LATTICE SEMICONDUCTOR CORPORATION 2000 ANNUAL REPORT

THE STRATEGY
OF RELATIVE
ADVANTAGE

FINANCIAL HIGHLIGHTS[1]

(IN THOUSANDS, EXCEPT PER SHARE DATA)	2000	FISCAL PERIOD 1999[2]	FISCAL YEAR 1999
Revenue	**$ 567,759**	$ 269,699	$ 200,072
Gross profit	**$ 349,929**	$ 161,012	$ 121,632
Earnings Before Goodwill ("EBG")	**$ 233,167**	$ 45,920	$ 42,046
Basic EBG per share[3]	**$ 2.29**	$ 0.48	$ 0.45
Diluted EBG per share[3][4]	**$ 2.02**	$ 0.46	$ 0.44
Cash and short-term investments	**$ 535,408**	$ 214,140	$ 319,434
Total assets	**$1,295,884**	$ 916,155	$ 540,896
Stockholders' equity	**$ 855,655**	$ 482,773	$ 483,734

2000 QUARTERLY INFORMATION

	DECEMBER 2000	SEPTEMBER 2000	JUNE 2000	MARCH 2000
Revenue	**$ 150,788**	$ 151,038	$ 139,878	$ 126,055
Gross profit	**$ 93,618**	$ 93,601	$ 86,240	$ 76,470
Earnings Before Goodwill ("EBG")	**$ 40,433**	$ 39,153	$ 33,551	$ 120,030
Basic EBG per share[3]	**$ 0.38**	$ 0.38	$ 0.34	$ 1.23
Diluted EBG per share[3][4]	**$ 0.34**	$ 0.34	$ 0.31	$ 1.05

(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"). EBG information does not include goodwill amortization and in-process research and development expense aggregating $81.9 million and $134.8 million in 2000 and fiscal period 1999, respectively, (and related tax benefits of $29.4 million and $49.2 million, respectively) which are reflected in our GAAP financial statements. In addition, an Extraordinary Item of approximately $1.7 million, net of income taxes, representing the writeoff 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 ($503.0 million) over 15 years on a straight-line basis using a 36.5% tax rate. This proforma adjustment is not recognized under GAAP. A consolidated statement of operations based on GAAP is included in the accompanying Form 10-K Annual Report.

(2) Amounts are for nine months ended December 31, 1999 or are December 31, 1999 balances. Operations of Vantis Corporation are included 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 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 $2.354, $2.365, $2.377, and $2.388 million for the December, September, June and March 2000 quarters, respectively, or $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 the notes.

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 markets of data communications, and telecommunications, as well as computing, industrial and military systems.

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All competition, by its very nature, is relative. Absolute advantage is at best rare and typically illusory. Energy expended in pursuit of such an absolute edge is wasted. Those that win are those who choose carefully where, when, and how to compete. At Lattice Semiconductor we employ this strategy. We continually assess our market, and analyze our competitors' strengths and weaknesses. We stand ready to take advantage of inevitable changes in our environment, and to capitalize on good fortune. In this way, we achieve relative advantage.

We choose where and how to be better. And when we choose to compete, we win.

— Cyrus Tsui

TO OUR SHAREHOLDERS In 1588, the Spanish Armada, a seemingly invincible fleet of the largest naval vessels the world had ever seen, was sunk by a flotilla of small, highly maneuverable craft piloted by skilled British seamen. The unquestioned dominance of the Spanish was over, and the wealth of their Empire was vulnerable.

Almost two centuries later, an ill-equipped, under-funded and largely untrained colonial army of farmers, merchants, and woodsmen sent the professional army of King George III back across the sea to England. They prevailed not by means of superior size or strength, but by understanding their environment, adapting their tactics, and capitalizing on their opponents' weaknesses.

Successful competition is not merely a matter of absolute superiority. In business, as in war, Companies who gain a *relative advantage* can win.

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SUCCESSFUL COMPETITION IS NOT MERELY A MATTER OF ABSOLUTE SUPERIORITY

Consider the broad context of our own semiconductor industry. Market participants are continually buffeted by external forces including rapid technological innovation, shifting customer requirements and dramatic cycles. In such an environment, where there can be no equilibrium, belief in an absolute competitive advantage is a dangerous illusion. No absolute edge can endure over the long term.

Until the 1980's, large, vertically integrated companies with broad product lines dominated our industry. With formidable resources, they built brand new, expensive fabrication facilities. But these giants had hidden weaknesses. Like the Spanish galleons, they were slow and not maneuverable. Like the Redcoats, they could not easily adapt to unfamiliar terrain. By the late 1980's, a smaller, quicker species of "fabless" semiconductor competitor had emerged.

By eschewing investment in manufacturing capacity, fabless semiconductor companies could focus on innovation and product development. Conventional wisdom held that these smaller firms lacked the muscle, the critical mass, to succeed. Those that adhered to this line of thinking were purveyors of the doctrine of absolute advantage through vertical integration.

A long time ago, China was divided into regional kingdoms. For centuries, territorial rulers strove to expand and acquire power.

Tradition taught that China had once been, and would one day again, be unified. Every local king aspired to become the great Emperor.

WE
CONCENTRATE
OUR
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However, the fabless model allowed astute managers to maneuver a company into a position of *relative advantage*. By utilizing dedicated third party foundries, fabless firms accessed the most advanced process technology while avoiding heavy capital investment and the burden of fixed costs in a cyclical industry. Through singular focus on anticipation of emerging market trends and the execution of products to intercept these requirements, fabless companies were able to develop better and more timely products.

Despite disadvantages in size and breadth, the concept of *relative advantage* makes the fabless strategy sound. In 1990, Lattice was among only a handful of public fabless companies with a collective market capitalization of $1.6 billion. Today there are nearly 100 such firms, boasting a total market capitalization of over $200 billion. And this group is growing at a rate three times as fast as the industry.

Lattice's strategy has always had at its foundation the concept of *relative advantage*. We concentrate our resources only in those areas where we have potential to win.

In the late 1980's, we introduced our E²CMOS® based GAL® family, the first truly re-programmable logic devices. Focusing all of our limited resources on this exciting area, we saw our path to *relative advantage*. Despite formidable obstacles and significantly larger competitors, we have since grown to dominate the simple PLD market. Only after securing our position in this area did we turn our attention to expanding our market coverage.

By 1992, we had made an enormous leap with our entry into the high-density PLD market. This attractive and rapidly growing market had evolved into two distinct architectural segments: complex PLDs, or CPLDs, and field programmable gate arrays, or FPGAs. We defined our entry strategy with precision, targeting the CPLD market using our newly developed ISP™ (in-system programmable) products. Again we concentrated our energy where we felt our innovative, differentiated products could ultimately succeed.

Kings and their generals recognized the importance of strategy. They employed scholars to advise them. One such individual was Sun Bin, a confidant of general Tian Ji in the kingdom of Qi.

One morning, Tian Ji came to Sun Bin perplexed and concerned. “The King has challenged me to a tournament,” he said. “He wants to race his three best horses against the three best horses in my army. The King is a superb judge of horses. To lose would be humiliating. What can I do?”

By 1996, we had staked out a promising beachhead, capturing nearly a 10 percent share of the CPLD market. Our Company was solidly profitable, growing and had attracted many talented employees. Yet we were still a bit player on the CPLD stage, an arena in which the leader owned more than half the market share. How could we continue to build our *relative advantage*? What was our next move?

