

LAM RESEARCH CORP  
Form 10-Q  
February 03, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended December 28, 2014**

**or**

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

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

**Commission file number 0-12933**

**LAM RESEARCH CORPORATION**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**94-2634797**  
**(I.R.S. Employer**  
**Identification No.)**

**4650 Cushing Parkway**  
**Fremont, California**  
**(Address of principal executive offices)**  
**(510) 572-0200**

**94538**  
**(Zip Code)**

**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act:

Large accelerated filer ☒ Accelerated filer ☐  
Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐  
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

As of January 28, 2015, the Registrant had 159,316,108 shares of common stock outstanding.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****LAM RESEARCH CORPORATION****CONSOLIDATED BALANCE SHEETS****(in thousands, except per share data)**

	<b>December 28, 2014 (unaudited)</b>	<b>June 29, 2014 (1)</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$ 981,275	\$ 1,452,677
Short-term investments	1,902,402	1,612,967
Accounts receivable, less allowance for doubtful accounts of \$4,927 as of December 28, 2014 and \$4,962 as of June 29, 2014	944,014	800,616
Inventories	913,390	740,503
Prepaid expenses and other current assets	173,731	176,899
Total current assets	4,914,812	4,783,662
Property and equipment, net	585,372	543,496
Restricted cash and investments	155,455	146,492
Goodwill	1,466,949	1,466,225
Intangible assets, net	815,057	894,078
Other assets	173,044	159,353
Total assets	\$ 8,110,689	\$ 7,993,306
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Trade accounts payable	\$ 296,423	\$ 223,515
Accrued expenses and other current liabilities	637,505	604,296
Deferred profit	254,765	235,923
Current portion of long-term debt, convertible notes, and capital leases	519,963	518,267
Total current liabilities	1,708,656	1,582,001
Long-term debt, convertible notes, and capital leases	830,880	817,202
Income taxes payable	205,535	258,357
Other long-term liabilities	183,678	122,662
Total liabilities	2,928,749	2,780,222
Commitments and contingencies		
Senior convertible notes	181,505	183,349

Stockholders' equity:

Preferred stock, at par value of \$0.001 per share; authorized - 5,000 shares; none outstanding		
Common stock, at par value of \$0.001 per share; authorized - 400,000 shares; issued and outstanding - 159,294 shares as of December 28, 2014 and 162,350 shares as of June 29, 2014	159	162
Additional paid-in capital	5,328,767	5,239,567
Treasury stock, at cost; 97,545 shares as of December 28, 2014 and 92,867 shares as of June 29, 2014	(4,118,752)	(3,757,076)
Accumulated other comprehensive loss	(45,391)	(28,655)
Retained earnings	3,835,652	3,575,737
Total stockholders' equity	5,000,435	5,029,735
Total liabilities and stockholders' equity	\$ 8,110,689	\$ 7,993,306

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements

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**LAM RESEARCH CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share data)

(unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Revenue	\$ 1,232,241	\$ 1,116,061	\$ 2,384,609	\$ 2,131,120
Cost of goods sold	695,584	628,272	1,342,413	1,211,473
Gross margin	536,657	487,789	1,042,196	919,647
Research and development	196,768	174,477	385,702	345,044
Selling, general and administrative	151,148	148,838	299,455	304,721
Total operating expenses	347,916	323,315	685,157	649,765
Operating income	188,741	164,474	357,039	269,882
Other expense, net	(9,799)	(3,837)	(15,447)	(18,099)
Income before income taxes	178,942	160,637	341,592	251,783
Income tax expense	2,002	11,645	23,571	17,285
Net income	\$ 176,940	\$ 148,992	\$ 318,021	\$ 234,498
Net income per share:				
Basic	\$ 1.11	\$ 0.92	\$ 1.98	\$ 1.44
Diluted	\$ 1.00	\$ 0.87	\$ 1.80	\$ 1.37
Number of shares used in per share calculations:				
Basic	159,248	162,305	160,467	162,603
Diluted	177,046	171,757	177,082	171,592
Cash dividend declared per common share	\$ 0.18	\$	\$ 0.36	\$

See Notes to Condensed Consolidated Financial Statements

**Table of Contents****LAM RESEARCH CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(in thousands)****(unaudited)**

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income	\$ 176,940	\$ 148,992	\$ 318,021	\$ 234,498
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	(8,843)	6,284	(17,802)	9,843
Cash flow hedges:				
Net unrealized gains during the period	7,604	4,328	7,902	8,835
Net gains reclassified into earnings	(2,622)	(3,017)	(2,724)	(6,819)
	4,982	1,311	5,178	2,016
Available-for-sale investments:				
Net unrealized (losses) gains during the period	(2,981)	386	(4,740)	1,073
Net losses (gains) reclassified into earnings	113	(218)	492	(145)
	(2,868)	168	(4,248)	928
Defined benefit plan, net change in unrealized component	70	71	136	385
Other comprehensive (loss) income, net of tax	(6,659)	7,834	(16,736)	13,172
Comprehensive income	\$ 170,281	\$ 156,826	\$ 301,285	\$ 247,670

See Notes to Condensed Consolidated Financial Statements

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

	<b>Six Months Ended</b>	
	<b>December 28, 2014</b>	<b>December 29, 2013</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 318,021	\$ 234,498
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	137,421	147,883
Deferred income taxes	6,506	12,457
Impairment of long-lived asset		7,632
Equity-based compensation expense	62,672	46,281
Income tax benefit on equity-based compensation plans	11,002	
Excess tax benefit on equity-based compensation plans	(11,003)	
Gain on sale of business	(7,431)	
Amortization of convertible note discount	17,118	16,339
Other, net	7,133	1,687
Changes in operating assets and liabilities	(239,039)	(285,829)
Net cash provided by operating activities	302,400	180,948
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(103,234)	(62,101)
Cash paid for business acquisition	(1,137)	(18,388)
Purchases of available-for-sale securities	(1,063,863)	(459,290)
Sales and maturities of available-for-sale securities	751,918	413,103
Repayment of notes receivable	3,978	10,000
Proceeds from sale of assets		21,635
Proceeds from sale of business	41,212	
Transfer of restricted cash and investments	122	150
Net cash used for investing activities	(371,004)	(94,891)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on long-term debt and capital lease obligations	(781)	(807)
Excess tax benefit on equity-based compensation plans	11,003	
Treasury stock purchases	(373,958)	(152,195)
Dividends paid	(58,621)	
Reissuances of treasury stock related to employee stock purchase plan	16,919	15,119
Proceeds from issuance of common stock	8,832	21,023



Net cash used for financing activities	(396,606)	(116,860)
Effect of exchange rate changes on cash	(6,192)	885
Net decrease in cash and cash equivalents	(471,402)	(29,918)
Cash and cash equivalents at beginning of period	1,452,677	1,162,473
Cash and cash equivalents at end of period	\$ 981,275	\$ 1,132,555

See Notes to Condensed Consolidated Financial Statements

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**LAM RESEARCH CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**December 28, 2014**

**(Unaudited)**

**NOTE 1 BASIS OF PRESENTATION**

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The accompanying unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of Lam Research Corporation ( Lam Research or the Company ) for the fiscal year ended June 29, 2014, which are included in the Company's Annual Report on Form 10-K as of and for the year ended June 29, 2014 (the 2014 Form 10-K ). The Company's Forms 10-K, Forms 10-Q and Forms 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is [www.sec.gov](http://www.sec.gov). The Company also posts its Forms 10-K, Forms 10-Q and Forms 8-K on its corporate website at <http://investor.lamresearch.com>.

The consolidated financial statements include the accounts of Lam Research and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 28, 2015 and includes 52 weeks. The quarters ended December 28, 2014 (the December 2014 quarter ) and December 29, 2013 (the December 2013 quarter ) included 13 weeks.

**NOTE 2 RECENT ACCOUNTING PRONOUNCEMENTS**

In July 2013, the FASB released Accounting Standards Update 2013-11 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new standard requires that an unrecognized tax benefit should be presented as a reduction of a deferred tax asset for a net operating loss carryforward or other tax credit carryforward when settlement in this manner is available under the tax law. The Company adopted this standard during the fiscal year without significant impact on its financial position, results of operations, or cash flows.

In April 2014, the FASB released Accounting Standards Update 2014-8 Presentation of Financial Statements and Property, Plant and Equipment: Reporting Discontinued Operations and Disclosure of Disposals of Components of an Entity. The new standard re-defines discontinued operations and requires only those disposals of components of an entity, including classifications as held for sale, that represent a strategic shift that has, or will have, a major effect on an entity's operations and financial results to be reported as discontinued operations. In addition, the new standard expands the disclosure requirements of discontinued operations. The Company adopted this standard during the fiscal year without significant impact on its financial position, results of operations, or cash flows.

In May 2014, the FASB released Accounting Standards Update 2014-9 Revenue from Contracts with Customers to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of the standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the

consideration that is expected to be received for those goods or services. The new standard defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The Company is required to adopt this standard starting in the first quarter of fiscal year 2018 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the standard; or (ii) retrospective with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per the standard. The Company has not yet selected a transition method, and has not determined the impact that the new standard will have on its consolidated financial statements.

### **NOTE 3 EQUITY-BASED COMPENSATION PLANS**

The Company has stock plans that provide for grants of equity-based awards to eligible participants, including stock options and restricted stock units ( RSUs ), of Lam Research common stock ( Common Stock ). An option is a right to purchase Common Stock at a set price. An RSU award is an agreement to issue shares of Common Stock at the time of vesting. The Company s options and RSU awards typically vest over a period of three years or less, although awards assumed in connection with the acquisition of Novellus Systems, Inc. ( Novellus ), have vesting terms up to four years. The Company also has an employee stock purchase plan that allows employees to purchase its Common Stock at a discount through payroll deductions.

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The Company recognized the following equity-based compensation expense and related income tax benefit in the Condensed Consolidated Statements of Operations:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Equity-based compensation expense	\$ 30,632	\$ 23,046	\$ 62,672	\$ 46,281
Income tax benefit related to equity-based compensation expense	\$ 6,116	\$ 3,744	\$ 10,840	\$ 7,599

The estimated fair value of the Company's stock-based awards, less expected forfeitures, is amortized over the awards vesting term on a straight-line basis.

**Stock Options and RSUs**

The Lam Research Corporation 2007 Stock Incentive Plan and 2011 Stock Incentive Plan (collectively the Stock Plans) provide for the grant of non-qualified equity-based awards to eligible employees, consultants and advisors, and non-employee directors of the Company and its subsidiaries. A summary of stock plan transactions is as follows:

	<b>Options Outstanding</b>		<b>Restricted Stock Units Outstanding</b>	
	<b>Number of Shares</b>	<b>Weighted-Average Exercise Price</b>	<b>Number of Shares</b>	<b>Weighted-Average Fair Market Value at Grant</b>
June 29, 2014	1,331,886	\$ 32.20	5,635,469	\$ 45.83
Granted		\$	175,344	\$ 72.47
Exercised	(325,243)	\$ 27.15	N/A	N/A
Cancelled	(7,452)	\$ 29.86	(89,307)	\$ 46.47
Vested restricted stock	N/A	N/A	(1,296,667)	\$ 39.71
December 28, 2014	999,191	\$ 33.86	4,424,839	\$ 48.67

As of December 28, 2014, there was \$2.3 million of total unrecognized compensation cost related to unvested stock options granted and outstanding; that cost is expected to be recognized over a weighted-average remaining vesting period of 1.6 years. As of December 28, 2014, there was \$135.2 million of total unrecognized compensation expense related to unvested RSUs granted; that expense is expected to be recognized over a weighted-average remaining period of 1.7 years.

**ESPP**

The 1999 Employee Stock Purchase Plan, as amended and restated (the 1999 ESPP), allows employees to designate a portion of their base compensation to be withheld through payroll deductions and used to purchase Common Stock at a purchase price per share equal to the lower of 85% of the fair market value of Common Stock on the first or last day of the applicable purchase period. Each offering period generally lasts up to 12 months and includes up to three

interim purchase dates.

Purchase rights under the 1999 ESPP were valued using the Black-Scholes option valuation model and the following weighted-average assumptions for the six months ended December 28, 2014 and December 29, 2013:

	<b>Six Months Ended</b>	
	<b>December 28, 2014</b>	<b>December 29, 2013</b>
Expected term (years)	0.68	0.66
Expected stock price volatility	29.07%	31.43%
Risk-free interest rate	0.07%	0.11%
Dividend Yield	0.29%	

As of December 28, 2014, there was \$9.6 million of unrecognized compensation expense related to the 1999 ESPP, which is expected to be recognized over a remaining period of approximately 8 months.

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**NOTE 4 FINANCIAL INSTRUMENTS**

The Company maintains an investment portfolio of various holdings, types, and maturities. The Company's mutual funds, which are related to the Company's obligations under the deferred compensation plan, are classified as trading securities. Investments classified as trading securities are recorded at fair value based upon quoted market prices. Differences between the cost and fair value of trading securities are recognized as other income (expense) in the Condensed Consolidated Statements of Operations. All of the Company's other short-term investments are classified as available-for-sale and consequently are recorded in the Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax.

***Fair Value***

The Company defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required or permitted to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact, and it considers assumptions that market participants would use when pricing the asset or liability.

A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. The level of an asset or liability in the hierarchy is based on the lowest level of input that is significant to the fair value measurement. Assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1: Valuations based on quoted prices in active markets for identical assets or liabilities with sufficient volume and frequency of transactions.

Level 2: Valuations based on observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or model-derived valuations techniques for which all significant inputs are observable in the market or can be corroborated by observable market data, for substantially the full term of the assets or liabilities.

Level 3: Valuations based on unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities and based on non-binding, broker-provided price quotes and may not have been corroborated by observable market data.

The Company's primary financial instruments include its cash, cash equivalents, short-term investments, restricted cash and investments, long-term investments, accounts receivable, accounts payable, long-term debt and capital leases, and derivative instruments. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to the short period of time to their maturities. The estimated fair values of capital lease obligations approximate their carrying value as the substantial majority of these obligations have interest rates that adjust to market rates on a periodic basis. Refer to Note 12 for additional information regarding the fair value of the Company's convertible notes.

