

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 July 3, 1999

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0 - 18032

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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)

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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

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At July 3, 1999 there were 23,740,175 shares of the Registrant's common  
stock, \$.01 par value, outstanding.

LATTICE SEMICONDUCTOR CORPORATION

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## LATTICE SEMICONDUCTOR CORPORATION

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

	Three Months Ended	
	July 3, 1999	June 27, 1998
Revenue	\$ 59,738	\$ 48,028
Costs and expenses:		
Cost of products sold	22,881	19,109
Research and development	9,889	7,895
Selling, general and administrative	10,845	9,005
In-Process research and development	89,003	--
Amortization of intangible assets	4,164	--
Total costs and expenses	136,782	36,009
(Loss) income from operations	(77,044)	12,019
Other income, net	1,805	2,523
(Loss) income before provision for income taxes	(75,239)	14,542
(Benefit) Provision for income taxes	(24,076)	4,726
Net (loss) income	\$ (51,163)	\$ 9,816
Basic net (loss) income per share	\$ (2.16)	\$ 0.42
Diluted net (loss) income per share	\$ (2.16)	\$ 0.41
Shares used in per share calculations:		
Basic net (loss) income	23,652	23,490
Diluted net (loss) income	23,652	23,858

See Accompanying Notes to Consolidated Financial Statements

## LATTICE SEMICONDUCTOR CORPORATION

CONSOLIDATED BALANCE SHEET  
(in thousands, except share data)

	July 3, 1999	April 3, 1999
	----- (unaudited)	-----
Assets		
Current Assets:		
Cash and cash equivalents	\$ 85,829	\$ 79,301
Short-term investments	70,067	240,133
Accounts receivable	32,305	23,788
Inventories	24,422	17,683
Prepaid expenses and other current assets	6,298	6,061
Deferred income taxes	15,358	14,400
	-----	-----
Total current assets	234,279	381,366
Property and equipment, net	55,825	44,993
Foundry investments, advances and other assets	126,505	114,537
Intangible assets, net	418,369	--
Deferred income taxes	29,813	--
	-----	-----
	\$ 864,791	\$ 540,896
	-----	-----
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 119,735	\$ 32,184
Bank borrowings	25,000	--
Deferred income on sales to distributors	22,988	19,993
Income taxes payable	8,025	4,985
	-----	-----
Total current liabilities	175,748	57,162
Bank borrowings	227,999	--
Other long-term liabilities	1,250	--
Commitments and contingencies	--	--
Stockholders' Equity:		
Preferred stock, \$.01 par value, 10,000,000 shares authorized; none issued or outstanding	--	--
Common stock, \$.01 par value, 100,000,000 shares authorized, 23,740,175 and 23,597,236 shares issued and outstanding	237	236
Paid-in capital	250,512	223,290
Retained earnings	209,045	260,208
	-----	-----
Total stockholders' equity	459,794	483,734
	-----	-----
	\$ 864,791	\$ 540,896
	-----	-----

See accompanying Notes to Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION  
CONSOLIDATED STATEMENT OF CASH FLOWS  
(in thousands)  
(unaudited)

	Three Months Ended	
	July 3, 1999	June 27, 1998
Cash flows from operating activities:		
Net (loss) income	\$ (51,163)	\$ 9,816
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	7,252	2,391
Acquisition of in-process research and development	89,003	--
Deferred income taxes pertaining to intangible assets	(30,771)	--
Changes in assets and liabilities:		
Accounts receivable	3,168	8,349
Inventories	1,227	(351)
Prepaid expenses and other assets	(1,267)	140
Deferred income taxes	--	(925)
Accounts payable and accrued expenses	2,639	(4,474)
Deferred income	2,051	(1,889)
Income taxes payable	2,397	(2,174)
Other liabilities	2,500	--
Total adjustments	78,199	1,067
Net cash provided by operating activities	27,036	10,883
Cash flows from investing activities:		
Proceeds from short-term investments, net	170,066	9,276
Acquisition of Vantis Corporation, net of cash acquired	(439,258)	--
Foundry investments	(4,590)	--
Capital expenditures	(3,056)	(6,040)
Net cash (used) provided by investing activities	(276,838)	3,236
Cash flows from financing activities:		
Proceeds from bank borrowings	252,999	--
Net proceeds from issuance of common stock	3,331	4,230
Repurchase of common stock	--	(1,234)
Net cash provided by financing activities	256,330	2,996
Net increase in cash and cash equivalents	6,528	17,115
Beginning cash and cash equivalents	79,301	60,344
Ending cash and cash equivalents	\$ 85,829	\$ 77,459
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 167	\$ --
Cash paid for income taxes	1,726	7,116
Supplemental disclosures of non-cash investing and financing activities:		
Conversion of Vantis Corporation stock options to Lattice stock options (Note 4)	23,982	--

See accompanying Notes to Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1 - Basis of Presentation:

In our opinion, the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments with the exception of the in-process research and development charge discussed in Note 4) necessary to present fairly the financial information included therein. We believe disclosures are adequate to make the information not misleading, however, we suggest that these financial statements be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K/A for the year ended April 3, 1999 and filed on July 27, 1999, and the report on Form 8-K which was filed with the Securities Exchange Commission on June 25, 1999.

On June 15, 1999, we completed the acquisition of all of the outstanding capital stock of Vantis Corporation ("Vantis") from Advanced Micro Devices, Inc. ("AMD"). The transaction was accounted for as a purchase, and accordingly, the results of operations of Vantis and estimated fair value of assets acquired and liabilities assumed were included in our consolidated condensed financial statements beginning June 16, 1999. The acquisition of Vantis is discussed further in Note 4. There are no significant differences between our accounting policies and those of Vantis.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates. For financial reporting purposes, we report on a 13 or 14 week quarter with the year ending April 1, 2000. The results of operations for the quarter ended July 3, 1999 are not necessarily indicative of the results to be expected for the full year.