In 1998, once again dedicating the majority of our resources, we initiated another new product launch. We had a singular goal, achievement of product leadership in the emerging 3.3-volt segment of the CPLD market. With fresh architectural approaches, our three pronged BFW (Bigger, Faster, Wider) product families seized the initiative from our competition in this fast growing arena. These innovative, differentiated products extended our *relative advantage* and, as the 3.3-volt segment continues to grow within the CPLD market, will provide us the ultimate path to full market leadership.

Last year, our strategy of *relative advantage* continued to bear financial fruit. Revenue for calendar year 2000 was a record $567.8 million, an increase of 76 percent over the $323.5 million achieved in the four calendar quarters of 1999. Perhaps more noteworthy are our results in the CPLD market. High-density revenue for 2000 was a record $431 million, an increase of 95 percent over the $221 million achieved during calendar year 1999.

During 2000, we also earned record profits due to realization of substantial operating leverage on our increased revenue base. We finish the year, on a before goodwill basis, with both operating and net margins at all time highs.

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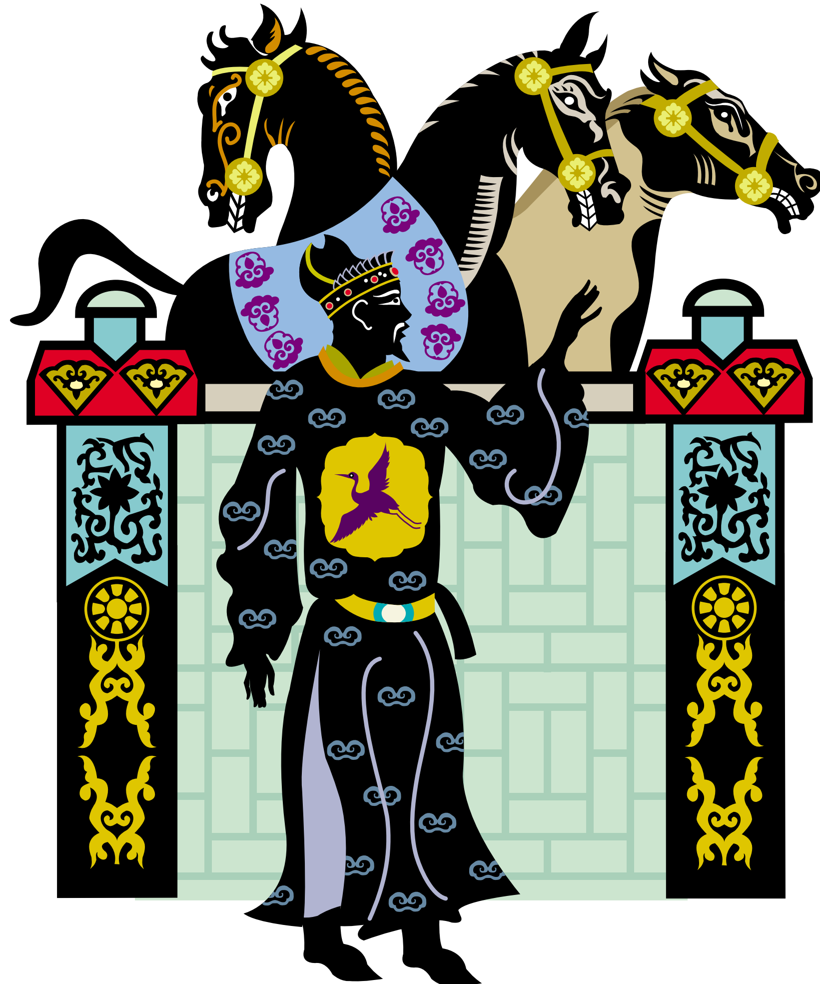
LAST YEAR OUR STRATEGY OF RELATIVE ADVANTAGE CONTINUED TO BEAR FINANCIAL FRUIT

In order to add critical mass and improve our market penetration, we acquired Vantis Corporation in June of 1999. With our business integration complete, we now possess the increased engineering scale and major customer access to accelerate the implementation of our strategy of *relative advantage*. The power of this integration is evidenced by our delivery to market of a record 35 new CPLD products in 2000. The

Sun Bin thought for a moment, and then he replied, "You, too, are a good judge of horses. But victory requires more. It is said, 'Victory comes easily to the one who can define a winning strategy.'"



Sun Bin confirmed. "Here is what you must do. Choose your three best horses. On the day of the tournament, match the worst of the three against the best horse of the King."

"What!" exclaimed Tian Ji. "My horse will surely lose!"

goal of this new product initiative, which continues through 2001, is to solidify our position of *relative advantage* and ultimately secure CPLD market share leadership.

Currently, the semiconductor market is a stormy and uncertain environment. What was characterized by industry pundits at the end of last year as an inventory bubble is now likely to be recognized as a full fledged cyclical downturn. Macroeconomic uncertainties add an extra note of caution to the outlook for 2001. Despite the fact that we may well be entering into the lean period of our industry cycle, we will continue to invest in product development and the execution of our strategy of *relative advantage*. Now more than ever, Lattice Semiconductor will prepare for our future.

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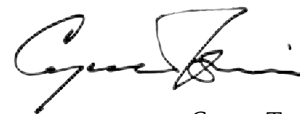
WE WILL CONTINUE TO SEEK OUT NEW AREAS WHERE WE CAN GAIN RELATIVE ADVANTAGE

Looking forward, we will continue to seek out new areas where we can gain *relative advantage*. With product development centers across the globe in Oregon, Silicon Valley, Texas, Colorado, Shanghai and the United Kingdom we have the requisite resources and talent to continue to develop innovative products. The focus of our expanded R&D scale is now turned towards new market opportunities.

We believe our strategy will allow us to thrive in a dynamic world. Lattice Semiconductor has been successful because we anticipate where our opportunities will be. We focus our energies and efforts to make the most of these opportunities. And we have the discipline to disregard those opportunities that are not yet ripe or are simply fleeting. We seek out, and then exploit *relative advantage*. We reap the rewards of our successes and grow larger and more profitable. And then, we reinvest the fruits of our labor in more ambitious efforts. But always we remain guided by the same principle.

We remain confident that the continued execution of this strategy will enable us to be successful in whatever environment we encounter on our journey through time. Thank you for your support.



Cyrus Tsui
President, Chief Executive Officer and Chairman of the Board

“Yes,” replied Sun Bin. “But hear me out. Then match your best horse against the second-best horse of the King, and your second-best horse against the worst of the King’s three.”

Tian Ji understood. On the day of the tournament, Tian Ji employed the strategy and defeated the King in two of the three races. Tian Ji won the tournament and became the chief general of the kingdom of Qi. Sun Bin became his councilor of war.

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

(unaudited)

(IN THOUSANDS, EXCEPT PER SHARE DATA)	2000	FISCAL PERIOD 1999 [2]	FISCAL YEAR 1999
Revenue	**$567,759**	$ 269,699	$ 200,072
Costs and expenses:			
Cost of products sold	**217,830**	108,687	78,440
Research and development	**77,057**	45,903	33,190
Selling, general and administrative	**81,082**	50,676	36,818
Income from operations	**191,790**	64,433	51,624
Gain on appreciation of foundry investments	**149,960**	—	—
Interest and other (expense) income, net	**2,194**	(4,120)	10,668
Income before provision for income taxes	**343,944**	60,313	62,292
Proforma provision for income taxes	**121,899**	21,208	20,246
Tax shield [1]	**11,122**	6,815	—
Earnings before Goodwill ("EBG")	**$233,167**	$ 45,920	$ 42,046
Basic EBG per share [3]	**$ 2.29**	$ 0.48	$ 0.45
Diluted EBG per share [3] [4]	**$ 2.02**	$ 0.46	$ 0.44
Shares used in per share calculations: [3]			
Basic	**101,716**	95,428	93,948
Diluted [4]	**120,321**	99,790	95,276

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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 markets of data communications and telecommunications, as well as computing, industrial and military systems.

