**$ 839,770**	$ 855,655	$ 482,773

2001 QUARTERLY INFORMATION

	DECEMBER 2001	SEPTEMBER 2001	JUNE 2001	MARCH 2001
Revenue	**$ 52,108**	$ 58,038	$ 74,082	$ 111,098
Gross profit	**$ 32,286**	$ 36,043	$ 46,311	$ 69,188
Operating income (1)	**$ 3,905**	$ 6,800	$ 14,819	$ 33,598
Earnings (loss) Before Goodwill ("EBG") (1)	**$ 5,088**	$ (86,957)	$ 13,623	$ 27,256
Basic (loss) EBG per share (4)	**$ 0.05**	$ (0.80)	$ 0.13	$ 0.25
Diluted (loss) EBG per share (4)(5)	**$ 0.05**	$ (0.80)	$ 0.12	$ 0.24

(1) This table presents consolidated operations information in a manner consistent with information reported by securities analysts who follow our company. This presentation method is referred to as Earnings Before Goodwill ("EBG") and differs from Generally Accepted Accounting Principles ("GAAP"). A consolidated statement of operations based on GAAP is included in the accompanying Form 10-K Annual Report. EBG information does not include goodwill amortization, deferred compensation amortization and in-process research and development expense aggregating $84.3 million, $81.9 million and $134.8 million in 2001, 2000 and fiscal period 1999, respectively, (and related tax benefits of $31.2 million, $29.4 million and $49.2 million, respectively) which are reflected in our GAAP financial statements. In addition, for 1999, an Extraordinary Item of approximately $1.7 million, net of income taxes, representing the write-off of unamortized debt issuance costs related to bank borrowings retired in conjunction with the issuance of $260 million 4 3/4% convertible notes is excluded from EBG. EBG information also includes a proforma adjustment referred to as a "Tax Shield," representing the current period tax deduction from amortizing intangible assets (approximately $500 million) over 15 years on a straight-line basis using a 33.0% tax rate. This proforma adjustment is not recognized under GAAP.

(2) Includes $150.0 million gain ($92.1 million after tax) on equity market appreciation of our UMC common shares recorded in the first quarter of 2000 and subsequent $152.8 million loss ($94.9 million after tax) recorded in the third quarter of 2001 related to the market depreciation of these shares.

(3) Includes operations of Vantis Corporation for the period from acquisition, June 16, 1999.

(4) All per share amounts have been adjusted retroactively to reflect two-for-one stock splits effected in the form of stock dividends which were paid on October 11, 2000 and September 16, 1999.

(5) For the three months ended March 31, 2001, the computation of diluted EBG per share includes the effect of stock options and $260 million of convertible notes. Diluted EBG per share is adjusted to exclude interest expense and debt issuance cost amortization (net of tax) of $2.340 for the March 2001 quarter and approximately 12.548 million shares issuable on the assumed conversion of the notes. For the three months ended June 30, 2001 and December 31, 2001, diluted EBG per share only includes the effect of stock options as the convertible notes are antidilutive. For the three months ended September 30, 2001 and the year ended December 31, 2001, the computation of (loss) earnings before goodwill excludes the effect of stock options and the convertible notes as both are antidilutive.

CORPORATE PROFILE

Lattice Semiconductor Corporation designs, develops and markets high-performance programmable logic devices, or PLDs, and related system software. Programmable logic devices are widely used semiconductor components that can be configured by the end customer as specific logic circuits, and enable the end customer to shorten design cycle times and reduce development costs. Our end customers are primarily original equipment manufacturers in the communications, computing, industrial, military and consumer end markets.

The object of your mission is to explore the Missouri River, and such principal stream of it, as by its course and communication with the waters of the Pacific Ocean, may offer the most direct and practicable water communication across this continent, for the purposes of commerce.... The commerce which may be carried on with the people inhabiting the line you will pursue, renders a knowledge of these people important. You will therefore endeavor to make yourself acquainted, as far as a diligent pursuit of your journey shall admit, with the nations...and articles of commerce they may need or furnish...

—Thomas Jefferson
June 20, 1803

To Our Shareholders: Two hundred years ago, Thomas Jefferson had a bold vision for the fledgling American republic. He foresaw a nation stretching from coast to coast across the vast North American continent. Such a nation would control commerce within the New World and, as a result, command a position in the Old World power structure. To realize his vision, Jefferson commissioned Captain Meriwether Lewis to plan and execute a bold journey.

In 1803, after nearly a year of detailed preparation, Lewis, his co-commander William Clark and their thirty-man Corps of Discovery set out towards the setting sun in search of the Pacific Ocean. They did not return for nearly three years. Their trek led them down three major rivers, over vast mountain ranges and across 2,000 miles of uncharted and unfriendly terrain. Rarely knowing what to expect on the trail ahead, Lewis and Clark conquered adversity every day. Along the way they made contact with numerous Native American tribes, establishing diplomatic ties on behalf of Jefferson. They also discovered and catalogued 300 species of plants and animals previously unknown to the modern world. The combination of

During Lewis and Clark's voyage of discovery, 122 species and subspecies of animals and 178 species of plants were observed, documented and gathered. By far the most valuable items they carried back, however, were the journals and the map that showed the way West for a new nation.

PLANNING FOR DISCOVERY. Preparing for the journey that would take them beyond the edge of the known world, Lewis and Clark sought out expertise to equip them for all they might encounter. Augmenting their considerable experience with new skills, they learned to describe and preserve botanical specimens, measure latitude and longitude, and identify fossil specimens. They received instruction on medical treatments they might need, and recruited crew members with an enormous breadth of abilities. As Lattice ventures into new programmable semiconductor market territory, we're going well prepared with a strengthened product development organization, differentiated silicon architectures and deliberately plotted strategies.

preparation, leadership, diplomacy, instinct and crisis management displayed by the Captains in pursuit of their destination blazed a western trail that millions would later follow.

In retrospect, although Lewis and Clark's physical journey ended on the shores of the Pacific, their odyssey marked the beginning of our nation's journey to greatness. Perhaps their most enduring accomplishment was the expansion of our national horizon. Our collective eye was turned westward to the two-thirds of the continent we neither inhabited nor influenced. From that small beachhead on the mouth of the Columbia River, Jefferson's ambitious vision for America would ultimately be realized.

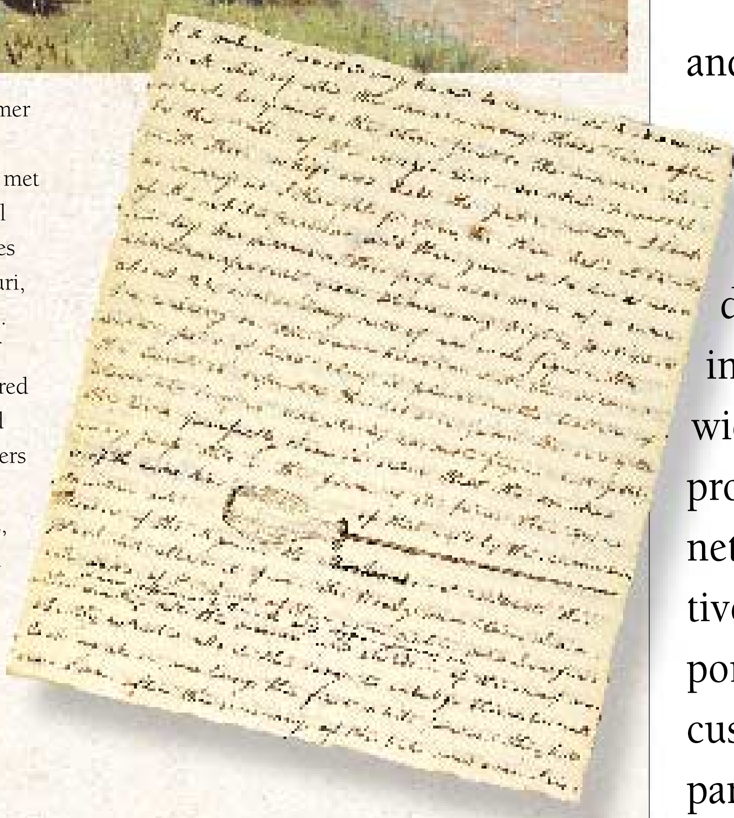
At Lattice Semiconductor, we too have a vision. And, we too are on a bold journey of discovery and expansion.

Our vision is one of extending programmability to new frontiers in the semiconductor industry. We believe that customers will always prefer a customizable, flexible integrated circuit over a static, fixed-function integrated circuit. Over time, those who chart the programmable terrain will lay claim to more industry territory. Thus we have embarked on a journey to expand our participation within the programmable semiconductor market.

We set out humbly in the late 1980's with the introduction of our $E^2CMOS^®$ based GAL® family, the first truly re-programmable simple logic devices. By 1992, armed with ground-breaking in-system programmable (ISP™) technology, our journey shifted into a new phase with our entry into the high-density complex programmable logic device (CPLD) market. Successful participation in this attractive market demanded a new core competency and sustained investment in software design tools. Thus, only after diligent preparation and planning did we venture into this new terrain. Our resulting ISP CPLD silicon and software products were truly innovative and by 1996 had placed us squarely on the high-density PLD map.

Our journey accelerated in 1998 with the successful release of three families of leadership CPLD products. Code named "BFW" for Big, Fast and Wide, these differentiated products staked our claim in the rapidly emerging low voltage market territory. The subsequent acquisition of Vantis Corporation, the PLD subsidiary of AMD, added necessary critical mass to our effort. This business combination and the continued growth of our BFW products catapulted us to the number two CPLD market position by 2000.

STRATEGIC ALLIANCES. Essential to Jefferson's vision of opening trade routes to the West coast, Lewis and Clark's expedition was tasked with a diplomatic mission as well as a scientific one. To help assure the success of a young nation's future commerce, treaties and alliances had to be made with the tribes who controlled the territory, also claimed by France, administered by Spain, and in which Canadian-based British traders had a monopoly on the fur trade. Jefferson told Lewis to assure the chiefs the wish of the United States was to be neighborly and reliable trading partners. With only sketchy knowledge of the native cultures, the team met with success making creative use of their limited translation skills to forge friendships. Building strong, viable relationships with our customers, foundries, third-party software vendors, manufacturer's representatives and distributors is also essential for the success of our own journey.



During the summer and fall of 1804, Lewis and Clark met in formal council with several tribes along the Missouri, seeking alliances. They showed off trade goods, shared ceremonials, and urged tribal leaders to travel to Washington, DC, to visit President Jefferson.

Our journey has allowed us to explore other programmable paths as well. Our ispPAC® family pioneered programmability in the analog marketplace while our ispGDX® family offers similar flexibility in the digital interconnect and interface market. We believe these unique technologies arm us with strategic capabilities for the road ahead.

Along the way we have built long-term alliances necessary to support our journey while allowing us to focus on our core competencies of product development and customer support.

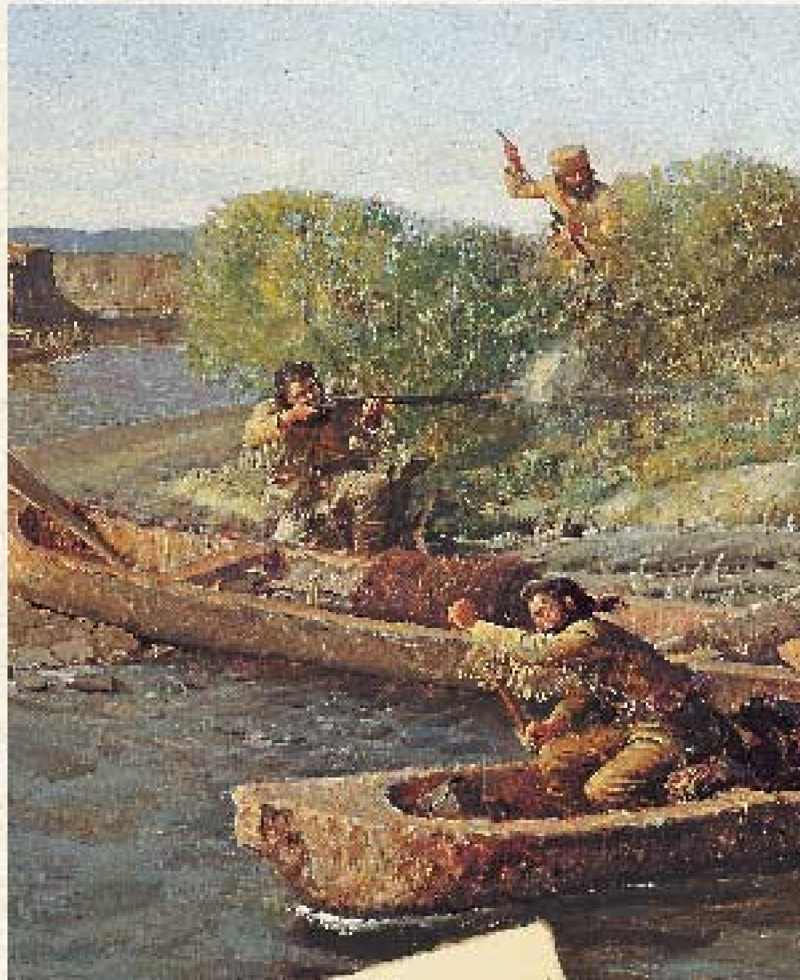
Our foundry partners Seiko Epson and UMC ensure we have a stable supply of technologically advanced silicon wafers. We collaborate with all leading third-party software design tool vendors with whom we integrate our own tools and provide widespread support for our silicon products. And we depend on our global network of manufacturer's representatives and distributors to sell and support our products within our mutual customer base. We are grateful for these partners, without whom our journey would not have been possible.

Although by most measures our journey has been successful, by no means has it been easy. Just as Lewis and Clark did, we have encountered adversity on our path.

Last year, driven by a decline in the communications and computing end markets, the semiconductor industry suffered a dramatic and unprecedented downturn. Lattice was not immune to these adverse market conditions. Revenue for calendar year 2001 was $295.3 million, a decline of 48 percent from the record $567.8 million we reported in the more robust market climate of 2000.

