Item 6. Selected Financial Data.

	YEAR ENDED DEC. 31, 2002	YEAR ENDED DEC. 31, 2001	YEAR ENDED DEC. 31, 2000	NINE MONTHS ENDED DEC. 31, 1999	YEAR ENDED MAR. 31, 1999
	(In thousands, except per share data)				
STATEMENT OF OPERATIONS DATA:					
Revenue	$ 229,126	$ 295,326	$ 567,759	$269,699	$200,072
Costs and expenses:					
Cost of products sold	91,546	111,498	217,830	108,687	78,440
Research and development	85,776	71,679	77,057	45,903	33,190
Selling, general and administrative	48,099	53,027	81,082	50,676	36,818
In-process research and development	29,853	—	—	89,003	—
Amortization of intangible assets[1]	73,415	84,349	81,873	45,780	—
	328,689	320,553	457,842	340,049	148,448
(Loss) income from operations	(99,563)	(25,227)	109,917	(70,350)	51,624
(Loss) gain on foundry investments	—	(152,795)	149,960	—	—
Interest and other income (expense), net	6,194	4,056	2,194	(6,787)	10,668
(Loss) income before provision (benefit) for income taxes	(93,369)	(173,966)	262,071	(77,137)	62,292
Provision (benefit) for income taxes	81,866	(64,447)	94,184	(28,991)	20,246
Net (loss) income	$(175,235)	$ (109,519)	$ 167,887	$ (48,146)	$ 42,046
Basic net (loss) income per share	$ (1.59)	$ (1.01)	$ 1.65	$ (0.50)	$ 0.45
Diluted net (loss) income per share	$ (1.59)	$ (1.01)	$ 1.47	$ (0.50)	$ 0.44
Shares used in per share calculations:					
Basic	110,193	108,814	101,716	95,428	93,948
Diluted	110,193	108,814	120,321	95,428	95,276
BALANCE SHEET DATA:					
Cash and short-term investments	$ 276,880	$ 531,556	$ 535,408	$214,140	$319,434
Total assets	$ 941,263	$1,185,982	$1,295,884	$916,155	$540,896
Convertible notes	$ 208,061	$ 260,000	$ 260,000	$260,000	$ —
Stockholders' equity	$ 661,135	$ 839,770	$ 855,655	$482,773	$483,734

[1] Includes $2,962 and $397 of amortization of deferred stock compensation expense for the year ended December 31, 2002 and December 31, 2001, respectively, attributable to Research and Development activities.

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

	2002 DEC.	2002 SEPT.	2002 JUNE	2002 MAR.	2001 DEC.	2001 SEPT.	2001 JUNE	2001 MAR.
UNAUDITED QUARTERLY DATA:								
Revenue	$ 57,710	$ 56,072	$56,466	$ 58,878	$ 52,108	$ 58,038	$74,082	$111,098
Gross profit	$ 34,691	$ 33,643	$33,974	$ 35,272	$ 32,286	$ 36,043	$46,311	$ 69,188
Net (loss) income	$(127,100)	$(14,371)	$ (8,147)	$(25,617)	$(12,517)	$(104,601)	$ (3,677)	$ 11,276
Basic net (loss) income per share	$ (1.14)	$ (0.13)	$ (0.07)	$ (0.23)	$ (0.11)	$ (0.96)	$ (0.03)	$ 0.10
Diluted net (loss) income per share	$ (1.14)	$ (0.13)	$ (0.07)	$ (0.23)	$ (0.11)	$ (0.96)	$ (0.03)	$ 0.10

CONSOLIDATED BALANCE SHEET

(In thousands, except share and par value amounts)

	DECEMBER 31, 2002	DECEMBER 31, 2001
ASSETS		
Current assets:		
Cash and cash equivalents	$169,475	$ 250,203
Short-term investments	107,405	281,363
Accounts receivable, net	26,374	19,452
Inventories (note 2)	56,241	64,926
Prepaid expenses and other current assets (note 9)	35,033	40,749
Deferred income taxes (note 9)	—	31,591
Total current assets	394,528	688,284
Foundry investments, advances and other assets (note 7)	104,507	162,418
Property and equipment, less accumulated depreciation (note 3)	62,786	63,222
Intangible assets, less accumulated amortization of $199,647 and $129,311 (notes 4, 5 and 6)	155,953	125,081
Goodwill (notes 5 and 6)	223,489	81,387
Deferred income taxes (note 9)	—	65,590
	$941,263	$1,185,982
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 18,860	$ 20,201
Accrued payroll obligations	14,737	18,054
Income taxes payable (note 9)	142	2,751
Deferred income	11,983	18,103
Total current liabilities	45,722	59,109
4¾% Convertible notes due in 2006 (notes 10 and 16)	208,061	260,000
Other long-term liabilities	26,345	27,103
Commitments and contingencies (notes 7, 8, 12 and 13)	—	—
Stockholders' equity (note 11):		
Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued and outstanding	—	—
Common stock, $.01 par value, 300,000,000 shares authorized; 112,358,043 and 109,428,061 shares issued and outstanding	1,124	1,094
Paid-in capital	580,987	548,053
Deferred stock compensation	(11,540)	(2,739)
Other comprehensive (loss) income	(4,631)	22,932
Retained earnings	95,195	270,430
	661,135	839,770
	$941,263	$1,185,982

The accompanying notes are an integral part of this statement

CONSOLIDATED STATEMENT OF OPERATIONS

(In thousands, except per share data)

	YEAR ENDED DECEMBER 31, 2002	YEAR ENDED DECEMBER 31, 2001	YEAR ENDED DECEMBER 31, 2000
Revenue (note 15)	$ 229,126	$ 295,326	$567,759
Costs and expenses:			
Cost of products sold	91,546	111,498	217,830
Research and development	85,776	71,679	77,057
Selling, general and administrative (note 14)	48,099	53,027	81,082
In-process research and development (notes 4 and 5)	29,853	—	—
Amortization of intangible assets[1] (notes 4, 5 and 6)	73,415	84,349	81,873
	328,689	320,553	457,842
(Loss) income from operations	(99,563)	(25,227)	109,917
Other income (expense), net:			
Interest income	5,362	17,733	16,202
Interest expense (note 10)	(12,611)	(13,962)	(14,036)
(Loss) gain on foundry investments (note 7)	—	(152,795)	149,960
Other income, net (notes 7 and 10)	13,443	285	28
	6,194	(148,739)	152,154
(Loss) income before (benefit) provision for income taxes	(93,369)	(173,966)	262,071
Provision (benefit) for income taxes (note 9)	81,866	(64,447)	94,184
Net (loss) income	$(175,235)	$(109,519)	$167,887
Basic net (loss) income per share	$ (1.59)	$ (1.01)	$ 1.65
Diluted net (loss) income per share	$ (1.59)	$ (1.01)	$ 1.47
Shares used in per share calculations:			
Basic	110,193	108,814	101,716
Diluted	110,193	108,814	120,321

[1] Includes $2,962 and $397 of amortization of deferred stock compensation expense for the years ended December 31, 2002 and December 31, 2001, respectively attributable to Research and Development activities.