In 1999, we acquired Vantis Corporation, the programmable logic device subsidiary of Advanced Micro Devices. This acquisition has increased our share of the PLD market, accelerated development of new products and technologies and expanded our penetration into new and existing customers.

As indicated in our Consolidated Financial Statements, 2000 is a twelve month fiscal period, as compared to the nine month fiscal period 1999 and twelve month fiscal year 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, 2000	NINE MONTHS ENDED DEC. 31 1999	YEAR ENDED MARCH 31, 1999
Revenue	**100%**	100%	100%
Costs and expenses:			
Cost of products sold	**38**	40	39
Research and development	**14**	17	17
Selling, general and administrative	**14**	19	18
In-process research and development	**—**	33	—
Amortization of intangible assets	**15**	17	—
Total costs and expenses	**81**	126	74
Income (loss) from operations	**19**	(26)	26
Other income (expense), net	**27**	(2)	5
Income (loss) before provision (benefit) for income taxes	**46**	(28)	31
Provision (benefit) for income taxes	**16**	(11)	10
Income (loss) before extraordinary item	**30**	(17)	21
Extraordinary item, net of income taxes	**—**	(1)	—
Net income (loss)	**30%**	(18)%	21%

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 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-acquisition 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 million at the acquisition date using a methodology consistent with current views of the staff of the SEC. These IPR&D costs were charged to operations on the acquisition date. Remaining intangible asset costs of $422.6 million, at the acquisition date, are being amortized to operations over five years using the straight-line method.

The purchase was financed using a combination of cash reserves and a new credit facility bearing interest at adjustable rates. The new credit facility was replaced with Convertible Notes in November 1999 (see note 8 to the Consolidated Financial Statements). We have taken certain actions to integrate the Vantis operations and, in certain instances, to consolidate duplicative operations.

Revenue Revenue was $567.8 million in 2000, an increase of 111% from fiscal period 1999. Fiscal period 1999 revenue of $269.7 million represented an increase of 35% from the $200.1 million recorded in fiscal year 1999.

In addition to our acquisition of Vantis, this increase in revenue is primarily attributable to increased sales of high density products, particularly our new 3.3 volt high density products, in all geographic regions. Revenue from the sale of high-density products represented 76%, 68% and 69% of total revenue for 2000, fiscal period 1999 and fiscal year 1999, respectively. Additionally, 2000 was a twelve month fiscal period, as opposed to the nine month fiscal period 1999. Fiscal period 1999 revenue, when compared to fiscal year 1999 revenue, was positively impacted by increased demand from Asia in conjunction with that region's economic recovery.

Our sales by major geographic region were as follows:

(IN THOUSANDS)	**YEAR ENDED DEC. 31, 2000**	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MARCH 31, 1999
United States	**$245,882**	$126,333	$100,778
Export sales:			
Europe	**158,591**	70,641	53,649
Asia	**120,285**	55,003	34,680
Other	**43,001**	17,722	10,965
	321,877	143,366	99,294
	$567,759	$269,699	$200,072

Revenue from export sales as a percentage of total revenue was approximately 57% for 2000, 53% for fiscal period 1999 and 50% for fiscal year 1999. We expect export sales to continue to represent a significant portion of revenue.

The average selling price of our products increased in 2000 as compared to fiscal period 1999, but decreased slightly in fiscal period 1999 as compared to fiscal year 1999. This fluctuation in overall average selling price is 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."

In March 2001, we announced that we expected a significant sequential decline in revenue in the first quarter of 2001. We believe this shortfall is the result of a general decline in PLD consumption within the communications and computing end markets. The extent of this decline and whether this decline will continue or accelerate is not known at this time.

Gross Margin Our gross margin was 62% for 2000, 60% for fiscal period 1999 and 61% for fiscal year 1999. The gross margin improvement in 2000 as compared to fiscal period 1999 is primarily due to continued reductions in our manufacturing costs and improvements in our product mix. The gross margin decline in fiscal period 1999 as compared to fiscal year 1999 is attributable to our acquisition of Vantis. The decline was partially offset by an improvement in product mix and reductions in our manufacturing costs. Reductions in manufacturing costs resulted primarily from yield improvements, migration of products to more advanced technologies and smaller die sizes.

Research and Development Research and development expense was $77.1 million in 2000, $45.9 million in fiscal period 1999 and $33.2 million in fiscal year 1999. In addition to our acquisition of Vantis, spending increases resulted primarily from the increased development of new products. Additionally, 2000 was a twelve month fiscal period, as opposed to the 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 $81.1 million in 2000, $50.7 million in fiscal period 1999 and $36.8 million in fiscal year 1999. Increased expenses 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, and are further described in note 4 to our Consolidated Financial Statements.

Amortization of Intangible Assets Amortization of intangible assets acquired in the Vantis acquisition was $81.9 million in 2000 and $45.8 million for fiscal period 1999. The increase in amortization for 2000 as compared to 1999 was primarily due to a full year of amortization in 2000 as opposed to approximately 6.5 months (June 15, 1999 acquisition date through December 31, 1999) 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.

Gain on Appreciation of Foundry Investments This gain on foundry investments in 2000 was recorded on January 3, 2000. It represents appreciation of equity investments made in two Taiwanese companies, UICC and Utek, as described in note 5 to our Consolidated Financial Statements.

Interest Income Interest income was $16.2 million in 2000, an increase of 167% as compared to fiscal period 1999. This increase was attributable to increased cash balances generated from our follow-on stock offering, completed in July 2000, a twelve month fiscal period in 2000 as opposed to the nine month fiscal period 1999, and cash generated from operations and exercises of stock options. Fiscal period 1999 interest income was $6.1 million, a decrease of 46% as compared to fiscal year 1999. This resulted primarily from lower cash and investment balances in conjunction with our Vantis acquisition, and a nine month fiscal period 1999 as compared to the twelve month fiscal year 1999.

Interest expense Interest expense was approximately $14.0 million in 2000, an increase of 44% as compared to fiscal period 1999. Substantially all interest expense resulted from the debt issued to partially fund our Vantis acquisition. Acquisition-related debt was outstanding for all of the 2000, but only for six and one-half months in fiscal period 1999.

Provision for Income Taxes Our effective tax rate was 35.9% in 2000, as compared to a benefit for income taxes of 37.6% for fiscal period 1999 and a 32.5% effective tax rate for fiscal year 1999. The benefit for income taxes for fiscal period 1999 was attributable to the tax effect of the In-process research and development recognized in conjunction with our Vantis acquisition. The effective tax rates for 2000 and fiscal year 1999 were lower than the statutory rate 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 credit facility repaid in conjunction with the re-financing of our acquisition of Vantis.

FACTORS AFFECTING FUTURE RESULTS

Notwithstanding any objectives, projections, estimates and other forward-looking statements contained in this Annual Report, our future operating results will continue to be subject to quarterly variations based on a wide variety of risks. The following risks, and potentially other risks, may cause our actual results to differ materially from those expressed in our forward-looking statements.

