UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended October 2, 2004

OR

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

For the transition period from to

Commission file number 000-18032

LATTICE SEMICONDUCTOR CORPORATION

(Exact name of Registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ☒ No o

At October 2, 2004, there were 113,421,564 shares of the Registrant's common stock, $.01 par value, outstanding.

The information contained in this Form 10-Q is as of November 9, 2004. This Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2003.

LATTICE SEMICONDUCTOR CORPORATION

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. We use words or phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projects," "may," "will," "should," "continue," "ongoing," "future," "potential" and similar words or phrases to identify forward-looking statements.

Forward-looking statements involve estimates, assumptions, risks and uncertainties that could cause actual results to differ materially from those expressed in them. Among the key factors that could cause our actual results to differ materially from the forward-looking statements are delay in product or technology development, change in economic conditions of the various markets we serve, lack of market acceptance or demand for our new products, dependencies on silicon wafer suppliers and semiconductor assemblers, the impact of competitive products and pricing, opportunities or acquisitions that we pursue, the availability and terms of financing, and the other risks that are described herein and that are otherwise described from time to time in our filings with the Securities and Exchange Commission, includin g but not limited to the items discussed in "Factors Affecting Future Results" set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part 1, Item 2 of this report. You should not unduly rely on forward-looking statements because our actual results could materially differ from those expressed in any forward-looking statements made by us. Further, any forward-looking statement applies only as of the date on which it is made. We are not required to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(In thousands, except per share data)
(unaudited)

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
Revenue	$ 57,281	$ 43,033	$ 177,291	$ 156,905
Costs and expenses:				
Cost of products sold	24,848	19,431	75,799	65,452
Research and development	23,213	21,173	68,071	64,707
Selling, general and administrative	13,630	12,114	40,786	37,211
Amortization of intangible assets (1)	5,785	18,665	41,490	58,466
Total costs and expenses	67,476	71,383	226,146	225,836
Loss from operations	(10,195)	(28,350)	(48,855)	(68,931)
Other income (expense), net	3,989	(3,611)	10,232	(3,485)
Loss before income tax expense (benefit)	(6,206)	(31,961)	(38,623)	(72,416)
Income tax expense (benefit)	118	(3,300)	218	(5,854)
Net loss	$ (6,324)	$ (28,661)	$ (38,841)	$ (66,562)
Basic net loss per share	$ (0.06)	$ (0.26)	$ (0.34)	$ (0.60)
Diluted net loss per share	$ (0.06)	$ (0.26)	$ (0.34)	$ (0.60)
Shares used in per share calculations:				
Basic	113,181	111,840	112,871	111,615
Diluted	113,181	111,840	112,871	111,615

(1) Includes $657 and $820 of amortization of deferred stock compensation expense for the three months ended September 30, 2004 and September 30, 2003, respectively, and $2,787 and $4,931 for the nine months ended September 30, 2004 and September 30, 2003, respectively, attributable to Research and Development activities.

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET
(In thousands, except share and par value data)
(unaudited)

Assets	Sept. 30, 2004	Dec. 31, 2003
Current assets:		
Cash and cash equivalents	$ 52,241	$ 35,276
Short-term investments	267,157	242,474
Accounts receivable, net	27,001	26,796
Inventories	39,099	46,630

Other current assets		47,743		51,537
Total current assets		433,241		402,713
Foundry investments, advances and other assets		74,225		86,883
Property and equipment, net		49,002		53,800
Intangible assets, net		45,972		84,676
Goodwill		223,556		223,556
	$	825,996	$	851,628
Liabilities and Stockholders' Equity				
Current liabilities:				
Accounts payable and accrued expenses	$	61,573	$	28,500
Deferred income on sales to distributors		16,040		10,564
Income taxes payable		41		37
Total current liabilities		77,654		39,101
Zero Coupon Convertible Subordinated Notes due in 2010		169,000		184,000
Other long-term liabilities		27,056		22,415
Commitments and contingencies		-		-
Stockholders' equity:				
Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued or outstanding		-		-
Common stock, $.01 par value, 300,000,000 shares authorized, 113,421,564 and 113,047,874 shares issued and outstanding		1,134		1,130
Paid-in capital		589,420		586,834
Deferred stock compensation		(2,548)		(5,444)
Accumulated other comprehensive income (loss)		(268)		20,203
Retained earnings (deficit)		(35,452)		3,389
Total stockholders' equity		552,286		606,112
	$	825,996	$	851,628

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands) (unaudited)

	Nine Months Ended			
		Sept. 30, 2004		Sept. 30, 2003
Cash flows from operating activities:				
Net loss	$	(38,841)	$	(66,562)
Adjustments to reconcile net loss to net cash provided by operating activities:				
Depreciation and amortization		58,134		74,873
Gain on sale of UMC Shares		(6,071)		(271)
(Gain) loss on retirement of convertible notes		(2,756)		1,381
Changes in assets and liabilities:				
Accounts receivable		(205)		(567)
Inventories		7,531		8,299
Foundry investments, advances and other assets		(5,486)		23,447
Accounts payable and accrued expenses		4,069		2,451
Deferred income		5,476		(2,217)
Income taxes payable		4		(142)
Other liabilities		4,133		(4,683)
Total adjustments		64,829		102,571
Net cash provided by operating activities		25,988		36,009
Cash flows from investing activities:				
Proceeds from sale of short-term investments		184,912		311,307
Purchase of short-term investments		(209,578)		(329,323)
Purchase of equity securities		-		(474)
Proceeds from sales of equity securities		29,612		745
Capital expenditures		(8,251)		(8,015)
Net cash used by investing activities		(3,305)		(25,760)
Cash flows from financing activities:				
Retirement of convertible notes		(11,999)		(223,684)
Issuance of convertible notes, net		-		194,558
Advances from Yen line of credit		4,508		-
Payments on Yen line of credit		(367)		-
Net proceeds from issuance of common stock		2,140		2,736
Net cash used in financing activities		(5,718)		(26,390)
Net increase (decrease) in cash and cash equivalents		16,965		(16,141)
Beginning cash and cash equivalents		35,276		169,475
Ending cash and cash equivalents	$	52,241	$	153,334
Supplemental disclosures of cash flow information:				
Cash received for income taxes, net	$	489	$	(28,370)

Cash paid for interest	**$**	**-**	**$**	**6,371**
Supplemental disclosures of non-cash investing and financing activities:				
Unrealized (loss) gain on (depreciation) appreciation of foundry investments included in other comprehensive income	**$**	**(15,009)**	**$**	**19,752**

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of Presentation:

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Lattice Semiconductor Corporation ("the Company") pursuant to the rules and regulations of the Securities and Exchange Commission and in our opinion include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These condensed consolidated financial statements should be read in conjunction with our audited financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2003.

The preparation of financial statements in conformity with generally accepted accounting principles requires us 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 amount of revenues and expenses during the periods presented. Actual results could differ from these estimates.

We report based on a 52 or 53 week year ending on the Saturday closest to December 31. For ease of presentation, we have adopted the convention of using March 31, June 30, September 30, and December 31, as period end dates for all financial statement captions.

This Quarterly Report on Form 10-Q contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. 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 this report.

Note 2 - Revenue Recognition:

Revenue from sales to OEM customers is recognized upon shipment provided that persuasive evidence of an arrangement exists, the price is fixed or determinable, title has transferred, collection of resulting receivables is probable, there are no customer 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 either the product is sold by the distributor or return privileges and price protection rights terminate, and related estimated revenue and estimated costs are then reflected in income. Revenue from software sales was not material for the periods presented.

Note 3 - Net Loss Per Share:

Net loss per share is computed based on the weighted average number of shares of common stock outstanding.

Net income per share is computed based on the weighted average number of shares of common stock outstanding 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 the computation of basic and diluted net income per share is that basic net income per share does not treat potentially dilutive securities such as stock options, warrants and convertible subordinated notes as outstanding. For all periods presented, the computation of net loss per share excludes the effect of our stock options, warrants and convertible notes, as they were antidilutive. A reconciliation of basic and diluted net loss per share is presented below (in thousands, except for per share data):

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
Basic and diluted net loss	$ (6,324)	$ (28,661)	$ (38,841)	$ (66,562)
Shares used in basic net loss per share calculations	113,181	111,840	112,871	111,615
Dilutive effect of stock options, warrants and other potentially dilutive securities	-	-	-	-
Shares used in diluted net loss per share	113,181	111,840	112,871	111,615
Basic net loss per share	$ (0.06)	$ (0.26)	$ (0.34)	$ (0.60)
Diluted net loss per share	$ (0.06)	$ (0.26)	$ (0.34)	$ (0.60)

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." Pro forma disclosures as required under SFAS 123, "Accounting for Stock-Based Compensation" and as amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," are presented below. Pursuant to FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Based Compensation - an interpretation of APB Opinion No. 25," effective July 1, 2000, the "in the money" portion of stock options granted to employees in connection with acquisitions is accounted for as Deferred Stock Compensation in Stockholders' Equity and amortized to operations as part of amortization of intangible assets over the vesting periods of the options.

The fair value of our stock-based employee compensation cost for purposes of our pro forma disclosures was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Grants for			
	Three Months Ended		Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
Stock Options:				
Expected Volatility	48.6%	57.5%	48.8%	58.1%
Risk-free interest rate	2.9%	2.4%	2.8%	2.1%
Expected life from vesting date	1.4 years	1.6 years	1.3 years	0.5 years
Dividend yield	0%	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.

As pertaining to activity for the three and nine months ended September 30, 2004 and 2003, the resultant grant date weighted-average fair values calculated using the Black-Scholes option pricing model and the noted assumptions for stock options granted were $1.71 and $3.35 for the third quarter of 2004 and 2003, respectively, and $1.80 and $1.24 for the nine months ended September 30, 2004 and 2003, 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):

	For the Three Months Ended		For the Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
Net loss, as reported	$ (6,324)	$ (28,661)	$ (38,841)	$ (66,562)
Add: Stock based employee compensation expense included in reported loss	657	820	2,787	4,931
Deduct: Total stock-based employee compensation expense determined under fair value based	(4,050)	(5,603	(14,210)	(19,915)

method for all awards		)		
Pro forma net loss	$ (9,717)	$ (33,444)	$ (50,264)	$ (81,546)
Net loss per share:				
Basic-as reported	$ (0.06)	$ (0.26)	$ (0.34)	$ (0.60)
Basic- pro forma	$ (0.09)	$ (0.30)	$ (0.45)	$ (0.73)
Diluted-as reported	$ (0.06)	$ (0.26)	$ (0.34)	$ (0.60)
Diluted-pro forma	$ (0.09)	$ (0.30)	$ (0.45)	$ (0.73)

Note 4 - Inventories (in thousands):

	Sept. 30, 2004	Dec. 31, 2003
Work in progress	$ 26,756	$ 34,327
Finished goods	12,343	12,303
	$ 39,099	$ 46,630

Note 5 - Changes in Stockholders' Equity (in thousands):

	Common Stock	Paid-in Capital	Deferred Stock Compensation	Accumulated Other Comprehensive Income/(Loss)	Retained Earnings (Deficit)	Total
Balances, Dec. 31, 2003	$ 1,130	$ 586,834	$ (5,444)	$ 20,203	$ 3,389	$ 606,112
Common stock issued	4	2,695	-	-	-	2,699
Unrealized loss on foundry investments, net (Note 9)	-	-	-	(15,009)	-	(15,009)
Recognized gain on sale of UMC stock (Note 9)	-	-	-	(5,556)	-	(5,556)
Unrealized gain on stock holdings	-	-	-	238	-	238
Deferred stock compensation	-	(109)	109	-	-	-
Amortization of deferred stock compensation	-	-	2,787	-	-	2,787
Translation adjustment	-	-	-	(144)	-	(144)
Net loss for the nine-month period	-	-	-	-	(38,841)	(38,841)
Balances, Sept. 30, 2004	$ 1,134	$ 589,420	$ (2,548)	$ (268)	$ (35,452)	$ 552,286

Total comprehensive loss for the first nine months of 2004 was approximately $59.3 million comprising primarily $38.8 million net loss from operations, $15.0 million in loss related primarily to foundry investments, and a $5.6 million realized gain on sale of foundry investments previously included in other comprehensive income.

Note 6 - Goodwill and Purchased Intangible Assets:

As a result of adopting SFAS 142 "Intangible Assets" in 2002, goodwill and certain intangibles with indefinite lives are no longer being amortized. To apply SFAS 142, a company is divided into separate "reporting units," each representing groups of products that are separately managed. For this purpose, we have one reporting unit. To determine whether or not goodwill may be impaired, a test is required comparing the book value of the "reporting unit" to its trading price. Similar tests are required in the future, at least annually, and more often where there is a change in circumstances that could result in an impairment of goodwill. If the trading price of our common stock is below the book value for a sustained period, a goodwill impairment test will be performed by comparing book value to&nbs p;estimated market value (trading price plus a control premium). The excess of book value over estimated market value will then be subtracted from the goodwill account with a resulting charge to operations. Subsequent unrealized recoveries in market value, if any, will not be recorded. We completed our annual goodwill impairment assessment in December 2003, upon which no impairment charge was recorded. Additional goodwill impairment tests will be performed at least annually.

The following tables present details of the Company's total purchased intangible assets (in millions):

September 30, 2004	Gross	Accumulated Amortization	Net
Current technology	$ 273.6	$ (242.5)	$ 31.1
Core technology	7.3	(3.0)	4.3
Licenses	10.2	(4.0)	6.2
Non-compete agreements	14.3	(12.7)	1.6
Workforce	4.7	(1.9)	2.8
Backlog	1.4	(1.4)	-
Customer list	17.4	(17.4)	-
Patents and trademarks	26.8	(26.8)	-
Total	$ 355.7	$ (309.7)	$ 46.0

December 31, 2003	Gross	Accumulated Amortization	Net
Current technology	$ 273.6	$ (214.3)	$ 59.3
Core technology	7.3	(1.9)	5.4
Licenses	10.2	(2.9)	7.3
Non-compete agreements	14.3	(9.2)	5.1
Workforce	4.7	(1.2)	3.5
Backlog	1.4	(1.4)	-
Customer list	17.4	(15.8)	1.6
Patents and trademarks	26.8	(24.3)	2.5
Total	$ 355.7	$ (271.0)	$ 84.7

The estimated future amortization expense of purchased intangible assets as of September 30, 2004 is as follows (in millions):

Fiscal Year:		Amount
2004 (remaining three months)	$	5.1
2005		14.4
2006		10.8
2007		9.8
Later years		5.9
	$	46.0

The estimated future amortization expense of deferred stock compensation attributable to Research and Development activities as of September 30, 2004 is approximately $0.7 million for the remainder of 2004 and $1.9 million for 2005.