The accompanying notes are an integral part of this statement

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except par value)

	COMMON STOCK ($.01 PAR VALUE) SHARES	AMOUNT	PAID-IN CAPITAL	DEFERRED STOCK COMPENSATION	ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME	RETAINED EARNINGS	TOTAL
Balances, Dec. 31, 1999	96,571	$ 966	$269,745	$ —	$ —	$ 212,062	$ 482,773
Common stock issued	11,502	114	237,266	—	—	—	237,380
Repurchase of common stock	(540)	(5)	(9,375)	—	—	—	(9,380)
Tax benefit of option exercises	—	—	24,856	—	—	—	24,856
Unrealized loss on foundry investments (net of tax of $30.0 million — note 7)	—	—	—	—	(47,861)	—	—
Net income for 2000	—	—	—	—	—	167,887	—
Total comprehensive income	—	—	—	—	—	—	120,026
Balances, Dec. 31, 2000	107,533	1,075	522,492	—	(47,861)	379,949	855,655
Common stock issued	2,491	25	20,491	—	—	—	20,516
Repurchase of common stock	(596)	(6)	(10,608)	—	—	—	(10,614)
Tax benefit of option exercises	—	—	12,542	—	—	—	12,542
Recognized loss on foundry investments	—	—	—	—	47,861	—	—
Unrealized gain on foundry investments (net of tax of $13.3 million — note 7)	—	—	—	—	24,106	—	—
Deferred stock compensation	—	—	3,136	(3,136)	—	—	—
Amortization of deferred stock compensation	—	—	—	397	—	—	397
Translation adjustments	—	—	—	—	(1,174)	—	—
Net loss for 2001	—	—	—	—	—	(109,519)	—
Total comprehensive loss	—	—	—	—	—	—	(38,726)
Balances, Dec. 31, 2001	109,428	1,094	548,053	(2,739)	22,932	270,430	839,770
Common stock issued	2,930	30	20,287	—	—	—	20,317
Tax benefit of option exercises	—	—	884	—	—	—	884
Unrealized loss on foundry investments (note 7)	—	—	—	—	(24,878)	—	—
Recognized gain on sale of foundry investments previously unrealized (note 7)	—	—	—	—	(3,398)	—	—
Deferred stock compensation	—	—	11,763	(11,763)	—	—	—
Amortization of deferred stock compensation	—	—	—	2,962	—	—	2,962
Translation adjustments	—	—	—	—	713	—	—
Net loss for 2002	—	—	—	—	—	(175,235)	—
Total comprehensive loss	—	—	—	—	—	—	(202,798)
Balances, Dec. 31, 2002	112,358	$1,124	$580,987	$(11,540)	$ (4,631)	$ 95,195	$ 661,135

The accompanying notes are an integral part of this statement

CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands)

	YEAR ENDED DECEMBER 31, 2002	YEAR ENDED DECEMBER 31, 2001	YEAR ENDED DECEMBER 31, 2000
Cash flow from operating activities:			
Net (loss) income	$ (175,235)	$(109,519)	$167,887
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	94,375	106,539	102,213
(Gain) loss on value of foundry investments	(4,017)	152,795	(149,960)
Gain on extinguishment of convertible notes	(9,341)	—	—
Tax benefit of option exercises	884	12,542	24,856
In process research and development	29,853	—	—
Changes in assets and liabilities (net of purchase accounting adjustments):			
Accounts receivable	(6,922)	30,236	(16,012)
Inventories	12,157	(5,433)	(33,457)
Prepaid expenses and other current assets	4,730	(7,327)	(2,842)
Deferred income taxes	110,792	(55,369)	15,092
Foundry investments, advances and other assets	3,562	(11,478)	(359)
Accounts payable and accrued expenses	(3,497)	(53,959)	(10,515)
Accrued payroll obligations	(2,099)	(4,822)	3,970
Income taxes payable	(2,609)	(6,733)	(2,975)
Deferred income	(6,120)	(40,081)	12,996
Other liabilities	(515)	(424)	3,371
Net cash provided by operating activities	45,998	6,967	114,265
Cash flow from investing activities:			
Proceeds from short-term investments	306,923	336,973	299,370
Purchase of short-term investments	(132,965)	(318,828)	(498,562)
Acquisition of Agere FPGA	(254,232)	(2,233)	—
Other acquisition costs	(2,530)	—	—
(Decrease) increase in intangible assets	—	(5,189)	4,886
Proceeds from sale of equity securities	9,930	—	—
Capital expenditures	(17,451)	(13,751)	(25,883)
Net cash used by investing activities	(90,325)	(3,028)	(220,189)
Cash flow from financing activities:			
Extinguishment of convertible notes	(42,077)	—	—
Repurchase of common stock	—	(10,614)	(9,380)
Net proceeds from issuance of common stock	5,676	20,978	237,380
Net cash (used) provided by financing activities	(36,401)	10,364	228,000
Net (decrease) increase in cash and cash equivalents	(80,728)	14,303	122,076
Beginning cash and cash equivalents	250,203	235,900	113,824
Ending cash and cash equivalents	$ 169,475	$ 250,203	$ 235,900
Supplemental disclosure of non-cash investing and financing activities:			
Unrealized (loss) gain on (depreciation) appreciation of foundry investments included in other comprehensive (loss) income	$ (24,878)	$ 24,106	$ (47,861)
Stock and options issued in conjunction with acquisition of Cerdelinx	$ 21,703	$ —	$ —

The accompanying notes are an integral part of this statement

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Operations and Significant Accounting Policies:

Nature of Operations

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

Fiscal Reporting Period

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

Principles of Consolidation

On August 26, 2002, we completed the stock for stock acquisition of Cerdelinx Technologies, Inc. (“Cerdelinx”) for 2.6 million shares valued at $8.30 per share. This transaction was accounted for as an asset purchase, and accordingly, the results of operations for Cerdelinx and estimated fair value of assets acquired and liabilities assumed are included in our consolidated financial statements beginning August 26, 2002. This acquisition is discussed further in note 4.