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 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;
- the timing of our and our competitors' new product introductions;
- product obsolescence;
- excessive inventory accumulation by our end customers;
- the scheduling, rescheduling and cancellation of large orders by our customers;
- the cyclical nature of demand for our customers' products;
- 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, all of our silicon wafers are manufactured by Seiko Epson in Japan, AMD in the United States and UMC in Taiwan. If Seiko Epson, through its U.S. affiliate Epson Electronics America, AMD or UMC 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, AMD or UMC were to reduce its supply commitment or increases 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, AMD's or UMC'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.

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

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 E^2CMOS process technologies at the new fabs of Seiko Epson, UMC or future foundries may not be achieved. This 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.

Substantially all 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.

Two of our three silicon wafer suppliers operate fabs located in Asia. Our finished silicon wafers are assembled and tested by independent subcontractors located in Hong Kong, Malaysia, the Philippines, 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;
- 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.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of December 31, 2000 and December 31, 1999 our investment portfolio consisted of fixed income securities of $507.3 million and $182.1 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, 2000 and December 31, 1999, the decline in the fair value of the 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 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 yen-denominated wafer purchases against specific and firm wafer purchases. If the foreign currency rates fluctuate by 10% from rates at December 31, 2000 and December 31, 1999, 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). 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. However, there can be no assurance that there will not be a material impact in the future.

LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2000, our principal source of liquidity was $535.4 million of cash and short-term investments, an increase of $321.3 million from the balance of $214.1 million at December 31, 1999. This increase was primarily due to the generation of approximately $210 million in net proceeds from our follow-on stock offering in July 2000, as well as cash generated from operations and exercises of stock options. Working capital increased to $552.2 million at December 31, 2000 from $152.8 million at December 31, 1999. This increase in working capital was primarily due to the increase in cash and short term investments. During 2000, we generated approximately $94.3 million of cash and cash equivalents from our operations compared with $80.9 million during the nine months of fiscal period 1999.

Accounts receivable at December 31, 2000 increased by $16.0 million, or 48%, as compared to the balance at December 31, 1999. This increase was primarily due to increased product shipments and revenue levels in comparison to fiscal period 1999. Inventories increased by $33.5 million, or 129%, as compared to the balance at December 31, 1999 primarily due to increased production in response to the higher revenue levels. Prepaid expenses and other current assets increased by $13.2 million, or 131% as compared to the balance at December 31, 1999, primarily due to a $10 million increase in the current portion of wafer supply advances. Current deferred income taxes increased $19.4 million, or 65%, as compared to the balance at December 31, 1999 primarily due to the increase in deferred income for 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 increased by $59.1 million, or approximately 45% as compared to the balance at December 31, 1999. This was primarily due to the $92.1 million after-tax gain recorded in the first quarter of 2000 representing the appreciation of our foundry investments, offset by a $47.9 million unrealized loss (recorded in Other Comprehensive Loss) on the unrestricted portion of these investments due to subsequent market depreciation. Net property and equipment increased by $8.9 million, or 15%, as compared to the balance at December 31, 1999 primarily due to capital expenditures. Intangible assets, net, decreased by $86.8 million, or 23% as compared to the balance at December 31, 1999 due primarily to goodwill and other intangibles amortization. Net non-current deferred tax assets decreased $4.5 million versus the balance at December 31, 1999. This decrease was primarily due to the following factors: (1) a $19.0 million increase in non-current deferred tax assets due to timing differences between book and tax recognition of future income tax benefits to be derived from the amortization of intangible assets and the IPR&D charges, (2) an increase in non-current deferred tax liabilities of $27.9 million recorded in conjunction with the gain and subsequent unrealized loss recorded on our foundry investments as discussed above, and (3) other timing differences between book and tax recognition of future income tax benefits.

Accounts payable and accrued expenses decreased by $10.5 million, or 12%, as compared to the balance at December 31, 1999 due primarily to liquidation of liabilities recorded in conjunction with our acquisition of Vantis in June 1999. Deferred income increased by $13.0 million, or 29%, as compared to the balance at December 31, 1999, due primarily to increased billings to distributors associated with higher revenue levels in 2000.

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, 2000, we had no senior indebtedness and our subsidiaries had $3.6 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 $2.1 million at December 31, 2000.

On June 15, 1999, we entered into a credit agreement with a group of lenders and ABN AMRO Bank N.V. ("ABN AMRO") 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.

Capital expenditures were approximately $25.9 million, $15.7 million and $18.4 million for 2000, fiscal period 1999, and fiscal year 1999, respectively. We expect to spend approximately $20 million to $25 million for the fiscal year ending December 31, 2001.

In March 1997, we entered into an advance payment production agreement with Seiko Epson and its affiliated U.S. distributor, Epson Electronics America, under which we agreed to advance approximately $86 million, payable upon completion of specific milestones, to Seiko Epson to finance construction of an eight-inch sub-micron wafer manufacturing facility. Under the terms of the agreement, the advance is to be repaid with semiconductor wafers over a multi-year period. The agreement calls for wafers to be supplied by Seiko Epson through Epson Electronics America, pursuant to purchase agreements with Epson Electronics America. Payments of approximately $51.2 million have been made under this agreement.

In 1995, we entered into a series of agreements with UMC, pursuant to which we agreed to join UMC and several other companies to form a separate Taiwanese company, UICC, for the purpose of building and operating an advanced semiconductor manufacturing facility in Taiwan. Under the terms of the agreements, we invested approximately $49.7 million for an approximate 10% equity interest in UICC 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, 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 in three separate installments.

On January 3, 2000, UICC and Utek merged into UMC. We own approximately 73 million shares of UMC common stock and have retained our capacity rights. Due to contractual and regulatory restrictions, approximately one-third of our shares may not be sold until after January 2002, with the regulatory restrictions expiring between January 2002 and January 2004.

In June 1999, as part of our acquisition of Vantis, we entered into a series of agreements with AMD to support the continuing operations of Vantis. AMD has agreed to provide us with finished silicon wafers through September 2003 in quantities based either on a rolling six-month or an annual forecast. We have committed to buy certain minimum quantities of wafers and AMD has committed to supply certain quantities of wafers during this period. Wafers for our products are manufactured in the United States at multiple AMD wafer fabrication facilities. Prices for these wafers will be reviewed and adjusted periodically.

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.

In an effort 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. We may in the future seek new or additional sources of funding. 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 DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MAR. 31, 1999	YEAR ENDED MAR. 31, 1998	YEAR ENDED MAR. 31, 1997
STATEMENT OF OPERATIONS DATA:					
Revenue	**$ 567,759**	$ 269,699	$ 200,072	$ 245,894	$ 204,089
Costs and expenses:					
Cost of products sold	**217,830**	108,687	78,440	98,883	83,736
Research and development	**77,057**	45,903	33,190	32,012	27,829
Selling, general and administrative	**81,082**	50,676	36,818	39,934	33,558
In-process research and development	**—**	89,003	—	—	—
Amortization of intangible assets	**81,873**	45,780	—	—	—
	457,842	340,049	148,448	170,829	145,123
Income (loss) from operations	**109,917**	(70,350)	51,624	75,065	58,966
Gain on appreciation of foundry investments	**149,960**	—	—	—	—
Interest and other income (expense), net	**2,194**	(4,120)	10,668	10,643	8,712
Income (loss) before provision (benefit) for income taxes	**262,071**	(74,470)	62,292	85,708	67,678
Provision (benefit) for income taxes	**94,184**	(27,989)	20,246	29,141	22,673
Income (loss) before extraordinary item	**167,887**	(46,481)	42,046	56,567	45,005
Extraordinary item, net of income taxes	**—**	(1,665)	—	—	—
Net income (loss)	**$ 167,887**	$ (48,146)	$ 42,046	$ 56,567	$ 45,005
Basic income (loss) per share, before extraordinary item	**$ 1.65**	$ (0.49)	$ 0.45	$ 0.61	$ 0.50
Diluted income (loss) per share, before extraordinary item	**$ 1.47**	$ (0.49)	$ 0.44	$ 0.59	$ 0.49
Basic net income (loss) per share	**$ 1.65**	$ (0.50)	$ 0.45	$ 0.61	$ 0.50
Diluted net income (loss) per share	**$ 1.47**	$ (0.50)	$ 0.44	$ 0.59	$ 0.49
Shares used in per share calculations:					
Basic	**101,716**	95,428	93,948	92,956	89,840
Diluted	**120,321**	95,428	95,276	95,576	91,892
BALANCE SHEET DATA:					
Cash and short-term investments	**$ 535,408**	$ 214,140	$ 319,434	$ 267,110	$ 228,647
Total assets	**1,295,884**	916,155	540,896	489,066	403,462
Stockholders' equity	**855,655**	482,773	483,734	434,686	360,491