Note 7 - New Accounting Pronouncements:

In January 2003, the Financial Accounting Standards Board ("FASB") issued Financial Standards Accounting Board Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities," an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FIN 46 establishes accounting guidance for consolidation of a variable interest entity. In a variable interest entity the equity investors do not have a controlling interest or their equity interest is insufficient to finance the entity's activities without receiving additional subordinated financial support from the other parties. We do not currently have any business relationship with a variable interest entity, so the adoption of FIN 46 had no impact on our consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This pronouncement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in certain circumstances) because that financial instrument embodies an obligation of the issuer. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim periods beginning after June 15, 2003. On November 7, 2003, FASB issued FASB Staff Position No. FAS 150-3 ("FSP 150-3"), "Effective Date, Dis closures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." FSP 150-3 deferred certain aspects of SFAS 150. The adoption of SFAS 150 and FSP 150-3 did not have a material impact on our consolidated financial position or results of operations.

In March 2004, the Emerging Issues Task Force finalized its consensus on EITF Issue 03-6, "Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share" (EITF 03-6). EITF 03-6 clarifies what constitutes a participating security and requires the use of the two-class method for computing basic earnings per share when participating convertible securities exist. EITF 03-6 is effective for fiscal periods beginning after March 31, 2004. The adoption of EITF 03-6 did not have a material effect on our results of operations.

In March 2004, the Emerging Issues Task Force reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities. The recognition and measurement guidance for which the consensus was reached in the March 2004 meeting is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. In September 2004, the FASB issued a final FASB Staff Position that delays the effective date for the measurement and recognition guidance for all investments within the scope of EITF 03-01. The consensus re ached in March 2004 also provided for certain disclosure requirements associated with cost method investments that was effective for fiscal years ending after June 15, 2004. Management will evaluate the affect of adopting the recognition and measurement guidance when the matter is finalized.

In March 2004, the FASB issued a proposed Statement "Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95", that addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for either equity instruments of the company or liabilities that are based on the fair value of the company's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using the intrinsic method currently used by us and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense in our consolidated statement of operations. The currently recommended effective date of the proposed sta ndard is for interim or fiscal periods beginning after June 15, 2005. Should this proposed statement be finalized in its current form, it will have a significant impact on our consolidated statement of operations, as we will be required to expense the fair value of our stock option grants and stock purchases under our employee stock purchase plan.

In April 2004, the Financial Accounting Standards Board issued FASB Staff Position (FSP)129-1, "Disclosure Requirements under FASB Statement No. 129, Disclosure of Information about Capital Structure, Relating to Contingently Convertible Securities", further defining disclosure requirements for convertible notes, among other things. As a result of adopting FSP 129-1 in April 2004, we further described circumstances under which our note holders may convert their notes into our common shares before note maturity.

In September 2004, the Emerging Issues Task Force issued EITF 04-08 "The Effect of Contingently Convertible Debt on Diluted Earnings Per Share" requiring us to include in diluted earnings per share, on the if-converted method, the aggregate of approximately 14 million shares of our common stock into which the Zero Coupon Convertible Subordinated Notes due in 2010 ("Convertible Notes") may be converted, regardless of whether the conversion threshold has been met. We adopted this standard as of September 2004. We have reported per share losses since June 2003 when our Convertible Notes were issued. Since inclusion of the additional shares would be anti-dilutive, no change to our historical results is appropriate required. However, to the extent inclusion of these shares is dilutive in the future, diluted earnings per share will include the effect of converting our outstanding Convertible Notes.

Note 8 - Legal Matters:

In September and October 2004, three putative class action complaints were filed in the United States District Court for the District of Oregon against Lattice Semiconductor Corporation, our Chief Executive Officer Cyrus Y. Tsui, and our President Stephen A. Skaggs. These complaints were filed on behalf of a putative class of investors who purchased our stock between April 22, 2003 and April 19, 2004. They generally allege violations of federal securities laws arising out of our previously announced restatement of financial results for the first, second, and third quarters of 2003. Consistent with the usual procedures for cases of this kind, we anticipate that these cases (and any other similar putative class action complaints that might be filed against us) may be consolidated into a single action. We believe that the co mplaints are without merit, and we intend to vigorously defend against the lawsuits.

In September and October 2004, two shareholder derivative complaints were filed, purportedly on behalf of Lattice Semiconductor Corporation, in the Circuit Court of the State of Oregon for the County of Washington, against all of our current directors, certain former directors, and certain executive officers. The derivative plaintiffs make allegations substantially similar to those in the putative class action complaints, as well as allegations of breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment. Consistent with the usual procedures for cases of this kind, we anticipate that these cases (and any other similar complaints that may be filed in the same jurisdiction) may be consolidated into a single putative shareholder derivative complaint.

All of the complaints generally seek an unspecified amount of damages, as well as attorney fees and costs. The cases are still in the preliminary stages, and it is not possible for us to quantify the extent of our potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on our business and financial results. In addition, defending any litigation may be costly and divert management's attention from the day-to-day operations of our business.

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

On September 6, 2004, we agreed with the U. S. Department of Commerce to settle charges that we did not comply with Export Administration Regulations between 2000 and 2002. The settlement resulted in a fine of $560,000. Provision for these costs has been made in prior year's financial statements. The charges involved the exportation of controlled semiconductor devices to a Hong Kong distributor that subsequently re-exported those devices to the Peoples Republic of China (PRC), and the release of controlled semiconductor manufacturing technology to nationals of the PRC employed by us in the United States, as well as the exportation of such manufacturing technology to our design center in the PRC. We voluntarily disclosed these circumstances to the Department, cooperated fully with an investigation of our export practi ces and procedures, and have implemented enhancements to strengthen our export control procedures.

Note 9 - Foundry Investments:

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 $49.7 million for an approximate 10% equity interest in the corporation and the right to receive a percentage of the facility's wafer production at market prices.

In 1996, we entered into an agreement with Utek Corporation ("Utek"), a public Taiwanese company in the wafer foundry business that became affiliated with the UMC group in 1998, pursuant to which we agreed to make a series of equity investments in Utek under specific terms. In exchange for these investments, we received the right to purchase a percentage of Utek's wafer production. Under this agreement, we invested $17.5 million. On January 3, 2000, UICC and Utek merged into UMC.

As of September 30, 2004, we owned 60.8 million shares of UMC common stock of which approximately 23.3 million are restricted by the terms of our agreement with UMC. Under the terms of the UMC agreement, if we sell any of these restricted shares, our rights to guaranteed wafer capacity at UMC may be reduced on a pro-rata basis based on the number of shares that we sell. If we sell over 10.1 million of these restricted shares, we may lose all of our rights to guaranteed wafer capacity at UMC.

For financial reporting purposes, all of our UMC shares are accounted for as available for sale and marked to market in our Condensed Consolidated Balance Sheet until they are sold, at which time a gain or loss is recognized in our Condensed Consolidated Statement of Operations. Unrealized gains and losses are included in Accumulated other comprehensive income (loss) within Stockholders' equity. An other than temporary impairment of UMC share value could result in a reduction of the Condensed Consolidated Balance Sheet carrying value and would result in a charge to our Condensed Consolidated Statement of Operations.

The carrying value of our investment in UMC was approximately $37.4 million and $81.1 million at September 30, 2004 and December 31, 2003, respectively, and this balance is classified as part of Other current assets ($24.6 million and $35.4 million at September 30, 2004 and December 31, 2003, respectively) and Foundry investments, advances and other assets. During the first nine months of 2004, we sold 36.6 million UMC shares for a gain of $6.1 million of which $5.6 million was already recorded as an unrealized gain in Accumulated other comprehensive income (loss). Also in the first nine months of 2004, we recorded a $15.0 million decrease in unrealized gain related primarily to the market value of our UMC shares. If we liquidate our UMC shares, it is likely that the amount of any future realized gain or loss wi ll be different from the accounting gain or loss reported in prior periods.

On September 10, 2004, we entered into an Advance Payment and Purchase Agreement (the "Fujitsu Agreement") with Fujitsu Limited ("Fujitsu"), pursuant to which we will advance $125 million to Fujitsu in support of the development and construction of a new 300mm wafer fabrication facility in Mie, Japan. The initial payment of $25 million was made in October 2004, with the remaining payments to be made in three stages upon the achievement of certain milestones. We currently anticipate that the advance payment will be paid in full by the second quarter of 2006.

Our $125 million advance will be credited against the purchase price of 300 mm wafers from the new wafer fabrication facility. In addition, during the term of the Fujitsu Agreement, we will receive a specified number of free wafers from Fujitsu whenever the aggregate number of wafers shipped by Fujitsu reaches a specified volume. The Fujitsu Agreement will continue until the full amount of the advance payment has been returned to us in the form of wafers or other repayment, subject to the right of either party to terminate the agreement upon the occurrence of certain events. We may request a refund of the unused amount of the advance payment if we have not used all of our wafer credits by December 31, 2007. The repayment obligation of Fujitsu is unsecured.

The foregoing summary description of the Fujitsu Agreement is qualified in its entirety by reference to the Fujitsu Agreement, which is filed as an exhibit to this Form 10Q.

Note 10 - Segment and Geographic Information:

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

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
United States:	$ 13,831	$ 10,623	$ 46,956	$ 47,390
Export:				
Europe	12,703	8,786	40,765	40,744
Asia Pacific (other than Japan)	18,602	14,645	56,447	41,004
Japan	8,508	5,702	23,248	17,074
Other	3,637	3,277	9,875	10,693
	$ 57,281	$ 43,033	$ 177,291	$ 156,905

Resale of product through two distributors accounted for approximately 13% and 10% of revenue in the first nine months of 2004, and 20% and 17%, respectively, for the first nine months of 2003. 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.

Note 11 - Stock Option Exchange Program:

On March 14, 2003, we completed an exchange offer related to a stock option exchange program. Under the exchange offer, eligible employees had the opportunity to tender for cancellation certain stock options in exchange for new options to be granted at least six months and one day after the cancellation of the tendered options. Each eligible participant received new options to purchase four shares of common stock for every seven shares subject to options submitted for cancellation. We accepted options to purchase 11.2 million shares for exchange at various exercise prices between $6.30 and $32.25 and granted new options to purchase 6.4 million shares on September 18, 2003, the new grant date. The exercise price per share of the new options of $8.21 was equal to the fair market value of our common stock on the new grant date. In connection with the stock option exchange program, we accelerated the write-off of accrued deferred compensation recorded in conjunction with certain of our acquisitions, due to the cancellation of certain assumed in-the-money stock options. Such acceleration resulted in $2.2 million of additional intangible asset amortization expense in the first quarter of 2003. However, we do not expect to record any additional compensation expense as a result of the exchange program.

Note 12 - Yen Line of Credit Borrowing Agreement:

To minimize foreign exchange risk related to Yen-based net assets on our Condensed Consolidated Balance Sheet, on August 11, 2004, we entered into an agreement with a bank under the terms of which we can borrow up to $6 million in Japanese Yen in a revolving line of credit arrangement. Outstanding borrowing is collateralized by cash equivalents. Interest on outstanding borrowing is based on the Japanese LIBOR Fixed Rate, and averaged 1.04% during the three months ended September 30, 2004. The average principal balance outstanding was $3.9 million, and the maximum borrowing outstanding and outstanding principal balance at the end of the three month period ended September 30, 2004 was $4.2 million.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

Overview of Three Month and Nine Month Periods Ended September 30, 2004

On September 10, 2004 we entered into an agreement with Fujitsu pursuant to which we will advance $125 million to Fujitsu in support of the development and construction of a new 300mm wafer fabrication facility in Mie, Japan. An initial payment of $25 million was made in October 2004, with the remaining payments to be made in three stages upon the achievement of certain milestones. We currently anticipate that the advance payment will be paid in full by the second quarter of 2006. Our $125 million advance will be credited against the purchase price of 300 mm wafers from the new wafer fabrication facility. Under the terms of the agreement, we will also have access to future process technologies to be developed for the manufacture of our wafers. We have the option of requesting repayment of the unused portion of the $125 mi llion wafer advance, if any, in January 2008. Fujitsu's repayment obligation is unsecured.

Revenue for our business in the third quarter and nine months ended September 30, 2004 grew to $57.3 million and $177.3 million, respectively, compared to $43.0 million and $156.9 million for the third quarter and first nine months of September 30, 2003, respectively. The increase in revenue was due to growth of our New* products while growth of our Mainstream* products was more than offset by a decline in our Mature* products. This improvement is attributable to general strengthening in the PLD market and improvement in the Communications end market. Future revenue growth is dependent on, among other things, continued favorable business conditions in our end markets and market acceptance of our new products.

Our gross margin percentage increased in the third quarter by 1.8% and declined in the first nine months of 2004 by 1.1% compared to the same periods in 2003. With respect to the third quarter of 2004 compared to the third quarter of 2003, the gross margin percentage improvement is primarily attributable to a provision for an allowance for price protection and sales returns from distributors in 2003. For the nine months ended in September 30, 2004 compared to 2003, the gross margin percentage decline is primarily due to growth in new products which currently carry a lower gross margin, and a decline in revenue from mature products, which have a higher gross margin.

Research and development expenses increased to $23.2 million (40.5% of revenue) and $68.1 million (38.4% of revenue) in the third quarter and first nine months of 2004, respectively, compared to $21.2 million (49.2% of revenue) and $64.7 million (41.2% of revenue) in the third quarter and first nine months of 2003, respectively. While there were no significant cost changes in the major categories of research and development expense between the periods, cost increases were primarily attributable to masks for new products. The majority of research and development spending is related to the continued development of next generation FPGA products.