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The following table sets forth the Company's cash, cash equivalents, short-term investments, restricted cash and investments, and other assets measured at fair value on a recurring basis at December 28, 2014 and June 29, 2014:

<b>December 28, 2014</b>								
<b>(Reported Within)</b>								
	<b>Cost</b>	<b>Unrealized Gain</b>	<b>Unrealized (Loss)</b>	<b>Fair Value</b>	<b>Cash and Cash Equivalents</b>	<b>Short-Term Investments</b>	<b>Restricted Cash &amp; Investments</b>	<b>Other Assets</b>
<b>(in thousands)</b>								
Cash	\$ 313,407	\$	\$	\$ 313,407	\$ 307,652	\$	\$ 5,755	\$
<b>Level 1:</b>								
Time Deposit	132,549			132,549			132,549	
Money Market Funds	673,623			673,623	673,623			
US Treasury and Agencies	293,606	48	(361)	293,293		276,142	17,151	
Mutual Funds	22,622	4,592		27,214				27,214
<b>Level 1 Total</b>	<b>\$ 1,122,400</b>	<b>\$ 4,640</b>	<b>\$ (361)</b>	<b>\$ 1,126,679</b>	<b>\$ 673,623</b>	<b>\$ 276,142</b>	<b>\$ 149,700</b>	<b>\$ 27,214</b>
<b>Level 2:</b>								
Municipal Notes and Bonds	250,218	520	(54)	250,684		250,684		
Government-Sponsored Enterprises	58,450	11	(84)	58,377		58,377		
Foreign Government Bonds	45,022	6	(154)	44,874		44,874		
Corporate Notes and Bonds	1,127,008	611	(3,236)	1,124,383		1,124,383		
Mortgage Backed Securities Residential	17,365	65	(103)	17,327		17,327		
Mortgage Backed Securities Commerical	131,287	45	(717)	130,615		130,615		
<b>Level 2 Total</b>	<b>\$ 1,629,350</b>	<b>\$ 1,258</b>	<b>\$ (4,348)</b>	<b>\$ 1,626,260</b>	<b>\$</b>	<b>\$ 1,626,260</b>	<b>\$</b>	<b>\$</b>
<b>Total</b>	<b>\$ 3,065,157</b>	<b>\$ 5,898</b>	<b>\$ (4,709)</b>	<b>\$ 3,066,346</b>	<b>\$ 981,275</b>	<b>\$ 1,902,402</b>	<b>\$ 155,455</b>	<b>\$ 27,214</b>

<b>June 29, 2014</b>								
<b>(Reported Within)</b>								
	<b>Cost</b>	<b>Unrealized Gain</b>	<b>Unrealized (Loss)</b>	<b>Fair Value</b>	<b>Cash and Cash Equivalents</b>	<b>Short-Term Investments</b>	<b>Restricted Cash &amp; Investments</b>	<b>Other Assets</b>
<b>(in thousands)</b>								
Cash	\$ 285,031	\$	\$	\$ 285,031	\$ 279,126	\$	\$ 5,905	

**Level 1:**

Time Deposit	132,549			132,549			132,549	
Money Market Funds	1,168,261			1,168,261	1,168,261			
US Treasury and Agencies	212,436	178	(27)	212,587		204,549	8,038	
Mutual Funds	18,784	2,974		21,758				21,758
<b>Level 1 Total</b>	<b>\$ 1,532,030</b>	<b>\$ 3,152</b>	<b>\$ (27)</b>	<b>\$ 1,535,155</b>	<b>\$ 1,168,261</b>	<b>\$ 204,549</b>	<b>\$ 140,587</b>	<b>\$ 21,758</b>

**Level 2:**

Municipal Notes and Bonds	334,329	1,108	(4)	335,433	5,290	330,143		
Government-Sponsored Enterprises	27,666	41	(15)	27,692		27,692		
Foreign Government Bonds	35,438	57	(28)	35,467		35,467		
Corporate Notes and Bonds	874,540	2,034	(335)	876,239		876,239		
Mortgage Backed Securities Residential	27,067	59	(182)	26,944		26,944		
Mortgage Backed Securities Commercial	112,642	100	(809)	111,933		111,933		
<b>Level 2 Total</b>	<b>\$ 1,411,682</b>	<b>\$ 3,399</b>	<b>\$ (1,373)</b>	<b>\$ 1,413,708</b>	<b>\$ 5,290</b>	<b>\$ 1,408,418</b>	<b>\$</b>	<b>\$</b>

<b>Total</b>	<b>\$ 3,228,743</b>	<b>\$ 6,551</b>	<b>\$ (1,400)</b>	<b>\$ 3,233,894</b>	<b>\$ 1,452,677</b>	<b>\$ 1,612,967</b>	<b>\$ 146,492</b>	<b>\$ 21,758</b>
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The Company accounts for its investment portfolio at fair value. Realized gains (losses) for investment sales are specifically identified. Management assesses the fair value of investments in debt securities that are not actively traded through consideration of



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interest rates and their impact on the present value of the cash flows to be received from the investments. The Company also considers whether changes in the credit ratings of the issuer could impact the assessment of fair value. The Company did not recognize any losses on investments due to other-than-temporary impairments during the three months ended December 28, 2014 or December 29, 2013. Additionally, gross realized gains and gross realized (losses) from sales of investments were approximately \$0.4 million and \$(0.4) million, respectively, in the three months ended December 28, 2014 and \$0.2 million and \$(0.5) million, respectively, in the three months ended December 29, 2013. Gross realized gains and gross realized (losses) from sales of investments were approximately \$0.9 million and \$(1.0) million, respectively, in the six months ended December 28, 2014 and \$0.4 million and \$(1.0) million, respectively, in the six months ended December 29, 2013.

The following is an analysis of the Company's cash, cash equivalents, short-term investments and restricted cash and investments in unrealized loss positions:

	<b>Unrealized Losses Less Than 12 Months</b>		<b>December 28, 2014 Unrealized Losses 12 Months or Greater</b>		<b>Total</b>	
	<b>Gross Unrealized Fair Value</b>	<b>Gross Unrealized Loss</b>	<b>Gross Unrealized Fair Value</b>	<b>Gross Unrealized Loss</b>	<b>Gross Unrealized Fair Value</b>	<b>Gross Unrealized Loss</b>
			(in thousands)			
Municipal Notes and Bonds	\$ 49,621	\$ (54)	\$	\$	\$ 49,621	\$ (54)
US Treasury & Agencies	201,166	(361)			201,166	(361)
Government-Sponsored Enterprises	42,900	(84)			42,900	(84)
Foreign Government Bonds	34,934	(154)			34,934	(154)
Corporate Notes and Bonds	856,576	(3,207)	3,279	(29)	859,855	(3,236)
Mortgage Backed Securities Residential	459		4,094	(103)	4,553	(103)
Mortgage Backed Securities Commercial	104,820	(458)	17,354	(259)	122,174	(717)
	<b>\$ 1,290,476</b>	<b>\$ (4,318)</b>	<b>\$ 24,727</b>	<b>\$ (391)</b>	<b>\$ 1,315,203</b>	<b>\$ (4,709)</b>

The amortized cost and fair value of cash equivalents, short-term investments and restricted investments with contractual maturities are as follows as of December 28, 2014:

	<b>Cost</b>	<b>Estimated Fair Value</b>
	(in thousands)	
Due in one year or less	\$ 888,234	\$ 888,312
Due after one year through five years	1,505,237	1,502,762
Due in more than five years	335,657	334,651
	<b>\$ 2,729,128</b>	<b>\$ 2,725,725</b>

Management has the ability, if necessary, to liquidate its investments in order to meet the Company's liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase nonetheless are classified as short-term on the accompanying Consolidated Balance Sheets.

### ***Derivative Instruments and Hedging***

The Company carries derivative financial instruments ( derivatives ) on its Consolidated Balance Sheets at their fair values. The Company enters into derivative contracts with financial institutions with the primary objective of reducing volatility of earnings and cash flows related to foreign currency exchange rate and interest rate fluctuations. The counterparties to these derivative contracts are large global financial institutions that the Company believes are creditworthy, and therefore, it does not consider the risk of counterparty nonperformance to be material.

### ***Cash Flow Hedges***

The Company's financial position is routinely subjected to market risk associated with foreign currency exchange rate fluctuations on non-U.S. dollar transactions or cash flows, primarily from Japanese yen-denominated revenues and euro-denominated expenses. The Company's policy is to mitigate the foreign exchange risk arising from the fluctuations in the value of these non-U.S. dollar denominated transactions or cash flows through a foreign currency cash flow hedging program, using forward contracts that generally expire within 12 months and no later than 24 months. These foreign currency forward contracts are designated as cash flow hedges and are carried on the Company's balance sheet at fair value with the effective portion of the contracts' gains or losses included in accumulated other comprehensive income (loss) and subsequently recognized in revenue/expense in the same period the hedged items are recognized.

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In addition, during the three months ended December 28, 2014, the Company entered into a series of forward-starting interest rate swap agreements, with a total notional value of \$375 million, to hedge against the variability of cash flows due to changes in the benchmark interest rate of fixed rate debt. These instruments were designated as cash flow hedges and are carried on the Company's balance sheet at fair value, with the effective portion of the contracts' gains or losses included in accumulated other comprehensive income (loss) and subsequently recognized into income as the hedged item impacts earnings.

At inception and at each quarter end, hedges are tested prospectively and retrospectively for effectiveness using regression analysis. Changes in the fair value of the forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in revenue or expense in the current period. The change in time value related to these contracts was not material for all reported periods. To qualify for hedge accounting, the hedge relationship must meet criteria relating both to the derivative instrument and the hedged item. These criteria include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows will be measured. There were no gains or losses during the three and six months ended December 28, 2014 or December 29, 2013 associated with ineffectiveness or forecasted transactions that failed to occur.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be tested to demonstrate an expectation of providing highly effective offsetting changes to future cash flows on hedged transactions. When derivative instruments are designated and qualify as effective cash flow hedges, the Company recognizes effective changes in the fair value of the hedging instrument within accumulated other comprehensive income (loss) until the hedged exposure is realized. Consequently, with the exception of excluded time value and hedge ineffectiveness recognized, the Company's results of operations are not subject to fluctuation as a result of changes in the fair value of the derivative instruments. If hedges are not highly effective or if the Company does not believe that the underlying hedged forecasted transactions will occur, the Company may not be able to account for its derivative instruments as cash flow hedges. If this were to occur, future changes in the fair values of the Company's derivative instruments would be recognized in earnings. Additionally, related amounts previously recorded in other comprehensive income would be reclassified to income immediately. At December 28, 2014, the Company had gains of \$5.1 million accumulated in other comprehensive income, which it expects to reclassify from other comprehensive income into earnings over the next 12 months.

### *Balance Sheet Hedges*

The Company also enters into foreign currency forward contracts to hedge fluctuations associated with foreign currency denominated monetary assets and liabilities, primarily third party accounts receivables, accounts payables and intercompany receivables and payables. These forward contracts are not designated for hedge accounting treatment. Therefore, the change in fair value of these derivatives is recorded as a component of other income (expense) and offsets the change in fair value of the foreign currency denominated assets and liabilities, which are also recorded in other income (expense).

As of December 28, 2014, the Company had the following outstanding foreign currency forward contracts that were entered into under its cash flow and balance sheet hedge program:

<b>Derivatives Designated as Hedging Instruments:</b>	<b>Derivatives Not Designated as Hedging Instruments:</b>
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(in thousands)

**Foreign Currency Forward Contracts**

	Buy Contracts	Sell Contracts	Buy Contracts	Sell Contracts
Japanese Yen	\$	\$ 66,567	\$	\$ 46,806
Swiss Franc				1,344
Euro	42,164		13,776	
Korean Won			13,774	
Taiwan Dollar			33,240	
	\$ 42,164	\$ 66,567	\$ 60,790	\$ 48,150

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The fair value of derivative instruments in the Company's Consolidated Balance Sheets as of December 28, 2014 and June 29, 2014 were as follows:

December 28, 2014				June 29, 2014			
Fair Value of Derivative Instruments (Level 2)				Fair Value of Derivative Instruments (Level 2)			
Asset Derivatives		Liability Derivatives		Asset Derivatives		Liability Derivatives	
Balance Sheet		Balance Sheet		Balance Sheet		Balance Sheet	
Location	Fair Value	Location	Fair Value	Location	Fair Value	Location	Fair Value
(in thousands)							
<b><u>Derivatives designated as hedging instruments:</u></b>							
Foreign exchange forward contracts	Prepaid expense and other assets \$ 6,867	Accrued liabilities	\$ 2,767	Prepaid expense and other assets	\$ 483	Accrued liabilities	\$ 805
Interest rate contracts	2,072				\$		\$
<b><u>Derivatives not designated as hedging instruments:</u></b>							
Foreign exchange forward contracts	Prepaid expense and other assets 31	Accrued liabilities	1,183	Prepaid expense and other assets	1,109	Accrued liabilities	118
<b>Total derivatives</b>	<b>\$ 8,970</b>	<b>\$ 3,950</b>		<b>\$ 1,592</b>		<b>\$ 923</b>	

Under the master netting agreements with the respective counterparties to the Company's derivative contracts, subject to applicable requirements, the Company is allowed to net settle transactions of the same currency with a single net amount payable by one party to the other. However, the Company has elected to present the derivative assets and derivative liabilities on a gross basis in its balance sheet. As of December 28, 2014, the potential effect of netting the above derivative contracts would be an offset to assets and liabilities by \$3.8 million, resulting in a net derivative asset of \$5.2 million. As of June 29, 2014, the potential effect of netting the above derivative contracts was an offset to both assets and liabilities by \$0.5 million, resulting in a net derivative asset of \$1.1 million and net derivative liabilities of \$0.5 million. The Company is not required to pledge, nor is the Company entitled to receive, cash collateral for these derivative transactions.

The effect of derivative instruments designated as cash flow hedges on the Company's Condensed Consolidated Statements of Operations, including accumulated other comprehensive income ( AOCI ) was as follows:

Location of Gain (Loss) Recognized in or Reclassified into Income	Three Months Ended December 28, 2014			Six Months Ended December 28, 2014		
	Ineffective Portion and Amount Excluded from Effective Portion			Ineffective Portion and Amount Excluded from Effective Portion		
	Effectiveness Testing			Effectiveness Testing		
	Gain	(Loss)	Gain	Gain	(Loss)	Gain
	Reclassified	from	Recognized	Reclassified	from	Recognized
	in AOCI	into Income	in Income	in AOCI	into Income	in Income
	(in thousands)			(in thousands)		
Revenue	\$ 8,765	\$ 4,967	\$ 81	\$ 11,789	\$ 5,436	\$ 124
Cost of goods sold	(1,264)	(1,557)	(19)	(3,287)	(1,833)	(25)
Selling, general, and administrative	(555)	(604)	(9)	(1,421)	(709)	(11)
Other expense, net	2,071			2,071		
	\$ 9,017	\$ 2,806	\$ 53	\$ 9,152	\$ 2,894	\$ 88

Location of Gain (Loss) Recognized in or Reclassified into Income	Three Months Ended December 29, 2013			Six Months Ended December 29, 2013		
	Ineffective Portion and Amount Excluded from Effectiveness			Ineffective Portion and Amount Excluded from Effectiveness		
	Gain	(Loss)	Gain	Gain	(Loss)	Gain
	Reclassified	from	Recognized	Reclassified	from	Recognized
	in AOCI	into Income	in Income	in AOCI	into Income	in Income
	(in thousands)			(in thousands)		
Revenue	\$ 3,226	\$ 2,777	\$ 85	\$ 8,104	\$ 6,159	\$ 178
Cost of goods sold	1,262	467	(24)	1,410	1,118	(56)
Selling, general, and administrative	506	193	(9)	554	510	(24)
	\$ 4,994	\$ 3,437	\$ 52	\$ 10,068	\$ 7,787	\$ 98

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The effect of derivative instruments not designated as cash flow hedges on the Company's Condensed Consolidated Statements of Operations was as follows:

Derivatives Not Designated as Hedging Instruments:	Location of Gain Recognized in Income	Three Months Ended		Six Months Ended	
		December 28, 2014	December 28, 2014	December 28, 2014	December 29, 2013
		Gain Recognized in Income	Gain Recognized in Income	Gain Recognized in Income	Gain Recognized in Income
		(in thousands)			
Foreign Exchange Contracts	Other income	\$ 1,118	\$ 5,012	\$ 2,086	\$ 11,040
Concentrations of Credit Risk					

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, short-term investments, restricted cash and investments, trade accounts receivable, and derivative financial instruments used in hedging activities. Cash is placed on deposit at large global financial institutions. Such deposits may be in excess of insured limits. Management believes that the financial institutions that hold the Company's cash are creditworthy and, accordingly, minimal credit risk exists with respect to these balances.