	2000				FISCAL PERIOD 1999			1999
	DECEMBER	**SEPTEMBER**	**JUNE**	**MARCH**	DECEMBER	SEPTEMBER	JUNE	MARCH
UNAUDITED QUARTERLY DATA:								
Revenue	**$150,788**	**$ 151,038**	**$139,878**	**$126,055**	$114,988	$94,973	$ 59,738	$53,788
Gross profit	**$ 93,618**	**$ 93,601**	**$ 86,240**	**$ 76,470**	$ 68,953	$55,202	$ 36,857	$33,045
Income (loss) before extraordinary item	**$ 23,623**	**$ 22,701**	**$ 16,742**	**$104,821**	$ 9,652	$ (4,970)	$(51,163)	$11,848
Extraordinary item	**—**	**—**	**—**	**—**	$ (1,665)	—	—	—
Net income (loss)	**$ 23,623**	**$ 22,701**	**$ 16,742**	**$104,821**	$ 7,987	$ (4,970)	$(51,163)	$11,848
Net income per share:								
Basic income (loss) per share, before extraordinary item	**$ 0.22**	**$ 0.22**	**$ 0.17**	**$ 1.08**	$ 0.10	$ (0.05)	$ (0.54)	$ 0.13
Diluted net income (loss) per share before extraordinary item	**$ 0.21**	**$ 0.21**	**$ 0.16**	**$ 0.92**	$ 0.09	$ (0.05)	$ (0.54)	$ 0.12
Basic net income (loss) per share	**$ 0.22**	**$ 0.22**	**$ 0.17**	**$ 1.08**	$ 0.08	$ (0.05)	$ (0.54)	$ 0.13
Diluted net income (loss) per share	**$ 0.21**	**$ 0.21**	**$ 0.16**	**$ 0.92**	$ 0.08	$ (0.05)	$ (0.54)	$ 0.12

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

CONSOLIDATED BALANCE SHEET

(IN THOUSANDS, EXCEPT SHARE AND PAR VALUE AMOUNTS)	DECEMBER 31, 2000	DECEMBER 31, 1999
	(Note 1)	
Assets		
Current assets:		
Cash and cash equivalents	**$ 235,900**	$113,824
Short-term investments	**299,508**	100,316
Accounts receivable, net	**49,688**	33,676
Inventories (note 2)	**59,493**	26,036
Prepaid expenses and other current assets	**23,249**	10,407
Deferred income taxes (note 7)	**49,093**	29,727
Total current assets	**716,931**	313,986
Foundry investments, advances and other assets (note 5)	**189,407**	130,274
Property and equipment, less accumulated depreciation (note 3)	**68,554**	59,689
Intangible assets, less accumulated amortization of $127,653 and $45,780 (note 4)	**286,358**	373,117
Deferred income taxes (note 7)	**34,634**	39,089
	$1,295,884	$916,155
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	**$ 74,160**	$ 84,675
Accrued payroll obligations	**22,876**	18,906
Income taxes payable (note 7)	**9,484**	12,459
Deferred income	**58,184**	45,188
Total current liabilities	**164,704**	161,228
4¾% Convertible notes due in 2006 (note 8)	**260,000**	260,000
Other long-term liabilities	**15,525**	12,154
Commitments and contingencies (notes 4, 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; 107,533,379 and 96,571,438 shares issued and outstanding	**1,075**	966
Paid-in capital	**522,492**	269,745
Other comprehensive loss	**(47,861)**	—
Retained earnings	**379,949**	212,062
	855,655	482,773
	$1,295,884	$916,155

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)	**YEAR ENDED DECEMBER 31, 2000**	NINE MONTHS ENDED DECEMBER 31, 1999	YEAR ENDED MARCH 31, 1999
		(Notes 1 and 14)	
Revenue (note 13)	**$567,759**	$269,699	$200,072
Costs and expenses:			
Cost of products sold	**217,830**	108,687	78,440
Research and development	**77,057**	45,903	33,190
Selling, general and administrative (note 12)	**81,082**	50,676	36,818
In-process research and development (note 4)	**—**	89,003	—
Amortization of intangible assets (note 4)	**81,873**	45,780	—
	457,842	340,049	148,448
Income (loss) from operations	**109,917**	(70,350)	51,624
Other income (expense), net:			
Interest income	**16,202**	6,057	11,279
Interest expense (note 8)	**(14,036)**	(9,732)	(274)
Gain on appreciation of foundry investments (note 5)	**149,960**	—	—
Other income (expense), net	**28**	(445)	(337)
	152,154	(4,120)	10,668
Income (loss) before provision (benefit) for income taxes	**262,071**	(74,470)	62,292
Provision (benefit) for income taxes (note 7)	**94,184**	(27,989)	20,246
Income (loss) before extraordinary item	**167,887**	(46,481)	42,046
Extraordinary item, net of income taxes (note 8)	**—**	(1,665)	—
Net income (loss)	**$167,887**	$ (48,146)	$ 42,046
Basic net income (loss) per share, before extraordinary item	**$ 1.65**	$ (0.49)	$ 0.45
Diluted net income (loss) per share, before extraordinary item	**$ 1.47**	$ (0.49)	$ 0.44
Basic net income (loss) per share	**$ 1.65**	$ (0.50)	$ 0.45
Diluted net income (loss) per share	**$ 1.47**	$ (0.50)	$ 0.44
Shares used in per share calculations:			
Basic	**101,716**	95,428	93,948
Diluted	**120,321**	95,428	95,276

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	ACCUMULATED OTHER COMPREHENSIVE LOSS	RETAINED EARNINGS	TOTAL
Balances, March 31, 1998	93,712	$ 937	$215,587	$ —	$218,162	$434,686
Common stock issued	2,028	20	11,192	—	—	11,212
Repurchase of common stock	(1,352)	(13)	(9,145)	—	—	(9,158)
Tax benefit of option exercises	—	—	4,888	—	—	4,888
Other	—	—	60	—	—	60
Net income for fiscal year 1999	—	—	—	—	42,046	—
Total comprehensive income	—	—	—	—	—	42,046
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**