This Quarterly Report on Form 10-Q contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In particular, the assumptions set forth in Note 4 and in the Management Discussion and Analysis section of this Current Report on Form 10-Q regarding revenue growth and cost of capital which underlie the Company's calculation of the in-process research and development expenses contain forward-looking statements and are qualified by the risks associated with overall semiconductor market conditions, market acceptance and demand for our new products, our dependencies on our foundry suppliers, the impact of competitive products and pricing, technological and product development risks, as well as our ability to successfully integrate Vantis into our operations, retain key employees of Vantis, retain key customers and suppliers, successfully increase our combined revenue and profitability, and other risks detailed in our Annual Report on Form 10-K for the year ended April 3, 1999 and other reports filed from time to time with the Securities Exchange Commission ("SEC"). Actual results could differ materially from those projected in the forward-looking statements.

Note 2 - Revenue Recognition:

Revenue from sales to OEM (original equipment manufacturer) customers is recognized upon shipment. Certain of our sales are made to distributors under agreements providing price protection and right of return on unsold merchandise. Revenue and costs relating to such distributor sales are deferred until the product is sold by such distributors and the related revenue and costs are then reflected in income.

Note 3 - Net (Loss) Income Per Share:

Net income per share is computed based on the weighted average number of shares of common stock and common stock equivalents assumed to be outstanding during the period (using the treasury stock method). Common stock equivalents consist of stock options and warrants to purchase common stock. Net loss per share is computed based on the weighted average number of shares of common stock outstanding during the period.

Note 4 - Acquisition of Vantis:

As discussed in Note 1, we completed the acquisition of all of the outstanding capital stock of Vantis from AMD on June 15, 1999. We paid approximately \$500.1 million in cash for all of the outstanding capital stock of Vantis. Additionally, we paid approximately \$10.8 million in direct acquisition costs, we accrued an additional \$5.4 million of pre-acquisition contingencies, we accrued \$8.3 million in exit costs and recorded normal accruals of \$34.5 million related to the Vantis business. This purchase was financed using a combination of cash reserves and a new credit facility bearing interest at adjustable rates (See Note 5). In addition, we exchanged Company stock options for all of the options outstanding under the former Vantis employee stock plans with a calculated Black-Scholes value of approximately \$24.0 million. The total purchase price of Vantis was \$583.1 million. The purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed based on an independent appraisal and management estimates. The purchase price and the related allocation are subject to further refinement and change over the next year. The total purchase price was allocated as follows (in millions):

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

## Vantis Integration

We have taken certain actions to integrate the Vantis operations and, in certain instances, to consolidate duplicative operations. Accrued exit costs related to Vantis were recorded as an adjustment to the fair value of net assets in the purchase price allocation. Accrued exit costs include \$4.2 million related to Vantis office closures, \$2.5 million related to separation benefits for Vantis employees and \$1.1 million in other exit costs primarily relating to the termination of Vantis foreign distributors. These accruals are based upon our current estimates and are in accordance with Emerging Issue Task Force ("EITF") No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination". There was no activity against these exit costs for the period June 16, 1999 to July 3, 1999.

## In-Process Research and Development ("IPR&D")

The value assigned to IPR&D was determined by identifying individual research projects for which technological feasibility had not been established. These include semiconductor projects with a value after application of the SEC's IPR&D valuation methodology of \$ 77.2 million and a process technology project with a value of \$11.8 million. The value of each project was determined by estimating the expected cash flows from the projects once commercially viable, applying a factor based on the stage of completion of each project so as to include only those cash flows that relate to development efforts prior to the acquisition date, and discounting the resulting net cash flows back to their present value. The percentage of completion for each project was determined using proportionate cost incurred and technical milestones achieved to date. The percentage of completion varied by individual project ranging from 50% to 69% for semiconductors on June 15, 1999. The process technology project was estimated to be 90% complete on June 15, 1999.

The nature of the efforts to develop the in-process research and development into commercially viable products for semiconductors principally relate to the completion of design, simulation, verification, documentation, test program development, prototyping, reliability testing and qualification, hardware and software integration as well as customer system-level testing and acceptance. For the process technology, the nature of the efforts required to establish the commercial viability of the in-process research and development project principally relate to transistor design, lithography and metalization process development, process integration, transistor size reduction plans, development of packaging integration technology, achievement of manufacturability goals, satisfaction of reliability standards and completion of qualification testing.

The semiconductor projects are related to new PLD products (requiring new architectures and process technologies) and have the attendant risks associated with development of advanced semiconductor circuit designs such as achievement of speed, power, density, reliability and cost goals. All of the semiconductor projects have remaining risks related to achievement of these design goals and effective software integration. In addition, certain projects have basic circuit design and layout activities which had not been completed as of June 15, 1999. These semiconductor projects are scheduled for market release beginning in November 1999 and

continuing through 2001. Estimated costs to complete all in-process semiconductor projects total \$19.0 million and range from \$0.2 million to \$16.5 million.

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

If the projects discussed above are not successfully developed, the future sales and profitability of the combined company may be adversely affected. Additionally, the value of other intangible assets acquired may become impaired. Management believes that the IPR&D charge of \$89 million is valued consistently with the SEC staff's current views regarding valuation methodologies. There can be no assurances, however, that the SEC staff will not take issue with any assumptions used in our valuation model and require a revision in the amount allocated to IPR&D.

The estimated costs to develop the in-process research and development into commercially viable products are approximately \$19.4 million in aggregate - --\$4.7 million in 1999 subsequent to the transaction date, \$10.0 million in 2000, and \$4.7 million in 2001.

The net cash flows from each project are based on management's estimates of revenues, cost of sales, research and development costs, selling, general and administrative costs, and income taxes from such projects. These estimates are based on the below mentioned assumptions.