But, like Lewis and Clark, we are determined travelers. Our advance preparation, management discipline and financial strength allowed us to successfully navigate this extremely difficult period in our industry. When we first saw signs of market turbulence looming on the horizon we took quick and decisive action. Discretionary spending was cut. Vendor prices were renegotiated. Production plans were rethought. And ultimately, sacrifices were asked of and made by each and every Lattice employee.

Our financial results speak for themselves. When measured before charges for intangible asset amortization, we posted an operating profit in each quarter of 2001. For the full year, our operating margin of 20 percent easily exceeded the levels posted by



Charging grizzlies were among the more spectacular examples of the continuing parade of obstacles met by the expedition. They were baffled by diverging forks in their river road, battered by bad weather and disheartened by range after range of higher, more perilous mountains than they had imagined. Yet the team remained steadfast in their strategy, their skills, and in the ultimate triumph of character.

OVERCOMING ADVERSITY. The success of any enterprise is measured more by how it overcomes difficulties than by its ability to prosper in good times. Lewis and Clark met challenges at every bend of the river that would have defeated less skillful, less strategic explorers. Hunger, illness, foul weather and exhaustion dogged them. When the Missouri River presented them with alternative routes, they applied their expertise in navigation to explore both options before moving on. When mountain barriers loomed, they negotiated for Shoshone horses and hired a guide who would make the critical difference. When we at Lattice found ourselves in the midst of a dramatic industry downturn, we were determined to prosper in the face of adversity. We used our financial strength to augment our product development organization and to make a strategic acquisition. We added the expertise necessary to strengthen our competitive position and position us for future success.

our PLD competitors and made us one of the most profitable companies in the semiconductor industry. Of course, as experienced travelers, we also knew it was important to keep our powder dry during lean times. Notably, we ended the year with $531.6 million in cash and short-term investments.

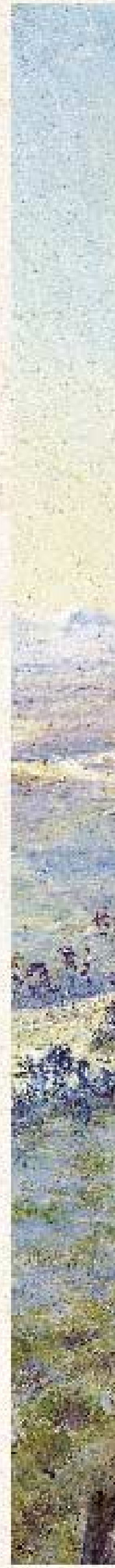
We accomplished these financial results without resorting to layoffs or other short-term actions that ultimately serve to erode competitiveness. On the contrary, we used our relative financial strength as a means to improve our position. Taking advantage of economic conditions we aggressively recruited experienced engineers, increasing our product development headcount by 20 percent during the year. This valuable additional capacity helped us accelerate the delivery of several new innovative CPLD product families.

Battling through the hostile market environment of last year, we maintained our focus on our CPLD business. We enhanced our competitiveness with the introduction of a record number of new BFW products by releasing the ispLSI® 2000VE, ispLSI 5000VE and ispMACH® 5000VG families. These three low voltage product families give us the most comprehensive and technically advanced CPLD product portfolio in our industry. In the fourth quarter, we further extended our leadership position by introducing the first of our third generation of BFW products. The ispMACH 4000 family offers performance and power consumption characteristics that clearly put Lattice one product generation ahead of our CPLD competition.

We also took advantage of adverse industry conditions to make a strategic acquisition. In January 2002, putting $250 million of our cash reserves to work, we purchased the field programmable gate array (FPGA) business of Agere Systems. The addition of an attractive product portfolio, experienced product development team and intellectual property licensed from Agere complements our own ongoing internal efforts to penetrate the largest territory within the PLD market. Our newly acquired business includes an innovative family of field programmable system chip (FPSC) products. FPSCs, which combine embedded IP cores and generic FPGA logic on a single chip, offer the best of both the PLD and ASIC worlds. We believe these products hold great promise and mark the beginning of a new journey for FPGA technology and for Lattice.

EXPANDING HORIZONS. Lewis and Clark successfully crossed the North American continent. And in doing so, they not only fulfilled Jefferson's charge, but mapped and described the new territory and its inhabitants in brilliant detail. They succeeded in extending the American territorial claim and American commerce all the way to the Pacific Coast. Their thrilling achievement and the information they brought back from their journey started the movement of generations of American settlers westward, secure in the knowledge that upon arrival they would be rewarded with fertile farmland and a better future. Similarly, the exploration of programmable semiconductors has allowed us to continually broaden our own horizons and market coverage. Now, after having established a beachhead in the FPGA market and extending our own territorial claim to the entire PLD market, all of us at Lattice look forward to expanding our presence in this attractive arena.

Acting on courage, yet without recklessness, Lewis and Clark were able to realize the explorer's ultimate reward.



Although it was a difficult year in many respects, we adapted and overcame the challenges that confronted us. We are stronger from our experience.

In one sense, our original journey is now complete. From a modest beginning a little more than a decade ago, we now lay claim to the full landscape of the programmable semiconductor market. We successfully entered the CPLD market and made the climb to leadership. With our recent acquisition, we have finally established a small beachhead in the FPGA market. In another sense, however, our journey has just begun. From this beachhead we must take on the challenge of expanding our presence in the PLD market to ultimately fulfill our vision.

As always, we are eager to embark on our next journey, face new challenges and explore new paths.

Thank you for sharing our journey,

Cyrus Tsui
Chief Executive Officer and
Chairman of the Board

CONSOLIDATED OPERATIONS INFORMATION — EARNINGS BEFORE GOODWILL (EBG) PRESENTATION[1]

(unaudited)

(IN THOUSANDS, EXCEPT PER SHARE DATA)	**2001**	2000	FISCAL PERIOD 1999[2]
Revenue	**$ 295,326**	$567,759	$269,699
Costs and expenses:			
Cost of products sold	**111,498**	217,830	108,687
Research and development	**71,679**	77,057	45,903
Selling, general and administrative	**53,027**	81,082	50,676
Income from operations[1]	**59,122**	191,790	64,433
(Loss) gain on foundry investments	**(152,795)**	149,960	—
Interest and other income (expense), net	**4,056**	2,194	(4,120)
(Loss) income before (benefit) provision for income taxes	**(89,617)**	343,944	60,313
(Benefit) provision for income taxes	**(37,559)**	121,899	21,208
Tax shield[1]	**11,068**	11,122	6,815
(Loss) Earnings Before Goodwill (EBG)	**$ (40,990)**	$233,167	$ 45,920
Basic (loss) EBG per share[3]	**$ (0.38)**	$ 2.29	$ 0.48
Diluted (loss) EBG per share[3][4]	**$ (0.38)**	$ 2.02	$ 0.46
Shares used in per share calculations[3]:			
Basic	**108,814**	101,716	95,428
Diluted[4]	**108,814**	120,321	99,790

(1) This table presents consolidated operations information in a manner consistent with information reported by securities analysts who follow our company. This presentation method is referred to as Earnings Before Goodwill ("EBG") and differs from Generally Accepted Accounting Principles ("GAAP"). A consolidated statement of operations based on GAAP is included in the accompanying Form 10-K Annual Report. EBG information does not include goodwill amortization, deferred compensation amortization and in-process research and development expense aggregating $84.3 million, $81.9 million and $134.8 million in 2001, 2000 and fiscal period 1999, respectively, (and related tax benefits of $31.2, $29.4 million and $49.2 million, respectively), which are reflected in our GAAP financial statements. In addition, for fiscal period 1999 an Extraordinary Item of approximately $1.7 million, net of income taxes, representing the write-off of unamortized debt issuance costs related to bank borrowings retired in conjunction with the issuance of $260 million 4¾% convertible notes is excluded from EBG. EBG information also includes a pro forma adjustment referred to as a "Tax Shield," representing the current period tax deduction from amortizing intangible assets (approximately $500 million) over 15 years on a straight-line basis using a 33.0% tax rate.This pro forma adjustment is not recognized under GAAP.

(2) Includes operations of Vantis Corporation for the period from acquisition, June 16, 1999.

(3) All per share amounts have been adjusted retroactively to reflect two-for-one stock splits effected in the form of stock dividends which were paid on October 11, 2000 and September 16, 1999.

(4) For 2001, the computation of diluted (loss) EBG per share excludes the effect of stock options and $260 million of convertible notes as both are antidilutive. For 2000, the computation of diluted EBG per share includes the effect of stock options and $260 million of convertible notes. Diluted EBG per share is adjusted to exclude interest expense and debt issuance cost amortization (net of tax) of $9.484 million for the 2000 year. Diluted weighted-average shares include the dilutive effect of stock options and, in 2000, approximately 12.548 million shares issuable on the assumed conversion of notes.

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

Lattice Semiconductor Corporation designs, develops and markets high performance programmable logic devices, or PLDs, and related software. Programmable logic devices are widely-used semiconductor components that can be configured by the end customer as specific logic circuits, and enable the end customer to shorten design cycle times and reduce development costs. Our end customers are primarily original equipment manufacturers in the communications, computing, industrial, military and consumer end markets.

The 2001 and 2000 fiscal years are twelve-month periods, as compared to our nine-month fiscal period 1999.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the percentage of revenue represented by selected items reflected in our Consolidated Statement of Operations:

	YEAR ENDED DEC. 31, 2001	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
Revenue	**100%**	100%	100%
Costs and expenses:			
Cost of products sold	**38**	38	40
Research and development	**24**	14	17
Selling, general and administrative	**18**	14	19
In-process research and development	**—**	—	33
Amortization of intangible assets	**29**	15	17
Total costs and expenses	**109**	81	126
(Loss) income from operations	**(9)**	19	(26)
Other (expense) income, net	**(50)**	27	(2)
(Loss) income before (benefit) provision for income taxes	**(59)**	46	(28)
(Benefit) provision for income taxes	**(22)**	16	(11)
(Loss) income before extraordinary item	**(37)**	30	(17)
Extraordinary item, net of income taxes	**—**	—	(1)
Net (loss) income	**(37)%**	30%	(18)%

Acquisition of Vantis As discussed in more detail in note 4 to our Consolidated Financial Statements, we completed the acquisition of Vantis Corporation ("Vantis") from Advanced Micro Devices, Inc. ("AMD") on June 15, 1999. We paid approximately $500.1 million in cash for all of the outstanding capital stock of Vantis, plus $10.8 million in direct acquisition costs, $5.4 million of accrued pre-acquistion contingencies, $8.3 million of accrued exit costs, and assumed certain liabilities of $34.5 million related to the Vantis business. In addition, we exchanged Lattice stock options for all of the outstanding stock options under the former Vantis employee stock plans with a calculated Black-Scholes value of $24.0 million. The total purchase price for Vantis was $583.1 million. The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed based on an independent appraisal and management estimates. In-process research and development (IPR&D) costs were appraised at $89.0 million and charged to operations on the acquisition date. Remaining intangible asset costs are being amortized to operations over five years using the straight-line method (see *New Accounting Pronouncements* in note 1 to our Consolidated Financial Statements).

The purchase was financed using a combination of cash reserves and a credit facility bearing interest at adjustable rates. The credit facility was replaced with Convertible Subordinated Notes in November 1999 (see note 8 to our Consolidated Financial Statements).

Revenue Revenue was $295.3 million in 2001, a decrease of 48% from 2000. Fiscal 2000 revenue of $567.8 million represented an increase of 111% from the $269.7 million recorded in fiscal period 1999. Revenue from the sale of high-density products represented 76%, 76% and 68% of total revenue for 2001, 2000 and fiscal period 1999, respectively.

During 2001, the semiconductor and PLD markets experienced a significant downturn. Our revenue decrease in 2001, as compared to 2000, was a result of this downturn and the resultant decrease in demand for our products. Revenue declined across all geographies while the communications end market was particularly weak.

In addition to our acquisition of Vantis, the increase in revenue in 2000 was primarily attributable to increased sales of high density products, particularly our new low-voltage high density products, in all geographic regions. Additionally, 2000 was a twelve-month fiscal year, as opposed to our nine-month fiscal period 1999.

Our sales by geographic region were as follows:

(IN THOUSANDS)	**YEAR ENDED DEC. 31, 2001**	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
United States	**$135,832**	$245,882	$126,333
Export sales:			
Europe	**81,177**	158,591	70,641
Asia	**62,582**	120,285	55,003
Other	**15,735**	43,001	17,722
	159,494	321,877	143,366
	$295,326	$567,759	$269,699

Revenue from export sales as a percentage of total revenue was approximately 54% for 2001, 57% for 2000 and 53% for fiscal period 1999. We expect export sales to continue to represent a significant portion of revenue.

The average selling price of our products was approximately flat in 2001 as compared to 2000, but increased in 2000 as compared to fiscal period 1999. The average selling price for our products decreased significantly in the second half of 2001 as a result of the significant downturn in the semiconductor and PLD markets. Other fluctuations in average selling price, including the overall increase in 2000, were due primarily to product mix changes and increased sales of high density products. Although selling prices of mature products generally decline over time, this decline is at times offset by higher selling prices of new products. Our ability to maintain or increase the level of our average selling price is dependent on the continued development, introduction and market acceptance of new products. See "Factors Affecting Future Results."

Gross Margin Our gross margin was 62% for 2001, 62% for 2000 and 60% for fiscal period 1999. Continued reductions in our overall manufacturing costs and improvements in our product mix generally offset an increased proportion of fixed manufacturing costs in 2001. Product mix in 2001 was favorably affected by a higher ratio of previously deferred income compared to income from direct customer sales. The gross margin improvement in 2000 was primarily due to reductions in our manufacturing costs and improvements in our product mix. Reductions in manufacturing costs resulted primarily from on-going yield improvements, migration of products to more advanced technologies and smaller die sizes.

Research and Development Research and development expense was $71.7 million for 2001, $77.1 million in 2000 and $45.9 million in fiscal period 1999. The decrease in 2001 when compared to 2000 was attributable to a decrease in discretionary spending, which more than offset headcount increases. In addition to our acquisition of Vantis, spending increases in 2000 were due to increased headcount and associated expenses related to development of new products. Additionally, 2000 was a twelve-month fiscal year, as opposed to our nine-month fiscal period 1999. We believe that a continued commitment to research and development is essential in order to maintain product leadership in our existing product families and provide innovative new product offerings, and therefore we expect to continue to make significant future investments in research and development.