Selling, general and administrative expenses increased to $13.6 million (23.8% of revenue) and $40.8 million (23.0% of revenue) in the third quarter and first nine months of 2004, respectively, compared to $12.1 million (28.2% of revenue) and $37.2 million (23.7% of revenue) in the third quarter and first nine months of 2003, respectively, primarily due to sales and marketing expenses related to new products. To the extent our revenues grow, we expect that there will be a less than proportionate increase in our Selling, general and administrative expenses.

Amortization of intangible assets was $5.8 million and $41.5 million in the third quarter and first nine months of 2004, respectively. Amortization of intangible assets acquired in the Vantis acquisition was completed during the June 30, 2004 quarter which accounts for the decline in amortization from $18.7 million and $58.5 million in the third quarter and first nine months of 2003, respectively.

Other income (expense), net was $4.0 million and $10.2 million in the third quarter and first nine months of 2004, respectively, and included gains from the sale of UMC shares ($0.5 million and $6.1 million, respectively) and extinguishment of Zero Coupon Convertible Subordinated Notes due July 1, 2010 ("Convertible Notes") of $2.8 million, interest and dividends on short term investments and cash equivalents, partially offset by amortization of issuance costs on our Convertible Notes. To the extent market conditions allow, we may make similar sales of UMC shares in future quarters and extinguishments of our Convertible Notes. We are paying foreign income taxes which are reflected in the Statement of Operations and are primarily related to the cost of operating our off shore sales subsidiaries. We are not cur rently paying federal or state income taxes and do not expect to pay or accrue such taxes in 2004.

* Product Classification:

New:	LatticeEC/P, FPSC, XPLD, XPGA, GDX2, ORCA 4, ispMACH 4000/Z, ispPAC-PWR, ispCLK
Mainstream:	ORCA 3, GDX/V, ispMACH L/V, ispLSI 2000V, ispLSI 5000V, ispLSI 8000V, ispMACH 5000VG, and Other
Mature:	ORCA 2, All 5-Volt CPLDs, All SPLDs

Results of Operations

Key elements of our consolidated statement of operations, expressed as a percentage of revenues, were as follows:

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
Revenue	100.0%	100.0%	100.0%	100.0%
Gross margin	56.6%	54.8%	57.2%	58.3%
Research and development expenses	40.5%	49.2%	38.4%	41.2%
Selling, general and administrative expenses	23.8%	28.2%	23.0%	23.7%
Amortization of intangible assets	10.1%	43.4%	23.4%	37.3%
Loss from operations	(17.8)%	(65.9)%	(27.6)%	(43.9)%

Revenue:

Revenue for the third quarter of 2004 increased by $14.2 million, or 33.1%, as compared to the third quarter of 2003, and by $20.4 million, or 13.0% for the first nine months of 2004 when compared to the first nine months of 2003. The composition of our revenue by product family for the third quarter and first nine months of 2004 and 2003, respectively, was as follows:

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2004	Sept. 30, 2003	Sept. 30, 2004	Sept. 30, 2003
FPGA	20%	21%	19%	17%
PLD	80%	79%	81%	83%

As a percentage of total revenue, U.S. sales declined to 24% and 26% for the third quarter of 2004 and for the first nine months of 2004, respectively, compared to 25% and 30% for the third quarter and the first nine months of 2003, respectively. Export sales to Japan rose as a percentage of total revenue, to 15% and 13% in the third quarter and the first nine months of 2004, respectively, from 13% and 11% in the third quarter and in the first nine months of 2003, respectively. Export sales to Europe rose from 20% to 22% for the third quarter from 2003 to 2004, respectively, and declined from 26% to 23% for the first nine months of 2003 and the first nine months of 2004, respectively. Export sales to Asia (excluding Japan) declined from 34% to 32% for the third quarter from 2003 to 2004, respectively, and rose from 26% to 32% for the first nine months of 2003 and the first nine months of 2004, respectively. Export sales to the rest of world (predominantly the Americas excluding the United States) declined to 6% for the third quarter of 2004 and for the first nine months of 2004, respectively, compared to 8% and 7% for the third quarter and the first nine months of 2003, respectively.

During the third quarter and first nine months of 2004 compared to the same periods in 2003, units sold increased by 39% and 14%, respectively, while average selling prices decreased 4% and 1%, respectively. The increase in units sold is predominantly attributable to new products. The decrease in average selling prices is attributable to product mix. Our ability to achieve revenue growth is in large part dependent on the continued development, introduction and market acceptance of new products. See "Factors Affecting Future Results."

Gross Margin:

In absolute terms, gross margin grew by $8.8 million in the three months ended September 30, 2004 compared to the three months ended September 30, 2003, and by $10.0 million in the nine months ended September 30, 2004 compared to the nine months ended September 30, 2003. As a percentage of revenue, gross margin declined from 58.3% for the first nine months of 2003 to 57.2% for the first nine months of 2004. These changes reflect revenue growth in new products, which currently carry a lower gross margin, and a decline in revenue from mature products, which have a higher gross margin. The gross margin percentage increased from 54.8% in the third quarter of 2003 to 56.6% in the third quarter of 2004. The improvement in gross margin for the three months ended September 30, 2004 compared to the three months ended September 30, 2003 is attributable to a provision for an allowance for price protection and sales returns from distributors in 2003.

Research and Development:

Research and development expenses increased by $2.0 million and $3.4 million in the third quarter and first nine months of 2004, respectively, when compared to the same periods in 2003, reflecting cost increases primarily attributable to masks for new products. Research and development expenses consist primarily of labor, masks, prototype wafers, third-party design automation software, assembly tooling and qualification expenses. We believe that a continued commitment to research and development is essential in order to provide innovative new product offerings and to maintain product leadership of our existing product families, and therefore we expect to continue to make significant future investments in research and development.

Selling, General and Administrative Expense:

Selling, general and administrative expenses increased approximately $1.5 million and $3.6 million, respectively, in the third quarter and first nine months of 2004 when compared to the same periods of 2003. These increases were primarily due to increased sales commissions on higher revenue and marketing expenses to support the next generation FPGA launch.

Amortization of Intangible Assets:

Amortization of intangible assets is related to our 2002 acquisitions of the Agere FPGA business and Cerdelinx, our 1999 Vantis acquisition and our 2001 acquisition of Integrated Intellectual Property, Inc. ("I2P"). Amortization expense was $5.8 million and $41.5 million in the third quarter and first nine months of 2004, a decrease of $12.9 million and $17.0 million when compared to the same calendar periods of 2003. The most significant portion of the decrease ($12.7 million) resulted from completion during the second quarter of 2004 of the amortization of intangible assets related to our purchase of Vantis. An additional $2.2 million of the decrease in the first nine months of 2004 resulted from the accelerated write-off of accrued deferred compensation recorded in the first quarter of 2003 in conjunction with certain of our acquisitions, due to the cancellation of certain assumed in-the-money stock options as part of a stock option exchange program initiated during the first quarter of 2003 (refer to Note 11 to the Condensed Consolidated Financial Statements).

Other Income (Expense), Net:

Other income (expense), net, was $4.0 million and $10.2 million, respectively, in the third quarter and first nine months of 2004, respectively**,** as compared to $(3.6) million and $(3.5) million, respectively, for the same periods of 2003. Gains on the sale of UMC shares (see Note 9 to the Condensed Consolidated Financial Statements) of $0.5 million and $6.1 million are included in the third quarter and first nine months of 2004, respectively. There were no similar sales in the comparable periods of 2003. During the third quarter of 2004 and 2003 we recorded a gain of approximately $2.8 million and $1.4 million, respectively, in connection with the extinguishment of a portion of our Convertible Notes. We recorded a gain of $2.9 million on extinguishment of our 4 ¾% Convertible Subordinated Notes due i n 2006 ("4 ¾% Convertible Notes") in the first quarter of 2003. During the third quarter of 2003, we redeemed for cash all of our outstanding 4¾% Convertible Notes plus accrued interest. In conjunction with the call of these notes, we paid a call premium of 2.71% of the outstanding notes, or approximately $4.7 million. This call premium, plus unamortized issuance costs of approximately $1.0 million on the redemption date, was recorded as "Other expense" in the quarter ended September 30, 2003. We recorded interest expense related to our 4 ¾% Convertible Notes of $0.4 million in the third quarter of 2003 and $4.7 million in the nine months ended September 2003. Additional increases in Other income (expense) in the third quarter and first nine months of 2004 as compared to the same periods in 2003 resulted from an increase in interest income on invested balances caused by higher interest rates.

Income Tax Expense (Benefit):

No Federal or state income taxes have been provided for in the first nine months of 2004 or 2003. This is the result of the following factors:

1) We continued to experience significant losses during the first nine months of 2004 and 2003 and are currently not paying any Federal or state income taxes;

2) Net operating loss carry backs and credit carry backs available in prior periods are no longer available; and

3) In the fourth quarter of 2002, we recorded a $118.6 million charge to income tax expense, representing a valuation allowance on our recorded deferred tax assets, in accordance with SFAS 109, "Accounting for Income Taxes." We provided a valuation allowance equal to our net deferred tax assets due to uncertainties regarding their realization. Due to continued uncertainties regarding their realization, we continue to provide a valuation allowance equal to our net deferred tax assets at September 30, 2004.

We are paying foreign income taxes which are reflected in the Statement of Operations and which are primarily related to the cost of operating our off shore sales subsidiaries.

During the third quarter of 2003, we recorded an income tax benefit of $3.3 million related to the release of certain income tax reserves. During the second quarter of 2003, we recorded an income tax benefit of approximately $2.6 million, related to a refund of federal income taxes of approximately $28.1 million received in the second quarter of 2003 resulting from the carry back of 2002 net operating losses to prior profitable periods.

Goodwill and Purchased Intangible Assets:

As a result of adopting SFAS 142 "Intangible Assets" in 2002, goodwill and certain intangibles with indefinite lives are no longer being amortized. To apply SFAS 142, a company is divided into separate "reporting units," each representing groups of products that are separately managed. For this purpose, we have one reporting unit. To determine whether or not goodwill may be impaired, a test is required comparing the book value of the "reporting unit" to its trading price. Similar tests are required in the future, at least annually, and more often where there is a change in circumstances that could result in an impairment of goodwill. If the trading price of our common stock is below the book value for a sustained period, a goodwill impairment test will be performed by comparing book value to estimated market value (trading price plus a control premium). The excess of book value over estimated market value will then be subtracted from the goodwill account with a resulting charge to operations. Subsequent unrealized recoveries in market value, if any, will not be recorded. We completed our annual goodwill impairment assessment in December 2003, upon which no impairment charge was recorded. Additional goodwill impairment tests will be performed at least annually.

The following tables present details of the Company's total purchased intangible assets (in millions):

September 30, 2004		Gross		Accumulated Amortization		Net
Current technology	$	273.6	$	(242.5)	$	31.1
Core technology		7.3		(3.0)		4.3
Licenses		10.2		(4.0)		6.2
Non-compete agreements		14.3		(12.7)		1.6
Workforce		4.7		(1.9)		2.8
Backlog		1.4		(1.4)		-
Customer list		17.4		(17.4)		-
Patents and trademarks		26.8		(26.8)		-
Total	$	355.7	$	(309.7)	$	46.0

December 31, 2003		Gross		Accumulated Amortization		Net
Current technology	$	273.6	$	(214.3)	$	59.3
Core technology		7.3		(1.9)		5.4
Licenses		10.2		(2.9)		7.3
Non-compete agreements		14.3		(9.2)		5.1
Workforce		4.7		(1.2)		3.5
Backlog		1.4		(1.4)		-
Customer list		17.4		(15.8)		1.6
Patents and trademarks		26.8		(24.3)		2.5
Total	$	355.7	$	(271.0)	$	84.7

The estimated future amortization expense of purchased intangible assets as of September 30, 2004 is as follows (in millions):

Fiscal Year:		Amount
2004 (remaining three months)	$	5.1
2005		14.4
2006		10.8
2007		9.8
Later years		5.9
	$	46.0

The estimated future amortization expense of deferred stock compensation attributable to Research and Development activities as of September 30, 2004 is approximately $0.7 million for the remainder of 2004 and $1.9 million for 2005.

New Accounting Pronouncements:

In January 2003, the Financial Accounting Standards Board ("FASB") issued Financial Standards Accounting Board Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities," an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." FIN 46 establishes accounting guidance for consolidation of a variable interest entity. In a variable interest entity the equity investors do not have a controlling interest or their equity interest is insufficient to finance the entity's activities without receiving additional subordinated financial support from the other parties. We do not currently have any business relationship with a variable interest entity, so the adoption of FIN 46 had no impact on our consolidated financial position or results of operations.

In May 2003, the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This pronouncement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in certain circumstances) because that financial instrument embodies an obligation of the issuer. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim periods beginning after June 15, 2003. On November 7, 2003, FASB issued FASB Staff Position No. FAS 150-3 ("FSP 150-3"), "Effective Da te, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." FSP 150-3 deferred certain aspects of SFAS 150. The adoption of SFAS 150 and FSP 150-3 did not have a material impact on our results of operations, financial position or cash flows.

In March 2004, the Emerging Issues Task Force finalized its consensus on EITF Issue 03-6, "Participating Securities and the Two-Class Method Under FASB Statement No. 128, Earnings Per Share" (EITF 03-6). EITF 03-6 clarifies what constitutes a participating security and requires the use of the two-class method for computing basic earnings per share when participating convertible securities exist. EITF 03-6 is effective for fiscal periods beginning after March 31, 2004. The adoption of EITF 03-6 did not have a material effect on our results of operations.

In March 2004, the Emerging Issues Task Force reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarifies the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities. The recognition and measurement guidance for which the consensus was reached in the March 2004 meeting is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. In September 2004, the FASB issued a final FASB Staff Position that delays the effective date for the measurement and recognition guidance for all investments with the scope of EITF 03-01. The consens us reached in March 2004 also provided for certain disclosure requirements associated with cost method investments which was effective for fiscal years ending after June 15, 2004. Management will evaluate the affect of adopting the recognition and measurement guidance when the matter is finalized.