On January 18, 2002, we completed the acquisition of the field-programmable gate array (“FPGA”) business (“Agere FPGA”) of Agere Systems Inc. (“Agere”) for $250 million in cash. This transaction was accounted for as a purchase, and accordingly, the results of operations for Agere FPGA and estimated fair value of assets acquired and liabilities assumed are included in our consolidated financial statements beginning January 18, 2002. This acquisition is discussed further in note 5.

On June 15, 1999, we completed the acquisition of all of the outstanding capital stock of Vantis Corporation (“Vantis”) from Advanced Micro Devices, Inc. (“AMD”). The transaction was accounted for as a purchase, and accordingly, the results of operations of Vantis and estimated fair value of assets acquired and liabilities assumed are included in our consolidated financial statements beginning June 16, 1999. This acquisition is discussed further in note 6.

The accompanying consolidated financial statements include the accounts of Lattice Semiconductor Corporation and its subsidiaries, all wholly-owned, after the elimination of all significant intercompany balances and transactions.

Cash Equivalents and Short-Term Investments

We consider all highly liquid investments, which are readily convertible into cash and have original maturities of three months or less, to be cash equivalents. Short-term investments, which are relatively less liquid and have maturities of less than one year, were composed of corporate auction preferred stocks ($43.2 million and $160.0 million), municipal and local government obligations ($64.2 million and $102.1 million) and time deposits ($0 and $19.2 million) at December 31, 2002 and December 31, 2001, respectively.

We account for our short-term investments as held-to-maturity, and state them at amortized cost with corresponding premiums or discounts amortized over the life of the investment as interest income. Amortized cost approximated fair value at December 31, 2002.

Financial Instruments

The carrying value of our financial instruments approximates fair value. We estimate the fair value of cash and cash equivalents, short-term investments, accounts receivable, other current assets and current liabilities based upon existing interest rates related to such assets and liabilities compared to the current market rates of interest for instruments of similar nature and degree of risk.

Derivative Financial Instruments

As of December 31, 2002, 2001 and 2000 and for the years then ended, we had no outstanding derivatives, including foreign exchange contracts for the purchase or sale of foreign currencies. We do not enter into derivative financial instruments for trading purposes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Operations and Significant Accounting Policies (continued):

Foreign Exchange and Translation of Foreign Currencies

A portion of our silicon wafer purchases are denominated in Japanese yen. We maintain a yen-denominated bank account and bill our Japanese customers in yen. Gains or losses from foreign exchange rate fluctuations on unhedged balances denominated in foreign currencies are reflected in Other income. Realized and unrealized gains or losses were not significant for the years presented. We translate accounts denominated in foreign currencies in accordance with SFAS 52, "Foreign Currency Translation." Translation adjustments related to the consolidation of foreign subsidiary financial statements are reflected in other comprehensive (loss) income in Stockholders' Equity.

Concentrations of Credit Risk

Financial instruments which potentially expose us to concentrations of credit risk consist primarily of short-term investments and trade receivables. We place our investments through several financial institutions and mitigate the concentration of credit risk by placing percentage limits on the maximum portion of the investment portfolio which may be invested in any one investment instrument. Investments consist primarily of A1 and P1 or better rated U.S. commercial paper, U.S. government agency obligations and other money market instruments, "AA" or better rated municipal obligations, money market preferred stocks and other time deposits. Concentrations of credit risk with respect to trade receivables are mitigated by a geographically diverse customer base and our credit and collection process. Accounts receivable are shown net of allowances for doubtful accounts of $1,074,000 and $1,475,000 at December 31, 2002 and 2001, respectively. We perform credit evaluations for all customers and secure transactions with letters of credit or advance payments where necessary. Write-offs for uncollected trade receivables have not been significant to date.

Revenue Recognition

Revenue from sales to OEM customers is recognized upon shipment provided that persuasive evidence of an arrangement exists, the price is fixed, title has transferred, collection of resulting receivables is probable, there are no customer acceptance requirements and no remaining significant obligations. Certain of our sales are made to distributors under agreements providing price protection and right of return on unsold merchandise. Revenue and cost relating to such distributor sales are deferred until the product is sold by the distributor and related revenue and costs are then reflected in income. Revenue from software sales was not material for the years presented.

Inventories

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

Long-Lived Assets

We account for our long-lived assets, primarily Property and equipment and amortizable Intangible assets, in accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), "Accounting for the Disposal of Long-Lived Assets," which requires us to review the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is measured by comparing the estimated undiscounted cash flows to the carrying amount. A loss is recorded if the carrying amount of the asset exceeds the estimated undiscounted cash flows. Intangible assets are generally being amortized over five years, and fifteen years for income tax purposes, on a straight-line basis.

Property and Equipment

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

Note 1. Nature of Operations and Significant Accounting Policies (continued):

Goodwill

We assess the initial carrying value of Goodwill recorded in connection with our acquisitions (see notes 5 and 6) by comparing our aggregate purchase price to the fair value of the net tangible assets and intangible assets acquired. We measure the initial carrying value for potential impairment in accordance with SFAS No.142, "Goodwill and Other Intangible Assets." To apply SFAS 142, a company is divided into separate "reporting units," each representing groups of products that are separately managed. For this purpose, we have one reporting unit. To determine whether or not goodwill may be impaired, a test is required comparing the book value of the "reporting unit" to its trading price. Similar tests are required in the future, at least annually, and more often where there is a change in circumstances that could result in an impairment of goodwill. If the trading price of our common stock is below book value for a sustained period, a goodwill impairment test will be performed by comparing book value to estimated market value (trading price plus a control premium). The excess of book value over estimated market value will then be subtracted from the goodwill account with a resulting charge to operations. Subsequent unrealized recoveries in market value, if any, will not be recorded. We completed an initial goodwill impairment assessment as of January 1, 2002 to determine if a transition impairment charge should be recognized under SFAS 142. Upon assessment, no transition impairment charge was recorded. We also completed our annual goodwill impairment assessment in December 2002, upon which no impairment charge was recorded.

Research and Development

Research and development costs are expensed as incurred.