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF CASH FLOWS

(IN THOUSANDS)	YEAR ENDED DECEMBER 31, 2000	NINE MONTHS ENDED DECEMBER 31, 1999	YEAR ENDED MARCH 31, 1999
Cash flow from operating activities:			
Net income (loss)	**$ 167,887**	$ (48,146)	$ 42,046
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:			
Depreciation and amortization	**102,213**	57,842	10,064
Gain on appreciation of foundry investments	**(149,960)**	—	—
In-process research and development costs	**—**	89,003	—
Deferred income taxes pertaining to intangible assets	**(18,522)**	(37,684)	—
Deferred income taxes pertaining to unrealized loss on foundry investments	**30,003**	—	—
Extraordinary item, net of income taxes	**—**	(1,665)	—
Changes in assets and liabilities (net of purchase accounting adjustments):			
Accounts receivable	**(16,012)**	(5,206)	4,441
Inventories	**(33,457)**	(884)	4,964
Prepaid expenses and other current assets	**(2,842)**	(387)	(489)
Deferred income taxes	**3,611**	(15,327)	100
Foundry investments, advances and other assets	**(359)**	769	(199)
Intangible assets	**4,886**	—	—
Accounts payable and accrued expenses	**(10,515)**	2,054	415
Accrued payroll obligations	**3,970**	443	2,342
Income taxes payable	**(2,975)**	7,474	775
Deferred income	**12,996**	25,195	(750)
Other liabilities	**3,371**	7,443	—
Net cash provided by operating activities	**94,295**	80,924	63,709
Cash flow from investing activities:			
Proceeds from (purchase of) short-term investments, net	**(199,192)**	139,817	(33,367)
Acquisition of Vantis Corporation, net of cash acquired	**—**	(439,258)	—
Foundry investments	**—**	(4,593)	—
Capital expenditures	**(25,883)**	(15,675)	(18,387)
Net cash used by investing activities	**(225,075)**	(319,709)	(51,754)
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, net	**(9,380)**	—	(9,158)
Net proceeds from issuance of common stock	**262,236**	23,203	16,160
Net cash provided by financing activities	**252,856**	273,308	7,002
Net increase in cash and cash equivalents	**122,076**	34,523	18,957
Beginning cash and cash equivalents	**113,824**	79,301	60,344
Ending cash and cash equivalents	**$ 235,900**	$ 113,824	$ 79,301
Supplemental disclosure of non-cash investing and financing activities:			
Fair value of options issued to Vantis employees (note 4)	$ —	$ 23,982	$ —
Unrealized loss on appreciation of foundry investments included in other comprehensive loss	$ (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 markets of data communications and telecommunications, as well as computing, industrial and military systems.

In 1999, we acquired Vantis Corporation, the programmable logic device subsidiary of Advanced Micro Devices. This acquisition has increased our share of the PLD market, accelerated development of new products and technologies and expanded our penetration into new and existing customers.

Fiscal Reporting Period In the fourth quarter of calendar 1999, we changed our reporting period to a 52 or 53 week year ending on the Saturday closest to December 31 from a 52 or 53 week fiscal year ending on the Saturday closest to March 31. For ease of presentation, December 31 or March 31 has been utilized as the fiscal period end date for all financial statement captions. Additionally, for purposes of these consolidated financial statements, our fiscal year ended December 30, 2000 is referred to as "the year ended December 31, 2000," or "2000." The nine-month fiscal period ended January 1, 2000 is referred to as "the nine months ended December 31, 1999" or "fiscal period 1999." Our fiscal year ended on April 3, 1999 is referred to as "the fiscal year ended March 31, 1999" or "fiscal year 1999." The fiscal year ended April 3, 1999 was a 53-week fiscal year.

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. The acquisition of Vantis is discussed further in note 4. The accompanying consolidated financial statements include the accounts of Lattice Semiconductor Corporation and its wholly owned subsidiaries 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, are composed of corporate auction preferred stocks ($190.3 million), municipal and local government obligations ($86.5 million), time deposits ($17.8 million) and commercial paper ($4.9 million) at December 31, 2000.

We account for our short-term investments as held-to-maturity, which are stated at amortized cost with corresponding premiums or discounts amortized over the life of the investment to interest income. Amortized cost approximates market value at December 31, 2000.

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 In order to minimize exposure to foreign exchange risk with respect to long-term investments made with foreign currencies as further described in note 5, we have at times entered into foreign forward exchange contracts in order to hedge these transactions. These contracts are accounted for as identifiable hedges against our firm commitments. Realized gain or loss with respect to these contracts for the fiscal periods presented was not material. As of December 31, 2000, we had no open 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. 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 and Accounts Receivable Revenue from sales to OEM customers is recognized upon shipment provided that persuasive evidence of an 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. Accounts receivable are shown net of allowances for doubtful accounts of $1,700,000 and $1,583,000 at December 31, 2000 and 1999, respectively.

Inventories Inventories are stated at the lower of first-in, first-out cost or market.

Long-Lived Assets We account for our long-lived assets, primarily Property and equipment, Foundry investments 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 would be recorded if the carrying amount of the asset exceeded the estimated undiscounted cash flows. We have not recorded any provisions for possible impairment of long-lived assets.

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) which are being amortized over five years on a straight-line basis, and fifteen years for income tax purposes. The undiscounted cash flows method is used to assess the carrying value of goodwill.

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 have not been significant to date.

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.

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 fiscal period 1999 is based only on the weighted average number of common shares outstanding during the period, as the inclusion of convertible subordinated notes, options and warrants would have been antidilutive. For 2000, diluted weighted-average shares outstanding include the effect of stock options 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, 2000**	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MAR. 31, 1999
Basic and diluted net income (loss)	**$167,887**	$(48,146)	$42,046
Shares used in basic net income per share calculations	**101,716**	95,428	93,948
Dilutive effect of stock options, warrants and convertible notes	**18,605**	—	1,328
Shares used in diluted net income per share calculations	**120,321**	95,428	95,276
Basic net income (loss) per share	**$ 1.65**	$ (0.50)	$ 0.45
Diluted net income (loss) per share	**$ 1.47**	$ (0.50)	$ 0.44

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 shareholders 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 and fiscal year 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).

Statement of Cash Flows Income taxes paid approximated $55.9 million, $10.1 million and $16.4 million in 2000, fiscal period 1999 and fiscal year 1999, respectively. Interest paid aggregated approximately $12.3 million, $6.9 million and $0.3 million in 2000, fiscal period 1999 and fiscal year 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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the fiscal periods presented. Actual results could differ from those estimates.

New Accounting Pronouncements In June 1998, the FASB issued SFAS 133, "Accounting for Derivatives 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. For Lattice, this pronouncement, as amended by SFAS 137, will be effective in 2001 and is not anticipated to have a material effect on the Consolidated Financial Statements.

In April 2000, FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation — an interpretation of APB Opinion No.25" ("FIN No. 44") was issued. The adoption of FIN No. 44 did not have a material effect on our financial position or results of operations.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition," which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements filed with the SEC. This pronouncement became effective in the fourth quarter of 2000, and did not have a material effect on our financial position or results of operations.

Financial Presentation Reclassifications of prior-year balances included in the Consolidated Financial Statements have been made to conform to the 2000 presentation.

NOTE 2. INVENTORIES

(IN THOUSANDS)	DECEMBER 31, 2000	1999
Work in progress	**$ 37,718**	$ 14,009
Finished goods	**21,775**	12,027
	$ 59,493	$ 26,036

NOTE 3. PROPERTY AND EQUIPMENT

(IN THOUSANDS)	DECEMBER 31, 2000	1999
Land	**$ 2,099**	$ 2,099
Buildings	**24,703**	24,689
Computer and test equipment	**103,454**	86,207
Office furniture and equipment	**8,750**	6,674
Leasehold and building improvements	**12,823**	6,625
	151,829	126,294
Accumulated depreciation and amortization	**(83,275)**	(66,605)
	$ 68,554	$ 59,689

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 new 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

Vantis Integration We have taken certain actions to integrate the Vantis operations and, in certain instances, to consolidate duplicative operations. Accrued exit costs recorded at June 15, 1999 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 $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 have been charged to this accrued liability as of December 31, 2000. The remaining balance is reflected as a liability in our Consolidated Balance Sheet at 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."