In March 2004, the FASB issued a proposed Statement "Share-Based Payment, an amendment of FASB Statements Nos. 123 and 95", that addresses the accounting for share-based payment transactions in which a Company receives employee services in exchange for either equity instruments of the Company or liabilities that are based on the fair value of the Company's equity instruments or that may be settled by the issuance of such equity instruments. The proposed statement would eliminate the ability to account for share-based compensation transactions using the intrinsic method currently used by the Company and generally would require that such transactions be accounted for using a fair-value-based method and recognized as expense in the Company's consolidated statement of operations. The currently recommended eff ective date of the proposed standard is for interim or fiscal periods beginning after June 15, 2005. Should this proposed statement be finalized in its current form, it will have a significant impact on our consolidated statement of operations, as we will be required to expense the fair value of our stock option grants and stock purchases under our employee stock purchase plan.

In April 2004, the Financial Accounting Standards Board issued FASB Staff Position (FSP)129-1, "Disclosure Requirements under FASB Statement 129, Disclosure of Information about Capital Structure, Relating to Contingently Convertible Securities", further defining disclosure requirements for convertible notes, among other things. As a result of adopting FSP 129-1 in April 2004, we further described circumstances under which note holders may convert their notes into our common shares before note maturity.

In September 2004, the Emerging Issues Task Force issued EITF 04-08 "The Effect of Contingently Convertible Debt on Diluted Earnings Per Share" requiring us to include in diluted earnings per share, on the if-converted method, the aggregate of approximately 14 million shares of our common stock into which the Notes may be converted, regardless of whether the conversion threshold has been met. We adopted this standard as of September 2004. We have reported per share losses since June 2003 when our Convertible Notes were issued. Since inclusion of the additional shares would be anti-dilutive, no change to our historical results is required. However, to the extent inclusion of these shares is dilutive in the future, diluted earnings per share will include the effect of converting our outstanding Convertible Notes.

Liquidity and Capital Resources

As of September 30, 2004, our principal source of liquidity was $319.4 million of cash and short-term investments, an increase of $41.6 million from the balance of $277.8 million at December 31, 2003. This increase was due primarily to the receipt of $29.6 million in the first nine months of 2004 from the sale of shares of our equity investment in UMC and from $26.0 million net cash flow from operations offset by $12.0 million expenditure to extinguish our Convertible Notes. Working capital decreased to $355.6 million at September 30, 2004 from $363.6 million at December 31, 2003.

Accounts receivable days outstanding declined from approximately 46 to 43 days from December 31, 2003, to September 30, 2004 reflecting the timing of receipts within the period. Inventories decreased by $7.5 million, or 16%, as compared to December 31, 2003 primarily due to increased customer shipments. Accounts payable and accrued expenses increased $33.1 million or 116.1% at September 30, 2004 compared to December 31 2003 primarily due to the accrual of $25 million due and paid to Fujitsu Limited in October 2004 (see Note 9 to the Condensed Consolidated Financial Statements) and to a lesser extent due to the renewal and extension of vendor agreements related to the use of third party software. Deferred income increased by $5.5 million at September 30, 2004 as compared to December 31, 2003 reflectin g an increase in the amount of inventory held by distributors to accommodate higher levels of resale by distributors to their end customers.

Foundry investments, advances and other assets decreased by $12.7 million from December 31, 2003 to September 30, 2004. This decrease is attributable to a decline in the market value of our equity investment in UMC shares as well as sale of UMC shares partially offset by an increase represented by the accrual of our first payment due and paid in October 2004 under the Fujitsu agreement.

On September 10, 2004, we entered into an Advance Payment and Purchase Agreement (the "Fujitsu Agreement") with Fujitsu Limited ("Fujitsu"), pursuant to which we will advance $125 million to Fujitsu in support of the development and construction of a new 300mm wafer fabrication facility in Mie, Japan. The initial payment of $25 million was made in October 2004, with the remaining payments to be made in three stages upon the achievement of certain milestones. We currently anticipate that the advance payment will be paid in full by the second quarter of 2006.

Our $125 million advance will be credited against the purchase price of 300 mm wafers from the new wafer fabrication facility. In addition, during the term of the Fujitsu Agreement, we will receive a specified number of free wafers from Fujitsu whenever the aggregate number of wafers shipped by Fujitsu reaches a specified volume. The Fujitsu Agreement will continue until the full amount of the advance payment has been returned to us in the form of wafers or other repayment, subject to the right of either party to terminate the agreement upon the occurrence of certain events. We may request a refund of the unused amount of the advance payment if we have not used all of our wafer credits by December 31, 2007. The repayment obligation of Fujitsu is unsecured.

The foregoing summary description of the Fujitsu Agreement is qualified in its entirety by reference to the Fujitsu Agreement, which is filed as an exhibit to this Form 10Q.

Convertible Notes with a face value of $15 million were extinguished during the three months ended September 30, 2004. A long term agreement with a third party to license and maintain software used to design the company's new products primarily accounts for the increase in Other long term liabilities at September 30, 2004 compared to December 31, 2003.

Deferred stock compensation within Stockholders' equity decreased by $2.9 million during the first nine months of 2004 due to amortization. The $20.5 million decrease in Accumulated other comprehensive income (loss) within the Stockholders' Equity during the first nine months of 2004 is attributable to the unrealized loss in equity securities partially offset by the realized gain on sale of UMC securities (see Note 9 to the Condensed Consolidated Financial Statements).

At September 30, 2004, we had no senior indebtedness and our subsidiaries had approximately $1.9 million of Other liabilities. Issuance costs of $2.5 million, net of debt extinguishments, relative to our Convertible Notes are included in Other assets in our Condensed Consolidated Balance Sheet and are being amortized to expense over the life of the notes. Accumulated amortization amounted to $2.8 million at September 30, 2004. The estimated fair value of our Convertible Notes, based on quoted market prices, was approximately $140 million at September 30, 2004. At the conversion price of $12.06 per share (82.9105 shares of common stock per each $1,000 principal amount notes), 14.0 million common shares are issuable upon conversion of the Convertible Notes. In general, and as further described in the related agreements and Note 11 to our consolidated financial statements in our annual report on Form 10-K for the fiscal year ended December 31, 2003, our Convertible Notes may be converted into common stock before maturity if we request a redemption, or make a distribution to common stock holders that is dilutive to note holders or if we become a party to a merger or consolidation or sale of substantially all of our assets.

Capital expenditures were $8.3 million for the first nine months of 2004. We expect to spend approximately $10 million to $13 million for the fiscal year ending December 31, 2004.

At September 30, 2004, we own 60.8 million shares of UMC common stock. Restrictions by UMC apply to approximately 23.3 million of these shares (see Note 9 to the Condensed Consolidated Financial Statements). During the first nine months of 2004, we sold 36.6 million of our UMC shares for $29.6 million in cash, resulting in a gain of $6.1 million. In the future, we may choose to liquidate additional UMC shares.

In March 1997 and as subsequently amended in January 2002 and March 2004, we entered into an advance payment production agreement with Seiko Epson and Epson Electronics America, Inc. ("EEA") under which we advanced $51.3 million 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 E EA. Cumulatively, $22.9 million of these payments have been repaid to us in the form of semiconductor wafers. We currently estimate that approximately $13.9 million of the outstanding advances are expected to be repaid with semiconductor wafers during the next twelve months and are thus reflected as part of Other current assets in our Condensed Consolidated Balance Sheet. We are not obligated to make additional payments under this agreement.

We believe that our existing liquid resources, expected cash generated from operations and existing credit facilities combined with our ability to borrow additional funds will be adequate to meet our operating and capital requirements and obligations for the next 12 months, including the continued possible extinguishment of a portion of our Convertible Notes as discussed above.

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

Off-Balance Sheet Arrangements

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

Factors Affecting Future Results

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 silicon and software products that meet customer needs while achieving acceptable margins. We are presently in the process of releasing next generation FPGA product families that are critical to our ability to address the FPGA segment of the programmable logic market. If we fail to introduce these, or other, new products in a timely manner or such products fail to achieve market acceptance, our operating results would be harmed.

Fujitsu Limited has agreed to manufacture our next generation FPGA products on its 130 nanometer and 90 nanometer CMOS process technologies, as well as on a 130 nanometer technology with embedded Flash memory that we have jointly developed with Fujitsu. The success of our next generation FPGA products is dependent on our ability to successfully partner with Fujitsu, which has not previously manufactured any of our products. If for any reason we are unsuccessful in our efforts to partner with Fujitsu in connection with these next generation FPGA products, our future revenue growth would be materially adversely affected.

The introduction of new silicon and software 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 market reception of new products depends on accurate projections of long-term customer demand, which by their nature are uncertain.

Our future revenue growth is dependent on market acceptance of our new silicon and software product families and the continued market acceptance of our current products. 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;

- product cost; and
- the quality and reliability of the product.

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

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

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

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

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

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

Historically, the semiconductor industry has experienced periodic downturns of varying degrees of severity and duration. Typically, after such downturns, semiconductor industry conditions improve, although such improvement may not be significant or sustainable. Increased demand for semiconductor industry products may not proportionately increase demand for programmable logic devices in general, or our products in particular. Even if demand for our products increases, average sales prices for our products may not increase, and could decline. Whenever adverse semiconductor industry conditions or other similar conditions exist, there is likely to be an adverse effect on our operating results.

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

The majority of our revenue is derived from customers in the communications equipment and computing end markets. Any deterioration in these end markets or any reduction in technology capital spending could lead to a reduction in demand for our products. Whenever adverse economic or end market conditions exist, there is likely to be an adverse effect on our operating results.

We face risks related to implementation of new Sarbanes Oxley Section 404 Controls Audit requirements.

Section 404 of the Sarbanes-Oxley Act of 2002 requires that our management assess our internal control over financial reporting annually and include a report on its assessment in our annual report. Our auditors are required to audit both the design and operating effectiveness of our internal controls and management's assessment of the design and the operating effectiveness of its internal controls. Through its assessment process, management believes there are no known material weaknesses at this time. This will be the first year that we have undergone an audit of our internal controls and procedures, and it is possible that material weaknesses could be found. If we are unable to remediate any such weaknesses, management may be unable to conclude our controls are operating effectively and our external auditors may i ssue an adverse opinion on our internal controls. If this were to occur, particularly in light of our recent restatement, investor confidence regarding our internal controls could be harmed and our stock price could decline.

We face risks related to our recent accounting restatement.

On January 22, 2004, we announced that we had discovered possible accounting inaccuracies in previously reported quarterly financial statements. An internal investigation was conducted by the Audit Committee of our Board of Directors to determine the scope and magnitude of these inaccuracies. On March 24, 2004, we announced that the Audit Committee had completed its internal accounting investigation and, as a result, we restated our financial statements for the first, second and third quarters of 2003 to correct inappropriate accounting entries and a failure to record a change in accounting estimate related to deferred income. On April 19, 2004, we filed such restated financial statements with Form 10Q/A for the affected quarters.

The restatement of these financial statements has led to litigation claims and may lead to further litigation claims and/or regulatory proceedings against us. The defense of any such claims or proceedings may cause the diversion of management's attention and resources, and we may be required to pay damages if any such claims or proceedings are not resolved in our favor. Any litigation or regulatory proceeding, even if resolved in our favor, could cause us to incur significant legal and other expenses. Moreover, we may be the subject of negative publicity focusing on the financial statement inaccuracies and resulting restatement. The occurrence of any of the foregoing could harm our business and reputation and cause the price of our common stock to decline.

If we are unable to effectively and efficiently implement our plan to improve our internal controls there could be a material adverse effect on our operations or financial results.

We received notice from our independent registered public accounting firm that, in connection with the 2003 year-end audit, the auditor identified a material weakness in our internal controls and procedures relating to separation of duties and establishment of standards for review of journal entries and related file documentation. We have implemented and are continuing to implement various initiatives intended to materially improve our internal controls and procedures to address this weakness. These initiatives address our control environment, organization and staffing, policies, procedures and documentation, and information systems. The implementation of these initiatives is one of our highest priorities. Our Board of Directors, in coordination with our Audit Committee, will continually asses s the progress and sufficiency of these initiatives and make adjustments as necessary. However, no assurance can be given that we will be able to successfully implement our revised internal controls and procedures or that our revised controls and procedures will have the desired effect. In addition, we may be required to hire additional employees, and may experience higher than anticipated capital expenditures and operating expenses, during the implementation of these changes and thereafter. If we are unable to implement these changes effectively or efficiently, there could be a material adverse effect on our operations or financial results. Moreover, we could be subject to additional regulatory oversight and our business and reputation could be harmed.

In addition, we may in the future experience accounting estimate changes related to our deferred income account, inventory account, income tax liability, accounts receivable collectibility, or realization of goodwill and intangible assets, any of which could adversely affect our business and financial results.

We face risks related to pending litigation.

Beginning in September 2004, three complaints on behalf of a purported class of investors who purchased our common stock between April 22, 2003 and April 19, 2004 were filed in the United States District Court for the District of Oregon. These complaints generally allege that we and some of our officers violated provisions of the Securities Exchange Act of 1934. Similar complaints purporting to be derivative actions have been filed on our behalf in Oregon state court alleging that some of our directors and officers breached their fiduciary duties. These complaints arise out of our restatement of financial results for the first three quarters of 2003 to correct inappropriate accounting entries and a failure to record a change in accounting estimate related to deferred income. The expense of defending such litigation may be costly and divert management's attention from the day-to-day operations of our business, which could adversely affect our business and financial results. In addition, an unfavorable outcome in any such litigation could have a material adverse effect on our business and financial results.

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

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

- general economic conditions in the countries where we sell our products;
- conditions within the end markets into which we sell our products;
- the cyclical nature of demand for our customers' products;
- excessive inventory accumulation by our end customers;
- the timing of our and our competitors' new product introductions;
- product obsolescence;

- the scheduling, rescheduling and cancellation of large orders by our customers;
- our ability to develop new process technologies and achieve volume production at the fabs of Seiko Epson, UMC, Chartered Semiconductor, Fujitsu or at other foundries;
- changes in manufacturing yields including delays in achieving target yields on New products;
- 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 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.