The Company's overall portfolio of available-for-sale securities must maintain an average minimum rating of AA- or Aa3 as rated by Standard and Poor's, Moody's Investor Services, or Fitch Ratings. To ensure diversification and minimize concentration, the Company's policy limits the amount of credit exposure with any one financial institution or commercial issuer.

The Company is exposed to credit losses in the event of nonperformance by counterparties on foreign currency forward hedge contracts, forward-starting interest rate swap agreements, and structured share repurchase arrangements. These counterparties are large global financial institutions and, to date, no such counterparty has failed to meet its financial obligations to the Company.

Credit risk evaluations, including trade references, bank references and Dun & Bradstreet ratings, are performed on all new customers and the Company monitors its customers' financial condition and payment performance. In general, the Company does not require collateral on sales.

**NOTE 5 INVENTORIES**

Inventories are stated at the lower of cost (first-in, first-out method) or market. System shipments to Japanese customers, for which title does not transfer until customer acceptance, are classified as finished goods inventory and carried at cost until title transfers. Inventories consist of the following:

	<b>December 28, 2014</b>	<b>June 29, 2014</b>
	<b>(in thousands)</b>	
Raw materials	\$ 564,243	\$ 449,623
Work-in-process	133,097	126,564

Finished goods	216,050	164,316
	\$ 913,390	\$ 740,503

**NOTE 6 GOODWILL AND INTANGIBLE ASSETS***Goodwill*

There were no significant changes in the goodwill balance during the three and six months ended December 28, 2014. Of the \$1.5 billion goodwill balance, \$61 million is tax deductible and the remaining balance is not tax deductible due to purchase accounting and applicable foreign law.



**Table of Contents***Intangible Assets*

The following table provides the Company's intangible assets as of December 28, 2014:

	<b>Gross</b>	<b>Accumulated Amortization</b> (in thousands)	<b>Net</b>
Customer relationships	\$ 615,484	\$ (202,065)	\$ 413,419
Existing technology	654,633	(269,105)	385,528
Patents	32,053	(25,420)	6,633
Other intangible assets	35,691	(35,314)	377
Intangible assets subject to amortization	1,337,861	(531,904)	805,957
Development rights	9,100		9,100
Intangible assets not subject to amortization	9,100		9,100
Total intangible assets	\$ 1,346,961	\$ (531,904)	\$ 815,057

The following table provides the Company's intangible assets as of June 29, 2014:

	<b>Gross</b>	<b>Accumulated Amortization</b> (in thousands)	<b>Net</b>
Customer relationships	\$ 615,618	\$ (169,162)	\$ 446,456
Existing technology	643,922	(224,246)	419,676
Patents	32,253	(24,407)	7,846
Other intangible assets	35,270	(35,270)	
Intangible assets subject to amortization	1,327,063	(453,085)	873,978
In process research and development	11,000		11,000
Development rights	9,100		9,100
Intangible assets not subject to amortization	20,100		20,100
Total intangible assets	\$ 1,347,163	\$ (453,085)	\$ 894,078

The Company recognized \$40.0 million and \$40.9 million in intangible asset amortization expense during the three months ended December 28, 2014, and December 29, 2013, respectively. The Company recognized \$79.2 million and \$82.5 million in intangible asset amortization expense during the six months ended December 28, 2014, and December 29, 2013, respectively.

The estimated future amortization expense of intangible assets, excluding those with indefinite lives, as of December 28, 2014 was as follows:

<b>Fiscal Year</b>	<b>Amount</b>
2015 (6 Months)	\$ 79,051
2016	155,657
2017	153,954
2018	152,741
2019	121,812
Thereafter	142,742
	<b>\$ 805,957</b>

**NOTE 7 ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES**

Accrued expenses and other current liabilities consist of the following:

	<b>December 28, 2014</b>	<b>June 29, 2014</b>
	<b>(in thousands)</b>	
Accrued compensation	\$ 352,226	\$ 311,054
Warranty reserves	79,029	68,324
Income and other taxes payable	43,278	93,934
Dividend payable	28,724	29,240
Other	134,248	101,744
	<b>\$ 637,505</b>	<b>\$ 604,296</b>

**Table of Contents****NOTE 8 OTHER EXPENSE, NET**

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Interest income	\$ 4,024	\$ 2,828	\$ 7,312	\$ 5,551
Interest expense	(15,797)	(15,297)	(31,501)	(30,599)
Gains on deferred compensation plan related assets	2,593	5,360	5,009	5,397
Foreign exchange gains (losses)	(130)	125	776	(97)
Other, net	(489)	3,147	2,957	1,649
	\$ (9,799)	\$ (3,837)	\$ (15,447)	\$ (18,099)

During the six months ended December 28, 2014, the Company sold all of Peter Wolters, a wholly owned subsidiary acquired as part of the Novellus acquisition. Net pre-tax gain of \$7.3 million associated with this divestiture is included in other, net in the Condensed Consolidated Statements of Operations.

**NOTE 9 INCOME TAX EXPENSE**

The Company recorded an income tax expense of \$2.0 million and \$23.6 million for the three and six months ended December 28, 2014, respectively, which yielded an effective tax rate for the three and six months ended December 28, 2014 of approximately 1.1% and 6.9%, respectively. The difference between the U.S. federal statutory tax rate of 35% and the Company's effective tax rate for the three and six months ended December 28, 2014 is primarily due to the geographic mix of income, the extension of the U.S. federal research and development tax credit for parts of fiscal years 2014 and 2015, and the recognition of previously unrecognized tax benefits due to lapse of statutes of limitation, offset by the tax effect of non-deductible stock-based compensation and unrecognized tax benefits due to uncertain tax positions.

**NOTE 10 NET INCOME PER SHARE**

Basic net income per share is computed by dividing net income by the weighted-average number of shares of Common Stock outstanding during the period. Diluted net income per share is computed using the treasury stock method, for dilutive stock options, RSUs, and convertible notes. Dilutive shares outstanding include the effect of the 2016, 2018 and 2041 Notes. The following table reconciles the numerators and denominators of the basic and diluted computations for net income per share.

<b>Three Months Ended</b>		<b>Six Months Ended</b>	
<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
<b>(in thousands, except per share data)</b>			

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<b>Numerator:</b>				
Net income	\$ 176,940	\$ 148,992	\$ 318,021	\$ 234,498
<b>Denominator:</b>				
Basic average shares outstanding	159,248	162,305	160,467	162,603
<b>Effect of potential dilutive securities:</b>				
Employee stock plans	3,304	2,847	3,432	2,869
Convertible notes	13,744	6,605	12,805	6,120
Warrants	750		378	
<b>Diluted average shares outstanding</b>	<b>177,046</b>	<b>171,757</b>	<b>177,082</b>	<b>171,592</b>
Net income per share - basic	\$ 1.11	\$ 0.92	\$ 1.98	\$ 1.44
Net income per share - diluted	\$ 1.00	\$ 0.87	\$ 1.80	\$ 1.37

For purposes of computing diluted net income per share, weighted-average common shares do not include potentially dilutive securities that are anti-dilutive under the treasury stock method. The following potentially dilutive securities were excluded:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 28, 2014</b>	<b>December 29, 2013</b>	<b>December 28, 2014</b>	<b>December 29, 2013</b>
	<b>(in thousands)</b>			
Number of potential dilutive securities excluded				296

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Diluted shares outstanding do not include any effect resulting from the note hedges associated with the Company's 2016 or 2018 Notes (as described in Note 12) as their impact would have been anti-dilutive.

**NOTE 11 ACCUMULATED OTHER COMPREHENSIVE LOSS**

The components of accumulated other comprehensive income (loss), net of tax at the end of the period, as well as the activity during the period, were as follows:

	Accumulated unrealized currency translation adjustment	holding gain (loss) on cash flow hedges	holding gain (loss) on available-for-sale investments (in thousands)	Accumulated unrealized components of defined benefit plans	Total
Balance as of June 29, 2014	\$ (12,986)	\$ (66)	\$ 1,557	\$ (17,160)	\$ (28,655)
Other comprehensive income before reclassifications	(14,478)	7,902	(4,740)	136	(11,180)
Losses (gains) reclassified from accumulated other comprehensive income to net income	(3,324)	(2,724) <sup>(1)</sup>	492 <sup>(2)</sup>		(5,556)
Net current-period other comprehensive income	\$ (17,802)	\$ 5,178	\$ (4,248)	\$ 136	\$ (16,736)
Balance as of December 28, 2014	\$ (30,788)	\$ 5,112	\$ (2,691)	\$ (17,024)	\$ (45,391)

(1) Amount of after tax gain reclassified from accumulated other comprehensive income into net income located in revenue: \$4,856 gain; cost of goods sold: \$1,590 loss; and selling, general and administrative expenses: \$542 loss.

(2) Amount of after tax gain reclassified from accumulated other comprehensive income into net income located in other expense, net

**NOTE 12 LONG-TERM DEBT AND OTHER BORROWINGS****Convertible Senior Notes**

In May 2011, the Company issued and sold \$450.0 million in aggregate principal amount of 0.50% Convertible Senior Notes due May 2016 (the 2016 Notes) at par. At the same time, the Company issued and sold \$450.0 million in aggregate principal amount of 1.25% Convertible Senior Notes due May 2018 (the 2018 Notes) at par. The Company pays cash interest at an annual rate of 0.5% and 1.25%, respectively, on the 2016 Notes and the 2018 Notes, on a semi-annual basis on May 15 and November 15 of each year.

In June 2012, with the acquisition of Novellus, the Company assumed \$700.0 million in aggregate principal amount of 2.625% Convertible Senior Notes due May 2041 (the 2041 Notes, and collectively with the 2016 Notes and the 2018 Notes, the Notes). The Company pays cash interest at an annual rate of 2.625%, on a semi-annual basis on May 15

and November 15 of each year. The 2041 Notes also have a contingent interest payment provision that may require the Company to pay additional interest, up to 0.60% per year, based on certain thresholds, beginning with the semi-annual interest payment on May 15, 2021, and upon the occurrence of certain events, as outlined in the indenture governing the 2041 Notes.

The Company separately accounts for the liability and equity components of the Notes. The initial debt components of the 2016 Notes, the 2018 Notes, and the 2041 Notes were valued based on the present value of the future cash flows using the Company's borrowing rate at the date of the issuance or assumption for similar debt instruments without the conversion feature, which equals the effective interest rate on the liability component disclosed in the following table, respectively.

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As of December 28, 2014 and June 29, 2014, the Notes consisted of the following:

	<b>December 28, 2014</b>			<b>June 29, 2014</b>		
	<b>2016 Notes</b>	<b>2018 Notes</b>	<b>2041 Notes (1)</b>	<b>2016 Notes</b>	<b>2018 Notes</b>	<b>2041 Notes (1)</b>
	(in thousands, except years, percentages, conversion rate, and conversion price)					
Carrying value, long-term	\$ 427,443	\$ 394,732	\$	\$ 419,561	\$ 387,338	\$
Carrying value, current portion			518,430			516,586
Unamortized discount	22,557	55,268	181,505	30,439	62,662	183,349
Principal amount	\$ 450,000	\$ 450,000	\$ 699,935	\$ 450,000	\$ 450,000	\$ 699,935
Remaining amortization period (years)	1.4	3.4	26.4			
Effective interest rate on liability component	4.29%	5.27%	4.28%			
Carrying amount of equity component, net of tax	\$ 76,230	\$ 104,895	\$ 328,109			
Fair Value of Notes (Level 1)	\$ 596,250	\$ 645,188	\$ 1,637,848			
Conversion rate (shares of common stock per \$1,000 principal amount of notes)	15.9868	15.9868	28.6901			
Conversion price (per share of common stock)	\$ 62.55	\$ 62.55	\$ 34.86			
If-converted value in excess of par value	\$ 132,431	\$ 132,431	\$ 925,839			

- (1) During the quarter-ended December 28, 2014 and June 29, 2014 the market value of the Common Stock was greater than or equal to 130% of the 2041 Note conversion price for 20 or more trading days of the 30 consecutive trading days preceding the quarter end. As a result, the 2041 Notes are convertible at the option of the holder. The carrying amount of the 2041 Notes was classified in current liabilities and the excess of the amount of cash payable, if converted, over the carrying amount of the 2041 Notes was classified as temporary equity in the Company's Consolidated Balance Sheets as of December 28, 2014 and June 29, 2014. Upon closure of a conversion period, all 2041 Notes not converted will be reclassified back to noncurrent liabilities and the temporary equity is reclassified to permanent equity.

The following table presents the amount of interest cost recognized relating to both the contractual interest coupon and amortization of the discount on the liability component of the Notes during the three and six months ended December 28, 2014 and December 29, 2013.

**Three Months Ended****Six Months Ended**

	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)			
Contractual interest coupon	\$ 6,562	\$ 6,562	\$ 13,124	\$ 13,124
Amortization of interest discount	8,610	8,217	17,119	16,339
Amortization of issuance costs	590	591	1,181	1,181
Total interest cost recognized	\$ 15,762	\$ 15,370	\$ 31,424	\$ 30,644

***Convertible Note Hedges and Warrants***

Concurrent with the issuance of the 2016 Notes and 2018 Notes, the Company sold warrants. At expiration, the Company may, at its option, elect to settle the warrants on a net share basis. As of December 28, 2014, the warrants had not been exercised and remained outstanding. The exercise price is adjusted for certain corporate events, including dividends on the Company's Common Stock.



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In addition, counterparties agreed to sell to the Company shares of Common Stock equal to the number of shares issuable upon conversion of the 2016 Notes and 2018 Notes in full. The convertible note hedge transactions will be settled in net shares and will terminate upon the earlier of the maturity date or the first day none of the respective notes remain outstanding due to conversion or otherwise. Settlement of the convertible note hedge in net shares, based on the number of shares issued upon conversion of the Notes, on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 2016 Notes and 2018 Notes. The exercise price is adjusted for certain corporate events, including dividends on the Company's Common Stock. The following table presents the details of the warrants and convertible note hedge arrangements as of December 28, 2014:

	2016 Notes	2018 Notes
	(shares in thousands)	
<b>Warrants:</b>		
Number of shares to be delivered upon exercise	7,194	7,194
Exercise price	\$ 70.81	\$ 75.54
Expiration date range	August 15 - October 21, 2016	August 15 - October 23, 2018
<b>Convertible Note Hedge:</b>		
Number of shares available from counterparties	7,194	7,194
Exercise price	\$ 62.55	\$ 62.55

**Revolving Credit Facility**

On March 12, 2014, the Company entered into a \$300 million revolving unsecured credit facility with a syndicate of lenders. The facility matures on March 12, 2019. The facility includes an option, subject to certain requirements, for the Company to request an increase in the facility of up to an additional \$200 million, for a potential total commitment of \$500 million. Proceeds from the credit facility can be used for general corporate purposes.