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 include 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 began to be released to market during the first half of 2000 and will continue 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.

Management believes that the IPR&D charge of $89 million is valued consistently with the SEC staff's current views regarding valuation methodologies. There can be no assurances, however, that the SEC staff will not take issue with any assumptions used in our valuation model and require a revision in the amount allocated to IPR&D.

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.

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	DEC. 31, 1998
Revenue	**$314,394**	$295,057
Income (loss) before extraordinary item	**$ 2,017**	$ (15,545)
Net income (loss)	**$ 352**	$ (15,545)
Basic net income (loss) per share	**$ 0.00**	$ (0.17)
Diluted net income (loss) per share	**$ 0.00**	$ (0.17)

NOTE 5. FOUNDRY INVESTMENTS, ADVANCES AND OTHER ASSETS

(IN THOUSANDS)	DECEMBER 31, 2000	1999
Foundry investments and other assets	**$153,665**	$ 83,512
Wafer supply advances	**35,742**	46,762
	$189,407	$130,274

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, 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) representing the appreciation of our foundry investment in UICC and Utek. We currently own approximately 73 million shares of UMC common stock and have retained our capacity rights. Due to contractual and regulatory restrictions, approximately one-third of our shares may not be sold until after January 2002, with the regulatory restrictions expiring between January 2002 and January 2004. As the regulatory restrictions expire and if we liquidate our UMC shares, it is likely that the amount of any future realized gain will be different from the accounting gain reported.

During 2000, subsequent to recognition of the gain above, we recorded an approximate $77.9 million unrealized loss ($47.9 million net of tax) due to market depreciation of our unrestricted UMC shares. This amount is included in Other Comprehensive Income in our accompanying Consolidated Statement of Stockholders' Equity.

In March 1997, we entered into an advance payment production agreement with Seiko Epson and Epson Electronics America, Inc. ("EEA") under which we agreed to advance approximately $86 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 $14.5 million of these advances are expected to be repaid with semiconductor wafers during fiscal year 2001 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 2006. Rental expense under the operating leases was approximately $5,469,000, $2,822,000 and $1,200,000 for 2000, fiscal period 1999 and fiscal year 1999, respectively. Future minimum lease commitments at December 31, 2000 are as follows:

FISCAL YEAR	(IN THOUSANDS)
2001	$ 6,897
2002	6,729
2003	6,305
2004	6,101
2005	5,702
Later years	12,759
	$ 44,493

Included above are certain previously occupied properties which are currently subleased. A portion of this sublease income is payable to the property owner. Future minimum sublease receipts at December 31, 2000, net of such payments are as follows:

FISCAL YEAR	(IN THOUSANDS)
2001	$ 2,898
2002	2,623
2003	2,473
2004	2,555
2005	2,622
Later years	886
	$ 14,057

NOTE 7. INCOME TAXES

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

(IN THOUSANDS)	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MAR. 31, 1999
Current:			
Federal	**$68,791**	$ 24,721	$17,883
State	**8,414**	1,706	2,263
	77,205	26,427	20,146
Deferred:			
Federal	**14,925**	(50,967)	89
State	**2,054**	(3,449)	11
	16,979	(54,416)	100
	$94,184	$(27,989)	$20,246

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

The provision (benefit) 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, 2000	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MAR. 31, 1999
Computed income tax expense (benefit) at the statutory rate	**$91,725**	$(26,064)	$21,802
Adjustments for tax effects of:			
State taxes, net	**6,805**	(1,133)	1,478
Research and development credits	**(808)**	(400)	(270)
Nontaxable investment income	**(3,976)**	(1,113)	(3,037)
Other	**438**	721	273
	$94,184	$(27,989)	$20,246

The components of our net deferred tax asset are as follows:

(IN THOUSANDS)	DECEMBER 31, 2000	1999
Current deferred tax assets:		
Deferred income	**$ 22,110**	$16,946
Expenses and allowances not currently deductible	**26,983**	12,781
	$ 49,093	$29,727

(IN THOUSANDS)	DECEMBER 31, 2000	1999
Non-current deferred tax assets:		
Intangible asset charges not currently deductible	**$ 56,708**	$37,684
Expenses and allowances not currently deductible	**3,920**	1,405
Other	**1,910**	—
Total deferred tax assets	**62,538**	39,089
Non-current deferred tax liabilities:		
Tax effect on net unrealized gain on market value of foundry investments	**(27,904)**	—
Net non-current deferred tax assets	**$ 34,634**	$39,089

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 was reduced by approximately $30.0 million as a result of the unrealized loss due to the market depreciation of our unrestricted UMC shares as also discussed in note 5. The remaining deferred tax liability related to our foundry investment, aggregating approximately $27.9 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, 2000, we had no senior indebtedness and our subsidiaries had $3.6 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 $2.1 million at December 31, 2000.

On June 15, 1999, we entered into a credit agreement with a group of lenders and ABN AMRO Bank N.V. (“ABN AMRO”) 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, 2000, we had repurchased 540,000 shares at an aggregate cost of approximately $9.4 million.

In June 1998, our Board of Directors authorized management to repurchase up to 2.4 million shares of our common stock. During fiscal year 1999, we repurchased 1,352,000 shares at an aggregate cost of approximately $9.2 million.

Stock Warrants As of December 31, 2000, we have issued warrants to purchase 2,826,968 shares of common stock to a vendor. Of this amount, 2,332,376 warrants were issued and 1,856,500 exercised prior to fiscal year 1999. During fiscal year 1999, a warrant was issued to purchase 200,392 shares of common stock, earned ratably from March 1998 to February 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. Expense recorded in conjunction with the vesting of warrants by this vendor was not material.

Stock Option Plans As of December 31, 2000, we had reserved 17,200,000 and 23,100,000 shares of common stock for issuance to officers and key employees under our 1996 Stock Option Plan and 1988 Stock Option Plan, respectively. The 1996 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 1988 Plan options are exercisable immediately and generally have terms of five years. The transfer of certain shares of common stock acquired through the exercise of 1988 Plan stock options is restricted under stock vesting agreements that grant us the right to repurchase unvested shares at the exercise price if employment is terminated. Generally, our repurchase rights lapse quarterly over four 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 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; 900,000 shares of our Common Stock are reserved for issuance thereunder. These options are granted at fair value at the date of grant and generally become exercisable quarterly over a four year period beginning on the date of grant and expire five 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, 2000		NINE MONTHS ENDED DECEMBER 31, 1999		YEAR ENDED MARCH 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	**16,444**	**$ 9.80**	11,748	$ 7.86	11,024	$10.09
Options granted	**5,170**	**27.31**	7,704	12.04	6,752	7.99
Options canceled	**(1,306)**	**13.22**	(1,072)	9.94	(4,272)	14.71
Options exercised	**(3,300)**	**9.32**	(1,936)	6.87	(1,756)	5.77
Options outstanding at end of fiscal period	**17,008**	**$14.95**	16,444	$ 9.80	11,748	$ 7.86

The following table summarizes information about stock options outstanding at December 31, 2000:

(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
$ 7.01 – $ 7.87	4,391	1.36	$ 7.56	2,758	$ 7.44
$ 7.88 – $ 9.65	3,640	1.83	8.58	2,112	8.64
$ 9.66 – $16.55	3,818	2.52	13.39	1,151	13.55
$16.56 – $26.67	3,620	3.43	24.92	346	21.93
$26.68 – $32.25	1,539	3.38	31.53	161	31.76
	17,008	2.34	$14.95	6,528	$10.27

On November 10, 1998, we offered employees the choice of exchanging certain previously granted stock options for new stock options. The new stock options had an exercise price of $7.75, the fair value of our common stock on the date of exchange, and vest over four years. As a result, approximately 3,767,880 options were exchanged. The exchanged stock options had a weighted average exercise price of $15.37.