Stock-Based Compensation

We account for our employee and director stock options and employee stock purchase plan in accordance with provisions of Accounting Principles Board Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." Pro forma disclosures as required under SFAS 123, "Accounting for Stock-Based Compensation," and as amended by SFAS 148, "Accounting for Stock-Based Compensation — Transition and Disclosure," are presented below (also see note 11). Pursuant to FASB Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Based Compensation — an interpretation of APB Opinion No. 25," effective July 1, 2000, the "in the money" portion of stock options granted to employees in connection with acquisitions is accounted for as Deferred stock compensation in Stockholders' Equity and amortized to operations as part of Amortization of Intangible Assets over the vesting periods of the options.

Our pro forma information is as follows (in thousands, except per share data):

	YEAR ENDED DEC. 31, 2002	YEAR ENDED DEC. 31, 2001	YEAR ENDED DEC. 31, 2000
Net (loss) income, as reported	$(175,235)	$(109,519)	$167,887
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(31,106)	(22,614)	(20,003)
Pro forma net (loss) income	$(206,341)	$(132,133)	$147,884
Earnings per share:			
Basic — as reported	$ (1.59)	$ (1.01)	$ 1.65
Basic — pro forma	$ (1.87)	$ (1.22)	$ 1.46
Diluted — as reported	$ (1.59)	$ (1.01)	$ 1.47
Diluted — pro forma	$ (1.87)	$ (1.22)	$ 1.31

Note 1. Nature of Operations and Significant Accounting Policies (continued):

Net (Loss) Income Per Share

Net (loss) income per share is computed based on the weighted average number of shares of common stock and potentially dilutive securities assumed to be outstanding during the period using the treasury stock method. Potentially dilutive securities consist of stock options, warrants to purchase common stock and convertible subordinated notes. The most significant difference between basic and diluted net income per share is that basic net income per share does not treat potentially dilutive securities such as convertible subordinated notes, options and warrants as outstanding. For 2000, diluted weighted-average shares outstanding include the effect of stock options, warrants and approximately 12.5 million shares issuable on the assumed conversion of our convertible subordinated notes (see note 10). For 2000, diluted net income per share is adjusted to exclude interest expense and debt issuance cost amortization (net of tax) of approximately $8.3 million and $1.2 million, respectively. Diluted loss per common share for 2002 and 2001 is based only on the weighted-average number of common shares outstanding during these periods, as the inclusion of options, warrants and convertible subordinated notes would have been antidilutive. A reconciliation of the numerators and denominators of basic and diluted net income per share is presented below:

	YEAR ENDED DEC. 31, 2002	YEAR ENDED DEC. 31, 2001	YEAR ENDED DEC. 31, 2000
	(in thousands, except per share data)		
Basic and diluted net (loss) income	$(175,235)	$(109,519)	$167,887
Shares used in basic net (loss) income per share calculations	110,193	108,814	101,716
Dilutive effect of stock options, warrants and convertible subordinated notes	—	—	18,605
Shares used in diluted net income per share calculations	110,193	108,814	120,321
Basic net (loss) income per share	$ (1.59)	$ (1.01)	$ 1.65
Diluted net (loss) income per share	$ (1.59)	$ (1.01)	$ 1.47

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

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

Comprehensive (Loss) Income

For 2000, comprehensive income consists primarily of net income of $167.9 million and an unrealized loss on depreciation of foundry investments (net of tax) of approximately $47.9 million. For 2001, comprehensive loss consists primarily of net loss of $109.5 million offset by unrealized gain recorded related to the market value of our foundry investments (net of tax) of approximately $72.0 million. For 2002, comprehensive loss consists primarily of net loss of $175.2 million, unrealized loss on depreciation of our foundry investments of approximately $24.9 million and recognized gain on sale of foundry investments previously unrealized of approximately $3.4 million (see note 7).

Statement of Cash Flows

During 2002, we received income tax refunds, net of payments, of approximately $37.2 million. Income taxes paid approximated $7.3 million and $55.9 million in 2001 and 2000, respectively. Interest paid aggregated approximately $12.0 million, $12.4 million and $12.3 million in 2002, 2001, and 2000, respectively.

Note 1. Nature of Operations and Significant Accounting Policies (continued):

Use of Estimates

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

New Accounting Pronouncements

In June 2001, the FASB issued SFAS 142, "Goodwill and Other Intangible Assets," which supersedes APB Opinion No. 17, "Intangible Assets." SFAS 142, among other things, establishes new standards for intangible assets acquired in a business combination, eliminates amortization of goodwill and sets forth requirements to periodically evaluate goodwill for impairment. We adopted this statement during the first quarter of 2002 and thus goodwill and certain intangibles with indefinite lives are no longer being amortized. Accordingly, approximately $8 million of previous quarterly amortization is no longer being recorded (see *Goodwill* in this note 1 above).

The following table presents the impact of SFAS 142 on our net income and our net income per share had the new standard been in effect for the years ended December 31, 2001 and 2000:

	YEAR ENDED DEC. 31, 2001	YEAR ENDED DEC. 31, 2000
	(In thousands, except per share amounts)	
Net (loss) income -as reported	$(109,519)	$167,887
Adjustments:		
Amortization of goodwill	32,949	30,997
Income tax effect	(12,206)	(11,140)
Net adjustments	20,743	19,857
Net (loss) income — as adjusted	$ (88,776)	$187,744
Basic net (loss) income per share — as reported	$ (1.01)	$ 1.65
Basic net (loss) income per share — adjusted	$ (.82)	$ 1.85
Diluted net (loss) income per share — as reported	$ (1.01)	$ 1.47
Diluted net (loss) income per share — adjusted	$ (.82)	$ 1.64

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

DECEMBER 31, 2002	GROSS	ACCUMULATED AMORTIZATION	NET
Current technology	$273.6	$(160.3)	$113.3
Core technology	7.3	(.5)	6.8
Licenses	10.2	(1.4)	8.8
Non-compete agreements	14.2	(4.4)	9.8
Workforce	4.7	(.3)	4.4
Backlog	1.4	(1.4)	—
Customer list	17.4	(12.3)	5.1
Patents and trademarks	26.8	(19.0)	7.8
Total	$355.6	$(199.6)	$156.0

DECEMBER 31, 2001	GROSS	ACCUMULATED AMORTIZATION	NET
Current technology	$210.2	$(106.8)	$103.4
Customer list	17.4	(8.9)	8.5
Patents and trademarks	26.8	(13.6)	13.2
Total	$254.4	$(129.3)	$125.1

Note 1. Nature of Operations and Significant Accounting Policies (continued):

The estimated future amortization expense of purchased intangible assets as of December 31, 2002 is as follows:

FISCAL YEAR:	AMOUNT (In millions)
2003	$ 71.4
2004	43.8
2005	14.4
2006	10.8
2007	9.8
Later years	5.8
	$156.0

The estimated future amortization expense of deferred stock compensation attributable to Research and Development activities as of December 31, 2002 is approximately $4.2 million annually for 2003 and 2004, and $3.1 million for 2005.