Interest on amounts borrowed under the credit facility is, at the Company's option, based on (i) a base rate, defined as the greatest of (a) prime rate, (b) Federal Funds rate plus 0.5%, or (c) one-month LIBOR plus 1.0%, plus a spread of 0.0% to 0.5%, or (ii) LIBOR plus a spread of 0.9% to 1.5%, in each case as the applicable spread is determined based on the rating of the Company's non-credit enhanced, senior unsecured long-term debt. Principal and any accrued and unpaid interest is due and payable upon maturity. Additionally, the Company will pay the lenders a quarterly commitment fee that varies based on the Company's rating described above. The credit facility contains certain restrictive covenants including maintaining a total consolidated indebtedness to consolidated capitalization ratio of no more than 0.5 to 1.0 and maintaining unrestricted or unencumbered cash and investments of no less than \$1.0 billion. As of December 28, 2014, the Company had no borrowings outstanding under the credit facility and was in compliance with all financial covenants.

**NOTE 13 COMMITMENTS AND CONTINGENCIES***Operating Leases and Related Guarantees*

The Company leases certain of its administrative, research and development ( R&D ) and manufacturing facilities, regional sales/service offices and certain equipment under non-cancelable operating leases. Certain of the Company's facility leases for buildings located at its Fremont, California headquarters and certain other facility leases provide the Company with options to extend the leases for additional periods or to purchase the facilities. Certain of the Company's facility leases provide for periodic rent increases based on the general rate of inflation.

The Company has operating leases regarding certain improved properties in Fremont and Livermore, California (the Operating Leases ). The Company was required to maintain cash collateral in an aggregate of approximately \$132.5 million in separate interest-bearing accounts, and marketable securities collateral in an aggregate of approximately \$17.2 million, as security for the Company's obligations. These amounts are recorded as restricted cash and investments in the Company's Consolidated Balance Sheet as of December 28, 2014.

During the term of the Operating Leases and when the terms of the Operating Leases expire, the property subject to those Operating Leases may be remarketed. The Company has guaranteed to the lessor that each property will have a certain minimum residual value. The aggregate guarantee made by the Company under the Operating Leases is generally no more than approximately \$191.2 million; however, under certain default circumstances, the guarantee with regard to an Operating Lease may be 100% of the lessor's aggregate investment in the applicable property, which in no case will exceed \$220.0 million, in the aggregate.

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The Company's contractual cash obligations with respect to operating leases, excluding the residential value guarantee discussed above, as of December 28, 2014 were as follows:

	<b>Operating Leases (in thousands)</b>
Payments due by period:	
One year	\$ 11,040
Two years	14,025
Three years	12,316
Four years	5,717
Five years	4,741
Over five years	14,790
Less: Sublease Income	(709)
<b>Total</b>	<b>\$ 61,920</b>

*Other Guarantees*

The Company has issued certain indemnifications to its lessors for taxes and general liability under some of its agreements. The Company has entered into certain insurance contracts that may limit its exposure to such indemnifications. As of December 28, 2014, the Company had not recorded any liability in connection with these indemnifications, as it does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

Generally, the Company indemnifies, under pre-determined conditions and limitations, its customers for infringement of third-party intellectual property rights by the Company's products or services. The Company seeks to limit its liability for such indemnity to an amount not to exceed the sales price of the products or services subject to its indemnification obligations. The Company does not believe, based on information available, that it is probable that any material amounts will be paid under these guarantees.

The Company provides guarantees and standby letters of credit to certain parties as required for certain transactions initiated during the ordinary course of business. As of December 28, 2014, the maximum potential amount of future payments that it could be required to make under these arrangements and letters of credit was \$14.3 million. The Company does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid.

*Warranties*

The Company provides standard warranties on its systems. The liability amount is based on actual historical warranty spending activity by type of system, customer, and geographic region, modified for any known differences such as the impact of system reliability improvements.

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

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 28,</b>	<b>December 29,</b>	<b>December 28,</b>	<b>December 29,</b>
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(in thousands)</b>			
Balance at beginning of period	\$ 70,452	\$ 59,871	\$ 69,385	\$ 58,078
Warranties issued during the period	28,700	25,546	53,236	42,299
Settlements made during the period	(23,988)	(18,967)	(48,056)	(33,272)
Changes in liability for pre-existing warranties	3,867	963	4,466	308
Balance at end of period	\$ 79,031	\$ 67,413	\$ 79,031	\$ 67,413

*Legal proceedings*

The Company is either a defendant or plaintiff in various actions that have arisen from time to time in the normal course of business, including intellectual property claims. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company believes that the amount of any such additional loss would be immaterial to the Company's business, financial condition, and results of operations.

**NOTE 14 STOCK REPURCHASE PROGRAM**

On April 29, 2014, the Board of Directors authorized the repurchase of up to \$850 million of Common Stock, which includes the remaining value available under the Company's prior authorization. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance with applicable law. Repurchases will be funded using the Company's on-shore cash and on-shore cash generation. This repurchase program has no termination date and may be suspended or discontinued at any time.

Repurchases under the repurchase program were as follows during the periods indicated:

<b>Period</b>	<b>Total Number of Shares Repurchased</b>	<b>Total Cost of Repurchase</b>	<b>Average Price Paid Per Share *</b>	<b>Amount Available Under Repurchase Program</b>
	<b>(in thousands, except per share data)</b>			
Available balance as of June 29, 2014				\$ 830,895
Quarter ended September 28, 2014	3,818	\$ 296,721	\$ 70.01	\$ 534,174
Quarter ended December 28, 2014	869	\$ 45,694	\$ 77.31	\$ 488,480

\* Average price paid per share excludes accelerated share repurchases for which cost was incurred during the September 2014 quarter, but that did not settle until the December 2014 quarter. See *Collared Accelerated Share Repurchase* section below for details regarding average price associated with these transactions.

In addition to shares repurchased under the Board-authorized repurchase program shown above, during the six months ended December 28, 2014, the Company acquired 409,418 shares at a total cost of \$31.3 million, which the Company withheld through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company's equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company's equity compensation plans.

As part of its share repurchase program, the Company may from time-to-time enter into structured share repurchase arrangements with financial institutions using general corporate funds. Such arrangements entered into or settled during the six months ended December 28, 2014 included the following:

*Collared Accelerated Share Repurchases*

During the three months ended September 28, 2014, the Company entered into a collared accelerated share repurchase ( ASR ) transaction under a master repurchase arrangement. Under the ASR, the Company made an up-front cash payment of \$250 million, in exchange for an initial delivery of approximately 3.2 million shares of its Common Stock.

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The number of shares to ultimately be repurchased by the Company was based generally on the volume-weighted average price ( VWAP ) of the Common Stock during the term of the ASR minus a pre-determined discount set at inception of the ASR, subject to collar provisions that provided a minimum and maximum number of shares that the Company could repurchase under the agreements. The minimum and maximum thresholds for the transaction were established based on the average of the VWAP prices for the Common Stock during an initial hedge period. The ASR was scheduled to end at any time on or after October 8, 2014 and on or before December 8, 2014.

The counterparty designated October 9, 2014 as the termination date, at which time the Company settled the ASR. Approximately 0.3 million shares were received at final settlement, which represented a weighted-average share price of approximately \$72.90 for the transaction period.

The Company accounted for the ASR as two separate transactions: (a) as shares of Common Stock acquired in a treasury stock transaction recorded on the acquisition date and (b) as a forward contract indexed to the Company's own Common Stock and classified in stockholders' equity. As such, the Company accounted for the shares that it received under the ASR as a repurchase of its Common Stock for the purpose of calculating earnings per common share. The Company has determined that the forward contract indexed to the Common Stock met all of the applicable criteria for equity classification in accordance with the Derivatives and Hedging topic of the FASB Accounting Standards Codification, and, therefore, the ASR was not accounted for as a derivative instrument. As of December 28, 2014, the aggregate repurchase price of \$250 million was reflected as Treasury stock, at cost, in the Consolidated Balance Sheet.

## **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS**

*With the exception of historical facts, the statements contained in this discussion are forward-looking statements, which are subject to the safe harbor provisions created by the Private Securities Litigation Reform Act of 1995. Certain, but not all, of the forward-looking statements in this report are specifically identified as forward-looking, by use of phrases and words such as believe, anticipate, expect, may, should, could and other future-oriented terms. The identification of certain statements as forward-looking is not intended to mean that other statements not specifically identified are not forward-looking. Forward-looking statements include, but are not limited to, statements that relate to: trends in the global economic environment and the semiconductor industry; the anticipated levels of, and rates of change in, future shipments, margins, market share, capital expenditures, revenue and operating expenses generally; management's plans and objectives for our current and future operations and business focus; volatility in our quarterly results; customer and end user requirements, and our ability to satisfy those requirements; our ability to address critical steps in the fabrication process; our ability to develop technologies and productivity solutions that benefit our customers, and to facilitate our customers' ability to meet more stringent performance or design standards; customer capital spending and their demand for our products; the reliability of indicators of change in customer spending and demand; the effect of variability in our customers' business plans on demand for our equipment and services; changes in demand for our products and in our market share resulting from, among other things, increases in our customers' proportion of capital expenditures (with respect to certain technology inflections); our ability to defend our market share and to gain new market share; factors that affect our tax rates; anticipated growth in the industry and the total market for wafer-fabrication equipment and our growth relative to such growth; levels of research and development expenditures; outsourced activities; the estimates we make, and the accruals we record, in order to implement our critical accounting policies (including but not limited to the adequacy of prior tax payments, future tax liabilities and the adequacy of our accruals relating to them); our access to capital markets; our intention to pay quarterly dividends and the amounts thereof, if any; our ability and intention to repurchase our shares; our ability to*

*manage and grow our cash position; and the sufficiency of our financial resources to support future business activities (including but not limited to operations, investments, debt service requirements and capital expenditures). Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value, and effect, including without limitation those discussed below under the heading **Risk Factors** within Part II Item 1A and elsewhere in this report and other documents we file from time to time with the Securities and Exchange Commission ( SEC ), such as our annual report on Form 10-K for the year ended June 29, 2014 (our 2014 Form 10-K ), our quarterly report on Form 10-Q for the quarter ended September 28, 2014, and our current reports on Form 8-K. Such risks, uncertainties and changes in condition, significance, value, and effect could cause our actual results to differ materially from those expressed in this report and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known to us. We do not undertake any obligation to release the results of any revisions to these forward-looking statements, which may be made to reflect events or circumstances that occur after the date of this report or to reflect the occurrence or effect of anticipated or unanticipated events.*

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***Documents To Review In Connection With Management's Discussion and Analysis Of Financial Condition and Results Of Operations***

For a full understanding of our financial position and results of operations for the three and six months ended December 28, 2014, and the related Management's Discussion and Analysis of Financial Condition and Results of Operations below, you should also read the Condensed Consolidated Financial Statements and notes presented in this Form 10-Q and the financial statements and notes in our 2014 Form 10-K.

***Overview***

Management's Discussion and Analysis of Financial Condition and Results of Operations consist of the following sections:

*Executive Summary* provides an overview of the Company's operations and a summary of certain highlights of our results of operations

*Results of Operations* provides an analysis of operating results

*Critical Accounting Policies and Estimates* discusses accounting policies that reflect the more significant judgments and estimates we use to prepare our Condensed Consolidated Financial Statements

*Liquidity and Capital Resources* provides an analysis of cash flows and financial position

**EXECUTIVE SUMMARY**

Lam Research has been an innovative supplier of wafer fabrication equipment and services to the semiconductor industry for more than 30 years. Our customers include semiconductor manufacturers that make memory, microprocessors, and other logic integrated circuits for a wide range of electronics; including cell phones, computers, storage devices and networking equipment.

Our market-leading products are designed to help our customers build the smaller, faster and more power-efficient devices that are necessary to power the capabilities required by end users. The process of integrated circuits fabrication consists of a complex series of process and preparation steps, and Lam's product offerings in deposition, etch and clean address a number of the most critical steps in the fabrication process. We leverage our expertise in semiconductor processing to develop technology and productivity solutions that typically benefit our customers through lower defect rates, enhanced yields, faster processing time, and reduced cost as well as by facilitating their ability to meet more stringent performance and design standards.

The semiconductor capital equipment industry has been highly competitive and subject to business cycles that historically have been characterized by rapid changes in demand. More recently, with consolidation in the customer base, the cyclical behavior appears to have diminished somewhat. With a reduced number of customers, variability in their business plans may lead to changes in demand for Lam's equipment and services over certain periods. The variability in our customers' investments during any particular period is dependent on several factors including but not limited to electronics demand, economic conditions (both general and in the semiconductor and electronics industries), industry supply and demand, prices for semiconductors, and our customers' ability to develop and manufacture increasingly complex and costly semiconductor devices.



Demand for our products was strong throughout calendar year 2014 as semiconductor device manufacturers made capacity and technology investments. Technology inflections in our industry including FinFET transistors, 3D NAND and multiple patterning, have led to an increase in the deposition, etch and clean market sizes. The capacity spending of our customers, as well as strengthened market share in these technology inflections, contributed to increased revenue in the 2014 calendar year as compared to the 2013 calendar year. We believe that, over the longer term, demand for our products should increase as the proportion of customers' capital expenditures rises in these technology inflection areas, and we continue to gain market share.

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

	<b>Three Months Ended</b>		
	<b>December 28, 2014</b>	<b>September 28, 2014</b>	<b>December 29, 2013</b>
	<b>(In thousands, except percentage and per share data)</b>		
Revenue	\$ 1,232,241	\$ 1,152,368	\$ 1,116,061
Gross margin	\$ 536,657	\$ 505,539	\$ 487,789
Gross margin as a percentage of revenue	43.6%	43.9%	43.7%
Total operating expenses	\$ 347,916	\$ 337,241	\$ 323,315
Net income	\$ 176,940	\$ 141,081	\$ 148,992
Diluted net income per share	\$ 1.00	\$ 0.80	\$ 0.87

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In the December 2014 quarter, revenue increased compared to the quarter ended September 28, 2014 (the September 2014 quarter), as a result of strong memory segment spending growth partially offset by a small decline in the foundry segment. Gross margin as a percent of revenue in the December 2014 quarter decreased slightly as compared to the September 2014 quarter due to changes in product mix. Operating expenses in the December 2014 quarter increased compared to the September 2014 quarter related primarily to our increased investment in R&D.

Our cash and cash equivalents, short-term investments, and restricted cash and investments balances totaled approximately \$3.0 billion as of December 28, 2014 and September 28, 2014. Cash generated by operations was approximately \$161 million during the December 2014 quarter. We used cash during the December 2014 quarter to repurchase \$66 million of our shares and purchase \$61 million of property and equipment. Employee headcount increased as of December 28, 2014 as compared to September 28, 2014 by approximately 300 people to approximately 6,900 people.