Selling, General and Administrative Selling, general and administrative expense was $53.0 million in 2001, $81.1 million in 2000 and $50.7 million in fiscal period 1999. The decrease in 2001 when compared to 2000 was primarily due to lower variable costs associated with reduced revenue and profitability, reductions in discretionary spending and, to a lesser extent, the reversal in the third quarter of 2001 of $2.8 million of reserves established in the Vantis acquisition related to the now-settled Altera litigation (see note 11 to our Consolidated Financial Statements). Increased expenses in 2000 were primarily due to increased variable costs associated with higher revenue levels and our Vantis acquisition. Additionally, 2000 was a twelve-month fiscal period, as opposed to the nine-month fiscal period 1999.

In-Process Research and Development In-process research and development costs of approximately $89.0 million were incurred on June 15, 1999 in connection with our acquisition of Vantis (see note 4 to our Consolidated Financial Statements).

Amortization of Intangible Assets Amortization of intangible assets acquired in the Vantis acquisition and the acquisition of Integrated Intellectual Property, Inc. ("I2P") on March 16, 2001 was $84.3 million in 2001, $81.9 million in 2000 and $45.8 million for fiscal period 1999. The increase in amortization for 2001 as compared to 2000 was primarily due to the I2P acquisition. The increase in amortization for 2000 was primarily due to a full year of amortization in 2000 as opposed to the approximately 6.5 months included in fiscal period 1999. The estimated weighted average useful life of the intangible assets for current technology, assembled workforce, customer lists, trademarks, patents and residual goodwill, created as a result of the acquisition, is approximately five years.

(Loss) Gain on Foundry Investments The gain on foundry investments recorded in the first quarter of 2000 and the loss on foundry investments recorded in the third quarter of 2001 represent equity market appreciation and subsequent impairment loss on our UMC common shares (see note 5 to our Consolidated Financial Statements).

Interest Income Interest income was $17.7 million in 2001, $16.2 million in 2000, and $6.1 million in fiscal period 1999. The increase in 2001 when compared to 2000 was attributable to overall increased cash balances generated from our follow-on stock offering, completed in July 2000, which more than offset lower interest rates on invested balances in 2001. The 2000 interest income increase was due to our follow-on stock offering, cash generated from operations and stock option exercises. Additionally, 2000 was a twelve-month fiscal period as opposed to our nine-month fiscal period 1999.

Interest Expense Interest expense was approximately $14.0 million in both 2001 and 2000 and $9.7 million in fiscal period 1999. Substantially all interest expense resulted from the debt issued to partially fund our Vantis acquisition. The 2000 interest expense increase of 44% was due to the fact that acquisition-related debt was outstanding for all of 2000, but only for 6.5 months in fiscal period 1999.

(Benefit) Provision for Income Taxes The benefit for income taxes for 2001 results in an effective tax rate of (37.0%), as compared to 35.9% in 2000 and (37.6%) for fiscal period 1999. The tax benefit in 2001 is the result of the pretax loss reported in the period. The rate associated with the tax benefit in 2001 is higher than the provision rate in 2000 because of the proportional impact of our marginal tax rate applied to the unrealized gain in 2000 and subsequent impairment loss in 2001 related to our foundry investments (see note 5 to our Consolidated Financial Statements) in comparison to taxes on operating income and non-taxable investment income. The benefit for income taxes for fiscal period 1999 was attributable to the tax effect of the in-process research and development cost recognized in conjunction with our Vantis acquisition. The effective rate for all periods presented is lower than the combined federal and state statutory rates primarily because of tax-exempt investment income and tax credits.

Extraordinary Item, Net of Income Taxes The extraordinary item, net of income taxes, in fiscal period 1999 represents the writeoff of unamortized loan fees related to the early retirement of our credit facility in connection with the re-financing of our Vantis acquisition.

FACTORS AFFECTING FUTURE RESULTS

A downturn in the communications equipment or computing end markets will cause a reduction in demand for our products and limit our ability to maintain or increase our revenue and profit levels.

A significant portion of our revenue is derived from customers in the communications equipment and computing end markets. A downturn in the overall global economy or in the economies of the countries where we derive significant revenue could lead to a contraction of capital spending on information technology. This in turn could lead to a reduction in the demand for communications or computing equipment and for our products.

Due to a deterioration in overall economic conditions and a significant reduction in information technology capital spending, the communications and computing end markets declined in 2001 when compared to prior years. In addition, the abrupt transition from an environment of rapid growth to the current environment in these end equipment markets has resulted in an excess of component inventory within our end customers. At present and in the future when these or other similar conditions exist, there is likely to be an adverse effect on our operating results.

The cyclical nature of the semiconductor industry may limit our ability to maintain or increase revenue and profit levels during future industry downturns.

The semiconductor industry is highly cyclical, to a greater extent than other less dynamic or less technology-driven industries. Our financial performance has periodically been negatively affected by past downturns in the semiconductor industry. Factors that have contributed to these downturns include:

- the cyclical nature of the demand for the products of semiconductor customers;
- general reductions in inventory levels by customers;
- excess production capacity; and
- accelerated declines in average selling prices.

In 2001, the semiconductor industry experienced a significant downturn. At present and in the future when these or other similar conditions exist, there is likely to be an adverse effect on our operating results.

We may experience unexpected difficulties integrating the FPGA business we recently purchased from Agere Systems.

On January 18, 2002, we acquired the field programmable gate array ("FPGA") business of Agere Systems and are currently in the process of integrating this business with our operations. If our integration is unsuccessful, more difficult or more time consuming than originally planned, we may incur unexpected disruptions to our ongoing business. These disruptions could harm our operating results. Further, the following specific factors may adversely affect our ability to integrate the FPGA business of Agere:

- we may experience unexpected losses of key employees or customers;
- we may not be able to coordinate our new product and process development in a way which permits us to bring future new products to the market in a timely manner;
- we may experience unexpected costs and discover unexpected liabilities;
- we may not achieve expected levels of revenue growth, cost reduction and profitability improvement; and
- we may experience difficulties or delays in conforming the standards, processes, procedures and controls of our two businesses.

In addition, as part of our acquisition, we entered into agreements with Agere Systems to obtain certain manufacturing, intellectual property and transition support and services. In the event that Agere fails to provide this support and service, or provides such support and service at a level of quality and timeliness inconsistent with the historical delivery of such support and service, our ability to integrate the FPGA business will be hampered and our operating results may be harmed.

We may be unsuccessful in defining, developing or selling new products required to maintain or expand our business.

As a semiconductor company, we operate in a dynamic environment marked by rapid product obsolescence. Our future success depends on our ability to introduce new or improved products that meet customer needs while achieving acceptable margins. If we fail to introduce these new products in a timely manner or these products fail to achieve market acceptance, our operating results would be harmed.

The introduction of new products in a dynamic market environment presents significant business challenges. Product development commitments and expenditures must be made well in advance of product sales. The success of a new product depends on accurate forecasts of long-term market demand and future technology developments.

Our future revenue growth is dependent on market acceptance of our new product families and the continued market acceptance of our software development tools. The success of these products is dependent on a variety of specific technical factors including:

- successful product definition;
- timely and efficient completion of product design;
- timely and efficient implementation of wafer manufacturing and assembly processes;
- product performance; and
- the quality and reliability of the product.

If, due to these or other factors, our new products do not achieve market acceptance, our operating results would be harmed.

Our products may not be competitive if we are unsuccessful in migrating our manufacturing processes to more advanced technologies or alternative fabrication facilities.

To develop new products and maintain the competitiveness of existing products, we need to migrate to more advanced wafer manufacturing processes that use larger wafer sizes and smaller device geometries. We also may need to use additional foundries. Because we depend upon foundries to provide their facilities and support for our process technology development, we may experience delays in the availability of advanced wafer manufacturing process technologies at existing or new wafer fabrication facilities. As a result, volume production of our advanced process technologies at the new fabs of Seiko Epson, UMC or future foundries may not be achieved. This could harm our operating results.

In late 2001, UMC informed us that as part of an overall capacity rationalization they were planning to close certain of their fabrication facilities. We were developing an advanced wafer manufacturing process at one of the UMC fabs that has been closed. With UMC's support, we have transferred this process to alternative UMC fabs. However, transfer of a manufacturing process is a technically demanding and time intensive challenge. As a result, our new product introduction schedules have been delayed. This could harm our operating results.

Our marketable securities, which we hold for strategic reasons, are subject to equity price risk and their value may fluctuate.

Currently we hold substantial equity in UMC Corporation, which we acquired as part of a strategic investment to obtain certain manufacturing rights. The market price and valuation of these equity shares has fluctuated widely due to market and other conditions over which we have little control. During the quarter ended September 30, 2001, we recorded a $152.8 million pre-tax impairment loss related to this investment. In the future, UMC shares may continue to experience significant price volatility. We have not attempted to reduce or eliminate this equity price risk through hedging or similar techniques and hence substantial, sustained changes in the market price of UMC shares could impact our financial results. To the extent that the market value of our UMC shares experiences further deterioration for an extended period of time, our net income could be reduced.

Our future quarterly operating results may fluctuate and therefore may fail to meet expectations.

Our quarterly operating results have fluctuated and may continue to fluctuate. Consequently, our operating results may fail to meet the expectations of analysts and investors. As a result of industry conditions and the following specific factors, our quarterly operating results are more likely to fluctuate and are more difficult to predict than a typical non-technology company of our size and maturity:

- general economic conditions in the countries where we sell our products;
- conditions within the end markets into which we sell our products;
- the cyclical nature of demand for our customers' products;
- excessive inventory accumulation by our end customers;
- the timing of our and our competitors' new product introductions;
- product obsolescence;
- the scheduling, rescheduling and cancellation of large orders by our customers;
- our ability to develop new process technologies and achieve volume production at the new fabs of Seiko Epson, UMC or at other foundries;
- changes in manufacturing yields;
- adverse movements in exchange rates, interest rates or tax rates; and
- the availability of adequate supply commitments from our wafer foundries and assembly and test subcontractors.

As a result of these factors, our past financial results are not necessarily a good predictor of our future results.

Our stock price may continue to experience large short-term fluctuations.

In recent years, the price of our common stock has fluctuated greatly. These price fluctuations have been rapid and severe and have left investors little time to react. The price of our common stock may continue to fluctuate greatly in the future due to a variety of company specific factors, including:

- quarter-to-quarter variations in our operating results;
- shortfalls in revenue or earnings from levels expected by securities analysts; and
- announcements of technological innovations or new products by other companies.

Our wafer supply may be interrupted or reduced, which may result in a shortage of finished products available for sale.

We do not manufacture finished silicon wafers. Currently, our silicon wafers are manufactured by Seiko Epson in Japan, UMC in Taiwan, Chartered Semiconductor in Singapore, Agere Systems and AMD in the United States. If Seiko Epson, through its U.S. affiliate, Epson Electronics America, UMC or Chartered significantly interrupts or reduces our wafer supply, our operating results could be harmed.

In the past, we have experienced delays in obtaining wafers and in securing supply commitments from our foundries. At present, we anticipate that our supply commitments are adequate. However, these existing supply commitments may not be sufficient for us to satisfy customer demand in future periods. Additionally, notwithstanding our supply commitments we may still have difficulty in obtaining wafer deliveries consistent with the supply commitments. We negotiate wafer prices and supply commitments from our suppliers on at least an annual basis. If any of Seiko Epson, Epson Electronics America, UMC or Chartered were to reduce its supply commitment or increase its wafer prices, and we cannot find alternative sources of wafer supply, our operating results could be harmed.

Many other factors that could disrupt our wafer supply are beyond our control. Since worldwide manufacturing capacity for silicon wafers is limited and inelastic, we could be harmed by significant industry-wide increases in overall wafer demand or interruptions in wafer supply. Additionally, a future disruption of Seiko Epson's, UMC's or Chartered's foundry operations as a result of a fire, earthquake or other natural disaster could disrupt our wafer supply and could harm our operating results.

If our foundry partners experience quality or yield problems, we may face a shortage of finished products available for sale.

We depend on our foundries to deliver reliable silicon wafers with acceptable yields in a timely manner. As is common in our industry, we have experienced wafer yield problems and delivery delays. If our foundries are unable to produce silicon wafers that meet our specifications, with acceptable yields, for a prolonged period, our operating results could be harmed.

The majority of our revenue is derived from products based on a specialized silicon wafer manufacturing process technology called E^2CMOS. The reliable manufacture of high performance E^2CMOS semiconductor wafers is a complicated and technically demanding process requiring:

- a high degree of technical skill;
- state-of-the-art equipment;
- the absence of defects in the masks used to print circuits on a wafer;
- the elimination of minute impurities and errors in each step of the fabrication process; and
- effective cooperation between the wafer supplier and the circuit designer.

As a result, our foundries may experience difficulties in achieving acceptable quality and yield levels when manufacturing our silicon wafers.

If our assembly and test subcontractors experience quality or yield problems, we may face a shortage of finished products available for sale.

We rely on subcontractors to assemble and test our devices with acceptable quality and yield levels. As is common in our industry, we have experienced quality and yield problems in the past. If we experience prolonged quality or yield problems in the future, our operating results could be harmed.

The majority of our revenue is derived from semiconductor devices assembled in advanced packages. The assembly of advanced packages is a complex process requiring:

- a high degree of technical skill;
- state-of-the-art equipment;
- the absence of defects in lead frames used to attach semiconductor devices to the package;
- the elimination of raw material impurities and errors in each step of the process; and
- effective cooperation between the assembly subcontractor and the device manufacturer.

As a result, our subcontractors may experience difficulties in achieving acceptable quality and yield levels when assembling and testing our semiconductor devices.

Deterioration of conditions in Asia may disrupt our existing supply arrangements and result in a shortage of finished products available for sale.

All three of our major silicon wafer suppliers operate fabs located in Asia. Our finished silicon wafers are assembled and tested by independent subcontractors located in China, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand. A prolonged interruption in our supply from any of these subcontractors could harm our operating results.

Economic, financial, social and political conditions in Asia have historically been volatile. Financial difficulties, governmental actions or restrictions, prolonged work stoppages or any other difficulties experienced by our suppliers may disrupt our supply and could harm our operating results.