Presently, our stock price is trading near our consolidated book value. A sustained decline in our stock price may result in a write-off of goodwill (see Note 6 of our Condensed Consolidated Financial Statements).

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

We do not manufacture finished silicon wafers. Currently, substantially all of our silicon wafers are manufactured by Seiko Epson and Fujitsu in Japan, UMC in Taiwan, and Chartered Semiconductor in Singapore. If any of our current or future foundry partners 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 our foundry partners were to reduce its supply commitment or increase its wafer prices, and we cannot find alternative sources of wafer supply, our operating results could be harmed.

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

If our foundry partners experience quality or yield problems, we may face a shortage of 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 for a prolonged period to produce silicon wafers that meet our specifications, with acceptable yields, our operating results could be harmed.

The majority of our revenue is derived from products based on a specialized silicon wafer manufacturing process technology called E²CMOS®. The reliable manufacture of high performance E²CMOS 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 us.

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 contractors experience quality or yield problems, we may face a shortage of products available for sale.

We rely on contractors 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 contractor and us.

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

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

All of our major silicon wafer suppliers operate fabs located in Asia. Our finished silicon wafers are assembled and tested by independent contractors located in China, Malaysia, the Philippines, South Korea and Taiwan. 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.

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

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

- changes in local economic conditions;
- exchange rate volatility;
- governmental controls and trade restrictions;
- export license requirements and restrictions on the export of technology;
- political instability or terrorism;
- changes in tax rates, tariffs or freight rates;

- interruptions in air transportation; and

- difficulties in staffing and managing foreign sales offices.

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

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

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

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

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

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

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

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

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

Our industry is characterized by frequent claims regarding patents and other intellectual property rights of others. We have been, and from time-to-time expect to be, notified of claims that we are infringing the intellectual property rights of others. If any third party makes a valid claim against us, we could face significant liability and could be required to make material changes to our products and processes. In response to any claims of infringement, we may seek licenses under patents that we are alleged to be infringing. However, we may not be able to obtain a license on favorable terms or without our operating results being adversely affected.

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

Currently we hold substantial equity in UMC, which we acquired as part of a strategic investment to obtain certain manufacturing rights. The market price and valuation of these equity shares has fluctuated widely due to business, stock market or other conditions over which we have little control. During the year ended December 31, 2001, we recorded a $152.8 million pre-tax impairment loss related to this investment. In the future, UMC shares may continue to experience significant price volatility. In the second quarter of 2002 and the first nine months of 2004, we sold a portion of our UMC shares, but have otherwise not attempted to reduce or eliminate this equity price risk through hedging or similar techniques and hence substantial, sustained changes in the market price of UMC shares could impac t our financial results. To the extent that the market value of our UMC shares experiences a significant decline for an extended period of time, our net income could be reduced.

Proposed changes in accounting for equity compensation could adversely affect earnings or could adversely affect our ability to attract and retain employees.

We have historically used stock options as a key component of employee compensation in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board and other agencies have proposed changes to generally accepted accounting principles that would require us and other companies to record a charge to earnings for employee stock option grants and other equity incentives. To the extent that these or other new regulations make it more difficult or expensive to grant options to employees, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain, and motivate employees. Any of these results could materially and adversely aff ect our business.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes from what we reported in our Annual Report on Form 10K for the year ended December 31, 2003.

Item 4. Controls and Procedures

This portion of our quarterly report is our disclosure of the conclusions of our management, including our Chief Executive Officer and Chief Financial Officer, regarding the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, based on management's evaluation of those disclosure controls and procedures. You should read this disclosure in conjunction with the certifications attached as Exhibit 31.1 and 31.2 to this quarterly report for a more complete understanding of the topics presented.

In January 2004, the Audit Committee of our Board of Directors, with the assistance of outside legal counsel and our independent auditor, commenced an internal investigation of the facts and circumstances surrounding inappropriate journal entries affecting the deferred income and accrued expense accounts. As a result of the investigation, it was determined that the unaudited consolidated condensed financial statements for each of the three month periods ended September 30, 2003, June 30, 2003 and March 31, 2003 required restatement.

After reviewing the restatement adjustments and performing an evaluation of our controls and disclosure procedures, management concurred with the Audit Committee that improvements to internal controls are needed relating to: (1) separation of duties and (2) establishment of standards for review and approval of journal entries as well as related file documentation.

We received notice from our independent registered public accounting firm that, in connection with the 2003 year-end audit, the auditor had identified a material weakness relating to our internal controls and procedures. Management agreed with this finding. Certain of these internal control deficiencies may also constitute deficiencies in our disclosure controls. While we are in the process of implementing a more effective system of controls and procedures, we have instituted controls, procedures and other changes to ensure that information required to be disclosed in this quarterly report on Form 10-Q has been recorded, processed, summarized and reported accurately.

The incremental steps that we have taken as a result of the aforementioned control deficiencies to ensure that all material information is accurately disclosed in this report include:

1. Performed an analytical review of all journal entries processed for the 2003 year and the first nine months of 2004;

2. Applied additional methods and techniques to evaluate the accuracy of the deferred income account balance;

3. Instituted an additional level of approval for non-recurring journal entries;

4. Strengthened segregation of duties by adding an additional level of review for authorization and review of significant transactions;

5. Made appropriate personnel changes;

6. Separated responsibilities for preparing financial statements and maintaining accounts in our general ledger;

7. Performed more detailed quarterly reconciliations and analyses of our deferred revenue accounts related to its distributors;

8. Enhanced quarterly accounting review procedures by requiring an independent review of material general ledger accounts;

9. Required all non recurring journal entries to be approved by an independent reviewer; and

10. Selected and began the process of implementation of improvements to information systems for distribution accounting.

Based in part on the steps listed above, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported accurately within the time periods specified in Securities and Exchange Commission rules and forms.

In addition, in order to further address deficiencies described above and to further improve our internal disclosure and control procedures for future periods, we will:

1. Complete implementation of newly selected improvements to information systems for distribution accounting;

2. Perform a review of internal controls and procedures in connection with Section 404 of Sarbanes-Oxley legislative requirements; and

3. Enhance staffing to provide sufficient resources to accomplish the foregoing objectives.

These steps will constitute material changes in internal controls.

In conjunction with (1) our ongoing reporting obligations as a public company and (2) the requirements of Section 404 of the Sarbanes-Oxley Act that management report as of December 31, 2004 on the effectiveness of our internal control over financial reporting and identify any material weaknesses in our internal control over financial reporting, we are engaged in an ongoing process to document, evaluate and test our disclosure controls and procedures, which include internal control over financial reporting. In response to any material weaknesses in the design or operation of our internal controls identified by us as part of this ongoing process, we may be required to implement additional controls and procedures or hire additional personnel. If a material weakness exists at year end, our management may be unable to report favorably as of year-end as to the effectiveness of our control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In September and October 2004, three putative class action complaints were filed in the United States District Court for the District of Oregon against Lattice Semiconductor Corporation, our Chief Executive Officer Cyrus Y. Tsui, and our President Stephen A. Skaggs. These complaints were filed on behalf of a putative class of investors who purchased our stock between April 22, 2003 and April 19, 2004. They generally allege violations of federal securities laws arising out of our previously announced restatement of financial results for the first, second, and third quarters of 2003. Consistent with the usual procedures for cases of this kind, we anticipate that these cases (and any other similar putative class action complaints that might be filed against us) may be consolidated into a single action. We believe that the complaints are without merit, and we intend to vigorously defend against the lawsuits.

In September and October 2004, two shareholder derivative complaints were filed, purportedly on behalf of Lattice Semiconductor Corporation, in the Circuit Court of the State of Oregon for the County of Washington, against all of our current directors, certain former directors, and certain executive officers. The derivative plaintiffs make allegations substantially similar to those in the putative class action complaints, as well as allegations of breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment. Consistent with the usual procedures for cases of this kind, we anticipate that these cases (and any other similar complaints that may be filed in the same jurisdiction) may be consolidated into a single putative shareholder derivative complaint.

All of the complaints generally seek an unspecified amount of damages, as well as attorney fees and costs. The cases are still in the preliminary stages, and it is not possible for us to quantify the extent of our potential liability, if any. An unfavorable outcome in any of these matters could have a material adverse effect on our business and financial results. In addition, defending any litigation may be costly and divert management's attention from the day-to-day operations of our business.

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

On September 6, 2004, we agreed with the U. S. Department of Commerce to settle charges that we did not comply with Export Administration Regulations between 2000 and 2002. The settlement resulted in a fine of $560,000. Provision for these costs has been made in prior year’s financial statements. The charges involved the exportation of controlled semiconductor devices to a Hong Kong distributor that subsequently re-exported those devices to the Peoples Republic of China (PRC), and the release of controlled semiconductor manufacturing technology to nationals of the PRC employed by Lattice in the United States, as well as the exportation of such manufacturing technology to our design center in the PRC. We voluntarily disclosed these circumstances to the Department, cooperated fully with an investigation of our export p ractices and procedures, and have implemented enhancements to strengthen our export control procedures.

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

On May 11, 2004, we issued a warrant to purchase 294,579 shares of our common stock to Bain & Company, Inc., in connection with consulting services provided to us. The warrant has an exercise price of $7.45 per share, and vests at a rate of 24,548.25 shares on the first day of each month, beginning March 1, 2004, subject to Bain’s continued service as a consultant to us. The foregoing transaction was exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof.

Item 6. Exhibits

(a) Exhibits

10.1	Advance Purchase and Payment Agreement dated September 10, 2004, between Lattice Semiconductor Corporation and Fujitsu Limited.[1]
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Pursuant to Rule 24b-2 under the Securities Exchange Act of 1934, confidential treatment has been requested for portions of this exhibit, which portions have been deleted and filed separately with the Securities and Exchange Commission.

SIGNATURES

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

LATTICE SEMICONDUCTOR CORPORATION (Registrant)

Date: November 9, 2004

By: /s/ Jan Johannessen

Jan Johannessen
Corporate Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer and Authorized Signatory)

* Omitted and filed separately with the SEC pursuant to a confidential treatment request.

ADVANCE PAYMENT AND PURCHASE AGREEMENT

THIS ADVANCE PAYMENT AND PURCHASE AGREEMENT (this "Agreement"), is entered into as of September 10, 2004 (the "Effective Date"), by and between Lattice Semiconductor Corporation, having an office at 5555 NE Moore Court, Hillsboro, OR 97124, ("Lattice") and Fujitsu Limited, having an office at Akiruno Technology Center, 50 Fuchigami, Akiruno, Tokyo, 197-0833, Japan ("Fujitsu").

RECITALS

A. Lattice is in the business of, among other things, designing, developing and marketing high performance programmable logic devices and related software.

B. Fujitsu is in the business of, among other things, fabricating semiconductor wafer products according to third-party requirements and specifications.

C. Lattice and Fujitsu have previously established a business relationship wherein Fujitsu fabricates 200mm semiconductor wafers according to specifications agreed between the parties and Lattice buys such wafers from Fujitsu via Fujitsu's subsidiary, Fujitsu Microelectronics America, Inc.

D. Lattice and Fujitsu mutually desire to deepen their current business relationship and establish a good faith commitment for a long-term business alliance between the two companies.

E. In connection with the foregoing intentions, Lattice wishes to provide an advance payment of money to Fujitsu to be used for the establishment of a new semiconductor wafer fabrication facility, including but not limited to the construction of the facilities and installation of fabrication equipments, and Fujitsu wishes to provide to Lattice 300mm wafers using certain proprietary technologies, all in accordance with the terms and conditions of this Agreement.

AGREEMENT

1. <u>Definitions</u>.

1.1 "300mm Wafers" will mean the 300mm semiconductor wafers fabricated by Fujitsu at the New Facility for delivery and sale to Lattice under this Agreement and the Product Supply Agreements.

1.2 "90nm Process Technology" will mean the 90nm logic Process Technology, presently designated as CS100 A/L-G, as the first Process Technology installed for Lattice at the New Facility to manufacture 300mm Wafers.

1.3 "65nm Process Technology" will mean the advanced 65nm logic Process Technology projected to be developed by Fujitsu for use by Lattice currently as set forth in Exhibit D.

1.4 "* Process Technology" will mean the * Process Technology projected to be developed by Fujitsu for use by Lattice currently as set forth in Exhibit D.

1.5 "* Process Technology" will mean a * Process Technology with * projected to be developed by Fujitsu or jointly by the parties.

1.6 "Advance Payment" will mean the One Hundred Twenty-Five Million U.S. Dollar (US$125,000,000) payment to be made by Lattice to Fujitsu in the manner described in Section 4.

1.7 "Akiruno Facility" will mean the Fujitsu 200mm semiconductor wafer fabrication facility located in Akiruno, Japan.

1.8 "Developed Technology" will mean, collectively, the * Process Technology, the 65nm Process Technology, the * Process Technology, and any other Process Technologies as mutually agreed by the parties.

1.9 "Equipment" will mean the semiconductor fabrication equipment that Fujitsu will install in the New Facility for purposes of fabricating 300mm Wafers.

1.10 "Force Majeure Event" will have the meaning ascribed to it in Section 13.13.

1.11 "New Facility" will mean the Fujitsu 300mm semiconductor wafer fabrication facility to be constructed in Mie, Japan.

1.12 "PLD" will mean any semiconductor or integrated circuit device designed principally for *.

1.13 "Price" will mean the price at which Fujitsu will sell and Lattice will purchase the 300mm Wafers and Reticles pursuant to Section 7.1 and a Product Supply Agreement.

1.14 "Process Technology" will mean a CMOS wafer manufacturing process used for 90 nm and/or 65nm generation, which will be used at the New Facility to fabricate 300mm Wafers. The Process Technology will include (a) all process flow, process steps, process conditions (and modifications thereto) used to manufacture semiconductor wafers at the New Facility as well as (b) all methods, formulae, procedures, technology and know-how associated with such process steps and process conditions.

1.15 "Products" will mean Lattice's PLDs produced from the 300mm Wafers provided by Fujitsu to Lattice under this Agreement. The Products will be ordered, fabricated, delivered and sold pursuant to the terms and conditions of Product Supply Agreement(s).