In October 2001, the FASB issued SFAS 144, "Accounting for the Disposal of Long-Lived Assets," which supersedes SFAS 121, "Accounting for the Impairment Of Long-Lived Assets and for Long-Lived Assets to be Disposed of." SFAS 144 retains the fundamental provisions of SFAS 121 regarding the recognition and measurement of the impairment of long-lived assets to be held and used and the measurement of long-lived assets to be disposed of by sale, but provides additional definition and measurement criteria for determining when an impairment has occurred. Goodwill and financial instruments are excluded from the scope of SFAS 144, however amortizable intangible assets fall within its scope. The adoption of this statement in the first quarter of 2002 did not have a material impact on our results of operations, financial position or cash flows.

In May 2002, the FASB issued SFAS 145, "Rescission of FAS Nos. 4, 44, and 64, Amendment of FAS 13, and Technical Corrections." Among other things, SFAS 145 rescinds various pronouncements regarding early extinguishment of debt and allows extraordinary accounting treatment for early extinguishment only when the provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," are met. SFAS 145 provisions regarding early extinguishment of debt are generally effective for fiscal years beginning after May 15, 2002. Management adopted this pronouncement during the second quarter of 2002.

During 2002, we extinguished approximately $51.9 million face value of our 4¾% convertible notes for approximately $42.8 million in cash, including accrued interest. We recognized a gain of approximately $9.3 million in connection with these transactions (see note 10). As specified in SFAS 145, this gain was recorded in "Other income, net" in the accompanying Consolidated Statement of Operations.

In July 2002, the FASB issued SFAS 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. SFAS 146 eliminates the definition and requirement for recognition of exit costs in Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)," where a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. This statement is effective for exit or disposal activities initiated after December 31, 2002. We do not believe that the adoption of this statement will have a material impact on our results of operations, financial position or cash flows.

In December 2002, the FASB issued SFAS 148, "Accounting for Stock-Based Compensation — Transition and Disclosure." This statement provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, it amends the disclosure requirements of SFAS 123 to require prominent disclosure in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reporting results. This statement is generally effective for fiscal years ending after December 15, 2002 and for the interim periods beginning after December 15, 2002. As we continue to report stock-based employee compensation costs using the intrinsic value method as defined by APB 25, adoption of the provisions of the new statement affects only our disclosure of these costs, which is presented in note 1.

Financial presentation

Certain reclassifications of prior year balances included in our consolidated financial statements have been made to conform to the 2002 presentation.

Note 2. Inventories:

	DECEMBER 31, 2002	DECEMBER 31, 2001
	(In thousands)	
Work in progress	$ 40,515	$ 44,460
Finished goods	15,726	20,466
	$ 56,241	$ 64,926

Note 3. Property and Equipment:

	DECEMBER 31, 2002	DECEMBER 31, 2001
	(In thousands)	
Land	$ 2,099	$ 2,099
Construction in progress	3,024	—
Buildings	24,703	24,703
Computer and test equipment	123,115	109,606
Office furniture and equipment	10,379	9,452
Leasehold and building improvements	13,833	13,513
	177,153	159,373
Accumulated depreciation and amortization	(114,367)	(96,151)
	$ 62,786	$ 63,222

Depreciation expense was approximately $19.2 million, $19.1 million and $17.1 million for 2002, 2001 and 2000, respectively.

Note 4. Acquisition of Cerdelinx:

On August 26, 2002, we completed the stock for stock acquisition of Cerdelinx for 2.6 million shares valued at $8.30 per share. Cerdelinx was an early stage fabless semiconductor company focused on the design of application specific standard products targeted towards emerging high-speed communications and storage applications. Cerdelinx had a team of engineers who were developing a portfolio of low-power CMOS transceivers and backplane interfaces with embedded high-speed SERDES I/O to support 10 gigabit-per-second applications. The acquisition serves to enhance our silicon development efforts and our ability to deliver leading-edge programmable solutions within the communications and storage market segments. This acquisition principally comprises intellectual property and a work force. The core technology portion of the intellectual property is valued using a royalty savings methodology which discounts estimated royalties that would be paid on an after tax basis. The in-process technology portion of the intellectual property is valued using a discounted cash flow methodology described in detail below. Work force is valued using a replacement cost methodology which discounts costs to an after tax amount. The transaction was completed pursuant to an Agreement and Plan of Reorganization entered into on July 15, 2002, as amended on July 24, 2002, among Lattice, Cerdelinx and affiliated parties. The components of the purchase price were as follows (in millions):

Stock issued and liabilities assumed	$ 22.8
Estimated direct acquisition costs	1.1
Total	$ 23.9

Note 4. Acquisition of Cerdelinx (continued):

In conformity with Financial Accounting Standard SFAS 142, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. As Cerdelinx was not considered a business under SFAS 141, "Business Combinations," no goodwill was recognized. In estimating the fair value of the assets acquired, management considered various factors, including an appraisal. The purchase price allocation is subject to further refinement and change over the four quarters subsequent to the acquisition. We are in the process of completing our integration of Cerdelinx and accordingly, the amounts recorded are based on our current estimates of these costs. The total purchase price was allocated as follows (in millions):

Core technology	$ 7.2
Deferred stock compensation	5.8
In process research and development costs	5.7
Work force	4.7
Liabilities assumed	(1.2)
Equipment	1.1
Non compete agreement	0.3
Cash	0.3
Total	$ 23.9

There were no significant exit costs incurred or accrued in connection with this transaction. Management does not expect intangible assets acquired to be deductible for income tax purposes.

Employees who joined Lattice as a result of this acquisition held Cerdelinx shares and options which were converted into 0.9 million Lattice shares and options which were either unvested or otherwise restricted from sale over terms up to four years at a grant price from $0.41 per share to $2.54 per share. The spread, which is the difference between grant price and market value of our common stock on the Closing Date, aggregating $5.8 million on these shares and options, was recorded as Paid-in capital and Deferred stock compensation and is being amortized to operations equally over the vesting (or restriction lapsing) period as part of Amortization of intangible assets.