Our wafer purchases from Seiko Epson are denominated in Japanese yen. The value of the dollar with respect to the yen fluctuates. Substantial deterioration of dollar-yen exchange rates could harm our operating results.

Export sales account for a substantial portion of our revenues and may decline in the future due to economic and governmental uncertainties.

Our export sales are affected by unique risks frequently associated with foreign economies including:

- changes in local economic conditions;
- exchange rate volatility;
- governmental controls and trade restrictions;
- export license requirements and restrictions on the export of technology;
- political instability or terrorism;
- changes in tax rates, tariffs or freight rates;
- interruptions in air transportation; and
- difficulties in staffing and managing foreign sales offices.

For example, our export sales have historically been affected by regional economic crises. Significant changes in the economic climate in the foreign countries where we derive our export sales could harm our operating results.

We may not be able to successfully compete in the highly competitive semiconductor industry.

The semiconductor industry is intensely competitive and many of our direct and indirect competitors have substantially greater financial, technological, manufacturing, marketing and sales resources. If we are unable to compete successfully in this environment, our future results will be adversely affected.

The current level of competition in the programmable logic market is high and may increase as our market expands. We currently compete directly with companies that have licensed our products and technology or have developed similar products. We also compete indirectly with numerous semiconductor companies that offer products and solutions based on alternative technologies. These direct and indirect competitors are established multinational semiconductor companies as well as emerging companies. We also may experience significant competition from foreign companies in the future.

We may fail to retain or attract the specialized technical and management personnel required to successfully operate our business.

To a greater degree than most non-technology companies or larger technology companies, our future success depends on our ability to attract and retain highly qualified technical and management personnel. As a mid-sized company, we are particularly dependent on a relatively small group of key employees. Competition for skilled technical and management employees is intense within our industry. As a result, we may not be able to retain our existing key technical and management personnel. In addition, we may not be able to attract additional qualified employees in the future. If we are unable to retain existing key employees or are unable to hire new qualified employees, our operating results could be adversely affected.

If we are unable to adequately protect our intellectual property rights, our financial results and competitive position may suffer.

Our success depends in part on our proprietary technology. However, we may fail to adequately protect this technology. As a result, we may lose our competitive position or face significant expense to protect or enforce our intellectual property rights.

We intend to continue to protect our proprietary technology through patents, copyrights and trade secrets. Despite this intention, we may not be successful in achieving adequate protection. Claims allowed on any of our patents may not be sufficiently broad to protect our technology. Patents issued to us also may be challenged, invalidated or circumvented.

Finally, our competitors may develop similar technology independently.

Companies in the semiconductor industry vigorously pursue their intellectual property rights. If we become involved in protracted intellectual property disputes or litigation we may utilize substantial financial and management resources, which could have an adverse effect on our operating results.

We may also be subject to future intellectual property claims or judgments. If these were to occur, we may not be able to obtain a license on favorable terms or without our operating results being adversely affected.

CRITICAL ACCOUNTING POLICIES

On December 12, 2001 and again on February 13, 2002 the Securities and Exchange Commission proposed new corporate disclosure rules related to critical accounting policies. Critical Accounting Policies are those "that are both most important to the portrayal of a company's financial condition and results and require management's most difficult, subjective and complex judgements, often as a result of the need to make estimates about the effect of matters that are inherently uncertain." A description of our critical accounting policies follows.

Revenue Recognition Revenue from direct customers is recognized upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is probable, there are no customer acceptance requirements and no remaining significant obligations. Certain of our sales are made to distributors under agreements providing price protection and right of return on unsold merchandise. Revenue and costs relating to such distributor sales are deferred until the product is sold by the distributor and related revenue and costs are then reflected in income.

Deferred Income In determining the amount of deferred income related to sales to distributors, we make estimates regarding sales prices and margins to be earned by our distributors upon sales to our end customers.

Inventory and Inventory Valuation Allowances We value inventory at the lower of cost or market on a quarterly basis. In addition, we establish reserves for unproven, excess and obsolete inventories. To value our inventory, we make a number of estimates and assumptions including future price declines and forecasted demand for our products.

Accounting for Income Taxes To report income tax expense related to operating results, we record current and deferred income tax assets and liabilities in our balance sheet. In determining the value of our deferred tax assets, we make estimates of future taxable income. We believe that it is more likely than not that we will earn sufficient future taxable income to realize these deferred tax assets, and therefore, we do not provide for valuation allowances on our deferred tax assets.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the FASB issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes new accounting treatment for derivatives and hedging activities and supersedes and amends a number of existing accounting standards. We adopted this pronouncement in the first quarter of 2001; such adoption did not and has not had a material effect on the consolidated financial statements.

In June 2001, the FASB issued SFAS 142, "Goodwill and Other Intangible Assets," which supersedes APB Opinion No. 17, "Intangible Assets." SFAS 142, among other things, establishes new standards for intangible assets acquired in a business combination, eliminates amortization of goodwill and sets forth requirements to periodically evaluate goodwill for impairment. We will adopt this statement during the first quarter of 2002, at which time goodwill and certain intangibles with indefinite lives will no longer be amortized, eliminating approximately $8 million of existing quarterly amortization. Amortization expense for the fourth quarter of 2001 and for the year ended December 31, 2001 was approximately $21.3 million and $84.3 million, respectively. As of December 31, 2001, the consolidated balance sheet caption "Intangible Assets" included approximately $81.4 million of goodwill and $125.1 million of net other intangible assets. We will complete an initial goodwill impairment assessment in 2002 to determine if a transition impairment charge should be recognized under SFAS 142. We do not anticipate a material impairment charge upon the completion of the initial impairment review.

In October 2001, the FASB issued SFAS 144, "Accounting for the Disposal of Long-Lived Assets," which supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of." SFAS 144 retains the fundamental provisions of SFAS 121 regarding the recognition and measurement of the impairment of long-lived assets to be held and used and the measurement of long-lived assets to be disposed by sale, but provides additional definition and measurement criteria for determining when an impairment has occurred. Goodwill and financial assets are excluded from the scope of SFAS 144, however amortizable intangible assets fall within its scope. We do not expect this pronouncement to materially affect our financial statements when we adopt it during the first quarter of 2002.

ITEM 7(A) QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2001 and December 31, 2000 our investment portfolio consisted of fixed income securities of $508.2 million and $507.3 million, respectively. As with all fixed income instruments, these securities are subject to interest rate risk and will decline in value if market interest rates increase. If market rates were to increase immediately and uniformly by 10% from levels as of December 31, 2001 and December 31, 2000 the decline in the fair value of our portfolio would not be material. Further, we have the ability to hold our fixed income investments until maturity and, therefore, we would not expect to recognize such an adverse impact in our income or cash flows.

We have international subsidiary and branch operations. Additionally, a portion of our silicon wafer purchases are denominated in Japanese yen. We therefore are subject to foreign currency rate exposure. To mitigate rate exposure with respect to our yen-denominated wafer purchases, we maintain yen-denominated bank accounts and bill our Japanese customers in yen. The yen bank deposits are utilized to hedge specific and firm yen-denominated wafer purchases. If the foreign currency rates were to fluctuate by 10% from rates at December 31, 2001 and December 31, 2000, the effect on our consolidated financial statements would not be material. However, there can be no assurance that there will not be a material impact in the future.

We are exposed to equity price risk due to our equity investment in UMC (see note 5 to our Consolidated Financial Statements). Neither a 10% increase nor a further 10% decrease in equity price related to this investment would have a material effect on our consolidated financial statements. We have not attempted to reduce or eliminate this equity price risk through hedging or similar techniques and hence substantial, sustained changes in the market price of UMC shares could impact our financial results. To the extent that the market value of our UMC shares experiences further deterioration for an extended period of time, our net income could be reduced.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2001, our principal source of liquidity was $531.6 million of cash and short-term investments, a slight decrease from the balance of $535.4 million at December 31, 2000. Working capital increased to $617.2 million at December 31, 2001 from $552.2 million at December 31, 2000. This increase was primarily due to decreases in deferred income, accounts payable and accrued expenses which more than offset a decrease in our accounts receivable. These decreases were associated with the significant downturn in the semiconductor and PLD markets during 2001 and our lower revenue and operating expense levels. During 2001, we generated approximately $7.0 million of cash and cash equivalents from our operations compared with $114.3 million during 2000. This reduction in cash generation was driven primarily by reduced receipts from end customers and distributors in conjunction with lower revenue levels and reduced cash inflow from stock option exercises.

Accounts receivable at December 31, 2001 decreased by $30.2 million, or 61%, as compared to the balance at December 31, 2000. This decrease was primarily due to decreased billings and revenue levels during the year. Inventories increased by $5.4 million, or nine percent, as compared to the balance at December 31, 2000 primarily due to lower revenue levels and the continued receipt of wafers started in the last half of 2000. Wafer starts were significantly reduced throughout 2001 and inventory levels stabilized in the second half of 2001. Prepaid expenses and other current assets increased by approximately $5.5 million, or 24%, as compared to the balance at December 31, 2000. This increase is due primarily to estimated income taxes paid in the first quarter of 2001 which are now refundable as a result of the pretax loss recorded in the second through fourth quarters of 2001. Current deferred tax assets decreased by approximately $17.5 million, or 36%, as compared to the balance at December 31, 2000. This was primarily due to the decrease in deferred income on sales to distributors (which is recognized currently for income tax purposes), and to a lesser extent the timing of deductions for certain expenses and allowances. Foundry investments, advances and other assets decreased by approximately $27.0 million, or 14% as compared to the balance at December 31, 2000. This decrease was primarily due to market value depreciation of our investment in UMC (see note 5 to our

Consolidated Financial Statements). Net intangible assets decreased by $79.9 million, or 28% as compared to the balance at December 31, 2000, primarily due to amortization of goodwill and other intangibles, partially offset by new intangible assets acquired during the period which are being amortized over four years. Amortization expense for these new assets totaled approximately $1.4 million, including $0.4 million of deferred compensation expense. The increase in non-current deferred income taxes of $31.0 million, or 89%, at December 31, 2001 as compared to December 31, 2000 is due primarily to a reduction of the deferred tax liability originally recorded on January 3, 2000 in conjunction with the gain recognized on the appreciation of our UMC shares (see note 7 to our Consolidated Financial Statements). The balance of this deferred tax liability of $27.9 million at December 31, 2000, was netted against non-current deferred income tax assets in our consolidated balance sheet. This liability was eliminated in the third quarter of 2001 as our impairment loss recognized in the third quarter of 2001 on the UMC shares was slightly in excess of the original gain recorded. In conjunction with the subsequent market appreciation of the UMC shares in the fourth quarter of 2001, a deferred tax liability of $13.3 million was recorded. The increase in non-current deferred taxes is also due, to a lesser extent, to the net tax effect of intangible asset amortization.

Accounts payable and accrued expenses at December 31, 2001 decreased by $54.0 million, or 73%, as compared to the balance at December 31, 2000. This decrease is due primarily to decreased wafer purchases and contracted assembly activities in response to decreased customer demand and revenue levels. The $6.7 million, or 71% decrease in income taxes payable at December 31, 2001 as compared to the balance at December 31, 2000 is primarily attributable to the net loss recorded in 2001 and to the timing of tax deductions and payments. Deferred income at December 31, 2001 decreased by $40.1 million, or 69%, as compared to the balance at December 31, 2000, due primarily to decreased billings to distributors associated with decreased shipments and lower revenue levels.

On October 28, 1999, we issued $260 million in 4¾% convertible subordinated notes due on November 1, 2006. These notes require that we pay interest semi-annually on May 1 and November 1. Holders of these notes may convert them into shares of our common stock at any time on or before November 1, 2006, at a conversion price of $20.72 per share, subject to adjustment in certain events. Beginning on November 6, 2002 and ending on October 31, 2003, we may redeem the notes in whole or in part at a redemption price of 102.71% of the principal amount. In the subsequent three twelve-month periods, the redemption price declines to 102.04%, 101.36% and 100.68% of principal, respectively. The notes are subordinated in right of payment to all of our senior indebtedness, and are subordinated to all liabilities of our subsidiaries. At December 31, 2001, we had no senior indebtedness and our subsidiaries had $2.5 million of other liabilities. Issuance costs relative to the convertible subordinated notes are included in Other Assets and aggregated approximately $6.9 million and are being amortized to expense over the life of the notes. Accumulated amortization amounted to approximately $3.6 million at December 31, 2001.

On June 15, 1999, we entered into a credit agreement with a group of lenders and ABN AMRO Bank N.V. as administrative agent for the lender group. The credit agreement consisted of two credit facilities: a $60 million unsecured revolving credit facility ("Revolver"), and a $220 million unsecured reducing term loan ("Term Loan"), both expiring and due on June 30, 2002. On June 15, 1999, we borrowed $220 million under the Term Loan and approximately $33 million under the Revolver. The $33 million Revolver was repaid in full during the third calendar quarter of 1999. In conjunction with the issuance of the convertible subordinated notes, we repaid the $220 million Term Loan in full during the fourth calendar quarter of fiscal 1999. Remaining unamortized loan fees at the time of repayment, aggregating approximately $2.6 million ($1.665 million net of income taxes or a charge of $0.02 for basic and diluted earnings per share), were written off and are reflected in our Consolidated Statement of Operations as an Extraordinary Item, Net of Income Taxes.

We do not have any financial partnerships with unconsolidated entities, such as entities often referred to as structured finance or special purpose entities, which are often established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had such relationships.

Capital expenditures were approximately $13.8 million, $25.9 million and $15.7 million for 2001, 2000 and fiscal period 1999, respectively. We expect to spend approximately $15 million to $20 million for the fiscal year ending December 31, 2002.

Certain of our facilities and equipment are leased under operating leases, which expire at various times through 2008. Rental expense under the operating leases was approximately $5.1 million, $5.5 million and $2.8 million for 2001, 2000, and fiscal period 1999, respectively. Future minimum lease commitments at December 31, 2001 are as follows:

YEAR	(IN THOUSANDS)
2002	$ 7,418
2003	6,903
2004	6,509
2005	5,903
2006	4,628
Later years	8,111
	$ 39,472

Included in these amounts are certain properties which are currently subleased. A portion of this sublease income is payable to the property owner. Future minimum sublease receipts, based on agreements in place at December 31, 2001, net of such payments are as follows:

YEAR	(IN THOUSANDS)
2002	$ 2,623
2003	2,473
2004	2,555
2005	2,622
2006	886
	$ 11,159

We currently own approximately 84 million shares of UMC common stock. Restrictions by UMC and the Taiwan government apply to approximately 28% of these shares. If we liquidate our UMC shares, it is likely that the amount of any future realized gain or loss will be different from the accounting gain or loss reported in prior periods.