The estimated revenues are based on projected average compounded annual revenue growth rates for semiconductor products that are in line with industry analysts' forecasts of growth in the markets in which Vantis competes. Estimated total revenues from the in-process research and development product areas are expected to peak in the year 2005 and decline rapidly thereafter as replacement products are expected to enter the market. These projections are based on management estimates of market size and growth, expected trends in technology, and the nature and expected timing of new product introductions by Vantis and its competitors.

In developing cash flow estimates, gross margins, research and development costs and selling general and administrative expenses were consistent with Vantis historical experience adjusted for expected changes in its stand-alone performance.

Vantis' management estimated a profit split from the in-process projects to the current products to account for the fact that Vantis' in-process projects are partially dependent on technology that has already established its feasibility. The profit split from each in-process product was

estimated as a percentage of the total value of the in-process product which was attributable to existing Vantis core technology.

The net cash flows were discounted back to their present value based on the weighted average cost of capital (WACC). The WACC calculation estimates the rate of return required on an investment in an operating enterprise and considers the rates of return required from investments in various areas of that enterprise. The WACC assumed for Vantis, as a corporate business enterprise, is approximately 16%. The discount rate used in discounting the net cash flows from in-process research and development is 20% to 22%, which is 4% to 6% higher than the discount rate used in discounting the net cash flows from current technology. This discount rate is higher than the WACC due to the inherent uncertainties in the estimates described above including uncertainty surrounding the successful development of the in-process research and development projects, the useful life of such technology, the profitability levels of such technology and the uncertainty of technological advances that are unknown at this time.

#### Useful lives of intangible assets

The estimated weighted average useful life of the intangible assets for current technology, assembled workforce, customer lists, trademarks, patents and residual goodwill, created as a result of the acquisition, is approximately five years.

#### PRO FORMA RESULTS

The following pro forma results of operations information is provided for illustrative purposes only and do not purport to be indicative of the consolidated results of operations for future periods or that actually would have been realized had Lattice and Vantis been a consolidated entity during the periods presented. These pro forma results do not include the effect of non-recurring purchase accounting adjustments. The pro forma results combine the results of operations as if Vantis had been acquired as of the beginning of the periods presented. The results include the impact of certain adjustments such as goodwill amortization, estimated changes in interest income (expense) related to cash outlays and borrowings associated with the transaction (see discussion in Note 5) and income tax benefits related to the aforementioned adjustments. Additionally, an in-process research and development charge of \$89 million discussed above has been excluded from the periods presented due to its non-recurring nature.

(in thousands, except per-share amounts)

Three Months Ended (Unaudited)	Pro Forma Results	
	July 3, 1999	June 27, 1998
Revenue	\$104,433	\$100,143
Net loss	\$ (4,697)	\$ (6,132)
Basic net loss per share	\$ (0.20)	\$ (0.26)
Diluted net loss per share	\$ (0.20)	\$ (0.26)

Note 5 - Debt:

On June 15, 1999, we entered into a credit agreement by and among the Company, a group of lenders and ABN AMRO Bank N.V. ("ABN AMRO") as administrative agent for the lender group. The credit agreement consists of two credit facilities: a \$60 million unsecured revolving credit facility ("Revolver"), and a \$220 million unsecured reducing term loan ("Term Loan"). On June 15, 1999, the Company borrowed \$220 million under the Term Loan and approximately \$33 million under the Revolver. The credit facilities allow for borrowings at adjustable rates. Interest payments are due quarterly. The Revolver and Term Loan expire on June 30, 2002 at which time outstanding borrowings are payable in full. The Term Loan has mandatory redemptions of \$12.5 million per quarter beginning March 31, 2000 through September 30, 2001, increasing to \$25 million per quarter for the two quarters ending December 31, 2001 and March 31, 2002, with the remaining balance due at maturity. We, in accordance with the credit agreement, must comply with certain financial covenants related to profitability, tangible net worth, working capital, and debt leverage. At July 3, 1999, we were in compliance with these covenants. Both the Revolver and the Term Loan may be prepaid in part or in full without penalty.

Note 6 - Reconciliation of basic and diluted net income (loss) per share (in thousands, except per share data):

The following is a reconciliation of the basic and diluted per share computations as required by SFAS No. 128, "Earnings Per Share ("EPS")."

	Three Months Ended	
	July 3, 1999	June 27, 1998
	-----	-----
Basic and diluted net (loss) income	\$(51,163)	\$9,816
	-----	-----
Shares used in basic net (loss) income per share calculations	23,652	23,490
Dilutive effect of options and warrants	--	368
Shares used in diluted net income per share calculations	23,652	23,858
	-----	-----
Basic net (loss) income per share	\$ (2.16)	\$ 0.42
	-----	-----
Diluted net (loss) income per share	\$ (2.16)	\$ 0.41
	-----	-----

For the three months ended July 3, 1999, 705 thousand common equivalent shares were excluded from the computation of diluted shares as a result of their anti-dilutive effect on loss per share.

Note 7 - Inventories (in thousands):

	July 3, 1999	April 3, 1998
	-----	-----
Work in progress	\$13,141	\$10,956
Finished goods	11,281	6,727
	-----	-----
	\$24,422	\$17,683
	-----	-----
	-----	-----

The July 3, 1999 inventory increased as a result of the acquisition of Vantis on June 15, 1999. Vantis inventory at July 3, 1999 was \$8.0 million, consisting of \$4.9 million in work-in-process and \$3.1 million in finished goods inventories.