**RESULTS OF OPERATIONS*****Shipments***

	Three Months Ended		
	December 28, 2014	September 28, 2014	December 29, 2013
Shipments (in millions)	\$ 1,247	\$ 1,111	\$ 1,139
Taiwan	23%	21%	22%
Korea	30%	16%	24%
United States	16%	25%	9%
Japan	13%	11%	13%
China	7%	8%	21%
Southeast Asia	4%	11%	4%
Europe	7%	8%	7%

Shipments for the December 2014 quarter increased 12% compared to the September 2014 quarter and increased 9% compared to the December 2013 quarter reflecting increases in customer demand for semiconductor equipment. The percentage of total system shipments to each of the market segments we serve were as follows for the periods presented:

	Three Months Ended		
	December 28, 2014	September 28, 2014	December 29, 2013
Memory	53%	44%	64%
Foundry	32%	45%	28%
Logic/integrated device manufacturing	15%	11%	8%

***Revenue***

	Three Months Ended			Six Months Ended	
	December 28, 2014	September 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Revenue (in millions)	\$ 1,232	\$ 1,152	\$ 1,116	\$ 2,385	\$ 2,131
Taiwan	25%	18%	28%	22%	26%
Korea	24%	19%	19%	21%	21%
United States	18%	28%	13%	23%	13%
Japan	12%	10%	17%	11%	15%
China	8%	9%	12%	8%	10%
Southeast Asia	7%	9%	6%	8%	8%
Europe	6%	7%	5%	7%	7%

Revenue for the December 2014 quarter increased 7% compared to the September 2014 quarter, and increased 10% as compared to the December 2013 quarter, reflecting the increase in the market noted in the shipment section above. Our deferred revenue balance increased to \$374 million as of December 28, 2014 compared to \$357 million as of September 28, 2014. Our deferred revenue balance does not include system shipments to Japanese customers, for which title does not transfer until customer acceptance. Shipments to Japanese customers are classified as inventory at cost until the time of acceptance. The anticipated future revenue value from shipments to Japanese customers was approximately \$53 million as of December 28, 2014 and \$34 million as of September 28, 2014.

**Table of Contents*****Gross Margin***

	Three Months Ended			Six Months Ended	
	December 28, 2014	September 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands, except percentages)				

Gross margin	\$ 536,657	\$ 505,539	\$ 487,789	\$ 1,042,196	\$ 919,647
Percent of revenue	43.6%	43.9%	43.7%	43.7%	43.2%

The slight decrease in gross margin as a percentage of revenue during the December 2014 quarter as compared to the September 2014 quarter was due to a less favorable product mix.

Gross margin as a percentage of revenue during the December 2014 quarter is down slightly when compared to the December 2013 quarter primarily due to a less favorable product mix.

***Research and Development***

	Three Months Ended			Six Months Ended	
	December 28, 2014	September 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands, except percentages)				

Research and development ( R&D )	\$ 196,768	\$ 188,934	\$ 174,477	\$ 385,702	\$ 345,044
Percent of revenue	16.0%	16.4%	15.6%	16.2%	16.2%

We continue to make significant R&D investments focused on leading-edge deposition, plasma etch, single-wafer clean and other semiconductor manufacturing requirements. The increased R&D spending as a percent of revenue from the September 2014 quarter to the December 2014 quarter reflects the continued spending on technologies for the industry inflection points. The increased total spending during the December 2014 quarter compared to the September 2014 quarter was primarily due to a \$6 million increase in supplies.

The increase in R&D expenses during the December 2014 quarter compared to the same period in the prior year was primarily due to a \$13 million increase in employee compensation, reflecting an increase in our product development efforts and a \$4 million increase in supplies.

***Selling, General and Administrative***

	Three Months Ended			Six Months Ended	
	December 28, 2014	September 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands, except percentages)				

Selling, general and administrative ( SG&A )	\$ 151,148	\$ 148,307	\$ 148,838	\$ 299,455	\$ 304,721
Percent of revenue	12.3%	12.9%	13.3%	12.6%	14.3%

The increase in SG&A expenses during the December 2014 quarter compared to the September 2014 quarter was primarily due to a \$2 million facility-related restructuring charge and a \$2 million increase in outside services.

SG&A expense in the December 2014 quarter increased slightly compared to the same period in the prior year. In the December 2014 quarter, there was a \$2 million facility-related restructuring charge, \$2 million increase in salaries and benefits, and a \$3 million increase in outside services, offset by a \$3 million decrease in integration costs.

**Table of Contents*****Other Expense, Net***

Other expense, net consisted of the following:

	Three Months Ended			Six Months Ended	
	December 28, 2014	September 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands)				
Interest income	\$ 4,024	\$ 3,288	\$ 2,828	\$ 7,312	\$ 5,551
Interest expense	(15,797)	(15,704)	(15,297)	(31,501)	(30,599)
Gains on deferred compensation plan related assets	2,593	2,416	5,360	5,009	5,397
Foreign exchange gains (losses)	(130)	906	125	776	(97)
Other, net	(489)	3,446	3,147	2,957	1,649
	\$ (9,799)	\$ (5,648)	\$ (3,837)	\$ (15,447)	\$ (18,099)

Interest income increased in the three and the six months ended December 28, 2014, as compared to the three and six months ended December 29, 2013 as a result of higher cash and investment balances.

In the three and six months ended December 28, 2014, as compared to the three and six months ended December 29, 2013, we recognized gains on assets that are related to obligations under our deferred compensation plan, due to changes in the market value of securities in this portfolio.

Foreign exchange losses in the three months ended December 28, 2014 and foreign exchange gains both in the September 2014 quarter and the December 2014 quarter were related to un-hedged portions of the balance sheet exposures.

During the six months ended December 28, 2014, we sold substantially all of Peter Wolters, a wholly owned subsidiary acquired as part of the Novellus acquisition. Net pre-tax gain of approximately \$7 million associated with this divestiture is included in Other, net. Other, net for the three and six months ended December 29, 2013 was primarily due to a gain on disposition of a private equity investment of approximately \$5 million.

***Income Tax Expense***

Our provision for income taxes and effective tax rate for the periods indicated were as follows:

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(in thousands, except percentages)			
Provision for income taxes	\$ 2,002	\$ 11,645	\$ 23,571	\$ 17,285
Effective tax rate	1.1%	7.2%	6.9%	6.9%

The change in the effective tax rate for the three months ended December 28, 2014 compared to the three months ended December 29, 2013 was primarily due to the change in level of income, the retroactive extension of the U.S. federal research and development tax credit for part of fiscal year 2014.

The effective tax rate for the six months ended December 28, 2014 remains consistent compared to the six months ended December 29, 2013.

International revenues account for a significant portion of our total revenues, such that a material portion of our pre-tax income is earned and taxed outside the United States at rates that are generally lower than in the United States. Please refer to Note 10 of the Notes to Consolidated Financial Statements in our 2014 Form 10-K.

### ***Uncertain Tax Positions***

We reevaluate uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in the recognition of a tax benefit or an additional charge to the tax provision.

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**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

A critical accounting policy is defined as one that has both a material impact on our financial condition and results of operations and requires us to make difficult, complex and/or subjective judgments, often as a result of the need to make estimates about matters that are inherently uncertain. The preparation of financial statements in conformity with U.S. generally accepted accounting principles ( GAAP ) requires management to make certain judgments, estimates and assumptions that could affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We based our estimates and assumptions on historical experience and on various other assumptions we believed to be applicable and evaluate them on an ongoing basis to ensure they remain reasonable under current conditions. Actual results could differ significantly from those estimates, which could have a material impact on our business, results of operations, and financial condition.

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

*Revenue Recognition:* We recognize all revenue when persuasive evidence of an arrangement exists, delivery has occurred and title has passed or services have been rendered, the selling price is fixed or determinable, collection of the receivable is reasonably assured, and we have received customer acceptance or are otherwise released from our customer acceptance obligations. If terms of the sale provide for a lapsing customer acceptance period, we recognize revenue upon the expiration of the lapsing acceptance period or customer acceptance, whichever occurs first. If the practices of a customer do not provide for a written acceptance or the terms of sale do not include a lapsing acceptance provision, we recognize revenue when it can be reliably demonstrated that the delivered system meets all of the agreed-to customer specifications. In situations with multiple deliverables, we recognize revenue upon the delivery of the separate elements to the customer and when we receive customer acceptance or are otherwise released from our customer acceptance obligations. We allocate revenue from multiple-element arrangements among the separate elements based on their relative selling prices, provided the elements have value on a stand-alone basis. Our sales arrangements do not include a general right of return. The maximum revenue we recognize on a delivered element is limited to the amount that is not contingent upon the delivery of additional items. We generally recognize revenue related to sales of spare parts and system upgrade kits upon shipment. We generally recognize revenue related to services upon completion of the services requested by a customer order. We recognize revenue for extended maintenance service contracts with a fixed payment amount on a straight-line basis over the term of the contract. When goods or services have been delivered to the customer but all conditions for revenue recognition have not been met, we record deferred revenue and/or deferred costs of sales in deferred profit on our Consolidated Balance Sheet.

*Inventory Valuation:* Inventories are stated at the lower of cost or market using standard costs that approximate actual costs on a first-in, first-out basis. We maintain a perpetual inventory system and continuously record the quantity on-hand and standard cost for each product, including purchased components, subassemblies, and finished goods. We maintain the integrity of perpetual inventory records through periodic physical counts of quantities on hand. Finished goods are reported as inventories until the point of title transfer to the customer. Unless specified in the terms of sale, title generally transfers when we complete physical transfer of the products to the freight carrier. Transfer of title for shipments to Japanese customers generally occurs at the time of customer acceptance.

Management evaluates the need to record adjustments for impairment of inventory at least quarterly. Our policy is to assess the valuation of all inventories including manufacturing raw materials, work-in-process, finished goods, and spare parts in each reporting period. Obsolete inventory or inventory in excess of management's estimated usage requirement is written down to its estimated market value if less than cost. Estimates of market value include, but are not limited to, management's forecasts related to our future manufacturing schedules, customer demand, technological



and/or market obsolescence, general semiconductor market conditions, and possible alternative uses. If future customer demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of goods sold in the period in which we make the revision.

*Warranty:* Typically, the sale of semiconductor capital equipment includes providing parts and service warranties to customers as part of the overall price of the system. We provide standard warranties for our systems. We record a provision for estimated warranty expenses to cost of sales for each system when we recognize revenue. We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. The amount recorded is based on an analysis of historical activity that uses factors such as type of system, customer, geographic region, and any known factors such as tool reliability trends. All actual or estimated parts and labor costs incurred in subsequent periods are charged to those established reserves on a system-by-system basis.

While we periodically monitor the performance and cost of warranty activities, if actual costs incurred are different than our estimates, we may recognize adjustments to provisions in the period in which those differences arise or are identified. In addition to the provision of standard warranties, we offer customer-paid extended warranty services. Revenues for extended maintenance and warranty services with a fixed payment amount are recognized on a straight-line basis over the term of the contract. Related costs are recorded as incurred.

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*Equity-based Compensation Employee Stock Purchase Plan ( ESPP ) and Employee Stock Plans:* GAAP requires us to recognize the fair value of equity-based compensation in net income. We determine the fair value of our restricted stock units ( RSUs ), excluding market-based performance RSUs, based upon the fair market value of Company stock at the date of grant. We estimate the fair value of our market-based performance RSUs using a Monte Carlo simulation model at the date of the grant. We estimate the fair value of our stock options and ESPP awards using the Black-Scholes option valuation model. This model requires us to input highly subjective assumptions, including expected stock price volatility and the estimated life of each award. We amortize the fair value of equity-based awards over the vesting periods of the awards, and we have elected to use the straight-line method of amortization.

We make quarterly assessments of the adequacy of our tax credit pool related to equity-based compensation to determine if there are any deficiencies that we are required to recognize in our Condensed Consolidated Statements of Operations. We will only recognize a benefit from stock-based compensation in paid-in-capital if we realize an incremental tax benefit after all other tax attributes currently available to us have been utilized. In addition, we have elected to account for the indirect benefits of stock-based compensation on the research tax credit through the income statement (continuing operations) rather than through paid-in-capital. We have also elected to net deferred tax assets and the associated valuation allowance related to net operating loss and tax credit carryforwards for the accumulated stock award tax benefits for income tax footnote disclosure purposes. We track these stock award attributes separately and will only recognize these attributes through paid-in-capital.

*Income Taxes:* Deferred income taxes reflect the net tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as the tax effect of carryforwards. We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Realization of our net deferred tax assets is dependent on future taxable income. We believe it is more-likely-than-not that such assets will be realized; however, ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at the time. In the event that we determine that we would not be able to realize all or part of our net deferred tax assets, an adjustment would be charged to earnings in the period such determination is made. Likewise, if we later determine that it is more-likely-than-not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

We recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. Our policy is to include interest and penalties related to unrecognized tax benefits as a component of income tax expense.

*Goodwill and Intangible Assets:* The valuation of intangible assets acquired in a business combination requires the use of management estimates including but not limited to estimating future expected cash flows from assets acquired and determining discount rates. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Estimates associated with the accounting for acquisitions may change as additional information becomes available.

Goodwill represents the amount by which the purchase price in each business combination exceeds the fair value of the net tangible and identifiable intangible assets acquired. Each component of the Company for which discrete financial information is available and for which management regularly reviews the results of operations is considered a reporting unit. All goodwill acquired in a business combination is assigned to one or more reporting units as of the acquisition date. Goodwill is assigned to the Company's reporting units that are expected to benefit from the synergies of the combination. The goodwill assigned to a reporting unit is the difference between the acquisition consideration

assigned to the reporting unit on a relative fair value basis and the fair value of acquired assets and liabilities that can be specifically attributed to the reporting unit. We test goodwill and identifiable intangible assets with indefinite useful lives for impairment at least annually. We amortize intangible assets with estimable useful lives over their respective estimated useful lives, and we review for impairment whenever events or changes in circumstances indicate that the carrying amount of the intangible asset may not be recoverable and the carrying amount exceeds its fair value.

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We review goodwill at least annually for impairment. If certain events or indicators of impairment occur between annual impairment tests, we would perform an impairment test at that date. In testing for a potential impairment of goodwill, we: (1) allocate goodwill to our reporting units to which the acquired goodwill relates; (2) estimate the fair value of our reporting units; and (3) determine the carrying value (book value) of those reporting units, as some of the assets and liabilities related to those reporting units are not held by those reporting units but by a corporate function. Prior to this allocation of the assets to the reporting units, we assess long-lived assets for impairment. Furthermore, if the estimated fair value of a reporting unit is less than the carrying value, we must estimate the fair value of all identifiable assets and liabilities of that reporting unit, in a manner similar to a purchase price allocation for an acquired business. This can require independent valuations of certain internally generated and unrecognized intangible assets such as in-process R&D and developed technology. Only after this process is completed can the amount of goodwill impairment, if any, be determined. In our goodwill impairment analysis we first assess qualitative factors to determine whether it is necessary to perform a quantitative analysis. We do not calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more-likely-than-not that its fair value is less than its carrying amount. Our most recent annual goodwill impairment analysis, which was performed as of the first day of our fourth quarter of fiscal year 2014, March 31, 2014, did not result in a goodwill impairment charge, nor did we record any goodwill impairment in fiscal years 2013 or 2012. As a result of historical performance and growth potential, our single-wafer clean systems reporting unit may be at greater risk for goodwill impairment than our other reporting units if our actual results for this reporting unit differ from our projections.

The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. We determine the fair value of our reporting units by using a weighted combination of both a market and an income approach, as this combination is deemed to be the most indicative of fair value in an orderly transaction between market participants.

Under the market approach, we use information regarding the reporting unit as well as publicly available industry information to determine various financial multiples to value our reporting units. Under the income approach, we determine fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn.

In estimating the fair value of a reporting unit for the purposes of our annual or periodic analyses, we make estimates and judgments about the future cash flows of our reporting units, including estimated growth rates and assumptions about the economic environment. Although our cash flow forecasts are based on assumptions that are consistent with the plans and estimates we are using to manage the underlying businesses, there is significant judgment involved in determining the cash flows attributable to a reporting unit. In addition, we make certain judgments about allocating shared assets to the estimated balance sheets of our reporting units. We also consider our market capitalization and that of our competitors on the date we perform the analysis. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge.