In December 2000, our Board of Directors authorized management to repurchase up to five million shares of our common stock. As of December 31, 2001, we had repurchased 1,136,000 shares (596,000 in 2001) at an aggregate cost of approximately $20.0 million ($10.6 million in 2001).

In March 1997, and as subsequently amended in January 2002, we entered into an advance payment production agreement with Seiko Epson and Epson Electronics America, Inc. ("EEA") under which we agreed to advance approximately $69 million, payable upon completion of specific milestones, to Seiko Epson to finance construction of an eight-inch sub-micron semiconductor wafer manufacturing facility. Under the terms of the agreement, the advance is to be repaid with semiconductor wafers over a multi-year period. No interest income is recorded. The agreement calls for wafers to be supplied by Seiko Epson through EEA pursuant to purchase agreements with EEA. Payments of approximately $51.2 million have been made under this agreement. Approximately $3.4 million of these advances are expected to be repaid with semiconductor wafers during fiscal year 2002 and are thus reflected as part of "Prepaid expenses and other current assets" in our accompanying Consolidated Balance Sheet.

On December 10, 2001, we announced a definitive agreement to acquire the FPGA business of Agere Systems, Inc. for $250 million in cash. This acquisition was completed on January 18, 2002 and financed with cash on hand. The transaction will be accounted for as a purchase.

The acquisition includes a general purpose ORCA® FPGA product portfolio, a field programmable system chip (FPSC) product portfolio and all related software design tools. In addition, we acquired certain intellectual property cores and patents unique to Agere's FPGA business and entered into a cross-license agreement with Agere covering certain FPGA and FPSC patents, intellectual property and technology. As part of the transaction, we also hired approximately 100 Agere product development, marketing and technical sales employees.

The $250 million purchase price, associated costs and assumed liabilities are tax deductible (over 15 years for substantially all of the sum). Management, with the assistance of a third party valuation of intangible assets, attributed $65 million to purchased technology, $24 million to in-process research and development costs, and $24 million to a non-compete agreement and to licensed technology. Value attributed to acquired tangible assets and assumed liabilities is not material to our financial statements. Goodwill is the difference between a) the sum of the purchase price, associated costs and assumed liabilities, and b) the fair value of acquired assets. Purchased and licensed (non-goodwill) intangible assets will be amortized over approximately 7 years on a straight line basis except in-process research and development costs which will be charged to operations in the March 2002 quarter.

We believe that our existing liquid resources, expected cash generated from operations and existing credit facilities combined with our ability to borrow additional funds will be adequate to meet our operating and capital requirements and obligations for the next 12 months, including our recent acquisition of the Agere FPGA business.

We may in the future seek new or additional sources of funding. In addition, in order to secure additional wafer supply, we may from time to time consider various financial arrangements including joint ventures, equity investments, advance purchase payments, loans, or similar arrangements with independent wafer manufacturers in exchange for committed wafer capacity. To the extent that we pursue any such additional financing arrangements, additional debt or equity financing may be required. There can be no assurance that such additional financing will be available when needed or, if available, will be on favorable terms. Any future equity financing will decrease existing stockholders' equity percentage ownership and may, depending on the price at which the equity is sold, result in dilution.

SELECTED FINANCIAL DATA

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED DECEMBER 31, 2001	YEAR ENDED DECEMBER 31, 2000	NINE MONTHS ENDED DECEMBER 31, 1999	YEAR ENDED MARCH 31, 1999	YEAR ENDED MARCH 31, 1998
STATEMENT OF OPERATIONS DATA:					
Revenue	**$ 295,326**	$ 567,759	$269,699	$200,072	$245,894
Costs and expenses:					
Cost of products sold	**111,498**	217,830	108,687	78,440	98,883
Research and development	**71,679**	77,057	45,903	33,190	32,012
Selling, general and administrative	**53,027**	81,082	50,676	36,818	39,934
In-process research and development	**—**	—	89,003	—	—
Amortization of intangible assets[1]	**84,349**	81,873	45,780	—	—
	320,553	457,842	340,049	148,448	170,829
(Loss) income from operations	**(25,227)**	109,917	(70,350)	51,624	75,065
(Loss) gain on foundry investments	**(152,795)**	149,960	—	—	—
Interest and other income (expense), net	**4,056**	2,194	(4,120)	10,668	10,643
(Loss) income before (benefit) provision for income taxes	**(173,966)**	262,071	(74,470)	62,292	85,708
(Benefit) provision for income taxes	**(64,447)**	94,184	(27,989)	20,246	29,141
(Loss) income before extraordinary item	**(109,519)**	167,887	(46,481)	42,046	56,567
Extraordinary item, net of income taxes	**—**	—	(1,665)	—	—
Net (loss) income	**$ (109,519)**	$ 167,887	$ (48,146)	$ 42,046	$ 56,567
Basic (loss) income per share, before extraordinary item	**$ (1.01)**	$ 1.65	$ (0.49)	$ 0.45	$ 0.61
Diluted (loss) income per share, before extraordinary item	**$ (1.01)**	$ 1.47	$ (0.49)	$ 0.44	$ 0.59
Basic net (loss) income per share	**$ (1.01)**	$ 1.65	$ (0.50)	$ 0.45	$ 0.61
Diluted net (loss) income per share	**$ (1.01)**	$ 1.47	$ (0.50)	$ 0.44	$ 0.59
Shares used in per share calculations:					
Basic	**108,814**	101,716	95,428	93,948	92,956
Diluted	**108,814**	120,321	95,428	95,276	95,576
BALANCE SHEET DATA:					
Cash and short-term investments	**$ 531,566**	$ 535,408	$214,140	$319,434	$267,110
Total assets	**1,173,980**	1,295,884	916,155	540,896	489,066
Stockholders' equity	**839,770**	855,655	482,773	483,734	434,686

[1] Includes $397 of amortization of deferred stock compensation expense for the year ended December 31, 2001 attributable to Research and Development activities.

	2001 DECEMBER	2001 SEPTEMBER	2001 JUNE	2001 MARCH	2000 DECEMBER	2000 SEPTEMBER	2000 JUNE	2000 MARCH
UNAUDITED QUARTERLY DATA:								
Revenue	**$ 52,108**	**$ 58,038**	**$ 74,082**	**$111,098**	$150,788	$151,038	$139,878	$126,055
Gross profit	**$ 32,286**	**$ 36,043**	**$ 46,311**	**$ 69,188**	$ 93,618	$ 93,601	$ 86,240	$ 76,470
Net (loss) income	**$(12,517)**	**$(104,601)**	**$ (3,677)**	**$ 11,276**	$ 23,623	$ 22,701	$ 16,742	$104,821
Basic net (loss) income per share	**$ (0.11)**	**$ (0.96)**	**$ (0.03)**	**$ 0.10**	$ 0.22	$ 0.22	$ 0.17	$ 1.08
Diluted net (loss) income per share	**$ (0.11)**	**$ (0.96)**	**$ (0.03)**	**$ 0.10**	$ 0.21	$ 0.21	$ 0.16	$ 0.92

All share and per share amounts have been adjusted retroactively to reflect two-for-one stock splits effected in the form of stock dividends paid on October 11, 2000 and September 16, 1999.

(IN THOUSANDS, EXCEPT SHARE AND PAR VALUE AMOUNTS)	**DECEMBER 31, 2001** (note 1)	DECEMBER 31, 2000
Assets		
Current assets:		
Cash and cash equivalents	**$ 250,203**	$ 235,900
Short-term investments	**281,363**	299,508
Accounts receivable, net	**19,452**	49,688
Inventories (note 2)	**64,926**	59,493
Prepaid expenses and other current assets	**28,747**	23,249
Deferred income taxes (note 7)	**31,591**	49,093
Total current assets	**676,282**	716,931
Foundry investments, advances and other assets (note 5)	**162,418**	189,407
Property and equipment, less accumulated depreciation (note 3)	**63,222**	68,554
Intangible assets, less accumulated amortization of $212,002 and $127,653 (note 4)	**206,468**	286,358
Deferred income taxes (note 7)	**65,590**	34,634
	$1,173,980	$1,295,884
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	**$ 20,201**	$ 74,160
Accrued payroll obligations	**18,054**	22,876
Income taxes payable (note 7)	**2,751**	9,484
Deferred income	**18,103**	58,184
Total current liabilities	**59,109**	164,704
$4\frac{3}{4}$% Convertible notes due in 2006 (note 8)	**260,000**	260,000
Other long-term liabilities	**15,101**	15,525
Commitments and contingencies (notes 5, 6, 10 and 11)	**—**	—
Stockholders' equity (note 9):		
Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued and outstanding	**—**	—
Common stock, $.01 par value, 300,000,000 shares authorized; 109,428,061 and 107,533,379 shares issued and outstanding	**1,094**	1,075
Paid-in capital	**548,053**	522,492
Deferred stock compensation	**(2,739)**	—
Other comprehensive income (loss)	**22,932**	(47,861)
Retained earnings	**270,430**	379,949
	839,770	855,655
	$1,173,980	$1,295,884

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)	**YEAR ENDED DECEMBER 31, 2001**	YEAR ENDED DECEMBER 31, 2000	NINE MONTHS ENDED DECEMBER 31, 1999
Revenue (note 13)	**$ 295,326**	$567,759	$269,699
Costs and expenses:			
Cost of products sold	**111,498**	217,830	108,687
Research and development	**71,679**	77,057	45,903
Selling, general and administrative (note 12)	**53,027**	81,082	50,676
In-process research and development (note 4)	**—**	—	89,003
Amortization of intangible assets [1] (note 4)	**84,349**	81,873	45,780
	320,553	457,842	340,049
(Loss) income from operations	**(25,227)**	109,917	(70,350)
Other (expense) income, net:			
Interest income	**17,733**	16,202	6,057
Interest expense (note 8)	**(13,962)**	(14,036)	(9,732)
(Loss) gain on foundry investments (note 5)	**(152,795)**	149,960	—
Other income (expense), net	**285**	28	(445)
	(148,739)	152,154	(4,120)
(Loss) income before (benefit) provision for income taxes	**(173,966)**	262,071	(74,470)
(Benefit) provision for income taxes (note 7)	**(64,447)**	94,184	(27,989)
(Loss) income before extraordinary item	**(109,519)**	167,887	(46,481)
Extraordinary item, net of income taxes (note 8)	**—**	—	(1,665)
Net (loss) income	**$(109,519)**	$167,887	$ (48,146)
Basic (loss) income per share, before extraordinary item	**$ (1.01)**	$ 1.65	$ (0.49)
Diluted (loss) income per share, before extraordinary item	**$ (1.01)**	$ 1.47	$ (0.49)
Basic net (loss) income per share	**$ (1.01)**	$ 1.65	$ (0.50)
Diluted net (loss) income per share	**$ (1.01)**	$ 1.47	$ (0.50)
Shares used in per share calculations:			
Basic	**108,814**	101,716	95,428
Diluted	**108,814**	120,321	95,428

[1] Includes $397 of amortization of deferred stock compensation expense for the year ended December 31, 2001 attributable to Research and Development activities.

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(IN THOUSANDS, EXCEPT PAR VALUE)	COMMON STOCK ($.01 PAR VALUE) SHARES	AMOUNT	PAID-IN CAPITAL	DEFERRED STOCK COMPEN-SATION	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	RETAINED EARNINGS	TOTAL
Balances, March 31, 1999	94,388	$ 944	$222,582	$ —	$ —	$260,208	$483,734
Common stock issued	2,183	22	14,187	—	—	—	14,209
Fair value of options issued to Vantis employees	—	—	23,982	—	—	—	23,982
Tax benefit of option exercises	—	—	8,937	—	—	—	8,937
Other	—	—	57	—	—	—	57
Net loss for fiscal period 1999	—	—	—	—	—	(48,146)	—
Total comprehensive loss	—	—	—	—	—	—	(48,146)
Balances, December 31, 1999	96,571	966	269,745	—	—	212,062	482,773
Common stock issued	11,502	114	237,266	—	—	—	237,380
Repurchase of common stock	(540)	(5)	(9,375)	—	—	—	(9,380)
Tax benefit of option exercises	—	—	24,856	—	—	—	24,856
Unrealized loss on foundry investments (net of tax of $30.0 million — note 5)	—	—	—	—	(47,861)	—	—
Net income for 2000	—	—	—	—	—	167,887	—
Total comprehensive income	—	—	—	—	—	—	120,026
Balances, December 31, 2000	107,533	1,075	522,492	—	(47,861)	379,949	855,655
Common stock issued	2,491	25	20,491	—	—	—	20,516
Repurchase of common stock	(596)	(6)	(10,608)	—	—	—	(10,614)
Tax benefit of option exercises	—	—	12,542	—	—	—	12,542
Impairment loss on foundry investments (note 5)	—	—	—	—	47,861	—	—
Unrealized gain on foundry investments (net of tax of $13.3 million — note 5)	—	—	—	—	24,106	—	—
Deferred stock compensation	—	—	3,136	(3,136)	—	—	—
Amortization of deferred stock compensation	—	—	—	397	—	—	397
Translation adjustments	—	—	—	—	(1,174)	—	—
Net loss for 2001	—	—	—	—	—	(109,519)	—
Total comprehensive loss	—	—	—	—	—	—	(38,726)
Balances, December 31, 2001	**109,428**	**$1,094**	**$548,053**	**$(2,739)**	**$22,932**	**$270,430**	**$839,770**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF CASH FLOWS