Note 8 - Changes in Stockholders' Equity (in thousands):

	Common Stock	Paid-in Capital	Retained Earnings	Total
	-----	-----	-----	-----
Balances, April 3, 1999	\$ 236	\$ 223,290	\$260,208	\$483,734
Fair value of options issued to Vantis employees (Note 4)	--	23,982	--	23,982
Common stock issued	1	1,433	--	1,434
Tax benefit of option exercises	--	1,897	--	1,897
Other comprehensive income	--	(90)	--	(90)
Loss for the three-month period	--	--	(51,163)	(51,163)
	-----	-----	-----	-----
Balances, July 3, 1999	\$ 237	\$ 250,512	\$209,045	\$459,794
	-----	-----	-----	-----
	-----	-----	-----	-----

Note 9 - New Accounting Pronouncements:

In June 1998, the FASB issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS 133 establishes new accounting treatment for derivatives and hedging activities and supercedes and amends a number of existing accounting standards. For the

Company, this pronouncement will be effective in fiscal year 2002, and is not anticipated to have a material effect on the consolidated financial statements.

Note 10 - Legal matters:

ADVANCED MICRO DEVICES, INC. V. ALTERA CORPORATION (CASE NO. C-94-20567-RMW, N.D. CAL.).

This litigation, which began in 1994, involves multiple claims and counterclaims for patent infringement relating to Vantis and Altera programmable logic devices. We assumed this litigation as part of our acquisition of Vantis.

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

In connection with our acquisition of Vantis, we have agreed to assume both the claims against Altera and the claims by Altera against AMD. Although there can be no assurance as to the results of such litigation, based upon information presently known to management, we do not believe that the ultimate resolution of this lawsuit will have a material adverse effect on our business. The foregoing statement constitutes a forward-looking statement and the actual results may differ materially depending on a number of factors, including new court decisions and additional counterclaims made by other parties to such litigation.

Note 11 - Subsequent event:

On August 11, 1999 our Board of Directors approved a two-for-one split of its common stock to be effected in the form of a stock dividend of one share of common stock for each share of our outstanding common stock.

The stock dividends will be payable on September 16, 1999 to stockholders of record as of August 26, 1999. A cash payout will be made in lieu of issuing any fractional shares.

Note 12 - Segment and Geographic Information:

The Company operates in one industry segment comprising the design, development, manufacture and marketing of high performance programmable logic devices. The Company's sales by major geographic area were as follows (in thousands):

	July 3, 1999	June 27, 1998
	-----	-----
United States	\$30,954	\$24,464
Export sales:		
Europe	14,559	13,640
Asia	12,181	7,078
Other	2,044	2,846
	-----	-----
	28,784	23,564
	-----	-----
	\$59,738	\$48,028
	-----	-----
	-----	-----

Resale of product through two distributors accounted for approximately 12% and 10% of revenues, respectively, in the first quarter of fiscal 2000. No individual customer accounted for more than 10% of revenue in the first quarter of fiscal 1999. No export sales to customers or distributors of any individual country accounted for more than 10% of revenue in the first quarters of fiscal 2000 and fiscal 1999, respectively.

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

RESULTS OF OPERATIONS

The results of operations for the three month period ended July 3, 1999 presented include the effect of the acquisition of Vantis from June 16, 1999, which is discussed in Note 4 to the Unaudited Consolidated Financial Statements contained herein.

Key elements of the statements of operations, expressed as a percentage of revenues, were as follows:

	Three Months Ended	
	July 3, 1999	June 27, 1998
Revenue	100.0%	100.0%
Gross margin	61.7%	60.2%
Research and development expenses	16.6%	16.4%
Selling, general and administrative expenses	18.2%	18.7%
(Loss) income from operations	(129.0)%	25.0%

REVENUE:

Revenue for the first quarter of fiscal 2000 increased \$11.7 million or 24% as compared to the first quarter of fiscal 1999. In addition to Vantis, the revenue increase was attributable to increased sales of ISP products and recovering demand from Asia.

Overall average selling prices decreased slightly in the first quarter of fiscal 2000 as compared to the first quarter of fiscal 1999. Fluctuations in overall average selling prices were due primarily to product mix changes. Although selling prices of mature products generally decline over time, this decline is at times offset by higher selling prices of new products. Our ability to 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:

Gross margin as a percentage of revenue was 61.7% in the first quarter of fiscal 2000 as compared to 60.2% in the first quarter of fiscal 1999. The increase was primarily related to an improvement in product mix and reductions in our manufacturing costs. Reductions in manufacturing costs resulted primarily from yield improvements, migration of products to more advanced technologies and smaller die sizes, and wafer price reductions.

#### RESEARCH AND DEVELOPMENT:

Research and development ("R&D") expenses increased by approximately \$2.0 million, or 25.3%, in the first quarter of fiscal 2000 when compared to the first quarter of fiscal 1999. In addition to the acquisition of Vantis, spending increases resulted primarily from the increased development of new products. We believe that a continued commitment to research and development is essential in order to maintain product leadership of our existing product families and provide innovative new product offerings, and therefore expect to continue to make significant future investments in research and development.

#### SELLING, GENERAL AND ADMINISTRATIVE EXPENSE:

Selling, general and administrative ("SG&A") expenses increased \$1.8 million, or 20%, in the first quarter of fiscal 2000 when compared to the first quarter of fiscal 1999. This increase was primarily due to the Vantis acquisition.

#### OTHER INCOME, NET:

Interest and other income (net of expense) decreased by approximately \$0.7 million in the first quarter of fiscal 2000 as compared to the first quarter of fiscal 1999. This was primarily due to interest expense of approximately \$0.9 million from acquisition-related debt as discussed in Note 5 offsetting increased interest income on higher cash balances prior to the acquisition.

#### AMORTIZATION OF INTANGIBLE ASSETS:

Amortization of intangibles increased by \$4.2 million for the first quarter of fiscal 2000 as compared to the first quarter of fiscal 1999 due to the inclusion of amortization of intangible assets arising from the Vantis acquisition on June 15, 1999. In-process research and development expenses of \$89.0 million in the first quarter of FY 2000 are further described in Note 4 to the Unaudited Consolidated Financial Statements.