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

IPR&D consists of those products obtained through acquisition that are not yet proven to be technologically feasible but have been developed to a point where there is value associated with them in relation to potential future revenue. Because technological feasibility was not yet proven and no alternative future uses are believed to exist for the in-process technologies, the assigned value was expensed immediately after the closing of the acquisition.

The fair value underlying the $5.7 million assigned to acquired IPR&D from the Cerdelinx acquisition was determined by identifying research projects in areas for which technological feasibility had not been established and there were no alternative future uses. The acquired IPR&D consists of low-power CMOS transceivers and backplane interfaces with embedded high-speed SERDES I/O. These products were approximately 60% complete and are estimated to be completed in 2003 at an estimated cost of approximately $2 million. There has been no material change in the schedule or estimated cost of this project.

The fair value was determined by an income approach where fair value is the present value of projected free cash flows that will be generated by the products incorporating the acquired technologies under development, assuming they are successfully completed. The estimated net free cash flows generated by the products over six year periods were discounted at rates ranging from 15 to 17 percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. The net cash flows for such projects were based on management's estimates of revenue, expenses and asset requirements.

All of these projects have completion risks related to silicon functionality, architecture performance, process technology availability, packaging technology, continued availability of key technical personnel and product reliability. To the extent that estimated completion dates are not met, the risk of competitive product introduction is greater and revenue opportunity may be permanently lost.

The core technology included in the acquisition of Cerdelinx has an estimated weighted average useful life of approximately six years, and the work force and non-compete agreements included in the Cerdelinx acquisition have estimated useful lives of approximately four years resulting in a weighted average useful life of approximately five years.

Note 5. Acquisition of Agere FPGA:

On January 18, 2002, we completed the acquisition of Agere FPGA for $250 million in cash. This acquisition increased our share of the PLD market, accelerated our entry into the FPGA portion of the market and provided us with additional technical employees and intellectual property. This acquisition principally comprises intellectual property, which was valued using a discounted cash flow methodology of which goodwill was a by-product. The transaction was completed pursuant to an Asset Purchase Agreement dated as of December 7, 2001 between Lattice and Agere. The components of the purchase price were as follows (in millions):

Cash	$ 250.0
Estimated direct acquisition costs	6.3
Total	$ 256.3

In accordance with SFAS 141, the total purchase price was allocated to the estimated fair value of assets acquired and liabilities assumed. In estimating the fair value of the assets acquired, management considered various factors, including an appraisal. We are in the process of completing our integration of Agere FPGA, and accordingly, the amounts recorded are based on our current estimates of these costs. The total purchase price was allocated as follows (in millions):

Excess of purchase price over net assets acquired	$ 142.4
Current technology	63.4
In-process research and development	24.2
Fair value of non-compete agreement	13.8
Licensed technology	10.2
Inventory	3.5
Backlog	1.4
Property, plant and equipment	0.2
Accrued liabilities	(2.8)
Total	$ 256.3

There were no significant exit costs incurred or accrued in connection with this transaction. Management expects the costs of this acquisition, including goodwill, to be deductible for income tax purposes.

Employees joining us from Agere during the first quarter of 2002 were awarded approximately 1.1 million stock options which vest equally over four years at a grant price of $14.76 per share. The difference between grant price and market value of our common stock on the grant date, aggregating approximately $7.0 million, was recorded as Paid-in capital and Deferred stock compensation and is being amortized to operations ratably over the vesting period as part of Amortization of intangible assets.

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

IPR&D consists of those products obtained through acquisition that are not yet proven to be technologically feasible but have been developed to a point where there is value associated with them in relation to potential future revenue. Because technological feasibility was not yet proven and no alternative future uses are believed to exist for the in-process technologies, the assigned value was expensed immediately upon the closing date of the acquisition.

The fair value underlying the $24.2 million assigned to acquired IPR&D in the Agere FPGA acquisition was determined by identifying research projects in areas for which technological feasibility had not been established and there was no alternative future use. Projects in the IPR&D category are the ORCA 4 FPGA family, the next generation FPGA family and the FPSC field-programmable system chips. The following is a brief description of these projects. The ORCA 4 FPGA family project, increasing speed and density and enhancing yields, was approximately 85% complete and estimated to be completed by 2003 at an estimated cost of $1.5 million. This project was completed during 2002 with no material change in cost. The next generation FPGA family project, increasing speed and density while reducing die size, was approximately 50% complete and estimated to be completed by 2004 at an estimated cost of $2 million. There has been no material change in the schedule or estimated cost of this project. The future development of FPSC field-programmable system chips (field-programmable system chips which combine embedded pre-defined logic circuits with an FPGA platform) was approximately 25% to 90% complete, and estimated to be completed by 2004 at an estimated cost

Note 5. Acquisition of Agere FPGA (continued):

of $2 million. There has been no material change in the schedule or estimated cost of this project. The IPR&D value of $24.2 million was determined by an income approach where fair value is the present value of projected free cash flows that will be generated by the products incorporating the acquired technologies under development, assuming they are successfully completed. The estimated net free cash flows generated by the products over 5-7 year periods were discounted at rates ranging from 23 to 25 percent in relation to the stage of completion and the technical risks associated with achieving technological feasibility. The net cash flows for such projects were based on management's estimates of revenue, expenses and asset requirements. Any delays or failures in the completion of these projects could impact our expected return on investment and future results. In addition, our financial condition would be adversely affected if the value of other intangible assets acquired became impaired.

All of these projects have completion risks related to silicon functionality, architecture performance, process technology availability, packaging technology, continued availability of key technical personnel, product reliability and availability of software support. To the extent that estimated completion dates are not met, the risk of competitors' product introductions is greater and revenue opportunity may be permanently lost.

The non-compete agreement from Agere and the current and licensed technology included in the acquisition of Agere FPGA have an estimated weighted average useful life of approximately 6.3 years. In accordance with SFAS 142, the excess of purchase price over net assets acquired, or Goodwill, is subject to an impairment test at least annually and is not amortized.