(IN THOUSANDS)	**YEAR ENDED DECEMBER 31, 2001**	YEAR ENDED DECEMBER 31, 2000	NINE MONTHS ENDED DECEMBER 31, 1999
Cash flow from operating activities:			
Net (loss) income	**$(109,519)**	$ 167,887	$ (48,146)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	**106,539**	102,213	57,842
Loss (gain) on value of foundry investments	**152,795**	(149,960)	—
In-process research and development costs	**—**	—	89,003
Tax benefit of option exercises	**12,542**	24,856	8,937
Extraordinary item, net of income taxes	**—**	—	(1,665)
Changes in assets and liabilities (net of purchase accounting adjustments):			
Accounts receivable	**30,236**	(16,012)	(5,206)
Inventories	**(5,433)**	(33,457)	(884)
Prepaid expenses and other current assets	**(7,327)**	(2,842)	(387)
Deferred income taxes	**(55,369)**	15,092	(53,011)
Foundry investments, advances and other assets	**(11,478)**	(359)	769
Accounts payable and accrued expenses	**(53,959)**	(10,515)	2,054
Accrued payroll obligations	**(4,822)**	3,970	443
Income taxes payable	**(6,733)**	(2,975)	7,474
Deferred income	**(40,081)**	12,996	25,195
Other liabilities	**(424)**	3,371	7,443
Net cash provided by operating activities	**6,967**	114,265	89,861
Cash flow from investing activities:			
Proceeds from (purchase of) short-term investments, net	**18,145**	(199,192)	139,817
Acquisition of Vantis Corporation, net of cash acquired	**—**	—	(439,258)
Other acquisition costs	**(2,233)**	—	—
Intangible assets	**(5,189)**	4,886	—
Foundry investments	**—**	—	(4,593)
Capital expenditures	**(13,751)**	(25,883)	(15,675)
Net cash used by investing activities	**(3,028)**	(220,189)	(319,709)
Cash flow from financing activities:			
Proceeds from bank borrowings and convertible notes	**—**	—	513,000
Payments on bank borrowings	**—**	—	(253,000)
Debt issuance costs	**—**	—	(9,895)
Repurchase of common stock	**(10,614)**	(9,380)	—
Net proceeds from issuance of common stock	**20,978**	237,380	14,266
Net cash provided by financing activities	**10,364**	228,000	264,371
Net increase in cash and cash equivalents	**14,303**	122,076	34,523
Beginning cash and cash equivalents	**235,900**	113,824	79,301
Ending cash and cash equivalents	**$ 250,203**	$ 235,900	$ 113,824
Supplemental disclosure of non-cash investing and financing activities:			
Fair value of options issued to Vantis employees (note 4)	$ —	$ —	$ 23,982
Unrealized gain (loss) on appreciation of foundry investments included in other comprehensive income (loss)	$ 24,106	$ (47,861)	$ —

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES:

Nature of Operations Lattice Semiconductor Corporation designs, develops and markets high performance programmable logic devices, or PLDs, and related software. Programmable logic devices are widely-used semiconductor components that can be configured by the end customer as specific logic circuits, and enable the end customer to shorten design cycle times and reduce development costs. Our end customers are primarily original equipment manufacturers in the communications, computing, industrial, military and consumer end markets.

Fiscal Reporting Period We report based on a 52 or 53 week year ending on the Saturday closest to December 31. For ease of presentation, we have adopted the convention of using March 31, June 30, September 30 and December 31 as period end dates for all financial statement captions. In the fourth quarter of 1999, we changed our fiscal year end from March 31 to December 31. The nine month fiscal period ended January 1, 2000 is referred to as "the nine months ended December 31, 1999" or "fiscal period 1999."

Principles of Consolidation On June 15, 1999, we completed the acquisition of all of the outstanding capital stock of Vantis Corporation ("Vantis") from Advanced Micro Devices, Inc. ("AMD"). The transaction was accounted for as a purchase, and accordingly, the results of operations of Vantis and estimated fair value of assets acquired and liabilities assumed were included in our consolidated financial statements beginning June 16, 1999 (see note 4). The accompanying consolidated financial statements include the accounts of Lattice Semiconductor Corporation and its subsidiaries, all wholly-owned, after the elimination of all significant intercompany balances and transactions.

Cash Equivalents and Short-Term Investments We consider all highly liquid investments, which are readily convertible into cash and have original maturities of three months or less, to be cash equivalents. Short-term investments, which are relatively less liquid and have maturities of less than one year, were composed of corporate auction preferred stocks ($160.0 million), municipal and local government obligations ($102.1 million), and time deposits ($19.2 million) at December 31, 2001.

We account for our short-term investments as held-to-maturity, and state them at amortized cost with corresponding premiums or discounts amortized over the life of the investment as interest income. Amortized cost approximated fair value at December 31, 2001.

Financial Instruments The carrying value of our financial instruments approximates fair value except the restricted portion of our foundry investment in Taiwan, which is carried at cost (see note 5). We estimate the fair value of cash and cash equivalents, short-term investments, accounts receivable, other current assets and current liabilities based upon existing interest rates related to such assets and liabilities compared to the current market rates of interest for instruments of similar nature and degree of risk.

Derivative Financial Instruments As of December 31, 2001, 2000 and 1999 and for the fiscal periods then ended, we had no outstanding derivatives, including foreign exchange contracts for the purchase or sale of foreign currencies. We do not enter into derivative financial instruments for trading purposes.

Foreign Exchange A portion of our silicon wafer purchases are denominated in Japanese yen. We maintain yen-denominated bank accounts and bill our Japanese customers in yen. The yen bank deposits utilized to hedge yen-denominated wafer purchases are accounted for as identifiable hedges against specific and firm wafer purchases. Gains or losses from foreign exchange rate fluctuations on unhedged balances denominated in foreign currencies are reflected in Other Income. Realized and unrealized gains or losses were not significant for the fiscal periods presented.

Concentrations of Credit Risk Financial instruments which potentially expose us to concentrations of credit risk consist primarily of short-term investments and trade receivables. We place our investments through several financial institutions and mitigate the concentration of credit risk by placing percentage limits on the maximum portion of the investment portfolio which may be invested in any one investment instrument. Investments consist primarily of A1 and P1 or better rated U.S. commercial paper, U.S. government agency obligations and other money market instruments, "AA" or better rated municipal obligations, money market preferred stocks and other time deposits. Concentrations of credit risk with respect to trade receivables are mitigated by a geographically diverse customer base and our credit and collection process. Accounts receivable are shown net of allowances for doubtful accounts of $1,475,000 and $1,700,000 at December 31, 2001 and 2000, respectively. We perform credit evaluations for all customers and secure transactions with letters of credit or advance payments where necessary. Write-offs for uncollected trade receivables have not been significant to date.

Revenue Recognition Revenue from direct customers is recognized upon shipment provided that persuasive evidence of a sales arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is probable, there are no customer acceptance requirements and no remaining significant obligations. Certain of our sales are made to distributors under agreements providing price protection and right of return on unsold merchandise. Revenue and cost relating to such distributor sales are deferred until the product is sold by the distributor and related revenue and costs are then reflected in income.

Inventories and Inventory Valuation Allowances Inventories are stated at the lower of first-in, first-out cost or market on a quarterly basis. In addition, we establish reserves for unproven, excess and obsolete inventories.

Long-Lived Assets We account for our long-lived assets, primarily Property and equipment and Intangible assets, in accordance with Statement of Financial Accounting Standards No. 121 (SFAS 121), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," which requires us to review the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is measured by comparing the estimated undiscounted cash flows to the carrying amount. A loss is recorded if the carrying amount of the asset exceeds the estimated undiscounted cash flows.

Property and Equipment Property and equipment are stated at cost. Depreciation is computed using the straight-line method for financial reporting purposes over the estimated useful lives of the related assets, generally three to five years for equipment and software and thirty years for buildings. Accelerated methods of computing depreciation are generally used for income tax purposes.

Intangible Assets Intangible assets consist of goodwill and other intangibles related to our acquisition of Vantis Corporation (see note 4) and the acquisition of Integrated Intellectual Property, Inc. ("I2P") on March 16, 2001. These assets are generally being amortized over five years, and fifteen years for income tax purposes, on a straight-line basis. The undiscounted cash flows method is used to assess the carrying value of goodwill (see note 5 and *New Accounting Pronouncements* in this footnote).

Translation of Foreign Currencies We translate accounts denominated in foreign currencies in accordance with SFAS 52, "Foreign Currency Translation." Translation adjustments related to the consolidation of foreign subsidiary financial statements are reflected in other comprehensive income (loss) in Stockholders' Equity. Foreign currency transaction gains and losses, which were insignificant for the fiscal periods presented, are included in other income.

Research and Development Research and development costs are expensed as incurred.

Stock-Based Compensation We account for our employee and director stock options and employee stock purchase plan in accordance with provisions of Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." Additional pro forma disclosures as required under SFAS 123, "Accounting for Stock-Based Compensation," are presented in note 9. Pursuant to FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Based Compensation — an interpretation of APB Opinion No. 25," effective July 1, 2000, the "in-the-money" portion of stock options granted to employees in connection with acquisitions is accounted for as Deferred stock compensation in Stockholders' Equity and amortized to operations over the vesting periods of the options.

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

The most significant difference between basic and diluted net income per share is that basic net income per share does not treat potentially dilutive securities such as convertible subordinated notes, options and warrants as outstanding. Diluted loss per common share for 2001 and fiscal period 1999 is based only on the weighted average number of common shares outstanding during these periods, as the inclusion of options, warrants and convertible subordinated notes would have been antidilutive. For 2000, diluted weighted-average shares outstanding include the effect of stock options, warrants and approximately 12.5 million shares issuable on the assumed conversion of our $260 million of convertible subordinated notes (see note 8). For 2000, diluted net income per share is adjusted to exclude interest expense and debt issuance cost amortization (net of tax) of approximately $8.3 million and $1.2 million, respectively. A reconciliation of the numerators and denominators of basic and diluted net income per share is presented below:

(IN THOUSANDS, EXCEPT FOR PER SHARE DATA)	**YEAR ENDED DEC. 31, 2001**	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
Basic and diluted net (loss) income	**$(109,519)**	$167,887	$(48,146)
Shares used in basic net income per share calculations	**108,814**	101,716	95,428
Dilutive effect of stock options, warrants and convertible notes	**—**	18,605	—
Shares used in diluted net income per share calculations	**108,814**	120,321	95,428
Basic net (loss) income per share	**$ (1.01)**	$ 1.65	$ (0.50)
Diluted net (loss) income per share	**$ (1.01)**	$ 1.47	$ (0.50)

On August 31, 2000 our Board of Directors approved a two-for-one stock split of our common stock to be effected in the form of a stock dividend of one share of common stock for each share of our outstanding common stock. This dividend was paid on October 11, 2000 to stockholders of record on September 20, 2000. On August 11, 1999 our Board of Directors approved a two-for-one stock split of our common stock to be effected in the form of a stock dividend of one share of common stock for each share of our outstanding common stock. All share and per share amounts presented in the accompanying consolidated financial statements and notes thereto have been adjusted retroactively to reflect these two-for-one splits.

In July 2000, we completed a follow-on public stock offering, consisting of 8,000,000 shares of our common stock at a price of $27.44 per share. Our net proceeds were approximately $210 million after deducting underwriting discounts and offering expenses.

Comprehensive Income (Loss) Comprehensive income (loss) approximated net income (loss) for fiscal period 1999. For 2000, comprehensive income consists primarily of net income of $167.9 million and an unrealized loss on depreciation of unrestricted foundry investments (net of tax) of approximately $47.9 million (see note 5). For 2001, comprehensive income consists primarily of net loss of $109.5 million offset by an unrealized gain recorded related to the market value appreciation of our unrestricted foundry investments (net of tax) of approximately $72.0 million (see note 5).

Statement of Cash Flows Income taxes paid approximated $7.3 million, $55.9 million and $10.1 million in 2001, 2000, and fiscal period 1999, respectively. Interest paid aggregated approximately $12.4 million, $12.3 million and $6.9 million in 2001, 2000, and fiscal period 1999, respectively.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, such as accounts receivable, inventory and deferred income taxes and liabilities, such as accrued liabilities, income taxes and deferred income, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the fiscal periods presented. Actual results could differ from those estimates.

New Accounting Pronouncements In June 1998, the FASB issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes new accounting treatment for derivatives and hedging activities and supersedes and amends a number of existing accounting standards. We adopted this pronouncement in the first quarter of 2001; such adoption did not and has not had a material effect on the consolidated financial statements.

In June 2001, the FASB issued SFAS 142, "Goodwill and Other Intangible Assets," which supersedes APB Opinion No. 17, "Intangible Assets." SFAS 142, among other things, establishes new standards for intangible assets acquired in a business combination, eliminates amortization of goodwill and sets forth requirements to periodically evaluate goodwill for impairment. We will adopt this statement during the first quarter of 2002, at which time goodwill and certain intangibles with indefinite lives will no longer be amortized, eliminating approximately $8 million of existing quarterly amortization. Amortization expense for the fourth quarter of 2001 and for the year ended December 31, 2001 was approximately $21.3 million and $84.3 million, respectively. As of December 31, 2001, the consolidated balance sheet caption "Intangible Assets" included approximately $81.4 million of goodwill and $125.1 million of other intangible assets. We will complete an initial goodwill impairment assessment in 2002 to determine if a transition impairment charge should be recognized under SFAS 142. We do not anticipate a material impairment charge upon the completion of the initial impairment review.

In October 2001, the FASB issued SFAS 144, "Accounting for the Disposal of Long-Lived Assets," which supersedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of." SFAS 144 retains the fundamental provisions of SFAS 121 regarding the recognition and measurement of the impairment of long-lived assets to be held and used and the measurement of long-lived assets to be disposed by sale, but provides additional definition and measurement criteria for determining when an impairment has occurred. Goodwill and financial assets are excluded from the scope of SFAS 144, however, amortizable intangible assets fall within its scope. We do not expect this pronouncement to materially affect our financial statements when we adopt it during the first quarter of 2002.

Financial presentation Reclassifications of prior year balances included in our consolidated financial statements have been made to conform to the 2001 presentation. Such reclassifications had no effect on the results of operations or on Stockholders' Equity.

NOTE 2. INVENTORIES

(IN THOUSANDS)	DECEMBER 31, 2001	2000
Work in progress	**$ 44,460**	$ 37,718
Finished goods	**20,466**	21,775
	$ 64,926	$ 59,493

NOTE 3. PROPERTY AND EQUIPMENT

(IN THOUSANDS)	DECEMBER 31, 2001	2000
Land	**$ 2,099**	$ 2,099
Buildings	**24,703**	24,703
Computer and test equipment	**109,606**	103,454
Office furniture and equipment	**9,452**	8,750
Leasehold and building improvements	**13,513**	12,823
	159,373	151,829
Accumulated depreciation and amortization	**(96,151)**	(83,275)
	$ 63,222	$ 68,554

Depreciation expense was approximately $19.1 million, $17.1 million and $10.4 million for 2001, 2000 and fiscal period 1999, respectively.