#### (BENEFIT) PROVISION FOR INCOME TAXES:

The benefit for income taxes for the three months ended July 3, 1999 is 32% of the loss before provision for income taxes. This reflects the estimated rate at which income taxes would be recoverable if a loss tax return were filed. The loss before provision for income taxes is attributable to the In-Process research and development charge during the period of approximately \$89 million. If this charge were not present, the Company would have taxable income and an income tax rate of approximately 36.5%. For the three month period ended June 27, 1998, the income tax rate was 32.5%. The principal reason for the increase from 32.5% to 36.5% is that there is less tax exempt and tax favored interest income in the current period (due to cash invested in the Vantis acquisition) than the same period last year.

#### IN-PROCESS RESEARCH AND DEVELOPMENT CHARGE - METHODOLOGY

The value assigned to IPR&D was determined by identifying individual research projects for which technological feasibility had not been established. These include semiconductor projects with a value after application of the SEC's IPR&D valuation methodology of \$77.2 million and a process technology project with a value of \$11.8 million. The value of each project was determined by estimating the expected cash flows from the projects once commercially viable, applying a factor based on the stage of completion of each project so as to include only those cash flows that relate to development efforts prior to the acquisition date, and discounting the resulting net cash flows back to their present value. The percentage of completion for each project was determined using proportionate cost incurred and technical milestones achieved to date. The percentage of completion varied by individual project ranging from 50% to 69% for semiconductors on June 16, 1999. The process technology project was estimated to be 90% complete on June 16, 1999.

The nature of the efforts to develop the in-process research and development into commercially viable products for semiconductors principally relate to the completion of design, simulation, verification, documentation, test program development, prototyping, reliability testing and qualification, hardware and software integration as well as customer system-level testing and acceptance. For the process technology, the nature of the efforts required to establish the commercial viability of the in-process research and development project principally relate to transistor design, lithography and metalization process development, process integration, transistor size reduction plans, development of packaging integration technology, achievement of manufacturability goals, satisfaction of reliability standards and completion of qualification testing.

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

The process technology project is related to the development of a new advanced manufacturing process to reduce transistor size, improve speed and lower power consumption. Through June 16, 1999, transistor design, lithography and metalization process development, process integration and certain transistor size reduction plans had been achieved. Development of packaging integration technology, achievement of manufacturability yield objectives, satisfaction of reliability standards and qualification testing had not been accomplished at June 16, 1999. The process is expected to be qualified for initial production in fourth quarter of 1999 with approximately \$450,000 of costs to be incurred after June 15, 1999 out of a total of \$4 million of estimated costs. This process technology, once qualified, is expected to remain in production through 2004.

If the projects discussed above are not successfully developed, the future sales and profitability of the combined company may be adversely affected. Additionally, the value of other intangible assets acquired may become impaired. Management believes that the IPR&D charge of \$89 million is valued consistently with the SEC staff's current views regarding valuation methodologies. There can be no assurances, however, that the SEC staff will not take issue with any assumptions used in our valuation model and require a revision in the amount allocated to IPR&D.

The estimated costs to develop the in-process research and development into commercially viable products are approximately \$19.4 million in aggregate--\$4.7 million in 1999 subsequent to the transaction date, \$10.0 million in 2000, and \$4.7 million in 2001.

The net cash flows from each project are based on management's estimates of revenues, cost of sales, research and development costs, selling, general and administrative costs, and income taxes from such projects. These estimates are based on the below mentioned assumptions.

The estimated revenues are based on projected average compounded annual revenue growth rates for semiconductor products that are in line with industry analysts' forecasts of growth in the markets in which Vantis competes. Estimated total revenues from the in-process research and development product areas are expected to peak in the year 2005 and decline rapidly thereafter as replacement products are expected to enter the market. These projections are based on management estimates of market size and growth, expected trends in technology, and the nature and expected timing of new product introductions by Vantis and its competitors.

In developing cash flow estimates, gross margins, research and development costs and selling general and administrative expenses were consistent with Vantis historical experience adjusted for expected changes in its stand-alone performance.

Vantis' management estimated a profit split from the in-process projects to the current products to account for the fact that Vantis' in-process projects are partially dependent on technology that has already established its feasibility. The profit split from each in-process product was estimated as a percentage of the total value of the in-process product which was attributable to existing Vantis core technology.

The net cash flows were discounted back to their present value based on the weighted average cost of capital (WACC). The WACC calculation estimates the rate of return required on an investment in an operating enterprise and considers the rates of return required from investments in various areas of that enterprise. The WACC assumed for Vantis, as a corporate business enterprise, is approximately 16%. The discount rate used in discounting the net cash flows from in-process research and development is 20% to 22%, which is 4% to 6% higher than the discount rate used in discounting the net cash flows from current technology. This discount rate is higher than the WACC due to the inherent uncertainties in the estimates described above including uncertainty surrounding the successful development of the in-process research and development projects, the useful life of such technology, the profitability levels of such technology and the uncertainty of technological advances that are unknown at this time.

#### Useful lives of intangible assets

The estimated weighted average useful life of the intangible assets for current technology, assembled workforce, customer lists, trademarks, patents and residual goodwill, created as a result of the acquisition, is approximately five years.

#### FACTORS AFFECTING FUTURE RESULTS

Notwithstanding the objectives, projections, estimates and other forward-looking statements in this Annual Report, our future operating results will continue to be subject to quarterly variations based on a wide variety of risks. These risks include, but are not limited to:

OUR WAFER SUPPLY COULD BE INTERRUPTED OR REDUCED AND RESULT IN A SHORTAGE OF FINISHED PRODUCTS AVAILABLE FOR SALE.