Pro forma results

The following pro forma results of operations information are provided for illustrative purposes only and do not purport to be indicative of the consolidated results of operations for future periods or that actually would have been realized had Lattice and Agere FPGA been a consolidated entity during the periods presented. The pro forma results combine the results of operations as if Agere FPGA had been acquired as of the beginning of the periods presented. The results include the impact of certain adjustments such as intangible asset amortization, estimated changes in interest income (expense) related to cash outlays associated with the transaction and income tax benefits related to the aforementioned adjustments. Additionally, the IPR&D charge of $24.2 million discussed above has been excluded from the periods presented due to its non-recurring nature.

	YEAR ENDED	
	DEC. 31, 2002	DEC. 31, 2001
	(in thousands, except per share amounts) (unaudited)	
Revenue	$ 234,518	$ 364,426
Net Loss	$(159,707)	$(122,419)
Basic net loss per share	$ (1.45)	$ (1.13)
Diluted net loss per share	$ (1.45)	$ (1.13)

Note 6. Acquisition of Vantis:

On June 15, 1999, we paid approximately $500.1 million in cash to AMD for all of the outstanding capital stock of Vantis Corporation. The total purchase price of Vantis was $583.1 million, including certain direct acquisition costs, the accrual of certain exit costs and the assumption of certain liabilities related to the Vantis business. Of this purchase price, approximately $422.6 million was allocated to goodwill and intangible assets.

The recorded balances of goodwill and intangible assets, net of accumulated amortization, related to the Vantis acquisition approximated $77.1 million and $ 74.2 million, respectively, at December 31, 2002 and $77.3 million and $125.1 million, respectively, at December 31, 2001. Amortization expense related to these assets approximated $50.9 million, $80.9 million and $81.9 million for 2002, 2001 and 2000, respectively. The decrease in amortization expense for 2002 was due to the elimination of goodwill amortization beginning in 2002 (see note 1).

Note 7. Foundry Investments, Advances and Other Assets:

	DECEMBER 31, 2002	DECEMBER 31, 2001
	(In thousands)	
Foundry investments and other assets	$ 68,990	$124,870
Wafer supply advances	35,517	37,548
	$104,507	$162,418

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

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

We own approximately 88.2 million shares of UMC common stock at December 31, 2002 of which approximately 23.3 million are restricted from sale for more than one year by the terms of our agreement with UMC. Under the terms of the UMC agreement, if we sell any of these restricted shares, our rights to guaranteed wafer capacity at UMC may be reduced on a pro-rata basis based on the number of shares that we sell. If we sell over 10.1 million of these restricted shares, we may lose all of our rights to guaranteed wafer capacity at UMC.

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

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

In the September 2001 quarter, the carrying value of the UMC shares was reduced as we recorded a $152.8 million loss representing a decline in the market value of our UMC shares. In each quarter that the market value of the UMC investment is below carrying value, we evaluate whether the investment is other than temporarily impaired. We recorded the unrealized loss on our UMC investment in the September 30, 2001 Statement of Operations. At that time, we believed the investment was other than temporarily impaired for the following reasons:

- it was becoming increasingly likely that the stock price would not recover based on the increasing size of the unrealized loss, the extended time period during which the stock price had continued to decline without a trend reversal, and the dampening volatility, which indicated to us that the stock price was becoming more stable;
- UMC's financial performance had weakened relative to earlier quarters;
- the opinion of many industry observers and analysts regarding the semiconductor downturn had become significantly more negative;
- the events of September 11, 2001 further exacerbated market conditions;

Note 7. Foundry Investments, Advances and Other Assets (continued):

- we had previously believed that UMC would initiate an ADR conversion program that would enable us to sell our shares at a premium on the New York Stock Exchange, but such a program was never initiated; and
- although we still had the intent and ability to hold the shares for an indefinite period, we concluded this fact did not overcome the negative factors associated with the shares.

The carrying value of our investment in UMC was approximately $103.1 million at December 31, 2001. During 2002, we recorded a $36.1 million unrealized loss ($24.9 million net of tax and reflected in Accumulated other comprehensive (loss) income) related to changes in the market value of our unrestricted UMC shares. In connection with the sale of certain UMC shares discussed below, approximately $3.4 million of previously unrealized gain (net of tax) on these shares was realized. During 2002, we sold approximately 7.6 million of our UMC shares for approximately $9.9 million cash. The resultant $4.0 million pre-tax gain associated with these sales was recorded in “Other income, net” in the accompanying Consolidated Statement of Operations and represents the difference between market value on the date of sale and the carrying value at September 30, 2001. The resultant carrying value of our UMC shares was approximately $56.3 million at December 31, 2002 and this balance is classified as part of Foundry investments, advances and other assets. If we liquidate our UMC shares, it is likely that the amount of any future realized gain or loss will be different from the accounting gain or loss reported in prior periods.

In March 1997 and as subsequently amended in January 2002, we entered into an advance payment production agreement with Seiko Epson and Epson Electronics America, Inc. (“EEA”) under which we agreed to advance up to $69 million, payable upon completion of specific milestones, to Seiko Epson to finance construction of an eight-inch sub-micron semiconductor wafer manufacturing facility. Under the terms of the agreement, the advance is to be repaid with semiconductor wafers over a multi-year period. No interest income is recorded. The agreement calls for wafers to be supplied by Seiko Epson through EEA pursuant to purchase agreements with EEA. Payments of approximately $51.3 million have been made under this agreement. Cumulatively, approximately $13.3 million of these payments have been repaid to us in the form of semiconductor wafers. Approximately $2.4 million of the outstanding advances are expected to be repaid with semiconductor wafers during 2003 and are thus reflected as part of Prepaid expenses and other current assets in our accompanying Consolidated Balance Sheet. We do not anticipate making additional payments under this agreement.

Note 8. Lease Obligations:

Certain of our facilities and equipment are leased under operating leases, which expire at various times through 2009. Rental expense under the operating leases was approximately $5,972,000, $5,078,000 and $5,469,000 for 2002, 2001, and 2000, respectively. Future minimum lease commitments (before consideration of sublease receipts discussed below) at December 31, 2002 are as follows (in thousands):

YEAR	
2003	$ 8,897
2004	8,751
2005	7,925
2006	7,905
2007	5,444
Later years	6,087
	$ 45,009

Note 8. Lease Obligations (continued):

Included in these amounts are certain properties which are currently subleased. A portion of this sublease income is payable to the property owner. Future minimum sublease receipts, based on agreements in place at December 31, 2002, net of such payments are as follows (in thousands):

YEAR	
2003	$ 2,473
2004	2,555
2005	2,622
2006	886
	$ 8,536

Note 9. Income Taxes:

The components of the provision (benefit) for income taxes for 2002, 2001, and 2000 are presented in the following table

	DEC. 31, 2002	DEC. 31, 2001	DEC. 31, 2000
		(In thousands)	
Current:			
Federal	$ (27,082)	$ (7,018)	$68,791
State	—	(2,087)	8,414
	(27,082)	(9,105)	77,205
Deferred:			
Federal	99,334	(47,482)	14,925
State	9,614	(7,860)	2,054
	108,948	(55,342)	16,979
	$ 81,866	$(64,447)	$94,184

Foreign income taxes were not significant for the years presented.