NOTE 4. ACQUISITION OF VANTIS

On June 15, 1999, we paid approximately $500.1 million in cash to AMD for all of the outstanding capital stock of Vantis Corporation. Additionally, we paid approximately $10.8 million in direct acquisition costs, accrued an additional $5.4 million of pre-acquisition contingencies, accrued $8.3 million in exit costs and assumed certain liabilities of $34.5 million related to the Vantis business. This purchase was financed using a combination of cash reserves and a credit facility bearing interest at adjustable rates (see note 8). In addition, we exchanged Lattice stock options for all of the options outstanding under the former Vantis employee stock plans with a calculated Black-Scholes value of approximately $24.0 million. The total purchase price of Vantis was $583.1 million. The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed based on an independent appraisal and management estimates. The total purchase price was allocated as follows:

(IN MILLIONS)	
Current technology	$210.3
Excess of purchase price over net assets assumed	158.8
In-process research and development	89.0
Fair value of other tangible net assets	61.3
Assembled workforce, customer list, patents and trademarks	53.5
Fair value of property, plant and equipment	10.2
Total	$583.1

Accrued exit costs recorded at June 15, 1999 in conjunction with the acquisition aggregated approximately $8.3 million. We recorded $4.2 million in accrued costs related to Vantis office closures, primarily for the planned closure of the main Vantis facilities in Sunnyvale, California. These closures were consummated in accordance with plans in June 2000. We also recorded $2.5 million related to separation benefits for

Vantis employees. Payments of approximately $1.4 million were made to Vantis employees who terminated for merger related reasons and have been charged to this accrued liability. If these employees had not terminated, substantially all of the related costs would have been charged to selling, general and administrative expenses. We reversed the remaining portion of this accrued liability during the June 2000 quarter, with an offsetting credit to Intangible Assets (Goodwill). Additionally, we recorded and incurred $1.6 million in other exit costs primarily relating to the termination of Vantis distributors and independent sales representative firms. Approximately $1.2 million of such costs had been charged to this accrued liability as of December 31, 2000. These accruals are based upon our current estimates and are in accordance with Emerging Issues Task Force ("EITF") No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination." There are no significant remaining exit cost liabilities at December 31, 2001.

In-Process Research and Development ("IPR&D") The value assigned to IPR&D was determined by identifying individual research projects for which technological feasibility had not been established. These included semiconductor projects with a value after application of the SEC's IPR&D valuation methodology of $77.2 million and a process technology project with a value of $11.8 million. The value of each project was determined by estimating the expected cash flows from the projects once commercially viable, applying a factor based on the stage of completion of each project so as to include only those cash flows that relate to development efforts prior to the acquisition date, and discounting the resulting net cash flows back to their present value. The percentage of completion for each project was determined using proportionate cost incurred and technical milestones achieved to date. The percentage of completion varied by individual project ranging from 50% to 69% for semiconductors on June 15, 1999. The process technology project was estimated to be 90% complete on June 15, 1999. Since June 15, 1999, there have been no significant changes in the assumptions underlying these valuations.

The semiconductor projects were related to new PLD products (requiring new architectures and process technologies) and had the attendant risks associated with development of advanced semiconductor circuit designs such as achievement of speed, power, density, reliability and cost goals. All of the semiconductor projects had remaining risks related to achievement of these design goals and effective software integration. In addition, certain projects had basic circuit design and layout activities which had not been completed as of June 15, 1999. These semiconductor projects were released to market beginning in the first half of 2000 and continuing through 2001. Estimated costs to complete all in-process semiconductor projects at June 15, 1999 totaled $19.0 million and ranged from $0.2 million to $16.5 million.

The process technology project was related to the development of a new advanced manufacturing process to reduce transistor size, improve speed and lower power consumption. Through June 15, 1999, transistor design, lithography and metalization process development, process integration and certain transistor size reduction plans had been achieved. Development of packaging integration technology, achievement of manufacturability yield objectives, satisfaction of reliability standards and qualification testing had not been accomplished at June 15, 1999. The process was qualified for initial production in the first quarter of 2000 with approximately $450,000 of costs incurred after June 15, 1999 out of a total of $4 million of estimated costs. This process technology is expected to remain in production through 2004.

The estimated costs to develop the in-process research and development into commercially viable products at June 15, 1999 were approximately $19.4 million in aggregate— $4.7 million in 1999 subsequent to our acquisition, $10.0 million in 2000, and $4.7 million in 2001.

Useful Lives of Intangible Assets The estimated weighted average useful life of the intangible assets for current technology, assembled workforce, customer lists, trademarks, patents and residual goodwill, created as a result of the acquisition, is approximately five years (see note 1— *New Accounting Pronouncements*).

Pro forma Results The following pro forma results of operations information is provided for illustrative purposes only and do not purport to be indicative of the consolidated results of operations for future periods or that actually would have been realized had Lattice and Vantis been a consolidated entity during the periods presented. These pro forma results do not include the effect of non-recurring purchase accounting adjustments. The pro forma results combine the results of operations as if Vantis had been acquired as of the beginning of the periods presented. The results include the impact of certain adjustments such as goodwill amortization, estimated changes in interest income (expense) related to cash outlays and borrowings associated with the transaction (see note 8) and income tax benefits related to the aforementioned adjustments. Additionally, the in-process research and development charge of $89.0 million discussed above has been excluded from the periods presented due to its non-recurring nature:

(IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)	PRO FORMA RESULTS (UNAUDITED) NINE MONTHS ENDED DEC. 31, 1999
Revenue	**$314,394**
Income before extraordinary item	**$ 2,017**
Net income	**$ 352**
Basic net income per share	**$ 0.00**
Diluted net income per share	**$ 0.00**

NOTE 5. FOUNDRY INVESTMENTS, ADVANCES AND OTHER ASSETS

(IN THOUSANDS)	DECEMBER 31, 2001	2000
Foundry investments and other assets	**$124,870**	$153,665
Wafer supply advances	**37,548**	35,742
	$162,418	$189,407

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

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

On January 3, 2000, UICC and Utek merged into UMC. As a result, during the first quarter of 2000, we recognized a $150.0 million gain ($92.1 million after-tax) in income representing the equity market appreciation of our foundry investment in UICC and Utek. During 2000, we subsequently recorded unrealized gains and losses related to this investment due to changes in the market value of our unrestricted UMC shares, to equity as Accumulated Other Comprehensive Loss. These unrealized losses in 2000 totaled $77.9 million ($47.9 million net of tax).

During the quarter ended September 30, 2001, we recorded a $152.8 million charge to our Consolidated Statement of Operations ($94.9 million net of tax) representing what we believe to be an other than temporary decline in the market value of this investment since the recording of the $150.0 million gain in the first quarter of 2000. The charge includes the $77.9 million in unrealized losses ($47.9 million after tax) previously reflected in Accumulated Other Comprehensive Loss. During the quarter ended December 31, 2001, we recorded a $37.4 million unrealized gain ($24.1 million net of tax), representing the appreciation of the unrestricted UMC shares during the quarter, as Accumulated Other Comprehensive Income.

We currently own approximately 84 million shares of UMC common stock. Restrictions by UMC and the Taiwan government apply to approximately 28% of these shares. If we liquidate our UMC shares, it is likely that the amount of any future realized gain or loss will be different from the accounting gain or loss reported in prior periods.

In March 1997, and as subsequently amended in January 2002, we entered into an advance payment production agreement with Seiko Epson and Epson Electronics America, Inc. ("EEA") under which we agreed to advance approximately $69 million, payable upon completion of specific milestones, to Seiko Epson to finance construction of an eight-inch sub-micron semiconductor wafer manufacturing facility. Under the terms of the agreement, the advance is to be repaid with semiconductor wafers over a multi-year period. No interest income is recorded. The agreement calls for wafers to be supplied by Seiko Epson through EEA pursuant to purchase agreements with EEA. Payments of approximately $51.2 million have been made under this agreement. Approximately $3.4 million of these advances are expected to be repaid with semiconductor wafers during fiscal year 2002 and are thus reflected as part of "Prepaid expenses and other current assets" in our accompanying Consolidated Balance Sheet.

NOTE 6. LEASE OBLIGATIONS

Certain of our facilities and equipment are leased under operating leases, which expire at various times through 2008. Rental expense under the operating leases was approximately $5,078,000, $5,469,000 and $2,822,000 for 2001, 2000 and fiscal period 1999, respectively. Future minimum lease commitments at December 31, 2001 are as follows:

FISCAL YEAR	(IN THOUSANDS)
2002	$ 7,418
2003	6,903
2004	6,509
2005	5,903
2006	4,628
Later years	8,111
	$ 39,472

Included in these amounts are certain properties which are currently subleased. A portion of this sublease income is payable to the property owner. Future minimum sublease receipts based on agreements in place at December 31, 2001, net of such payments are as follows:

FISCAL YEAR	(IN THOUSANDS)
2002	$ 2,623
2003	2,473
2004	2,555
2005	2,622
2006	886
	$ 11,159

NOTE 7. INCOME TAXES

The components of the (benefit) provision for income taxes for 2001, 2000, and fiscal period 1999 are presented in the following table:

(IN THOUSANDS)	**YEAR ENDED DEC. 31, 2001**	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
Current:			
Federal	**$ (7,018)**	$68,791	$ 24,721
State	**(2,087)**	8,414	1,706
	(9,105)	77,205	26,427
Deferred:			
Federal	**(47,482)**	14,925	(50,967)
State	**(7,860)**	2,054	(3,449)
	(55,342)	16,979	(54,416)
	$(64,447)	$94,184	$(27,989)

Foreign income taxes were not significant for the fiscal periods presented.

The (benefit) provision for income taxes differs from the amount of income tax determined by applying the applicable U.S. statutory federal income tax rate to pretax income as a result of the following differences:

(IN THOUSANDS)	**YEAR ENDED DEC. 31, 2001**	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
Computed income tax (benefit) expense at the statutory rate	**$(60,886)**	$91,725	$(26,064)
Adjustments for tax effects of:			
State taxes, net	**(6,466)**	6,805	(1,133)
Research and development credits	**(1,175)**	(808)	(400)
Nontaxable investment items	**4,177**	(3,976)	(1,113)
Other	**(97)**	438	721
	$(64,447)	$94,184	$(27,989)

The components of our net deferred tax assets are as follow:

(IN THOUSANDS)	DECEMBER 31, **2001**	2000
Current deferred tax assets:		
Deferred income	**$ 5,929**	$ 22,110
Expenses and allowances not currently deductible	**25,662**	26,983
	$ 31,591	$ 49,093

(IN THOUSANDS)	DECEMBER 31, **2001**	2000
Non-current deferred tax assets:		
Intangible asset charges not currently deductible	**$ 70,011**	$ 56,708
Expenses and allowances not currently deductible	**5,576**	3,920
Other	**3,333**	1,910
Total deferred tax assets	**78,920**	62,538
Non-current deferred tax liabilities:		
Tax effect on net unrealized gain on market value of foundry investments	**(13,330)**	(27,904)
Net non-current deferred tax assets	**$ 65,590**	$ 34,634

In conjunction with the $150.0 million pre-tax gain on our foundry investments as discussed in note 5, we recorded a deferred tax liability of approximately $57.9 million. This deferred tax liability has been adjusted for subsequent recorded gains and losses related to these investments. The remaining deferred tax liability related to our foundry investments, aggregating approximately $13.3 million, is netted against non-current deferred tax assets as summarized above.

Prior to fiscal period 1999, we recorded valuation allowances to reduce deferred tax assets which could only be realized by earning taxable income in distant future years. We established the valuation allowances because we could not determine if it was more likely than not that such income would be earned. Management now believes that it is more likely than not that such taxable income will be earned, and therefore, no valuation allowance has been provided. The effect of this change in estimate was recorded in the first quarter of fiscal period 1999, and is included in the deferred tax benefit of $54.4 million for fiscal period 1999.

NOTE 8. LONG-TERM DEBT

On October 28, 1999, we issued $260 million in 4¾% convertible subordinated notes due on November 1, 2006. These notes pay interest semi-annually on May 1 and November 1. Holders of these notes may convert them into shares of our common stock at any time on or before November 1, 2006, at a conversion price of $20.72 per share, subject to adjustment in certain events. Beginning on November 6, 2002 and ending on October 31, 2003, we may redeem the notes in whole or in part at a redemption price of 102.71% of the principal amount. In the subsequent three twelve-month periods, the redemption price declines to 102.04%, 101.36% and 100.68% of principal, respectively. The notes are subordinated in right of payment to all of our senior indebtedness, and are subordinated by operation of law to all liabilities of our subsidiaries. At December 31, 2001, we had no senior indebtedness and our subsidiaries had $2.5 million of debt and other liabilities outstanding. Issuance costs relative to the convertible subordinated notes are included in Other Assets and aggregated approximately $6.9 million and are being amortized to expense over the lives of the notes. Accumulated amortization of these issuance costs amounted to approximately $3.6 million at December 31, 2001. The estimated fair value of the convertible subordinated notes, based on quoted market prices, was approximately $315.9 million and $285.7 million at December 31, 2001 and December 31, 2000, respectively.

On June 15, 1999, we entered into a credit agreement with a group of lenders and ABN AMRO Bank N.V. as administrative agent for the lender group. The credit agreement consisted of two credit facilities: a $60 million unsecured revolving credit facility (“Revolver”), and a $220 million unsecured reducing term loan (“Term Loan”), both expiring and due on June 30, 2002. On June 15, 1999, we borrowed $220 million under the Term Loan and approximately $33 million under the Revolver. The $33 million Revolver was repaid in full during the third calendar quarter of 1999.

In conjunction with the issuance of the convertible subordinated notes, we repaid the $220 million Term Loan in full during the fourth calendar quarter of 1999. Remaining unamortized loan fees at the time of repayment, aggregating approximately $2.6 million ($1.665 million net of income taxes or a charge of $0.02 for basic and diluted earnings per share), were written off and are reflected in the accompanying Consolidated Statement of Operations as an Extraordinary Item, Net of Income Taxes.