We do not manufacture finished silicon wafers. Currently all our silicon wafers are manufactured by Seiko Epson in Japan; the UMC Group, a group of affiliated companies in Taiwan; and AMD in the United States. If Seiko Epson, through its U.S. affiliate Epson Electronics America, the UMC Group or AMD significantly interrupts or reduces our wafer supply, our operating results would be adversely affected.

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, during times of capacity shortage, notwithstanding our supply commitments, we may still have difficulty obtaining wafer deliveries consistent with the supply commitments. We negotiate wafer prices and supply commitments on at least an annual basis. If Seiko Epson, Epson Electronics America, the UMC Group or AMD reduces our supply commitment or increases our wafer prices, and we cannot find alternative sources of wafer supply, our operating results would be adversely affected.

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 adversely affected by significant industry wide increases in overall wafer demand or interruptions in wafer supply. Additionally, a disruption of Seiko Epson's, the UMC Group's or AMD's foundry operations as a result of a fire, earthquake or other natural disaster would disrupt our wafer supply and would have an adverse effect on our operating results.

IF OUR FOUNDRY PARTNERS EXPERIENCE QUALITY OR YIELD PROBLEMS, WE MAY FACE A SHORTAGE OF FINISHED PRODUCTS AVAILABLE FOR SALE.

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

Substantially all of our revenues are derived from products based on a specialized silicon wafer manufacturing process technology called E(2)CMOS-REGISTERED TRADEMARK-. The reliable manufacture of high performance E(2)CMOS semiconductor wafers is a complicated and technically demanding process requiring:

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

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

OUR PRODUCTS MAY NOT BE COMPETITIVE IF WE ARE UNSUCCESSFUL IN MIGRATING OUR MANUFACTURING PROCESSES TO MORE ADVANCED TECHNOLOGIES.

In order to develop new products and maintain the competitiveness of existing products, we need to migrate to more advanced wafer manufacturing processes that utilize larger wafer sizes and smaller device geometries. We may also utilize additional foundries. Since we depend upon foundries to provide their facilities and support for our process technology development, we may experience delays in the availability of advanced wafer manufacturing process technologies at existing or new wafer fabrication facilities. As a result, volume production of our advanced E(2)CMOS-REGISTERED TRADEMARK- process technologies at the new fabs of Seiko Epson, the UMC Group or future foundries may not be achieved. This could have an adverse effect on our operating results.

WE MAY BE UNSUCCESSFUL IN DEFINING AND DEVELOPING NEW PRODUCTS REQUIRED TO MAINTAIN OR GROW OUR BUSINESS.

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

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

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

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

If, due to these or other factors, our new products do not achieve market acceptance, our business and financial condition will be adversely affected.

WE MAY EXPERIENCE UNEXPECTED DIFFICULTIES INTEGRATING VANTIS CORPORATION.

We acquired Vantis on June 15, 1999, and are currently in the process of integrating Vantis with our other operations. If integration is unsuccessful, more difficult or more time consuming than originally planned, we may incur unexpected disruptions to our ongoing business. These disruptions may have an adverse effect on our operations and financial results. Further, the following specific factors may adversely affect our ability to integrate the business of Vantis:

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

In addition, as part of our acquisition of Vantis, we entered into arrangements with Vantis' former parent, AMD, for AMD to provide Vantis with certain manufacturing support and administrative services. In the event AMD fails to provide these services, or provides such services at a level of quality and timeliness inconsistent with the historical delivery of such services, our ability to integrate Vantis will be severely hampered and our business may suffer.

DETERIORATION OF CONDITIONS IN ASIA MAY DISRUPT OUR EXISTING SUPPLY ARRANGEMENTS AND RESULT IN A SHORTAGE OF FINISHED PRODUCTS AVAILABLE FOR SALE.

Two of our three silicon wafer suppliers operate fabs located in Asia. Our finished silicon wafers are assembled and tested by independent subcontractors located in Hong Kong, Malaysia, the Philippines, South Korea, Taiwan and Thailand. A prolonged interruption in our supply from any of these subcontractors could have an adverse effect on our operating results.

Although we have yet not experienced significant supply interruptions, the economic, financial, social and political situation in Asia has recently been volatile. Financial difficulties, governmental actions or restrictions, prolonged work stoppages or any other difficulties experienced by these suppliers may disrupt our supply and could have an adverse effect on our operating results.

Our wafer purchases from Seiko Epson are denominated in Japanese yen. The value of the dollar with respect to the yen has fluctuated in the past and may not remain stable in the future. Future substantial deterioration of dollar-yen exchange rates could have an adverse effect on our operating results.

EXPORT SALES ACCOUNT FOR A SUBSTANTIAL PORTION OF OUR REVENUES AND MAY DECLINE IN THE FUTURE DUE TO ECONOMIC AND GOVERNMENTAL UNCERTAINTIES.

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

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

For example, our export sales have recently been affected by the Asian economic crisis. Significant changes in the economic climate in the foreign countries where we derive our export sales could have an adverse effect on our operating results.

IF OUR ASSEMBLY AND TEST SUBCONTRACTORS EXPERIENCE QUALITY OR YIELD PROBLEMS, WE MAY FACE A SHORTAGE OF FINISHED PRODUCTS AVAILABLE FOR SALE.

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

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

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

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

THE CYCLICAL NATURE OF THE SEMICONDUCTOR INDUSTRY MAY LIMIT OUR ABILITY TO MAINTAIN OR GROW REVENUE AND PROFIT LEVELS DURING FUTURE INDUSTRY DOWNTURNS.

The semiconductor industry is highly cyclical, to a greater extent than other less dynamic or less technology-driven industries. In the past, our financial performance has been negatively affected by significant downturns in the semiconductor industry as a result of:

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

If these or other conditions in the semiconductor industry occur in the future, there could be an adverse effect on our operating results.