1.16 "Projected New Facility Completion Schedule" will have the meaning ascribed to it in Section 3.1.2 and as set forth in Exhibit A.

1.17 "Product Supply Agreement(s)" will mean the agreement(s) by and between Fujitsu and Lattice for the Process Technology pursuant to which Fujitsu agrees to sell and Lattice agrees to purchase the 300mm Wafers for the Products manufactured using such Process Technology.

1.18 "Qualification Wafers" will mean the 300mm Wafers used to test and evaluate the performance of a Product or Process Technology, as applicable.

1.19 "Reticles" will mean the reticles produced by Fujitsu for each type of Product, used in the development and fabrication of the 300mm Wafers or qualification of a Process Technology, as applicable.

1.20 "Subsidiary" will mean any corporation, partnership, joint venture or other legal entity which agrees in writing to be bound by the terms and conditions of this Agreement and more than fifty percent (50%) of whose ownership rights are controlled directly or indirectly by Fujitsu or Lattice, as the case may be, but only so long as such control exists.

1.21 "Supply Commitment" will have the meaning ascribed to it in Section 3.1.1.

1.22 "Target Defect Densities" will mean the anticipated target defect density levels for the 300mm Wafers as described on Exhibit C.

2. <u>Representations.</u>

2.1 <u>Representations of Fujitsu</u>. In order to induce Lattice to enter into this Agreement and to make the Advance Payment hereunder, Fujitsu hereby represents and warrants that:

2.1.1 <u>Corporate Status</u>. Fujitsu (a) is duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation, (b) has the corporate power to own or lease its assets and to transact the business in which it is currently engaged and (c) is in compliance with all requirements of law except to the extent that the failure to comply therewith will not materially affect the ability of Fujitsu to perform its obligations under this Agreement.

2.1.2 <u>Corporate Authority</u>. (a) Fujitsu has the corporate power, authority and legal right to execute, deliver and perform this Agreement and has taken as of the date hereof all necessary corporate action to execute this Agreement, (b) the person executing this Agreement has actual authority to do so on behalf of Fujitsu and (c) there are no outstanding assignments, grants, licenses, encumbrances, obligations or agreements, either written, oral or implied, that prohibit execution of this Agreement.

2.1.3 <u>Ownership of the Site</u>. Fujitsu has such right, title and interest in and to the real property on which the New Facility will be constructed and the structures located thereon as is required to permit the operation of the New Facility as contemplated to be conducted under this Agreement.

2.2 <u>Representations of Lattice</u>. In order to induce Fujitsu to enter into this Agreement and to make the Supply Commitment hereunder, Lattice hereby represents and warrants that:

2.2.1 <u>Corporate Status</u>. Lattice (a) is duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation, (b) has the corporate power to own or lease its assets and to transact the business in which it is currently engaged and (c) is in compliance with all requirements of law except to the extent that the failure to comply therewith will not materially affect the ability of Lattice to perform its obligations under this Agreement.

2.2.2 Corporate Authority. (a) Lattice has the corporate power, authority and legal right to execute, deliver and perform this Agreement and has taken as of the date hereof all necessary corporate action to execute this Agreement, (b) the person executing this Agreement has actual authority to do so on behalf of Lattice and (c) there are no outstanding assignments, grants, licenses, encumbrances, obligations or agreements, either written, oral or implied, that prohibit execution of this Agreement.

2.2.3 Capability of Making Advance. Lattice has prepared and has enough capability to make the Advance Payment to Fujitsu in accordance with the schedule as ascribed in Section 4.

3. Description and Operation of the New Facility

3.1 Description of the New Facility.

3.1.1 Foundry at the New Facility. Fujitsu hereby agrees to construct the New Facility and to install the Equipment therein to produce 300mm Wafers. The first Process Technology used to manufacture the 300mm Wafers will be the 90nm Process Technology. The Developed Technology will be used subsequently subject to separate agreement between the parties. Fujitsu will use its best efforts to achieve and maintain sufficient foundry capacity to manufacture the 300mm Wafers for Lattice ("Supply Commitment") according to Lattice's forecast, as currently set forth on Exhibit B, which will be updated periodically.

3.1.2 Completion Schedule. The projected completion schedule for the construction and facilitization of the New Facility (the "Projected New Facility Completion Schedule") is set forth in Exhibit A attached hereto, and the projected 300mm capacity plan is set forth in Exhibit E attached hereto.

a) In the event Fujitsu has reason to believe that any item in the Projected New Facility Completion Schedule designated as a "Construction Milestone" will be delayed by more than thirty (30) calendar days, Fujitsu will promptly notify Lattice in writing and (i) explain the reason for the delay, (ii) describe the estimated amount of time that construction will be delayed, and (iii) describe the action that Fujitsu will take to minimize the delay.

b) Without limiting the foregoing, (i) if Fujitsu cancels development or construction of the New Facility at any time prior to completion or (ii) if achievement of the milestone labeled "Mass Production Milestone" is delayed by more than six (6) months after the date set forth on the Projected New Facility Completion Schedule (more than nine (9) months if due to a Force Majeure Event), then, in each such case, Lattice will have the option, in its sole discretion and subject to the dispute resolution process provided in Section 13.2, of terminating this Agreement by delivering written notice to Fujitsu pursuant to Section 12.

3.2 Installation of Process Technology.

3.2.1 90nm Process Technology. Fujitsu will install its 90nm Process Technology in the New Facility according to the Projected New Facility Completion Schedule. Fujitsu will be responsible for all costs of such installation, including qualification of such process.

3.2.2 Developed Technology. Fujitsu will develop and install the Developed Technology in the New Facility subject to separate agreement between the parties. Fujitsu will be responsible for all costs of such installation, including qualification of such processes unless otherwise agreed between the parties.

3.3 Product Qualification Wafers and Reticles. Fujitsu will provide the Reticles and Qualification Wafers at no charge to Lattice for qualification of Products on 300mm Wafers that have first taped-out to the Akiruno Facility. Lattice will bear the cost of Reticles and Qualification Wafers for other Products that have not first taped-out to the Akiruno Facility.

4. Advance Payment.

4.1 Advance Payment. Lattice will pay to Fujitsu an amount equal to One Hundred Twenty-Five Million U.S. Dollars (US$125,000,000) (the "Advance Payment"), which will be credited against certain future purchases by Lattice of 300mm Wafers as provided in Section 5.2. The Advance Payment will be made in the following installments:

4.1.1 First installment of Twenty-Five Million U.S. Dollars (US$25,000,000) within thirty (30) days after the Effective Date.

4.1.2 Second installment of Twenty-Five Million U.S. Dollars (US$25,000,000) within thirty (30) days after satisfactory confirmation by Fujitsu of full completion of the installation of the Equipment at the New Facility for the initial manufacturing line for 300mm Wafers.

4.1.3 Third installment of Thirty-Seven Million Five Hundred Thousand U.S. Dollars (US$37,500,000) within thirty (30) days after satisfactory confirmation by Fujitsu of the first process qualification at the New Facility in accordance with applicable Product Supply Agreement for 300mm Wafers for the Products using Lattice Products on the 90nm Process Technology.

4.1.4 Fourth installment of Thirty-Seven Million Five Hundred Thousand U.S. Dollars (US$37,500,000) within thirty (30) days from Fujitsu's shipment of the first lot of 300mm Wafers for Products manufactured at the New Facility and meeting the Target Defect Density as set forth in Exhibit C.

4.2 Failure to Make Advance Payment. In the event Lattice has reason to believe that any item in the schedule to make the Advance Payment set forth in Section 4.1 will be delayed, Lattice will promptly notify Fujitsu in writing and (i) explain the reason for the delay, (ii) describe the estimated time that such Advance Payment will be delayed. The parties shall consult to reschedule whole procedure and timing set forth in this Agreement.

4.3 Payment Method. All payments made by Lattice to Fujitsu will be in immediately available funds and will be made by wire transfer in U.S. Dollars to a bank account designated by Fujitsu.

5. Product Purchases and Credit of Advance Payment.

5.1 Purchase of Products.

5.1.1 Wafer Capacity. Lattice intends to buy Products from Fujitsu in such quantities and with such 300mm Wafer capacity as is determined by Lattice and Fujitsu, based on Exhibit B attached hereto.

5.1.2 General Terms and Conditions. Fujitsu will fabricate and supply the 300mm Wafers for Products to Lattice pursuant to terms and conditions for the prototype wafer fabrication, wafer fabrication, order and acceptance, shipping, insurance, warranty, and other standard terms and conditions as set forth in a Product Supply Agreement to be entered into with respect to each Process Technology. The parties hereby express their good-faith commitment to enter into all Product Supply Agreements required to implement the terms and conditions of this Agreement. Fujitsu agrees to provide and Lattice agrees to purchase all 300mm Wafers covered by this Agreement in the manner required by the Product Supply Agreements. The parties acknowledge that a target of defect densities, turn around times, and other customary items will be reviewed and amended from time to time by the parties hereto, and will be incorporated into all Product Supply Agreements.

5.1.3 Limited Exclusivity. For a period beginning on the date of commencement of mass production of Products using a specific Process Technology at the New Facility ("Mass Production Commencement Date") and ending * ("Exclusivity Period"), Lattice will be the exclusive PLD market foundry customer of Fujitsu for such Process Technology. During the Exclusivity Period, Fujitsu agrees that *. Notwithstanding the foregoing, the parties shall discuss in good faith a mutual early termination of an Exclusivity Period if actual loading of Products is substantially below the forecasted volume, as currently set forth on Exhibit B, which will be updated periodically.

5.1.4 Scope of Business. The parties acknowledge and agree that Fujitsu may develop, fabricate, offer, market, sell or deliver its products existing as of the date hereof (including succeeding products thereof), notwithstanding the limited exclusivity ascribed in Section 5.1.3.

5.2 Credit of Advance Payment. The One Hundred Twenty-Five Million U.S. Dollars (U.S.$125,000,000) Advance Payment (once paid, referred to as the "Credited Amount") will be repaid through means of an offsetting adjustment in the amount of one hundred percent (100%) of the Price, as described in Section 7, for 300mm Wafers purchased hereunder. The then current Price for all purchases by Lattice of 300mm Wafers will be offset cumulatively against the Credited Amount until the aggregate dollar value of the Price for all 300mm Wafers purchased by Lattice equals the amount of the Credited Amount.

5.3 Free 300mm Wafers. As a consideration for Lattice's payment of the Advance Payment, Fujitsu will provide Lattice with * free 300mm Wafers whenever the aggregated amount of the 300mm Wafers shipped by Fujitsu reaches every * 300mm Wafers while the Credited Amount exists, provided that, all the 300mm Wafers for which free 300mm Wafers will be provided are paid for by offsetting the Price thereof against the Credited Amount. The Credited Amount will not be reduced by the Price of such free 300mm Wafers. Lattice will not receive free 300mm Wafers with respect to any 300mm Wafers purchased by Lattice other than through reduction of the Credited Amount.

5.4 Calculation of Aggregate Value of 300mm Wafers Purchased. The Credited Amount will be offset and reduced at the end of each calendar month by an amount equal to the then current Price multiplied by the number of 300mm Wafers shipped from the New Facility (or other facility, if approved by Lattice in accordance with Section 6.5.1(c)) to Lattice during such calendar month in a manner to be agreed upon by the parties. The then current Credited Amount balance will be increased at the end of each calendar month as applicable, to adjust for 300mmWafers previously offset against the Credited Amount but subsequently returned by Lattice to Fujitsu for credit in accordance with the applicable Product Supply Agreement. Any replacement 300mm Wafers made for such returned 300mm Wafers for the Product shall not be included in the amount calculated to grant s uch free 300mm Wafers. No adjustment to the Credited Amount will be made for free wafers, or for any 300mm Wafers paid for by Lattice outside of this Agreement.

5.5 Invoices; Reports. Fujitsu shall issue invoices, Return Material Authorizations (RMAs) and other reports pertaining to the sale and purchase of 300mm Wafers for Products in accordance with applicable Product Supply Agreements. Within ten business (10) days after the end of each month, Fujitsu will deliver to Lattice a written report describing (a) the then outstanding balance of the Credited Amount (after application of all prior offsets, reductions, and credits), and (b) the number of 300mm Wafers shipped to Lattice and 300mm Wafers returned to Fujitsu by Lattice for credit during such calendar month, and the Price for each such 300mm Wafer. Within ten (10) business days from the receipt of such report, Lattice will review the accuracy and completeness of such report. Lattice will notify Fujitsu of its approval of the report, or any inacc uracies or incompleteness and Fujitsu will research such claim. If the parties determine any such inaccuracy, Fujitsu will make the applicable changes to such reports, to be confirmed by Lattice.

6. Forecasts; Purchase Orders; Supply Commitment. Forecast methodologies, purchase orders and acknowledgment mechanisms, supply commitments, and processes for adjusting to changes will be specified in greater detail in each Product Supply Agreement, based on the following general principles:

6.1 Forecasting and Supply Commitment.

On or before the 15th of each month during the term of this Agreement, Lattice will provide Fujitsu with a * forecast ("Lattice Forecast") which will set forth the estimated quantity of 300mm Wafers to be fabricated by Fujitsu at the New Facility pursuant to purchase orders issued by Lattice. Fujitsu commits to supply Lattice with sufficient foundry capacity to deliver the amount of 300mm Wafers listed in each Lattice Forecast delivered hereunder. In the event that a Lattice Forecast exceeds the Supply Commitment, then the parties will discuss in good faith alternatives for meeting the requirements in such Lattice Forecast.

6.2 Business Meetings; Long-range Forecasts. The parties will attempt to hold business meetings to discuss issues arising under this Agreement quarterly, but in no event less than three times annually. At each such meeting, Lattice will provide Fujitsu with a * forecast setting forth the estimated quantity of 300mm Wafers to be fabricated by Fujitsu, and Fujitsu will provide Lattice with a * forecast of its capacity plan for each Process Technology in the New Facility. In addition, Lattice will provide Fujitsu with its tape-out plans for forecasted 300mm Wafers, and Fujitsu will provide Lattice with its forecasted Process Technology road map. All of these forecasts and plans will be provided only for forecasting purposes and will not bind either party legally.