As a result, several factors could result in impairment of a material amount of our goodwill balance in future periods, including, but not limited to: (1) weakening of the global economy, weakness in the semiconductor equipment industry, or our failure to reach our internal forecasts, which could impact our ability to achieve our forecasted levels of cash flows and reduce the estimated discounted cash flow value of our reporting units; and (2) a decline in our stock price and resulting market capitalization, if we determine that the decline is sustained and indicates a reduction in the fair value of our reporting units below their carrying value. In addition, the value we assign to intangible assets, other than goodwill, is based on our estimates and judgments regarding expectations such as the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from our estimates, we may be required to record an impairment charge to write down the asset to its realizable value.

*Recent Accounting Pronouncements*

In July 2013, the FASB released Accounting Standards Update 2013-11 Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new standard requires that an unrecognized tax benefit should be presented as a reduction of a deferred tax asset for a net operating loss carryforward or other tax credit carryforward when settlement in this manner is available under the tax law. We adopted this standard during the fiscal year without significant impact on our financial position, results of operations, or cash flows.

In April 2014, the FASB released Accounting Standards Update 2014-8 Presentation of Financial Statements and Property, Plant and Equipment: Reporting Discontinued Operations and Disclosure of Disposals of Components of an Entity. The new standard re-defines discontinued operations and requires only those disposals of components of an entity, including classifications as held for sale, that represent a strategic shift that has, or will have, a major effect on an entity's operations and financial results to be reported as discontinued operations. In addition, the new standard expands the disclosure requirements of discontinued operations. We adopted this standard during the fiscal quarter without significant impact on our financial position, results of operations, or cash flows.

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In May 2014, the FASB released Accounting Standards Update 2014-9 Revenue from Contracts with Customers to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of the standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The new standard defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. We are required to adopt this standard starting in the first quarter of fiscal year 2018 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the standard; or (ii) retrospective with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per the standard. We have not yet selected a transition method, and have not determined the impact that the new standard will have on our consolidated financial statements.

**LIQUIDITY AND CAPITAL RESOURCES**

As of December 28, 2014, we had \$3.0 billion in gross cash and cash equivalents, short-term investments, and restricted cash and investments (total cash and investments) compared to \$3.2 billion as of June 29, 2014. Approximately \$2.4 billion and \$2.2 billion of our total cash and investments as of December 28, 2014 and June 29, 2014, respectively, was held outside the United States in our foreign subsidiaries, the majority of which is held in U.S. Dollars and would be subject to tax at U.S. rates if it were to be repatriated.

***Cash Flows from Operating Activities***

Net cash provided by operating activities of \$302 million during the six months ended December 28, 2014 consisted of (in millions):

Net income	\$ 318
Non-cash charges:	
Depreciation and amortization	137
Equity-based compensation	63
Amortization of convertible note discount	17
Deferred income taxes	7
Changes in operating asset and liability accounts	(239)
Other	(1)
	\$ 302

Changes in operating asset and liability accounts, net of foreign exchange impact, included the following uses of cash: increases in accounts receivable of \$144.2 million, inventories of \$173.0 million and prepaid expense and other assets of \$43.6 million, partially offset by sources of cash resulting from increases in trade accounts payable, accrued liabilities and deferred profit of \$72.8 million, \$30.2 million, and \$18.8 million, respectively.

***Cash Flows from Investing Activities***

Net cash used for investing activities during the six months ended December 28, 2014 was \$371.0 million, primarily consisting of capital expenditures of \$103.2 million and net purchases of available-for-sale securities of \$311.9 million, off-set by net proceeds on sale of business of \$41.2 million.

***Cash Flows from Financing Activities***

Net cash used for financing activities during the six months ended December 28, 2014 was \$396.6 million, primarily consisting of \$374.0 million in treasury stock repurchases and \$58.6 million of dividends paid, partially offset by net proceeds from issuance of Common Stock related to employee equity-based plans of \$25.8 million.

**Table of Contents*****Liquidity***

Given the cyclical nature of the semiconductor equipment industry, we believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in R&D and capital infrastructure. Anticipated cash flows from operations based on our current business outlook, combined with our current levels of cash, cash equivalents, and short term investments at December 28, 2014, are expected to be sufficient to support our anticipated levels of operations, investments, debt service requirements, capital expenditures, capital redistributions and dividends, through at least the next 12 months. However, uncertainty in the global economy and the semiconductor industry, as well as disruptions in credit markets, have in the past, and could in the future, impact customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers, and creditors.

In the longer term, liquidity will depend to a great extent on our future revenues and our ability to appropriately manage our costs based on demand for our products and services. While we have substantial cash balances in the United States and offshore, we may require additional funding and need to raise the required funds through borrowings or public or private sales of debt or equity securities. We believe that, if necessary, we will be able to access the capital markets on terms and in amounts adequate to meet our objectives. However, given the possibility of changes in market conditions or other occurrences, there can be no certainty that such funding will be available in needed quantities or on terms favorable to us.

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

For financial market risks related to changes in interest rates, marketable equity security prices, and foreign currency exchange rates, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our 2014 Form 10-K. Other than noted below, our exposure related to market risk has not changed materially since June 29, 2014. All of the potential changes noted below are based on sensitivity analyses performed on our financial position as of December 28, 2014. Actual results may differ materially.

**Fixed Income Securities**

Our investments in various interest earning securities carry a degree of market risk for changes in interest rates. At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our fixed income investment portfolio. Conversely, declines in interest rates could have a material adverse impact on interest income for our investment portfolio. We target to maintain a conservative investment policy, which focuses on the safety and preservation of our capital by limiting default risk, market risk, reinvestment risk, and concentration risk. The following table presents the hypothetical fair values of fixed income securities that would result from selected potential decreases and increases in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points ( BPS ), 100 BPS, and 150 BPS. The hypothetical fair values as of December 28, 2014 were as follows:

Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of December 28, 2014	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
(150 BPS)	(100 BPS)	(50 BPS)		50 BPS	100 BPS	150 BPS



	(in thousands)						
Time Deposits	\$ 132,549	\$ 132,549	\$ 132,549	\$ 132,549	\$ 132,549	\$ 132,549	\$ 132,549
Municipal Notes and Bonds	251,864	251,824	251,591	250,684	249,497	248,310	247,124
US Treasury & Agencies	296,643	296,540	295,298	293,293	291,003	288,712	286,422
Government-Sponsored Enterprises	58,854	58,844	58,693	58,377	58,036	57,693	57,350
Foreign Government Bond	45,591	45,555	45,246	44,874	44,503	44,131	43,760
Corporate Notes and Bonds	1,142,867	1,138,550	1,131,835	1,124,383	1,116,919	1,109,458	1,101,998
Mortgage Backed Securities - Residential	17,554	17,487	17,409	17,327	17,236	17,147	17,057
Mortgage Backed Securities - Commercial	132,281	131,796	131,240	130,615	129,982	129,349	128,716
<b>Total</b>	<b>\$ 2,078,203</b>	<b>\$ 2,073,145</b>	<b>\$ 2,063,861</b>	<b>\$ 2,052,102</b>	<b>\$ 2,039,725</b>	<b>\$ 2,027,349</b>	<b>\$ 2,014,976</b>

We mitigate default risk by investing in high credit quality securities and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to achieve portfolio liquidity and maintain a prudent amount of diversification.

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**ITEM 4. Controls and Procedures**

***Design of Disclosure Controls and Procedures and Internal Control over Financial Reporting***

We maintain disclosure controls and procedures and internal control over financial reporting that are designed to comply with Rule 13a-15 of the Exchange Act. In designing and evaluating the controls and procedures associated with each, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and that the effectiveness of controls cannot be absolute because the cost to design and implement a control to identify errors or mitigate the risk of errors occurring should not outweigh the potential loss caused by the errors that would likely be detected by the control. Moreover, we believe that a control system cannot be guaranteed to be 100% effective all of the time. Accordingly, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

***Disclosure Controls and Procedures***

As required by Exchange Act Rule 13a-15(b), as of December 28, 2014, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer, along with our Chief Financial Officer, concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

We intend to review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis and to correct any material deficiencies that we may discover. Our goal is to ensure that our senior management has timely access to material information that could affect our business.

***Changes in Internal Control over Financial Reporting***

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

***Effectiveness of Controls***

While we believe the present design of our disclosure controls and procedures and internal control over financial reporting is effective, future events affecting our business may cause us to modify our disclosure controls and procedures or internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

The Company is either a defendant or plaintiff in various actions that have arisen from time to time in the normal course of business, including intellectual property claims. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company believes that the amount of any such additional loss would be immaterial to the Company's business, financial condition, and results of operations.

**ITEM 1A. Risk Factors**

In addition to the other information in this Form 10-Q, the following risk factors should be carefully considered in evaluating the Company and its business because such factors may significantly impact our business, operating results, and financial condition. As a result of these risk factors, as well as other risks discussed in our other SEC filings, our actual results could differ materially from those projected in any forward-looking statements. No priority or significance is intended, nor should be attached, to the order in which the risk factors appear.

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***The Semiconductor Equipment Industry is Subject to Fluctuations and, as a Result, We Face Risks Related to Our Strategic Resource Allocation Decisions***

The business cycle in the semiconductor equipment industry has historically been characterized by frequent periods of rapid change in demand that challenge our management to adjust spending and other resources allocated to operating activities. During periods of rapid growth or decline in demand for our products and services, we face significant challenges in maintaining adequate financial and business controls, management processes, information systems, procedures for training and managing our work force, and in appropriately sizing our supply chain infrastructure, work force, and other components of our business on a timely basis. If we do not adequately meet these challenges during periods of demand decline, our gross margins and earnings may be negatively impacted.

We continuously reassess our strategic resource allocation choices in response to the changing business environment. If we do not adequately adapt to the changing business environment, we may lack the infrastructure and resources to scale up our business to meet customer expectations and compete successfully during a period of growth, or we may expand our capacity too rapidly and/or beyond what is appropriate for the actual demand environment.

Especially during transitional periods, resource allocation decisions can have a significant impact on our future performance, particularly if we have not accurately anticipated industry changes. Our success will depend, to a significant extent, on the ability of our executive officers and other members of our senior management to identify and respond to these challenges effectively.

***Future Declines in the Semiconductor Industry, and the Overall World Economic Conditions on Which it is Significantly Dependent, Could Have a Material Adverse Impact on Our Results of Operations and Financial Condition***

Our business depends on the capital equipment expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits. The semiconductor industry is cyclical in nature and experiences periodic downturns. Global economic and business conditions, which are often unpredictable, have historically impacted customer demand for our products and normal commercial relationships with our customers, suppliers, and creditors. Additionally, in times of economic uncertainty our customers' budgets for our products, or their ability to access credit to purchase them, could be adversely affected. This would limit their ability to purchase our products and services. As a result, economic downturns can cause material adverse changes to our results of operations and financial condition including, but not limited to:

a decline in demand for our products or services;

an increase in reserves on accounts receivable due to our customers' inability to pay us;

an increase in reserves on inventory balances due to excess or obsolete inventory as a result of our inability to sell such inventory;

valuation allowances on deferred tax assets;

restructuring charges;

asset impairments including the potential impairment of goodwill and other intangible assets;

a decline in the value of our investments;

exposure to claims from our suppliers for payment on inventory that is ordered in anticipation of customer purchases that do not come to fruition;

a decline in the value of certain facilities we lease to less than our residual value guarantee with the lessor;  
and

challenges maintaining reliable and uninterrupted sources of supply.

Fluctuating levels of investment by semiconductor manufacturers may materially affect our aggregate shipments, revenues, operating results and earnings. Where appropriate, we will attempt to respond to these fluctuations with cost management programs aimed at aligning our expenditures with anticipated revenue streams, which sometimes result in restructuring charges. Even during periods of reduced revenues, we must continue to invest in R&D and maintain extensive ongoing worldwide customer service and support capabilities to remain competitive, which may temporarily harm our profitability and other financial results.

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***Our Quarterly Revenues and Operating Results Are Variable***

Our revenues and operating results may fluctuate significantly from quarter to quarter due to a number of factors, not all of which are in our control. We manage our expense levels based in part on our expectations of future revenues. Because our operating expenses are based in part on anticipated future revenues, and a certain amount of those expenses are relatively fixed, a change in the timing of recognition of revenue and/or the level of gross profit from a small number of transactions can unfavorably affect operating results in a particular quarter. Factors that may cause our financial results to fluctuate unpredictably include, but are not limited to:

economic conditions in the electronics and semiconductor industries in general and specifically the semiconductor equipment industry;

the size and timing of orders from customers;

procurement shortages;

the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;

manufacturing difficulties;

customer cancellations or delays in shipments, installations, and/or customer acceptances;

the extent that customers continue to purchase and use our products and services in their business;

our customers' reuse of existing and installed products, to the extent that such reuse decreases their need to purchase new products or services;

changes in average selling prices, customer mix, and product mix;

our ability in a timely manner to develop, introduce and market new, enhanced, and competitive products;

our competitors' introduction of new products;

legal or technical challenges to our products and technology;

transportation, communication, demand, information technology or supply disruptions based on factors outside our control such as strikes, acts of God, wars, terrorist activities, and natural disasters;

legal, tax, accounting, or regulatory changes (including but not limited to change in import/export regulations) or changes in the interpretation or enforcement of existing requirements;

changes in our estimated effective tax rate;

foreign currency exchange rate fluctuations; and

the dilutive impact of our convertible notes and related warrants on our earnings per share.

***We May Incur Impairments to Goodwill or Long-Lived Assets***

We review our long-lived assets, including goodwill and other intangible assets, for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Negative industry or economic trends, including reduced market prices of our Common Stock, reduced estimates of future cash flows, disruptions to our business, slower growth rates, or lack of growth in our relevant business segments, could lead to impairment charges against our long-lived assets, including goodwill and other intangible assets. If, in any period, our stock price decreases to the point where our fair value, as determined by our market capitalization, is less than the book value of our assets, this could also indicate a potential impairment, and we may be required to record an impairment charge in that period, which could adversely affect our result of operations.

Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. We operate in a highly competitive environment and projections of future operating result and cash flows may vary significantly from actual results. Additionally, if our analysis indicates potential impairment to goodwill one or more of our business segments, we may be required to record additional charges to earnings in our financial statements, which could negatively affect our results of operations. As a result of historical performance and growth potential, our single-wafer clean systems reporting unit may be at greater risk for goodwill impairment than our other reporting units if our actual results for this reporting unit differ from our projections.

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***Our Leverage and Debt Service Obligations and Potential Note Conversion or Related Hedging Activities May Adversely Affect Our Financial Condition, Results of Operations and Earnings Per Share***

As a result of the issuance of our 2016 and 2018 convertible notes and the assumption of the 2041 convertible notes in connection with our acquisition of Novellus Systems, Inc. (collectively the Notes), we have a greater amount of debt than we have maintained in the past. Furthermore, in March 2014, we entered into an unsecured credit agreement providing us with the ability to borrow up to \$300 million (and, under certain circumstances, to increase such availability to \$500 million). We may, in the future, decide to borrow amounts under this facility, or to enter into additional debt arrangements.

In addition, we have entered, and in the future may enter, into derivative instrument arrangements to hedge against the variability of cash flows due to changes in the benchmark interest rate of fixed rate debt. We could be exposed to losses in the event of nonperformance by the counterparties to our derivative instruments.