OUR STOCK PRICE MAY CONTINUE TO EXPERIENCE LARGE SHORT-TERM FLUCTUATIONS WHICH MAY RESULT IN INVESTORS LOSING ALL OR PART OF THEIR INVESTMENT.

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 revenues or earnings from levels expected by securities analysts;
- - announcements of technological innovations or new products by other companies.

WE MAY NOT BE ABLE TO SUCCESSFULLY COMPETE IN THE HIGHLY COMPETITIVE SEMICONDUCTOR INDUSTRY.

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

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

WE MAY FAIL TO RETAIN OR ATTRACT THE SPECIALIZED TECHNICAL AND MANAGEMENT PERSONNEL REQUIRED TO SUCCESSFULLY OPERATE OUR BUSINESS.

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

IF WE ARE NOT ABLE TO ADEQUATELY PROTECT OUR INTELLECTUAL PROPERTY RIGHTS OUR FINANCIAL RESULTS AND COMPETITIVE POSITION MAY SUFFER.

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

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

Companies in the semiconductor industry vigorously pursue their intellectual property rights. If we become involved in protracted intellectual property disputes or litigation we may utilize substantial financial and management resources, which could have an adverse effect on our operating results. We may also be subject to future intellectual property claims or judgements. If these were to occur, we may not be able to obtain a license on favorable terms or without our operating results being adversely affected.

#### YEAR 2000 COMPLIANCE

We are currently working to address the potential impact of the Year 2000 on the processing of information by our computerized systems, including interfaces to our business partners.

In June 1999, we completed our planned Year 2000 compliance activities with respect to our products and internal systems, software, equipment and facilities. Based solely on these activities, management believes that all products and material internal systems, software, equipment and facilities are currently Year 2000 compliant. We do not anticipate that potential Year 2000 issues will have a material adverse impact on our financial position or operating results. In aggregate, approximately \$2 million in expenses were incurred to fund Year 2000 compliance activities.

However, we could be adversely impacted if any of our critical business partners were to experience a severe business interruption due to a failure to address their internal Year 2000 issues in a timely manner. The most reasonably likely worst case Year 2000 scenario is a

temporary disruption in supplier deliveries or customer shipments. If a severe disruption occurs in either of these two areas and is not corrected in a timely manner, a revenue or profit shortfall may result in the first half of calendar year 2000. Based solely on responses received to date from our business partners, we have no reason to believe that there will be such a material adverse impact. However, if the responses received from our business partners are inaccurate or happen to change, then there could be such a material adverse impact. Management is evaluating Year 2000 business interruption scenarios and developing appropriate contingency plans.

#### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to interest rate risk on our outstanding debt and our investment portfolio.

A 70 basis-point move in interest rates, 10% of our weighted-average interest expense rate on the floating rate debt issued on June 15, 1999 (see Note 5 to the Unaudited Consolidated Financial Statements), would have an insignificant effect on our pretax earnings, debt compliance ratios, cash flow and financial condition over the next fiscal year. A 35 basis-point move in interest rates (10% of our weighted-average interest income rate on our cash, cash equivalent and short term investment income) would have an insignificant effect on our pretax earnings, debt compliance ratios, cash flow and financial condition over the next fiscal year. Similarly, a 35 basis-point move in interest income rates would have had an insignificant effect on pretax earnings, cash flow and financial condition in the fiscal year completed on April 3, 1999.

We manage our interest rate risk on borrowings by keeping cash reserves adequate to cover unexpected changes in interest rates. Another alternative is refinancing. Although there is no assurance that a refinancing could be accomplished, the terms of existing borrowing agreements do not preclude this solution.

We have international subsidiary and branch operations. Additionally, a large portion of our silicon wafer purchases are denominated in Japanese yen. We are therefore subject to foreign currency rate exposure. To mitigate rate exposure with respect to yen-denominated wafer purchases, we maintain yen-denominated bank accounts and bill our Japanese customers in yen. The yen bank deposits are utilized to hedge yen-denominated wafer purchases against specific and firm wafer purchases. If foreign currency rates fluctuated by 10% from rates at July 3, 1999 and June 27, 1998, the effect on our consolidated financial statements would not be material. However, there can be no assurance that there will not be a material impact in the future.

#### LIQUIDITY AND CAPITAL RESOURCES:

Our cash, cash equivalents and short-term investments decreased \$163.5 million to \$155.9 million during the first quarter of fiscal 2000 from \$319.4 million at April 3, 1999. The decrease was due to utilization of cash for the Vantis acquisition. Working capital decreased \$265.7 million to \$58.5 million at July 3, 1999 from \$324.2 million at April 3, 1999. This decrease in working capital was primarily a result of utilization of cash for the Vantis acquisition and higher current liabilities as a result of the short-term portion of the new debt facility we entered in order to purchase Vantis (see below). During the first quarter of fiscal 2000, we generated approximately \$27.0 million of cash and cash equivalents from our operating activities compared with \$10.9 million during the same period in 1999. This increase in cash and cash equivalents was primarily attributable to the liquidation of short-term investments in contemplation of the Vantis acquisition coupled with the changes in assets and liabilities described below.

Accounts receivable increased by \$8.5 million, or 36%, as compared to the balance at April 3, 1999. This increase was primarily due to the inclusion of approximately \$11.7 million of Vantis

receivables, offset by decreases due primarily to the timing of collections. Inventories increased by \$6.7 million, or 38%, as compared to the balance at April 3, 1999 due to the inclusion of approximately \$8.0 million of Vantis inventories. Net property and equipment increased by \$10.8 million, or 24%, as compared to the balance at April 3, 1999 primarily due to the inclusion of Vantis assets. Long-term deferred income taxes increased \$29.8 million versus the balance at April 3, 1999 and represents future income tax benefits to be derived from the amortization for income tax purposes of in-process research and development charges as described in Note 4 to the Unaudited Consolidated Financial Statements which were written off in the first quarter of fiscal 2000 for financial reporting purposes. Accounts payable and accrued expenses increased by \$87.6 million, or 272%, due primarily to the inclusion of Vantis liabilities (see Note 4 to the Unaudited Consolidated Financial Statements). The \$3.0 million, or 61% increase in income taxes payable as compared to the balance at April 3, 1999 is primarily attributable to the timing of tax deductions and payments. Deferred income increased by \$3.0 million, or 15%, as compared to the balance at April 3, 1999, due primarily to increased billings to distributors associated with higher revenue levels.