6.3 Ordering and Delivery. Lattice will place purchase orders for the 300mm Wafers in accordance with the applicable Product Supply Agreement. Fujitsu will fabricate and deliver the 300mm Wafers based on the applicable Product Supply Agreement and such purchase orders.

6.4 Excess Capacity. If Lattice requests to purchase 300mm Wafers in excess of Lattice Forecast ("Excess Capacity"), Fujitsu will use its best efforts to provide Lattice Excess Capacity in the manner specified below:

6.4.1 First, Lattice will specify in writing the amount of Excess Capacity required, the 300mm Wafers it desires to purchase, and the date from which such Excess Capacity is required.

6.4.2 Second, Fujitsu will then determine in good faith how much capacity is available and notify Lattice of its determination. *

6.4.3 Third, the parties will then mutually agree upon a preliminary excess capacity allocation.

6.5 Short-Term Failure to Meet Supply Commitment.

6.5.1 Failure Due to Fujitsu. In the event that (a) Fujitsu fails to fulfill the Supply Commitment by the end of any month or (b) Fujitsu has reason to believe that it will be unable to fulfill the Supply Commitment by the end of such month, then Fujitsu will take the following measures:

a) First, Fujitsu will promptly notify Lattice in writing and describe the nature of the difficulty.

b) Second, Fujitsu will use its best efforts to remedy the difficulty in an expeditious manner.

c) Third, in the event that a delay is expected to exceed one (1) month, Fujitsu will use its best efforts to make available sufficient capacity at the Akiruno Facility or any other Fujitsu facility (if technically feasible), to cover the deficiency between the 300mm Wafers ordered and the actual capacity at the New Facility. If such deficiency is covered by Fujitsu providing capacity at another Fujitsu facility, the parties will discuss whether and how the Credited Amount will be offset. The parties acknowledge, however, that Fujitsu cannot guarantee the availability of alternative capacity.

6.5.2 Failure Due to Lattice. Notwithstanding anything contained in Section 6.5.1 to the contrary, in the event that Fujitsu fails to fulfill the Supply Commitment in any month due solely to (a) design defects in the 300mm Wafers caused by Lattice, (b) design changes requested by Lattice, (c) process flow changes requested by Lattice or (d) any other reason caused by Lattice, Fujitsu shall not be liable for such failure and will only be required to cooperate with Lattice to fulfill the Supply Commitment in such month.

6.5.3 Failure Due to Both Parties. Notwithstanding anything contained in Section 6.5.1, or 6.5.2 to the contrary, in the event that Fujitsu fails to fulfill the Supply Commitment due to difficulties caused jointly by Lattice and Fujitsu, the parties will mutually agree in writing upon a fair and equitable solution.

6.5.4 Failure Due to Catastrophe. In the event that any Force Majeure Event prevents Fujitsu from fabricating 300mm Wafers for Lattice, then (a) Fujitsu will immediately implement the measures required by Section 6.5.1, (b) Fujitsu will permit Lattice to inspect the New Facility or such other facilities as may be necessary, and (c) the parties will promptly begin good faith negotiations to agree on a corrective action plan.

6.6 Long-Term Failure to Meet Supply Commitment. In the event that (a) Fujitsu fails to substantially fulfill the Supply Commitment or (b) there is reason to believe that Fujitsu will be unable to substantially fulfill the Supply Commitment, and such failure is or is expected to be chronic or for an extended period, and thus is not subject to Section 6.5 above, then Lattice will have the option, in its sole discretion and subject to the dispute resolution process provided in Section 13.2, of terminating this Agreement pursuant to Section 12.

7. Wafer Pricing and Payment.

7.1 Determination of Price. Pricing for the 300mm Wafers and Reticles for the first * periods of production at the New Facility (such a * period hereinafter referred to as "Pricing Periods") will be set forth in the applicable Product Supply Agreement(s). At least * prior to the end of the first Pricing Period and each Pricing Period thereafter the parties will meet and discuss the Prices for the 300mm Wafers and Reticles for the following Pricing Period. Prices negotiated in accordance with this Section 7.1 will be market competitive and will take into consideration the long-term business alliance of the parties.

7.2 Shipping, Insurance, Taxes, Duties, and Other Fees. Delivery terms and bearing of sales, use, value added, withholding, or other taxes or duties that may be applicable to purchase of the 300mm Wafers by Lattice will be prescribed in the Product Supply Agreement.

7.3 Payment. Other than through offset of the Credited Amount, Lattice will not be required to pay for any 300mm Wafers delivered under this Agreement or any Product Supply Agreement until the Credited Amount has been fully offset and reduced. Once the Advance Payment is fully offset, reduced or otherwise repaid, Lattice will pay Fujitsu in the manner specified in the Product Supply Agreements based on the Price for any additional 300mm Wafers purchased.

8. Repayment of Any Unused Credited Amount. If, for any reason, there remains a portion of the Credited Amount that has not been used to purchase 300mm Wafers by December 31, 2007 (or such later date as may be mutually agreed), then Lattice will have the option, in its sole discretion and subject to the dispute resolution process provided in Section 13.2, to elect to receive repayment in cash of all or part of such then remaining outstanding portion of the Credited Amount. Fujitsu will repay any such amount within ninety (90) days of Lattice's written request therefor, together with simple interest at the rate of one and seventy-five one hundredths percent (1.75%) per annum from the date of such written request.

9. Cooperation.

9.1 Developed Technology. Fujitsu will design and develop the Developed Technology in accordance with specifications and requirements pertaining thereto mutually agreed upon by both parties. Fujitsu will have primary responsibility for Developed Technology used in the New Facility. Fujitsu will consider Lattice's technical and business requirements in defining Developed Technology and establishing schedules for development and implementation in the New Facility. The parties will use their best efforts to develop the new Developed Technology according to the schedules set forth in Exhibit D.

9.2 *

9.3 Other Development. Without limiting the foregoing, the parties anticipate from time to time engaging in various other types of joint development and technical cooperation activities required to fabricate the 300mm Wafers and to effectuate the terms and conditions of this Agreement. The parties will discuss such joint development opportunities and will enter into appropriate agreements where applicable.

10. Intellectual Property Rights.

10.1 Warranty and Indemnity. All warranties and indemnities with respect to the 300mm Wafers shall be as set forth in the Product Supply Agreement.

10.2 Ownership of Intellectual Property. Fujitsu will retain ownership of all of its current intellectual property rights, including those pertaining to its Process Technology. Lattice will retain ownership of all of its current intellectual property rights, including those pertaining to its Products. New inventions will be the intellectual property of the party creating the invention. In the event the parties engage in joint development activities and as a result develop joint inventions, then if such inventions are derivatives of existing intellectual property rights, then they will be owned by the party owning such intellectual property rights. If such inventions are not derivatives of existing intellectual property rights, then if such inventions (i) relate to or cover circuitry or product designs, then they will be owned by Lattice; (ii) relat e to or cover Process Technology, then they will be owned by Fujitsu; and (iii) cannot be clearly identified as (i) or (ii) above, or consist of the final SPICE parameters generated during a joint development project, then they will be owned jointly by both parties. The parties will cooperate in good faith concerning use of intellectual property rights, and define any such licenses and understandings in separate agreement(s) between the parties. The parties agree to cooperate in obtaining patents, copyrights, mask works, and such other protection that the parties deem appropriate to secure their respective intellectual property rights as described herein.

10.3 Ownership of Reticles and Qualification Wafers. Subject to Fujitsu’s and Lattice’s rights described in Section 10.2 above, Lattice will have ownership of all right, title, and interest in and to the Reticles for Products and Product Qualification Wafers.

11. Confidential Information.

11.1 Definitions. "Confidential Information" means technical information, specifications, data, drawings, designs or know-how, prices, order volumes, forecasts, product roadmaps, financial information, strategic plans, and other proprietary information disclosed between Fujitsu and Lattice in connection with this Agreement, including without limitation the provisions hereof. Confidential Information does not include information or material that is expressly covered by confidentiality provisions of a Product Supply Agreement or other agreement between the parties, it being understood that the confidentiality provisions in such agreements will apply to confidential information exchanged thereunder.

11.2 Marking. If Confidential Information is provided in a tangible form, it will be marked as confidential or proprietary. If Confidential Information is provided orally or visually, it will be treated as confidential and proprietary if it is designated as confidential or proprietary at the time of disclosure by the disclosing party and described as such in a writing provided to the other party within thirty (30) days of the oral or visual disclosure, which writing will be marked as confidential or proprietary.

11.3 Restrictions on Use. During the term of this Agreement and for a period of five (5) years thereafter, the receiving party will: (a) hold the Confidential Information in confidence using the same degree of care that it normally exercises to protect its own proprietary information but no less than a reasonable degree of care, (b) restrict disclosure of Confidential Information solely to those employees (including any contract employees or consultants) of such party on a need-to-know basis, and not disclose it to other employees or parties, (c) restrict the number of copies of Confidential Information to the number required to carry out its obligations under this Agreement, and (d) restrict use of the Confidential Information to that which is necessary to permit the receiving party of such Confidential Information to perform its obligations and e xercise its rights under this Agreement.

11.4 Exceptions to Confidentiality Obligations. Neither party will use or disclose the other party's Confidential Information except as permitted by this Agreement. The receiving party, however, will have no obligations concerning the disclosing party's Confidential Information if the disclosing party's Confidential Information:

a) is made public before the disclosing party discloses it to the receiving party;

b) is made public after the disclosing party discloses it to the receiving party (unless its publication is a breach of this Agreement or any other agreement between Fujitsu and Lattice);

c) is rightfully in the possession of the receiving party before the disclosing party discloses it to the receiving party;

d) is independently developed by the receiving party without the use of the Confidential Information, if such independent development is supported by documentary evidence; or

e) is rightfully obtained by the receiving party from a third party who is lawfully in possession of the information and not in violation of any contractual, legal, or fiduciary obligation to the disclosing party with respect to the information.

11.5 Permitted Disclosures. In addition, the receiving party will be allowed to disclose Confidential Information of the disclosing party to the extent that such disclosure is (a) approved in writing by the disclosing party, (b) necessary for the receiving party to enforce its rights under this Agreement in connection with a legal proceeding; or (c) required by law, including the securities laws and regulations applicable to reporting companies under the Securities Exchange Act of 1934, or by the order or a court of similar judicial or administrative body, provided that the receiving party notifies the disclosing party of such required disclosure promptly and in writing and cooperates with the disclosing party, at the disclosing party's reasonable request and expense, in any lawful action to contest or limit the scope of such required disclosu re.

11.6 Post-termination Procedure for Confidential Information. Upon termination of this Agreement, a party that has received Confidential Information from the other party pursuant to this Agreement will return or destroy, within fourteen (14) days of the disclosing party's request for return, all Confidential Information that was obtained or learned by the receiving party from the disclosing party, together with all copies, excerpts, and translations thereof.

12. Term and Termination of Agreement.

12.1 Term. The term of this Agreement will extend from the date first written above until all of the Credited Amount has been credited against 300mm Wafers purchased hereunder or repaid to Lattice, unless terminated earlier pursuant to Section 12.2 or 12.3. After the expiration of this Agreement, any Product Supply Agreement in effect between the parties at such time will govern the relationship between the parties with respect to the manufacture, shipment, sale, and purchase of the 300mm Wafers or other wafers provided under this Agreement.

12.2 Termination. Either party may terminate or suspend this Agreement immediately and without liability upon written notice to the other party if any one of the following events occurs:

a) the other party files a voluntary petition in bankruptcy or otherwise seeks protection under any law for the protection of debtors;

b) a proceeding is instituted against the other party under any provision of any bankruptcy laws which is not dismissed within ninety (90) days;

c) the other party is adjudged bankrupt;

d) a court assumes jurisdiction of all or a substantial portion of the assets of the other party under a reorganization law;

e) a trustee or receiver is appointed by a court for all or a substantial portion of the assets of the other party;

f) the other party becomes insolvent, ceases, or suspends all or substantially all of its business;

g) the other party makes an assignment of the majority of its assets for the benefit of creditors; or

h) a direct competitor of one party acquires, through merger, consolidation, acquisition, or otherwise, an interest in excess of fifty percent (50%) of the voting securities or assets of the other party; or

i) if one party transfers all or substantially all of its business to which this Agreement relates to a direct competitor of the other party.

12.3 Termination for Cause.

12.3.1 If either party fails to perform or violates any material obligation of this Agreement, then, sixty (60) days after providing written notice to the breaching party specifying the default (the "Default Notice"), the non-breaching party may terminate this Agreement, without liability, unless:

a) the breach specified in the Default Notice has been cured within the sixty (60) day period; or

b) the default reasonably required more than sixty (60) days to correct, and the defaulting party has begun substantial corrective action to remedy the default within such sixty (60) day period and diligently pursues such action, in which event, the non-breaching party may not terminate or suspend this Agreement unless one hundred twenty (120) days has expired from the date of the Default Notice without such corrective action being completed and the default remedied.

12.3.2 In addition, Lattice will have the right to terminate this Agreement pursuant to Section 3.l.2 (b) or Section 6.6 by delivering twenty (20) days written notice thereof to Fujitsu.

12.4 Effect of Termination

12.4.1 Subject to Section 12.4.2 and Section 12.4.3, if Lattice terminates this Agreement pursuant to Section 12.2 or 12.3.1, Fujitsu will pay to Lattice within thirty (30) days after such termination an amount of money in U.S. Dollars equal to the unused balance of the Credited Amount, together with interest at one and seventy-five one hundredths percent (1.75%) per annum from the date of notice.

12.4.2 If Lattice exercises its right to terminate this Agreement pursuant to Section 3.1.2(b), then, within six (6) months after Lattice's delivery of the requisite notice of termination to Fujitsu, Fujitsu will repay to Lattice all installments of the Advance Payment paid to Fujitsu by Lattice under this Agreement, together with interest at one and seventy-five one hundredths percent (1.75%) per annum from the date of notice.