Our maintenance of higher levels of indebtedness could have adverse consequences including:

impacting our ability to satisfy our obligations;

increasing the portion of our cash flows that may have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes; and

impairing our ability to obtain additional financing in the future.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory and other factors. Furthermore, our operations may not generate sufficient cash flows to enable us to meet our expenses and service our debt. As a result, we may need to enter into new financing arrangements to obtain the necessary funds. If we determine it is necessary to seek additional funding for any reason, we may not be able to obtain such funding or, if funding is available, obtain it on acceptable terms. If we fail to make a payment on our debt, we could be in default on such debt, and this default could cause us to be in default on our other outstanding indebtedness.

Conversion of our Notes may cause dilution to our stockholders and to our earnings per share. The number of shares of our Common Stock into which the Notes are convertible may be adjusted from time to time, including increases in such rates as a result of dividends that we pay to our stockholders. Upon conversion of any Notes, we will deliver cash in the amount of the principal amount of the Notes and, with respect to any excess conversion value greater than the principal amount of the Notes, shares of our Common Stock, which would result in dilution to our stockholders. This dilution may be mitigated to some extent by the hedging transactions we entered into in connection with the sale of the 2016 and 2018 Notes or through share repurchases. Prior to the maturity of the Notes, if the price of our Common Stock exceeds the conversion price, U.S. generally accepted accounting principles require that we report an increase in diluted share count, which would result in lower reported earnings per share. The price of our Common Stock could also be affected by sales of our Common Stock by investors who view the Notes as a more attractive means of equity participation in our company and also by hedging activity that may develop involving our Common Stock by holders of the Notes.



***Our Credit Agreements Contain Covenant Restrictions That May Limit Our Ability To Operate Our Business.***

We may be unable to respond to changes in business and economic conditions, engage in transactions that might otherwise be beneficial to us, or obtain additional financing, because our debt agreements contain, and any of our other future similar agreements may contain, covenant restrictions that limit our ability to, among other things:

incur additional debt, assume obligations in connection with letters of credit, or issue guarantees;

create liens;

enter into transactions with our affiliates;

sell certain assets; and

merge or consolidate with any person.

Our ability to comply with these covenants is dependent on our future performance, which will be subject to many factors, some of which are beyond our control, including prevailing economic conditions. In addition, our failure to comply with these covenants could result in a default under the Notes or our other debt, which could permit the holders to accelerate such debt. If any of our debt is accelerated, we may not have sufficient funds available to repay such debt, which could materially and negatively affect our financial condition and results of operation.

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**Table of Contents*****We Have a Limited Number of Key Customers***

Sales to a limited number of large customers constitute a significant portion of our overall revenue, shipments, cash flows, collections and profitability. As a result, the actions of even one customer may subject us to variability in those areas that are difficult to predict. In addition, large customers may be able to negotiate requirements that result in decreased pricing; increased costs and/or lower margins for us; compliance to specific environmental, social and corporate governance standards; and limitations on our ability to share jointly developed technology with others. Similarly, significant portions of our credit risk may, at any given time, be concentrated among a limited number of customers, so that the failure of even one of these key customers to pay its obligations to us could significantly impact our financial results.

***We Depend on New Products and Processes for Our Success. Consequently, We are Subject to Risks Associated with Rapid Technological Change***

Rapid technological changes in semiconductor manufacturing processes subject us to increased pressure to develop technological advances that enable those processes. We believe that our future success depends in part upon our ability to develop and offer new products with improved capabilities and to continue to enhance our existing products. If new products have reliability, quality, or design problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may be unable to develop and manufacture new products successfully, or new products that we introduce may fail in the marketplace. For over twenty years the primary driver of technology advancement in the semiconductor industry has been to shrink the lithography that prints the circuit design on semiconductor chips. That driver appears to be approaching its technological limit, leading semiconductor manufacturers to investigate more complex changes in multiple technologies in an effort to continue technology development. In the face of uncertainty on which technology solutions will become successful, we will need to focus our efforts on developing the technology changes that are ultimately successful in supporting our customer requirements. Our failure to develop and offer the correct technology solutions in a timely manner with productive and cost-effective products could adversely affect our business in a material way. Our failure to commercialize new products in a timely manner could result in loss of market share, unanticipated costs, and inventory obsolescence, which would adversely affect our financial results.

In order to develop new products and processes, we expect to continue to make significant investments in R&D and to pursue joint development relationships with customers, suppliers or other members of the industry. We must manage product transitions and joint development relationships successfully, as the introduction of new products could adversely affect our sales of existing products and certain jointly developed technologies may be subject to restrictions on our ability to share that technology with other customers, which could limit our market for products incorporating those technologies. Future technologies, processes or product developments may render our current product offerings obsolete, leaving us with non-competitive products, or obsolete inventory, or both. Moreover, customers may adopt new technologies or processes to address the complex challenges associated with next generation devices. This shift may result in a reduction in the size of our addressable markets or could increase the relative size of markets in which we either do not compete or have relatively low market share.

***We are Subject to Risks Relating to Product Concentration and Lack of Product Revenue Diversification***

We derive a substantial percentage of our revenues from a limited number of products. System sales constitute a significant portion of our total revenue. Our systems are priced up to approximately \$8 million per system, and our revenues in any given quarter are dependent upon customer acceptance of a limited number of systems. As a result, the inability to recognize revenue on even a few systems can cause a significantly adverse impact on our revenues for a given quarter, and, in the longer term, the continued market acceptance of these products is critical to our future

success. Our business, operating results, financial condition, and cash flows could therefore be adversely affected by:

a decline in demand for even a limited number of our products;

a failure to achieve continued market acceptance of our key products;

export restrictions or other regulatory or legislative actions that could limit our ability to sell those products to key customer or market segments;

an improved version of products being offered by a competitor in the market in which we participate;

increased pressure from competitors that offer broader product lines;

technological changes that we are unable to address with our products; or

a failure to release new or enhanced versions of our products on a timely basis.

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In addition, the fact that we offer limited product lines creates the risk that our customers may view us as less important to their business than our competitors that offer additional products. This may impact our ability to maintain or expand our business with certain customers. Such product concentration may also subject us to additional risks associated with technology changes. Our business is affected by our customers' use of our products in certain steps in their wafer fabrication processes. Should technologies change so that the manufacture of semiconductors requires fewer steps using our products, this could have a larger impact on our business than it would on the business of our less concentrated competitors.

***Strategic Alliances and Customer Consolidation May Have Negative Effects on Our Business***

Increasingly, semiconductor manufacturing companies are entering into strategic alliances or consolidating with one another to expedite the development of processes and other manufacturing technologies and/or achieve economies of scale. The outcomes of such an alliance can be the definition of a particular tool set for a certain function and/or the standardization of a series of process steps that use a specific set of manufacturing equipment; while the outcomes of consolidation can lead to an overall reduction in the market for semiconductor manufacturing equipment as customers' operations achieve economies of scale and/or increased purchasing power based on their higher volumes. In certain instances, this could work to our disadvantage if a competitor's tools or equipment become the standard equipment for such functions or processes. Some semiconductor manufacturing companies are also consolidating. Additional outcomes of such consolidation may include our customers re-evaluating their future supplier relationships to consider other competitors' products and/or gaining additional influence over the pricing of products and the control of intellectual property.

Similarly, our customers may partner with, or follow the lead of, educational or research institutions that establish processes for accomplishing various tasks or manufacturing steps. If those institutions utilize a competitor's equipment when they establish those processes, it is likely that customers will tend to use the same equipment in setting up their own manufacturing lines. Even if they select our equipment, the institutions and the customers that follow their lead could impose conditions on acceptance of that equipment, such as adherence to standards and requirements or limitations on how we license our proprietary rights that increase our costs or require us to take on greater risk. These actions could adversely impact our market share and financial results.

***We Depend On a Limited Number of Key Suppliers and Outsource Providers, and We Run the Risk That They Might Not Perform as We Expect***

Outsource providers and component suppliers have played and will continue to play a key role in our manufacturing operations and in many of our transactional and administrative functions, such as information technology, facilities management, and certain elements of our finance organization. These providers and suppliers might suffer financial setbacks, be acquired by third parties, become subject to exclusivity arrangements that preclude further business with us or suffer *force majeure* events that could interrupt or impair their continued ability to perform as we expect.

Although we attempt to select reputable providers and suppliers, and we attempt to secure their performance on terms documented in written contracts, it is possible that one or more of these providers or suppliers could fail to perform as we expect, and such failure could have an adverse impact on our business. In some cases, the requirements of our business mandate that we obtain certain components and sub-assemblies included in our products from a single supplier or a limited group of suppliers. Where practical, we endeavor to establish alternative sources to mitigate the risk that the failure of any single provider or supplier will adversely affect our business, but this is not feasible in all circumstances. There is therefore a risk that a prolonged inability to obtain certain components or secure key services could impair our ability to manage operations, ship products and generate revenues, which could adversely affect our operating results and damage our customer relationships.

***We Face Risks Related to the Disruption of Our Primary Manufacturing Facilities***

Our manufacturing facilities are concentrated in just a few locations. These locations are subject to disruption for a variety of reasons such as natural disasters, terrorist attacks, disruptions of our information technology resources and utility interruptions. Such disruptions may cause delays in shipping our products which could result in the loss of business or customer trust, adversely affecting our business and operating results.

***Once a Semiconductor Manufacturer Commits to Purchase a Competitor's Semiconductor Manufacturing Equipment, the Manufacturer Typically Continues to Purchase that Competitor's Equipment, Making it More Difficult for Us to Sell Our Equipment to that Customer***

Semiconductor manufacturers must make a substantial investment to qualify and integrate wafer processing equipment into a semiconductor production line. We believe that once a semiconductor manufacturer selects a particular supplier's processing equipment, the manufacturer generally relies upon that equipment for that specific production line application for an extended period of time. Accordingly, we expect it to be more difficult to sell our products to a given customer if that customer initially selects a competitor's equipment for the same product line application.

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***We Face a Challenging and Complex Competitive Environment***

We face significant competition from multiple competitors and with the pending merger of two of our largest competitors we may face increasing competitive pressures. Other companies continue to develop systems and products that are competitive to ours and may introduce new products, which may affect our ability to sell our existing products. We face a greater risk if our competitors enter into strategic relationships with leading semiconductor manufacturers covering products similar to those we sell or may develop, as this could adversely affect our ability to sell products to those manufacturers.

We believe that to remain competitive we must devote significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide, and to invest in product and process R&D. Certain of our competitors, including those that are created and financially backed by foreign governments, have substantially greater financial resources and more extensive engineering, manufacturing, marketing, and customer service and support resources than we do and therefore have the potential to offer customers a more comprehensive array of products and to therefore achieve additional relative success in the semiconductor equipment industry. These competitors may deeply discount or give away products similar to those that we sell, challenging or even exceeding our ability to make similar accommodations and threatening our ability to sell those products. We also face competition from our own customers, who in some instances have established affiliated entities that manufacture equipment similar to ours. For these reasons, we may fail to continue to compete successfully worldwide.

In addition, our competitors may be able to develop products comparable or superior to those we offer or may adapt more quickly to new technologies or evolving customer requirements. In particular, while we continue to develop product enhancements that we believe will address future customer requirements, we may fail in a timely manner to complete the development or introduction of these additional product enhancements successfully, or these product enhancements may not achieve market acceptance or be competitive. Accordingly, competition may intensify, and we may be unable to continue to compete successfully in our markets, which could have a material adverse effect on our revenues, operating results, financial condition, and/or cash flows.

***Our Future Success Depends Heavily on International Sales and the Management of Global Operations***

Non-U.S. sales accounted for approximately 77% of total revenue for the six months ended December 28, 2014, 86% of total revenue in fiscal year 2014, and 80% of total revenue in fiscal year 2013. We expect that international sales will continue to account for a substantial majority of our total revenue in future years.

We are subject to various challenges related to international sales and the management of global operations including, but not limited to:

trade balance issues;

global economic and political conditions;

changes in currency controls;

differences in the enforcement of intellectual property and contract rights in varying jurisdictions;

our ability to respond to customer and foreign government demands for locally sourced systems, spare parts and services and develop the necessary relationships with local suppliers;

compliance with U.S. and international laws and regulations affecting foreign operations, including U.S. and international export restrictions and foreign labor laws;

fluctuations in interest and foreign currency exchange rates;

our ability to repatriate cash in a tax-efficient manner;

the need for technical support resources in different locations; and

our ability to secure and retain qualified people in all necessary locations for the successful operation of our business.

Certain international sales depend on our ability to obtain export licenses from the U.S. government. Our failure or inability to obtain such licenses would substantially limit our markets and severely restrict our revenues. Many of the challenges noted above are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships among China, Taiwan, Japan, South Korea, and the United States, that political and diplomatic influences might lead to trade disruptions. This would adversely affect our business with China, Taiwan, Japan, and/or South Korea and perhaps the entire Asia Pacific region. A significant trade disruption in these areas could have a materially adverse impact on our future revenue and profits.

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We are potentially exposed to adverse as well as beneficial movements in foreign currency exchange rates. The majority of our sales and expenses are denominated in U.S. dollars. However, we are exposed to foreign currency exchange rate fluctuations primarily related to revenues denominated in Japanese yen and expenses denominated in euro. Currently, we enter into foreign currency forward contracts to minimize the short-term impact of the foreign currency exchange rate fluctuations on certain foreign currency monetary assets and liabilities; primarily third party accounts receivables, accounts payables and intercompany receivables and payables. In addition, we hedge certain anticipated foreign currency cash flows, primarily anticipated revenues denominated in Japanese yen and euro-denominated expenses. We believe these are our primary exposures to currency rate fluctuation. We expect to continue to enter into hedging transactions, for the purposes outlined, for the foreseeable future. However, these hedging transactions may not achieve their desired effect because differences between the actual timing of the underlying exposures and our forecasts of those exposures may leave us either over-or under-hedged on any given transaction. Moreover, by hedging these foreign currency denominated revenues, expenses, monetary assets and liabilities with foreign currency forward contracts, we may miss favorable currency trends that would have been advantageous to us but for the hedges. Additionally, we are exposed to short-term foreign currency exchange rate fluctuations on non-U.S. dollar-denominated monetary assets and liabilities (other than those currency exposures previously discussed) and currently we do not enter into foreign currency hedge contracts against these exposures. Therefore, we are subject to both favorable and unfavorable foreign currency exchange rate fluctuations to the extent that we transact business (including intercompany transactions) for these currencies.

The magnitude of our overseas business also affects where our cash is generated. Certain uses of cash, such as share repurchases or the repayment of our convertible notes, can usually only be made with cash balances and cash generated on-shore. Since the majority of our cash is generated outside of the United States, this may limit certain business decisions and adversely affect business outcomes.

***Our Ability to Attract, Retain and Motivate Key Employees Is Critical to Our Success***

Our ability to compete successfully depends in large part on our ability to attract, retain and motivate key employees. This is an ongoing challenge due to intense competition for top talent, as well as fluctuations in industry economic conditions that may require cycles of hiring activity and workforce reductions. Our success in hiring depends on a variety of factors, including the attractiveness of our compensation and benefit programs and our ability to offer a challenging and rewarding work environment. We periodically evaluate our overall compensation programs and make adjustments, as appropriate, to maintain or enhance their competitiveness. If we are not able to successfully attract, retain and motivate key employees, we may be unable to capitalize on market opportunities and our operating results may be materially and adversely affected.