NOTE 9. STOCKHOLDERS' EQUITY

Common Stock In December 2000, our Board of Directors authorized management to repurchase up to five million shares of our common stock. As of December 31, 2001, we had repurchased 1,136,000 shares (596,000 in 2001) at an aggregate cost of approximately $20.0 million ($10.6 million in 2001).

Stock Warrants As of December 31, 2001, we have issued warrants to purchase 2,922,531 shares of common stock to a vendor. Of this amount, 2,532,768 warrants were issued and 1,856,500 exercised prior to fiscal period 1999. During fiscal period 1999, a warrant was issued to purchase 220,200 shares of common stock, earned ratably from March 1999 to February 2000. Additionally, the vendor exercised warrants for 269,716 shares at $8.50 per share. During 2000, a warrant was issued to purchase 74,000 shares of common stock, earned ratably from March 2000 to February 2001. During 2001, a warrant was issued to purchase 95,563 shares of common stock, earned ratably from March 2001 to February 2002. Expense recorded in conjunction with the vesting of warrants by this vendor was not material.

Stock Option Plans As of December 31, 2001, we had reserved 9,000,000 and 17,200,000 shares of common stock for issuance to officers and key employees under our 2001 Stock Option Plan and 1996 Stock Option Plan, respectively. The 2001 Plan options are granted at fair value at the date of grant, generally vest over four years in increments as determined by the Board of Directors and have terms up to ten years. The 1996 Plan options are typically granted at fair value at the date of grant, generally vest over four years in increments as determined by the Board of Directors and have terms up to ten years.

In conjunction with the acquisition of I2P on March 16, 2001, we exchanged 223,276 Lattice stock options for all of the options outstanding under the for I2P stock option plans. These options generally vest over four years and have terms of 10 years. Additionally, on June 16, 1999, we exchanged 4,720,544 Lattice stock options for all of the options outstanding under the former Vantis stock option plans. These options generally vest over four years and have terms of ten years.

The 2001 Directors' Stock Option Plan, which replaced the 1993 Directors' Stock Option Plan, provides for the issuance of stock options to members of our Board of Directors who are not employees of Lattice; 1,000,000 shares of our Common Stock are reserved for issuance thereunder. These options are granted at fair value at the date of grant and become exercisable quarterly over a one year period beginning three years after the date of grant and expire ten years from the date of grant.

The following table summarizes our stock option activity and related information for the past three fiscal periods:

	YEAR ENDED DECEMBER 31, 2001		YEAR ENDED DECEMBER 31, 2000		NINE MONTHS ENDED DECEMBER 31, 1999	
(NUMBER OF SHARES IN THOUSANDS)	**NUMBER OF SHARES UNDER OPTION**	**WEIGHTED-AVERAGE EXERCISE PRICE**	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE
Options outstanding at beginning of fiscal period	**17,008**	**$14.95**	16,444	$ 9.80	11,748	$ 7.86
Options granted	**5,713**	**22.16**	5,170	27.31	7,704	12.04
Options canceled	**(399)**	**17.81**	(1,306)	13.22	(1,072)	9.94
Options exercised	**(2,247)**	**8.15**	(3,300)	9.32	(1,936)	6.87
Options outstanding at end of fiscal period	**20,075**	**$17.71**	17,008	$14.95	16,444	$ 9.80

The following table summarizes information about stock options outstanding at December 31, 2001:

(NUMBER OF SHARES IN THOUSANDS)	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OF SHARES	WEIGHTED-AVERAGE REMAINING CONTRACT LIFE (IN YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
$ 1.88 – $ 7.88	4,701	0.78	$ 7.75	3,468	$ 7.79
$ 7.89 – $13.32	2,800	1.42	10.44	1,795	10.16
$13.33 – $21.38	3,925	2.41	15.99	1,370	15.33
$21.39 – $24.91	3,914	3.57	24.86	222	24.83
$24.92 – $32.25	4,735	2.52	27.40	1,566	27.62
	20,075	2.14	$17.71	8,421	$13.66

Stock Purchase Plan Our employee stock purchase plan, most recently approved by the stockholders in August 1997, permits eligible employees to purchase shares of common stock through payroll deductions, not to exceed 10% of the employee's compensation. The purchase price of the shares is the lower of 85% of the fair market value of the stock at the beginning of each six-month period or 85% of the fair market value at the end of such period, but in no event less than the book value per share at the mid-point of each offering period. Amounts accumulated through payroll deductions during the offering period are used to purchase shares on the last day of the offering period. Of the 2,800,000 shares authorized to be issued under the plan, 203,049, 200,072, and 78,580 shares were issued during 2001, 2000 and fiscal period 1999, respectively, and 353,719 shares were available for issuance at December 31, 2001.

Pro forma Disclosures We account for our stock options and employee stock purchase plan in conformity with APB 25 and have adopted the additional pro forma disclosure provisions of SFAS 123. The fair value, as defined by SFAS 123, for stock options and employee stock plan purchase rights was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	GRANTS FOR PERIODS ENDED		
	DEC. 31, 2001	DEC. 31, 2000	DEC. 31, 1999
Stock options:			
Expected volatility	**56.1%**	53.9%	41.4%
Risk-free interest rate	**3.9%**	6.3%	5.9%
Expected life from vesting date	**1.9 years**	1.8 years	1.6 years
Dividend yield	**0%**	0%	0%
Stock purchase rights:			
Expected volatility	**53.3%**	46.6%	52.8%
Risk-free interest rate	**4.65%**	6.3%	5.3%
Expected life	**6 months**	6 months	6 months
Dividend yield	**0%**	0%	0%

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

The resultant grant date weighted-average fair values calculated using the Black-Scholes option pricing model and the noted assumptions for stock options granted was $10.29, $13.13 and $5.71, and for stock purchase rights $5.92, $7.79 and $3.87, for 2001, 2000, and fiscal period 1999, respectively. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

Our pro forma information is as follows:

(IN THOUSANDS, EXCEPT PER SHARE DATA)	**YEAR ENDED DEC. 31, 2001**	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
Pro forma net (loss) income	**$(132,133)**	$147,884	$(56,337)
Pro forma basic (loss) earnings per share	**$ (1.22)**	$ 1.46	$ (0.59)
Pro forma diluted (loss) earnings per share	**$ (1.22)**	$ 1.31	$ (0.59)

Because the SFAS 123 pro forma disclosure applies only to options granted subsequent to April 1, 1995, its pro forma effect was not fully reflected until 2000.

NOTE 10. EMPLOYEE BENEFIT PLANS

Profit Sharing Plan We initiated a profit sharing plan effective April 1, 1990. Under the provisions of this plan, as approved by the Board of Directors, a percentage of our operating income, as defined and calculated at the end of March and September for the prior six-month period, is paid to qualified employees. In 2001, 2000, and fiscal period 1999, approximately $2.1 million, $6.7 million, and $2.6 million, respectively, was charged against operations in connection with the plan.

Qualified Investment Plan In 1990, we adopted a 401(k) plan, which provides participants with an opportunity to accumulate funds for retirement. Under the terms of the plan, eligible participants may contribute up to 15% of their eligible earnings to the plan Trust. The plan allows for us to make discretionary matching contributions. For the fiscal periods presented, matching contributions of up to 5% of base pay, vesting over four years, were made through the second quarter of 2001. Expense related to our matching contributions was approximately $1.0 million, $1.8 million and $0.9 million, respectively, for 2001, 2000 and fiscal period 1999.

NOTE 11. COMMITMENTS AND CONTINGENCIES

We are exposed to certain asserted and unasserted potential claims. Patent and other proprietary rights infringement claims are common in the semiconductor industry. There can be no assurance that, with respect to potential claims made against us, that we could obtain a license on terms or under conditions that would not have a material adverse effect on our financial position, cash flows or results of operations.

In connection with our 1999 acquisition of Vantis, we agreed to assume both the claims against Altera and the claims by Altera against AMD in the case captioned Advanced Micro Devices, Inc. V. Altera Corporation (Case No. C-94-20567-RMW) proceeding in the United States District Court for the Northern District of California. This litigation, which began in 1994, involved multiple claims and counterclaims for patent infringement relating to Vantis and Altera programmable logic devices and both parties were seeking damages and injunctive relief.

On July 23, 2001, we and Altera announced a comprehensive, royalty-free patent cross-license agreement and a multi-year patent peace agreement. In addition, we and Altera each agreed to dismiss all patent infringement suits against each other without any admission of liability. No payments were exchanged as part of the settlement.

NOTE 12. RELATED PARTY

Larry W. Sonsini is a member of our Board of Directors and is presently the Chairman and CEO of Wilson Sonsini Goodrich & Rosati, Professional Corporation, a law firm that provides us with corporate legal services. Legal services billed to Lattice aggregated approximately $1,314,000, $373,000, and $1,086,000, respectively, for 2001, 2000 and fiscal period 1999. Amounts payable to the law firm were not significant at December 31, 2001 or 2000, respectively.

NOTE 13. SEGMENT AND GEOGRAPHIC INFORMATION

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

(IN THOUSANDS)	**YEAR ENDED DEC. 31, 2001**	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999
United States	**$135,832**	$245,882	$126,333
Export sales:			
Europe	**81,177**	158,591	70,641
Asia	**62,582**	120,285	55,003
Other	**15,735**	43,001	17,722
	159,494	321,877	143,366
	$295,326	$567,759	$269,699

Resale of product through two distributors accounted for approximately 29% and 20%, 23% and 18%, and 20% and 15%, for 2001, 2000, and fiscal period 1999, respectively. No individual customer accounted for more than 10% of revenue for any of the fiscal periods presented. More than 90% of our property and equipment is located in the United States. Other long-lived assets located outside the United States consist primarily of foundry investments and advances (see note 5).

NOTE 14. ACQUISITION

On December 10, 2001, we announced a definitive agreement to acquire the FPGA business of Agere Systems, Inc. for $250 million in cash. This acquisition was completed on January 18, 2002 and financed with cash on hand. The transaction will be accounted for as a purchase.

The acquisition includes a general purpose ORCA® FPGA product portfolio, a field programmable system chip (FPSC) product portfolio and all related software design tools. In addition, we acquired certain intellectual property cores and patents unique to Agere's FPGA business and also entered into a cross-license agreement with Agere covering certain FPGA and FPSC patents, intellectual property and technology. As part of the transaction, we also hired approximately 100 Agere product development, marketing and technical sales employees.

The $250 million purchase price, associated costs and assumed liabilities are tax deductible (over 15 years for substantially all of the sum). Management, with the assistance of a third party valuation of intangible assets, attributed $65 million to purchased technology, $24 million to in-process research and development costs, and $24 million to a non-compete agreement and to licensed technology. Value attributed to acquired tangible assets and assumed liabilities is not material to our financial statements. Goodwill is the difference between a) the sum of the purchase price, associated costs and assumed liabilities, and b) the fair value of acquired assets. Purchased and licensed (non-goodwill) intangible assets will be amortized over approximately 7 years on a straight line basis except in-process research and development costs which will be charged to operations in the March 2002 quarter.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Lattice Semiconductor Corporation

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of changes in stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Lattice Semiconductor Corporation and its subsidiaries (the Company) at December 31, 2001 and 2000, and the results of their operations and their cash flows for the years ended December 31, 2001 and December 31, 2000, and for the nine months ended December 31, 1999 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Portland, Oregon
January 30, 2002

CORPORATE DIRECTORY

BOARD OF DIRECTORS

Cyrus Y. Tsui
Chairman and
Chief Executive Officer

Steven A Laub
President

Mark O. Hatfield[1,2]
Former U.S. Senator

Daniel S. Hauer[2]
Business Consultant
Chairman (Retired),
Epson Electronics America, Inc.

Soo Boon Koh[1]
Managing Partner,
iGlobe Partners, Inc.

Harry A. Merlo[1]
President,
Merlo Corporation

Larry W. Sonsini
Chairman and CEO,
Wilson, Sonsini, Goodrich & Rosati
Professional Corporation

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Web: www.mellon-investor.com

ANNUAL MEETING

Our annual meeting of stockholders will be held at our corporate headquarters on Tuesday, May 7, 2002, at 1:00 PM.

FORM 10-K

Financial information, including our Annual Report on Form 10-K as filed with the Securities and Exchange Commission and our quarterly operating results, is available by accessing our investor relations web site (www.lscc.com) or on request by telephone.

COMMON STOCK

Our common stock is traded on the NASDAQ National Market System under the symbol "LSCC."

STOCK PRICE HISTORY

	Low	High
2000:		
March	$20.44	$41.31
June	22.78	41.69
September	23.00	40.00
December	15.00	29.63
2001:		
March	$16.75	$27.25
June	15.88	27.65
September	14.04	25.85
December	14.36	22.65

All share amounts have been adjusted retroactively to reflect our two-for-one stock split effected in the form of a stock dividend paid on October 11, 2000.

ILLUSTRATION CREDITS

Cover: “Up the Jefferson” by John Clymer. Courtesy of The Clymer Museum and Gallery, Ellensburg, WA

Map of North America in 1802 by Aaron Arrowsmith, Courtesy of The Library of Congress, Washington, DC

Pages 2, 3 Collage of pages from the Lewis and Clark journals. Courtesy of American Philosophical Society, Philadelphia, PA

“Salmonberry” by Frederick Pursh. American Philosophical Society.

Pages 4,5 “Peace Pipe” by John Clymer. The Clymer Museum and Gallery

Description of pipe ceremony and drawing of Shoshone smoking pipe from Lewis and Clark journals, 917.3 L58 Codex F:99. American Philosophical Society.

Pages 6, 7 “Hasty Retreat” by John Clymer. The Clymer Museum and Gallery

Description of grizzly bear attack from Lewis and Clark journals, 917.3 L58 Codex E:114,.American Philosophical Society.

Pages 8, 9 “Lewis’s First Glimpse of the Rockies” by Olaf C. Seltzer, Courtesy of The Gilcrease Museum, Tulsa, OK

Reaching the ocean, from Lewis and Clark Journals, 917.3 L58 Codex H:147. American Philosophical Society.

Design Lawrence Bender & Associates

[1] Member of the Audit Committee
[2] Member of the Compensation Committee

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