12.4.3 If Lattice exercises its right to terminate this Agreement pursuant to Section 6.6, then, within six (6) months after Lattice's delivery of the requisite notice of termination to Fujitsu, Fujitsu will repay to Lattice the unused balance of the Credited Amount, together with interest at one and seventy-five one hundredths percent (1.75%) per annum from the date of notice.

12.4.4 If Fujitsu terminates this Agreement pursuant to Section 12.2 or 12.3.1, the parties will complete the purchase and sale of 300mm Wafers ordered in accordance with the applicable Product Supply Agreement and offset the relevant Credited Amount. Fujitsu will repay the then remaining Credited Amount with no interest by the later of (i) December 31, 2007, or (ii) six (6) months from such termination.

12.5 Survival. The following Sections will survive any expiration, termination or cancellation of this Agreement and the parties will continue to be bound by the terms and conditions thereof: 1, 8, 10, 11, 12.4, 12.5, and 13.

13. Miscellaneous.

13.1 Order of Precedence. In the event of any conflicts between this Agreement and any Product Supply Agreement priority will be given first to this Agreement and second to the Product Supply Agreements. The terms and conditions on any purchase orders, acceptances, or similar documents exchanged between the parties will not apply and are hereby rejected by the receiving party.

13.2 Dispute Resolution.

13.2.1 Meeting of Executives. In the event that any dispute or disagreement between the parties as to any provision of this Agreement arises, prior to taking any other action, the matter will be referred to responsible executives of the parties for consideration and resolution. Any party may commence such proceedings by delivering a written request to the other party for a meeting of such responsible executives. The other party will be required to set a date for the meeting to be held within thirty (30) days after receipt of such request and the parties agree to exercise their best efforts to settle the matter amicably.

13.2.2 Location of Meeting. In the event that Fujitsu initiates the proceedings described in Section 13.2.1, the first meeting will be held in Hillsboro, Oregon, and all subsequent meetings will alternate between Tokyo, Japan, and Hillsboro, Oregon. In the event that Lattice initiates the proceedings described in Section 13.2.1, the first meeting will be held in Tokyo, Japan, and all subsequent meetings will alternate between Hillsboro, Oregon, and Tokyo, Japan.

13.2.3 Demand for Arbitration. Any dispute that relates to and/or arises out of this Agreement and is not resolved through a meeting of responsible executives will be decided exclusively by binding arbitration under procedures which ensure efficient and speedy resolution. Such an arbitration may be commenced by either party involved in the dispute (a) after the expiration of a sixty (60) day period following the written request to resolve the dispute, and/or (b) at such earlier time as any party involved repudiates and/or refuses to continue with its obligations to negotiate in good faith. The arbitration hearing will be conducted in the State of Hawaii, and will be in the English language (with translations and interpretations as reasonable for the presentation of evidence and/or conduct of the arbitration). Notwithstanding anything to the contrar y, any party may apply to any court of competent jurisdiction for interim injunctive relief as may be allowed under applicable law with respect to irreparable harm which cannot be avoided and/or compensated by such arbitration proceedings, without breach of this Section 13.2.3 and without any abridgment of the powers of the arbitrators.

The arbitration will be conducted under the then current rules of the American Arbitration Association together with the provisions of California Code of Civil Procedure Section 1283.05. Notwithstanding anything to the contrary, (a) the arbitrators will have the power to order discovery to the extent they find such discovery necessary to achieve a fair and equitable result and (b) the arbitrators will require pre-hearing exchange of documentary evidence to be relied upon by each of the respective parties in their respective cases in chief, and pre-hearing exchange of briefs, witness lists, and summaries of expected testimony.

The arbitrators will make their decision in writing.

13.2.4 Arbitrators. The arbitration will be conducted by three (3) arbitrators. No person with a beneficial interest in the dispute under arbitration may be an arbitrator. The parties will make reasonable efforts to select arbitrators with experience in the field of semiconductor fabrication and law.

13.2.5 Binding Effect. The decision or award rendered or made in connection with such arbitration will be binding upon the parties and judgment thereon may be entered in any court having jurisdiction and/or application may be made to such court for enforcement of such decision or award. However, the arbitrators will not have the authority to create any licenses. They will only be permitted to enforce licenses which the parties have otherwise agreed to in this Agreement or the Existing Agreements.

13.2.6 Expenses. The expenses of the arbitrators will be shared equally by the parties; each party will otherwise be responsible for the costs and attorneys' fees incurred by it.

13.3 Liability Limits. EXCEPT FOR LIABILITY FOR A BREACH OF SECTION 10.2 OR SECTION 11, FOR WHICH EQUITABLE REMEDIES WILL BE AVAILABLE, IN NO EVENT WILL EITHER PARTY BE LIABLE TO THE OTHER PARTY FOR ANY INDIRECT, SPECIAL, CONSEQUENTIAL, INCIDENTAL OR PUNITIVE DAMAGES (INCLUDING LOST PROFITS) WHETHER BASED ON WARRANTY, CONTRACT, TORT, OR ANY OTHER LEGAL THEORY, REGARDLESS OF WHETHER SUCH PARTY HAD ACTUAL OR CONSTRUCTIVE NOTICE OF SUCH DAMAGES. IN NO EVENT WILL EITHER PARTY'S AGGREGATE LIABILITY UNDER THIS AGREEMENT EXCEED ONE HUNDRED TWENTY-FIVE MILLION U.S. DOLLARS (US$125,000,000), PLUS THE RETURN TO LATTICE OF THE THEN REMAINING OUTSTANDING PORTION OF THE CREDITED AMOUNT (INCLUDING ANY APPLICABLE INTEREST).

13.4 Assignment. Neither party will assign, transfer, or otherwise dispose of this Agreement in whole or in part without the prior consent of the other party in writing, and such consent will not be unreasonably withheld. Except in the case set forth in Section 12.2(h) or (i) above, this Agreement may be assigned in whole or in part to any Subsidiary or to a successor that has acquired a majority of the business or assets of the assigning party. Any attempted assignment in contravention of the foregoing will be null and void.

13.5 Public Announcements. The parties will jointly publicly announce the execution of this Agreement and the basic terms and conditions of this Agreement. The text of such announcement will be jointly approved by the parties. For any subsequent announcement concerning this Agreement, the party wishing to make the announcement will submit the text thereof to the other party and receive the approval of the other party of such text, which approval, unless public disclosure is required by a court or a government agency, may be delayed or withheld for any reason. However, Lattice may disclose the existence and the terms of this Agreement in a registration statement or any reports required to be filed with the Securities and Exchange Commission or in accordance with generally accepted accounting procedures under the rules of the Securities and Exchange Commission or National Association of Securities Dealers Automated Quotations, and Fujitsu may disclose the existence and the terms of this Agreement in annual or interim securities reports or any other reports required to be filed with the Financial Service Agency of Japan and as otherwise required under applicable laws and regulations.

13.6 Notice and Communications. Any notices required or permitted to be given hereunder will be in English and be sent by (a) registered airmail or (b) facsimile to be confirmed by registered airmail, addressed to:

To Fujitsu:	FUJITSU LIMITED Attention: Director, Business Planning and Operation Dept. Foundry Business Div, Electronic Devices Group Akiruno Technology Center, 50 Fuchigami, Akiruno Tokyo, 197-0833, Japan
To Lattice:	Lattice Semiconductor Corporation Attention: General Counsel 5555 N.E. Moore Court Hillsboro, Oregon 97124 U.S.A.

Any such notice will be deemed given at the time of its receipt by the addressee.

13.7 Relationship of the Parties. Fujitsu and Lattice are independent contractors and neither of them will be nor represent themselves to be the legal agent, partner, or employee of the other party for any purpose. Neither party will have the authority to make any warranty or representation on behalf of the other party nor to execute any contract or otherwise assume any obligation or responsibility in the name of or on behalf of the other party. In addition, neither party will be bound by, nor liable to, any third person for any act or any obligations or debt incurred by the other party, except to the extent specifically agreed to in writing by the parties.

13.8 Waiver and Amendment. Failure by either party, at any time, to require performance by the other party or to claim a breach of any provision of this Agreement will not be construed as a waiver of any right accruing under this Agreement, nor will it affect any subsequent breach or the effectiveness of this Agreement or any part hereof, or prejudice either party with respect to any subsequent action. A waiver of any right accruing to either party pursuant to this Agreement will not be effective unless given in writing.

13.9 Severability. In the event that any provision of this Agreement will be unlawful or otherwise unenforceable, such provision will be severed, and the entire agreement will not fail on account thereof, the balance continuing in full force and effect, and the parties will endeavor to replace the severed provision with a similar provision that is not unlawful or otherwise unenforceable.

13.10 Rights and Remedies Cumulative. The rights and remedies provided herein will be cumulative and not exclusive of any other rights or remedies provided by law or otherwise.

13.11 Headings. The Section headings in this Agreement are for convenience only and will not be considered a part of, or affect the interpretation of, any provision of this Agreement.

13.12 Governing Language. This Agreement and all communications pursuant to it will be in the English language. If there is any conflict between the English version and any translated version of this Agreement, the English version will govern.

13.13 Force Majeure. Except as otherwise expressly provided for herein, no party will be liable in any manner for failure or delay in fulfillment of all or part of this Agreement directly or indirectly owing to any causes or circumstances beyond its control, including, but not limited to, acts of God, governmental order or restrictions, war, war-like conditions, hostilities, sanctions, revolutions, riot, looting, plague or other epidemics, earthquake, fire, or flood ("Force Majeure Event").

13.14 Counterparts. This Agreement may be executed in any number of counterparts, and all such counterparts will together constitute but one Agreement.

13.15 Integration. This Agreement sets forth the entire agreement and understanding between the parties as to its subject matter and supersedes all prior agreements, understandings, and memoranda between the parties, except for the Product Supply Agreements and applicable non-disclosure agreements. No amendments or supplements to this Agreement will be effective for any purpose except by a written agreement signed by the parties that references this Agreement.

13.16 Government Approvals; Export Control Laws. Fujitsu will file all reports and notifications that may be required to be filed with any agency of the Government of Japan in order to allow the performance of this Agreement according to its terms. Lattice will file all reports and notifications that may be required to be filed with any agency of the Government of the United States in order to allow the performance of this Agreement according to its terms. Fujitsu will be responsible for obtaining all licenses and permits required to export the 300mmWafers from Japan, transfer technical information, and develop the technologies contemplated herein together with Lattice under any applicable Japanese laws or regulations. Lattice will be responsible for obtaining all licenses and permits required to import the 300mm Wafers to the United States, transf er technical information, and develop the technologies contemplated herein together with Fujitsu under any applicable United States laws or regulations. Neither party will transfer indirectly or directly any 300mm Wafers or technical information except in accordance with applicable Japanese and United States export control laws, import laws, and related regulations and procedures.

13.17 Governing Law. This Agreement will be governed by and construed in accordance with the laws of the State of California, U.S.A. without application of its conflict of laws provisions that would require the application of the laws of any other jurisdiction.

IN WITNESS WHEREOF, the parties have signed this Agreement as of the date first above written.

LATTICE SEMICONDUCTOR CORPORATION		FUJITSU LIMITED	
By:	/s/	By:	/s/
Name:	Cyrus Tsui	Name:	Toshihiko Ono
Title:	Chairman and CEO	Title:	Corporate Executive Vice President, Group President, Electronic Devices Business Group
Date:	10-Sep-2004	Date:	10-Sep-2004

Exhibit A

Projected New Facility Completion Schedule

*

Exhibit B

Lattice Forecasted Capacity Requirement

*

Exhibit C

Target Defect Densities and Target Yields

Fujitsu will use all reasonable efforts to achieve defect density levels (D_o defects/cm^2) that are representative of the industry for ICs with equivalent complexity, feature size, and using a comparable copper process technology. Progress on defect density reduction will be reviewed on a quarterly basis.

For purposes of the fourth installment payment prerequisite as specified in Section 4.1.4, the relevant Target Defect Density will be less than or equal to *.

Fujitsu's target production level defect densities are anticipated to follow the trends below:

*	D_o (est.) for 90nm Process Technology	D_o (est.) for 65nm Process Technology	D_o (est.) for * Process Technology	D_o (est.) for * Process Technology
*	*	*	*	*
*	*	*	*	*
*	*	*	*	*
*	*	*	*	*

1) D_o = estimated target defect density (defects per cm^2)
2) Target Yield Y = *
3) The assumption is that the * Process will be similar to *.

Exhibit D

New Process Technology Development Schedule

Calendar Year

	65nm Process Technology	* Process Technology	* Process Technology
Define product requirements (e.g. cost, performance, schedule)	*	*	*
*	*	*	*
*	*	*	*
*	*	*	*
*	*	*	*
*	*	*	*
*	*	*	*
*	*	*	*
*	*	*	*
First Product tape-out	*	*	*
Demonstrate technology manufacturability as measured by meeting target yields *	*	*	*
Process qualified	*	*	*
First Product qualified	*	*	*

*	*	*	*

*

The assumption is that the * Process will be similar to *.

The dates in the schedule above are for *.

Notwithstanding anything contrary in this Agreement, the content and schedule above show Fujitsu's project as of the date hereof and may be changed upon mutual agreement.

The * Process Technology will require a separate development agreement between the parties.

Exhibit E

Total 300mm Capacity

*

Exhibit 31.1

CERTIFICATION

I, Cyrus Y. Tsui, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lattice Semiconductor Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2004

/s/ Cyrus Y. Tsui

Cyrus Y. Tsui
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Jan Johannessen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lattice Semiconductor Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2004

/s/Jan Johannessen

Jan Johannessen
Corporate Vice President and Chief Financial Officer

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Cyrus Y. Tsui, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Lattice Semiconductor Corporation for the quarter ended October 2, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of Lattice Semiconductor Corporation.

By: /s/ Cyrus Y. Tsui

Name: Cyrus Y. Tsui
Title: Chief Executive Officer

I, Jan Johannessen, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Lattice Semiconductor Corporation for the quarter ended October 2, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of Lattice Semiconductor Corporation.

By: /s/ Jan Johannessen

Name: Jan Johannessen
Title: Corporate Vice President and
Chief Financial Officer