On June 15, 1999, we entered into a credit agreement by and among the Company, a group of lenders and ABN AMRO Bank N.V. ("ABN AMRO") as administrative agent for the lender group. The credit agreement consists of two credit facilities: a \$60 million unsecured revolving credit facility ("Revolver"), and a \$220 million unsecured reducing term loan ("Term Loan"). On June 15, 1999, the Company borrowed \$220 million under the Term Loan and approximately \$33 million under the Revolver. The credit facilities allow for borrowings at adjustable rates. Interest payments are due quarterly. The Revolver and Term Loan expire on June 30, 2002 at which time outstanding borrowings are payable in full. The Term Loan has mandatory redemptions of \$12.5 million per quarter beginning March 31, 2000 through September 30, 2001, increasing to \$25 million per quarter for the two quarters ending December 31, 2001 and March 31, 2002, with the remaining balance due at maturity. We, in accordance with the credit agreement, must comply with certain financial covenants related to profitability, tangible net worth, working capital, and debt leverage. At July 3, 1999, we were in compliance with these covenants. Both the Revolver and the Term Loan may be prepaid in part or in full without penalty.

Capital additions were \$3.1 million, net of retirements, during the first fiscal quarter of 2000. We expect to spend approximately \$25 to \$30 million for the fiscal year ending April 1, 2000. The primary financing activities during the first quarter of fiscal 2000 are attributable to the new debt facility entered into to fund the Vantis acquisition (see Note 5 to the Unaudited Consolidated Financial Statements).

In March 1997, we entered into an advance payment production agreement with Seiko Epson and its affiliated U.S. distributor, Epson Electronics America, Inc., under which we agreed to advance approximately \$85 million, payable upon completion of specific milestones, to Seiko Epson to finance construction of an eight-inch sub-micron wafer manufacturing facility. Under the terms of the agreement, the advance is to be repaid with semiconductor wafers over a multi-year period. The agreement calls for wafers to be supplied by Seiko Epson through Epson Electronics America, Inc. pursuant to purchase agreements with Epson Electronics America, Inc. We also have an option under this agreement to advance Seiko Epson an additional \$60 million

for additional wafer supply under similar terms. The first payment pursuant to this agreement, approximately \$17.0 million, was made during fiscal 1997. During fiscal 1998, we made two additional payments aggregating approximately \$34.2 million. The balance of the advance payment is currently anticipated to be made in two installments during fiscal 2000.

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

In October 1996, we entered into an agreement with Utek Corporation, a public Taiwanese company in the wafer foundry business that became affiliated with the UMC group in 1998, pursuant to which we agreed to make a series of equity investments in Utek under specific terms. In exchange for these investments we received the right to purchase a percentage of Utek's wafer production. Under this agreement, we have invested approximately \$17.5 million in three separate installments and currently own approximately 2.5% of the outstanding equity of Utek.

In June 1999, the Board of Directors of UICC and Board of Directors of UMC voted in favor of merging UICC into UMC. Also in June 1999, the Board of Directors of Utek and the Board of Directors of UMC voted in favor of merging Utek into UMC. This matter was scheduled for a shareholder vote in July 1999. If the shareholder vote is successful and the merger is subsequently approved by Taiwanese authorities we will receive approximately 60 million shares of UMC stock in exchange for our equity interests in UICC and Utek. After the merger, we expect to own less than one percent of UMC's common stock. We have no plans to liquidate this investment. We have also received assurance from UMC management that our capacity rights will be preserved after the merger.

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

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

In an effort to secure additional wafer supply, the Company 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 the Company pursues any such additional financing

arrangements, additional debt or equity financing may be required. We may in the future seek new or additional sources of funding. There can be no assurance that such additional financing will be available when needed or, if available, will be on favorable terms. Any future equity financing will decrease existing stockholders' equity percentage ownership and may, depending on the price at which the equity is sold, result in dilution.

PART II. OTHER INFORMATION

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

11.1 Computation of Net Income Per Share (\*)

27 Financial Data Schedule for Three Months Ended July 3, 1999

(b) Reports on Form 8-K

(1) On May 7, 1999, the Company filed a Current Report on Form 8-K representing a Stock Purchase Agreement dated April 21, 1999 between Lattice Semiconductor Corporation and Advanced Micro Devices, Inc.

(2) On June 25, 1999, the Company filed a Current Report on Form 8-K dated June 15, 1999 regarding the June 15, 1999 acquisition of Vantis Corporation.

(\*) Incorporated by reference to Note 6 to the Unaudited Consolidated Financial Statements in the Company's report on Form 10-Q for the three months ended July 3, 1999.

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: August 16, 1999

By /s/ STEPHEN A. SKAGGS

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Stephen A. Skaggs  
Senior Vice President Finance, Chief Financial Officer  
and Secretary



3-MOS

	APR-01-2000	
	APR-04-1999	
	JUL-03-2000	
		85,829
		70,067
		32,305
		(1,488)
		24,422
	234,279	
		114,284
	(58,459)	
	864,791	
175,748		
		229,249
	0	
		0
		237
		459,557
864,791		
		59,738
	59,738	
		22,881
		136,782
		0
		18
	908	
	(75,239)	
	(24,076)	
(51,163)		
		0
		0
		0
	(51,163)	
	(2.16)	
	(2.16)	