***We Rely Upon Certain Critical Information Systems for the Operation of Our Business***

We maintain and rely upon certain critical information systems for the effective operation of our business. These information systems include telecommunications, the internet, our corporate intranet, various computer hardware and software applications, network communications, and e-mail. These information systems may be owned and maintained by us, our outsourced providers or third parties such as vendors and contractors. Many of these information systems and outsourced service providers, including certain hosted software applications that we use for confidential data storage, employ cloud computing technology for such storage (which refers to an information technology hosting and delivery system in which data is not stored within the user's physical infrastructure but instead is delivered to and consumed by the user as an Internet-based service). All of these information systems are subject to attacks, failures, and access denials from a number of potential sources including viruses, destructive or inadequate code, power failures, and physical damage to computers, hard drives, communication lines, and networking equipment. Confidential and/or sensitive information stored on these information systems or transmitted to or from



cloud storage could be intentionally or unintentionally compromised, lost and/or stolen. While we have implemented security procedures, such as virus protection software and emergency recovery processes, to mitigate the outlined risks with respect to information systems that are under our control, they cannot be guaranteed to be failsafe and our inability to use or access these information systems at critical points in time, or unauthorized releases of confidential information, could unfavorably impact the timely and efficient operation of our business.

***Our Financial Results May be Adversely Impacted by Higher than Expected Tax Rates or Exposure to Additional Tax Liabilities***

As a global company, our effective tax rate is highly dependent upon the geographic composition of worldwide earnings and tax regulations governing each region. We are subject to income taxes in the United States and various foreign jurisdictions, and significant judgment is required to determine worldwide tax liabilities. Our effective tax rate could be adversely affected by changes in the split of earnings between countries with differing statutory tax rates, in the valuation of deferred tax assets, in tax laws, by material audit assessments, or changes in or expirations of agreements with tax authorities. These factors could affect our profitability. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. In addition, the amount of income taxes we pay is subject to ongoing audits in various jurisdictions, and a material assessment by a governing tax authority could affect our profitability.

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***A Failure to Comply with Environmental Regulations May Adversely Affect Our Operating Results***

We are subject to a variety of governmental regulations related to the handling, discharge, and disposal of toxic, volatile or otherwise hazardous chemicals. Failure to comply with present or future environmental regulations could result in fines being imposed on us, require us to suspend production, or cease operations, or cause our customers to not accept our products. These regulations could require us to alter our current operations, acquire significant additional equipment, incur substantial other expenses to comply with environmental regulations, or take other actions. Any failure to comply with regulations governing the use, handling, sale, transport or disposal of hazardous substances could subject us to future liabilities that may adversely affect our operating results, financial condition and ability to operate our business.

***If We Choose to Acquire or Dispose of Businesses, Product Lines and Technologies, We May Encounter Unforeseen Costs and Difficulties That Could Impair Our Financial Performance***

An important element of our management strategy is to review acquisition prospects that would complement our existing products, augment our market coverage and distribution ability, or enhance our technological capabilities. As a result, we may make acquisitions of complementary companies, products or technologies, or we may reduce or dispose of certain product lines or technologies that no longer fit our long-term strategies. Managing an acquired business, disposing of product technologies or reducing personnel entail numerous operational and financial risks, including difficulties in assimilating acquired operations and new personnel or separating existing business or product groups, diversion of management's attention away from other business concerns, amortization of acquired intangible assets, adverse customer reaction to our decision to cease support for a product, and potential loss of key employees or customers of acquired or disposed operations. There can be no assurance that we will be able to achieve and manage successfully any such integration of potential acquisitions, disposition of product lines or technologies, or reduction in personnel or that our management, personnel, or systems will be adequate to support continued operations. Any such inabilities or inadequacies could have a material adverse effect on our business, operating results, financial condition, and cash flows.

In addition, any acquisition could result in changes such as potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, the amortization of related intangible assets, and goodwill impairment charges, any of which could materially adversely affect our business, financial condition, and results of operations and/or the price of our Common Stock.

***The Market for Our Common Stock is Volatile, Which May Affect Our Ability to Raise Capital, Make Acquisitions, or Subject Our Business to Additional Costs***

The market price for our Common Stock is volatile and has fluctuated significantly over the past years. The trading price of our Common Stock could continue to be highly volatile and fluctuate widely in response to a variety of factors, many of which are not within our control or influence. These factors include but are not limited to the following:

general market, semiconductor, or semiconductor equipment industry conditions;

economic or political events and trends occurring globally or in any of our key sales regions;

variations in our quarterly operating results and financial condition, including our liquidity;

variations in our revenues, earnings or other business and financial metrics from forecasts by us or securities analysts, or from those experienced by other companies in our industry;

announcements of restructurings, reductions in force, departure of key employees, and/or consolidations of operations;

government regulations;

developments in, or claims relating to, patent or other proprietary rights;

technological innovations and the introduction of new products by us or our competitors;

commercial success or failure of our new and existing products;

disruptions of relationships with key customers or suppliers; or

dilutive impacts of our Notes and related warrants.

In addition, the stock market experiences significant price and volume fluctuations. Historically, we have witnessed significant volatility in the price of our Common Stock due in part to the price of and markets for semiconductors. These and other factors have and may again adversely affect the price of our Common Stock, regardless of our actual operating performance. In the past, following volatile periods in the price of their stock, many companies became the object of securities class action litigation. If we are sued in a securities class action, we could incur substantial costs, and it could divert management's attention and resources and have an unfavorable impact on our financial performance and the price for our Common Stock.

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**Table of Contents*****Intellectual Property, Indemnity and Other Claims Against Us Can be Costly and We Could Lose Significant Rights That are Necessary to Our Continued Business and Profitability***

Third parties may assert infringement, unfair competition, product liability, breach of contract, or other claims against us. From time to time, other parties send us notices alleging that our products infringe their patent or other intellectual property rights. In addition, law enforcement authorities may seek criminal charges relating to intellectual property or other issues. We also face risks of claims arising from commercial and other relationships. In addition, our Bylaws and other indemnity obligations provide that we will indemnify officers and directors against losses that they may incur in legal proceedings resulting from their service to us. From time to time, in the normal course of business, we indemnify third parties with whom we enter into contractual relationships, including customers and suppliers, with respect to certain matters. We have agreed, under certain conditions, to hold these third parties harmless against specified losses, such as those arising from a breach of representations or covenants, other third party claims that our products when used for their intended purposes infringe the intellectual property rights of such other third parties, or other claims made against certain parties. In such cases, it is our policy either to defend the claims or to negotiate licenses or other settlements on commercially reasonable terms. However, we may be unable in the future to negotiate necessary licenses or reach agreement on other settlements on commercially reasonable terms, or at all, and any litigation resulting from these claims by other parties may materially adversely affect our business and financial results, and we may be subject to substantial damage awards and penalties. Moreover, although we have insurance to protect us from certain claims and cover certain losses to our property, such insurance may not cover us for the full amount of any losses, or at all, and may be subject to substantial exclusions and deductibles.

***We May Fail to Protect Our Critical Proprietary Technology Rights, Which Could Affect Our Business***

Our success depends in part on our proprietary technology and our ability to protect key components of that technology through patents, copyrights and trade secret protection. Protecting our key proprietary technology helps us to achieve our goals of developing technological expertise and new products and systems that give us a competitive advantage; increasing market penetration and growth of our installed base; and providing comprehensive support and service to our customers. As part of our strategy to protect our technology we currently hold a number of U.S. and foreign patents and pending patent applications, and we keep certain information, processes and techniques as trade secrets. However, other parties may challenge or attempt to invalidate or circumvent any patents the United States or foreign governments issue to us, these governments may fail to issue patents for pending applications, or we may lose trade secret protection over valuable information due to the intentional or unintentional actions or omissions of third parties, of ours or even our own employees. Additionally, intellectual property litigation can be expensive and time-consuming and even when patents are issued or trade secret processes are followed, the legal systems in certain of the countries in which we do business do not enforce patents and other intellectual property rights as rigorously as the United States. The rights granted or anticipated under any of our patents, pending patent applications or trade secrets may be narrower than we expect or, in fact, provide no competitive advantages. Moreover, because we determine the jurisdictions in which to file patents at the time of filing, we may not have adequate protection in the future based on such previous decisions. Any of these circumstances could have a material adverse impact on our business.

***We Are Exposed to Various Risks from Our Regulatory Environment***

We are subject to various risks related to (i) new, different, inconsistent or even conflicting laws, rules and regulations that may be enacted by legislative bodies and/or regulatory agencies in the countries that we operate; (ii) disagreements or disputes between national or regional regulatory agencies related to international trade; and (iii) the interpretation and application of laws, rules and regulations. As a public company with global operations, we are subject to the laws of multiple jurisdictions and the rules and regulations of various governing bodies, including

those related to financial and other disclosures, corporate governance, privacy, anti-corruption, such as the Foreign Corrupt Practices Act and other local laws prohibiting corrupt payments to governmental officials, and antitrust regulations, among others. Each of these laws, rules and regulations imposes costs on our business, including financial costs and potential diversion of our management's attention associated with compliance, and may present risks to our business, including potential fines, restrictions on our actions, and reputational damage if we are unable to fully comply. For example, financial reform legislation and the regulations enacted under such legislation have also added costs to our business by, among other things, requiring advisory votes on executive compensation and on severance packages upon a change in control.

To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with all evolving standards. Changes in or ambiguous interpretations of laws, regulations and standards may create uncertainty regarding compliance matters. Efforts to comply with new and changing regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management's time and attention from revenue generating activities to compliance activities. If we are found by a court or regulatory agency not to be in compliance with the laws and regulations, our business, financial condition, and results of operations could be adversely affected.

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***There Can Be No Assurance That We Will Continue To Declare Cash Dividends Or Repurchase Our Shares At All Or In Any Particular Amounts.***

Our Board of Directors has declared quarterly dividends since April 2014. Our intent to continue to pay quarterly dividends and to repurchase our shares is subject to capital availability and, in the case of dividends, periodic determinations by our Board of Directors that cash dividends are in the best interest of our stockholders and are in compliance with all laws and agreements applicable to the declaration and payment of cash dividends by us. Future dividends and share repurchases may also be affected by, among other factors: our views on potential future capital requirements for investments in acquisitions and the funding of our research and development; legal risks; stock repurchase programs; changes in federal and state income tax laws or corporate laws; contractual restrictions, such as financial or operating covenants in our debt arrangements; and changes to our business model. Our dividend payments and share repurchases may change from time to time, and we cannot provide assurance that we will continue to declare dividends or repurchase shares at all or in any particular amounts. A reduction or suspension in our dividend payments or share repurchase activity could have a negative effect on our stock price.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**  
***Repurchases of Company Shares***

On April 29, 2014, the Board of Directors authorized us to repurchase up to \$850 million of common stock, which included the remaining value available under our prior authorization. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance with applicable law. Repurchases will be funded using our on-shore cash and on-shore cash generation. This repurchase program has no termination date and may be suspended or discontinued at any time.

As part of our share repurchase program, we may from time-to-time enter into structured share repurchase arrangements with financial institutions using general corporate funds. Such arrangements entered into or settled during the six months ended December 28, 2014 included the following:

***Collared Accelerated Share Repurchases***

During the three months ended September 28, 2014, we entered into a collared accelerated share repurchase ( ASR ) transaction under a master repurchase arrangement. Under the ASR, we made an up-front cash payment of \$250 million, in exchange for an initial delivery of approximately 3.2 million shares of our Common Stock.

The number of shares to ultimately be repurchased by us was based generally on the volume-weighted average price ( VWAP ) of the Common Stock during the term of the ASR minus a pre-determined discount set at inception of the ASR, subject to collar provisions that provided a minimum and maximum number of shares that we could repurchase under the agreements. The minimum and maximum thresholds for the transaction were established based on the average of the VWAP prices for the Common Stock during an initial hedge period. The ASR was scheduled to end at any time on or after October 8, 2014 and on or before December 8, 2014.

The counterparty designated October 9, 2014 as the termination date, at which time we settled the ASR. Approximately \$0.3 million additional shares were received at final settlement, which represented a weighted-average share price of approximately \$72.90 for the transaction period.

We accounted for the ASR as two separate transactions: (a) as shares of Common Stock acquired in a treasury stock transaction recorded on the acquisition date and (b) as a forward contract indexed to our Common Stock and classified in stockholders' equity. As such, we accounted for the shares that we received under the ASR as a repurchase of our Common Stock for the purpose of calculating earnings per common share. We determined that the forward contract indexed to the Common Stock met all of the applicable criteria for equity classification in accordance with the Derivatives and Hedging topic of the FASB Accounting Standards Codification, and, therefore, the ASR was not accounted for as a derivative instrument. As of December 28, 2014, the aggregate repurchase price of \$250 million was reflected as Treasury stock, at cost, in the Consolidated Balance Sheet.

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Share repurchases, including those under the repurchase program, were as follows:

Period	Total Number of Shares		Total Number of Shares		Announced or Program	Available Under Repurchase Program
	Repurchased	Average Price Paid Per Share *	Repurchased	Average Price Paid Per Share *		
	(1)					
(in thousands, except per share data)						
Amount available at June 29, 2014						830,895
Quarter ended September 28, 2014	3,938		70		3,818	534,174
September 29, 2014 - October 26, 2014	437	\$ 70.06			432	523,399
October 27, 2014 - November 23, 2014	377	\$ 79.16			182	509,135
November 24, 2014 - December 28, 2014	344	\$ 80.63			255	488,480
Total	1,158	\$ 78.10			869	

\* Average price paid per share excludes accelerated share repurchases for which cost was incurred during the September 2014 quarter, but that did not settle until the December 2014 quarter. See *Collared Accelerated Share Repurchases* section above for details regarding average price associated with these transactions.

(1) In addition to shares repurchased under the Board-authorized repurchase program (as described above), included in this column are 409,418 shares acquired at a total cost of \$31.3 million, which we withheld through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under our equity compensation plans. The shares retained by us through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under our equity compensation plans.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Mine Safety Disclosures**

Not applicable.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**



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See the Exhibit Index following the signature page to this Quarterly Report on Form 10-Q for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.

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**LAM RESEARCH CORPORATION**

**SIGNATURES**

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

Date: February 3, 2015

LAM RESEARCH CORPORATION

(Registrant)

/s/ Douglas R. Bettinger

**Douglas R. Bettinger**

**Executive Vice President, Chief Financial Officer**  
**(Principal Financial Officer and Principal Accounting Officer)**

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Exhibit Number	Description
10.1(1)*	Employment Agreement with Martin B. Anstice, dated January 13, 2015
10.2(1)*	Employment Agreement with Timothy M. Archer, dated January 13, 2015
10.3(1)*	Employment Agreement with Douglas R. Bettinger, dated January 13, 2015
10.4(1)*	Employment Agreement with Richard A. Gottscho, dated January 13, 2015
10.5(1)*	Form of Change in Control Agreement
10.6	Chairman's Agreement
10.7	Form of Confidentiality Agreement for Directors
31.1	Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer)
31.2	Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer)
32.1	Section 1350 Certification (Principal Executive Officer)
32.2	Section 1350 Certification (Principal Financial Officer)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated by reference to the Registrant's Current Report on Form 8-K filed on January 16, 2015

\* Indicates management contract or compensatory plan or arrangement in which the executive officers of the Company are eligible to participate