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, 200,072, 78,580, and 256,036 shares were issued during 2000, fiscal period 1999, and fiscal year 1999, respectively, and 556,768 shares were available for issuance at December 31, 2000.

Pro forma Disclosures We account for our stock options and employee stock purchase plan in conformity with APB 25 and have adopted the additional proforma 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, 2000	DEC. 31, 1999	MARCH 31, 1999
Stock options:			
Expected volatility	**53.9%**	41.4%	43.9%
Risk-free interest rate	**6.3%**	5.9%	4.7%
Expected life from vesting date	**1.8 years**	1.6 years	1.3 years
Dividend yield	**0%**	0%	0%
Stock purchase rights:			
Expected volatility	**46.6%**	52.8%	43.6%
Risk-free interest rate	**6.3%**	5.3%	4.8%
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 $13.13, $5.71 and $2.60, and for stock purchase rights $7.79, $3.87 and $2.39, for 2000, fiscal period 1999 and fiscal year 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, 2000**	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MARCH 31, 1999
Pro forma net income (loss)	**$147,884**	$(56,337)	$32,425
Pro forma basic earnings (loss) per share	**$ 1.46**	$ (0.59)	$ 0.35
Pro forma diluted earnings (loss) per share	**$ 1.31**	$ (0.59)	$ 0.34

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.

Shareholder Rights Plan A shareholder rights plan approved on September 11, 1991 provides for the issuance of one right for each share of outstanding common stock. With certain exceptions, the rights will become exercisable only in the event that an acquiring party accumulates beneficial ownership of 20% or more of the Company's outstanding common stock or announces a tender or exchange offer, the consummation of which would result in ownership by that party of 20% or more of the Company's outstanding common stock. The rights expire on September 11, 2001 if not previously redeemed or exercised. Each right entitles the holder to purchase, for $60.00, a fraction of a share of our Series A Participating Preferred Stock with economic terms similar to that of one share of our common stock. We will generally be entitled to redeem the rights at $0.01 per right at any time on or prior to the tenth day after an acquiring person has acquired beneficial ownership of 20% or more of our common stock. If, prior to the redemption or expiration of the rights, an acquiring person or group acquires beneficial ownership of 20% or more of the Company's our common stock, each right not beneficially owned by the acquiring person or group will entitle its holder to purchase, at the rights' then current exercise price, that number of shares of common stock having a value equal to two times the exercise price.

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 2000, fiscal period 1999, and fiscal year 1999, approximately $6.7 million, $2.6 million, and $2.1 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. We match eligible employee contributions of up to 5% of base pay. These contributions are discretionary and vest over four years.

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, 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.

ADVANCED MICRO DEVICES, INC. V. ALTERA CORPORATION (CASE NO. C-94-20567-RMW, N.D. CAL.).
In connection with our acquisition of Vantis, we have 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, involves multiple claims and counterclaims for patent infringement relating to Vantis and Altera programmable logic devices and both parties are seeking damages and injunctive relief.

In April 1999, the United States Court of Appeals for the Federal Circuit reversed earlier jury and District Court decisions and held that Altera is not licensed to the eight AMD patents-in-suit. These eight AMD patents were subsequently assigned to Vantis. Also in April 1999, following the decision of the Court of Appeals, Altera filed a petition for rehearing. In June 1999, the Court of Appeals denied Altera's petition for rehearing.

On May 31, 2000, Altera Corporation filed a complaint against us in U.S. District Court in the Northern District of California, alleging infringement of certain Altera patents by unspecified Lattice products. On June 22, 2000, we answered Altera's complaint denying any infringement by Lattice, and simultaneously brought a series of counterclaims alleging infringement by Altera of certain Lattice patents.

Although there can be no assurance as to the results of litigation, based upon information presently known to management, we do not believe that the ultimate resolution of the lawsuits will have a material adverse effect on our financial position, cash flows or results of operations.

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 $373,000, $1,086,000, and $61,000, respectively, for 2000, fiscal period 1999, and fiscal year 1999. Amounts payable to the law firm were not significant at December 31, 2000 or 1999, 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 region were as follows:

(IN THOUSANDS)	**YEAR ENDED DEC. 31, 2000**	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MARCH 31, 1999
United States	**$245,882**	$126,333	$100,778
Export sales:			
Europe	**158,591**	70,641	53,649
Asia	**120,285**	55,003	34,680
Other	**43,001**	17,722	10,965
	321,877	143,366	99,294
	$567,759	$269,699	$200,072

Resale of product through two distributors accounted for approximately 23% and 18%, 20% and 15%, and 15% and 10% for 2000, fiscal period 1999, and fiscal year 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. TRANSITION REPORTING

The following table of selected consolidated financial data below provides a nine-month comparison of the results of operations through December 31, 1999 and 1998 (the transition period). The 1998 transition period figures are unaudited, however, we believe that all necessary adjustments have been made to make the periods comparable. Condensed consolidated results of operations for the comparable 1999 and 1998 nine-month periods are as follows:

	NINE MONTHS ENDED	
(IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)	**DEC. 31, 1999**	DEC. 31, 1998
Revenue	**$269,699**	$146,284
Gross margin	**$161,012**	$ 88,587
(Benefit) provision for income taxes	**$ (27,989)**	$ 14,541
Extraordinary item, net of income taxes	**$ (1,665)**	$ —
Net (loss) income	**$ (48,146)**	$ 30,199
Basic net (loss) income per share	**$ (0.50)**	$ 0.33
Diluted net (loss) income per share	**$ (0.50)**	$ 0.32

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, 2000 and 1999, and the results of their operations and their cash flows for the years ended December 31, 2000 and March 31, 1999, 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 18, 2001

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Chief Executive Officer

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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

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Wilson, Sonsini, Goodrich & Rosati
Professional Corporation

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Thomas J. Kingzett
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Quality Assurance

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[2] MEMBER OF THE COMPENSATION COMMITTEE

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New Venture Business

Rodney F. Sloss
Vice President
Finance

Kenneth K. Yu
Vice President and Managing Director
Lattice Asia
Technology Advisor to the
Office of the President

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ANNUAL MEETING
The annual meeting of stockholders for Lattice Semiconductor Corporation will be held at our corporate headquarters on Tuesday, May 1, 2001, at 1:00 PM.

FORM 10-K
Financial information, including our Annual Report on 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
The following table sets forth the low and high sale prices of our common stock over the last two fiscal periods.

	Low	High
Fiscal Period 1999:		
June 1999	$ 9.516	$ 15.578
September 1999	13.469	17.313
December 1999	13.625	27.188
Fiscal Period 2000:		
March 2000	$ 20.438	$ 41.313
June 2000	22.782	41.688
September 2000	23.000	40.000
December 2000	15.000	29.625

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

DESIGN: LAWRENCE BENDER & ASSOCIATES

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