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

.	YEAR ENDED DEC. 31, 2002	YEAR ENDED DEC. 31, 2001	YEAR ENDED DEC. 31, 2000
		(In thousands)	
Computed income tax (benefit) expense at the statutory rate	$ (32,679)	$(60,886)	$91,725
Adjustments for tax effects of:			
State taxes, net	(4,016)	(6,466)	6,805
Research and development credits	(800)	(1,175)	(808)
Nontaxable investment items	(1,388)	4,177	(3,976)
Valuation allowance	118,648	—	—
Other	2,101	(97)	438
	$ 81,866	$(64,447)	$94,184

In the fourth quarter of 2002, we recorded a $118.6 million charge to income tax expense, representing a valuation allowance on our recorded deferred tax assets, in accordance with SFAS 109, “Accounting for Income Taxes.” SFAS 109 provides for the recognition of deferred tax assets if realization of these assets is more likely than not. We have provided a valuation allowance equal to our net deferred tax assets due to uncertainties regarding their realization.

Note 9. Income Taxes (continued):

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

	DECEMBER 31, 2002	DECEMBER 31, 2001
	(In thousands)	
Current deferred tax assets:		
Deferred income	$ 4,434	$ 5,929
Expenses and allowances not currently deductible	15,931	25,662
	20,365	31,591
Less: valuation allowance	(20,365)	—
	$ —	$ 31,591
Non-current deferred tax assets:		
Intangible asset charges not currently deductible	$ 82,686	$ 70,011
Expenses and allowances not currently deductible	7,673	5,576
Net operating loss and credit carryforwards	11,658	—
Other	3,613	3,333
	105,630	78,920
Less: valuation allowance	(105,630)	—
Total deferred tax assets	—	78,920
Non-current deferred tax liabilities:		
Tax effect on net unrealized gain on market value of foundry investments	—	(13,330)
Net non-current deferred tax assets	$ —	$ 65,590

Valuation allowances approximating $7.3 million were provided earlier in 2002 for deferred tax assets acquired with Cerdelinx as discussed below and for certain net operating loss and state credit carryforwards.

In conjunction with the $150.0 million pre-tax gain on our foundry investments as discussed in note 7, we recorded a deferred tax liability of approximately $57.9 million. This deferred tax liability was adjusted for subsequent realized and unrealized gains and losses related to these investments during 2001 and 2002. The December 31, 2001 balance for the deferred tax liability related to our foundry investments, aggregating approximately $13.3 million, was netted against non-current deferred tax assets as summarized above. Deferred taxes related to our foundry investments at December 31, 2002 were not significant.

As of December 31, 2002 and 2001, respectively, we had approximately $26.0 million and $30.0 million in federal and other income taxes receivable relating primarily to federal net operating loss carrybacks. These amounts are reflected in Prepaid expenses and other current assets in the Consolidated Balance Sheet.

As of December 31, 2002, we have federal and state credit carryforwards of approximately $6.6 million, most of which have no expiration date and with the remainder expiring at various dates between 2006 and 2022. We also have federal net operating loss carryforwards of $5.5 million and state net operating loss carryforwards of $7.7 million that expire at various dates from 2006 through 2022.

We acquired Cerdelinx on August 26, 2002 (see note 4). Cerdelinx had federal and state net operating loss and tax credit carryforwards at the time of the acquisition for which we recorded deferred tax assets of $2.8 million with an offsetting valuation allowance. In conjunction with the change in ownership, applicable Internal Revenue code sections limit the use of these tax benefits to approximately $400,000 per year.

Note 10. Long-term debt:

On October 28, 1999, we issued $260 million in 4 3/4% convertible subordinated notes due on November 1, 2006. These notes pay interest semi-annually on May 1 and November 1. Holders of these notes may convert them into shares of our common stock at any time on or before November 1, 2006, at a conversion price of $20.72 per share, subject to adjustment in certain events. Beginning on November 6, 2002 and ending on October 31, 2003, we may redeem the notes in whole or in part at a redemption price of 102.71% of the principal amount. In the subsequent three twelve-month periods, the redemption price declines to 102.04%, 101.36% and 100.68% of principal, respectively. The notes are subordinated in right of payment to all of our senior indebtedness, and are subordinated by operation of law to all liabilities of our subsidiaries. At December 31, 2002, we had no senior indebtedness and our subsidiaries had $2.5 million of debt and other liabilities outstanding.

During 2002, we extinguished approximately $51.9 million face value of our 4 3/4% convertible notes for approximately $42.8 million in cash, including accrued interest. We recognized a gain of approximately $9.3 million in connection with these transactions.

Issuance costs relative to the convertible subordinated notes are included in Other assets and aggregated approximately $6.9 million and are being amortized to expense over the lives of the notes. Accumulated amortization of these issuance costs amounted to approximately $5.3 million at December 31, 2002. The estimated fair value of the convertible subordinated notes, based on quoted market prices, was approximately $184.7 million and $315.9 million at December 31, 2002 and December 31, 2001, respectively.

Note 11. Stockholders' Equity:

Common Stock

In December 2000, our Board of Directors authorized management to repurchase up to five million shares of our common stock. As of December 31, 2002, we had repurchased 1,136,000 shares (596,000 in 2001) at an aggregate cost of approximately $20.0 million ($10.6 million in 2001). There were no repurchases of common stock in 2002.

Stock Warrants

During 2000, we issued a warrant to a vendor to purchase 74,000 shares of common stock, earned ratably from March 2000 to February 2001. During 2001, a warrant was issued to purchase 95,563 shares of common stock, earned ratably from March 2001 to February 2002. During 2002, a warrant was issued to purchase 119,074 shares of common stock, earned ratably from March 2002 to February 2003. Additionally, during 2002 the vendor exercised warrants for 206,200 shares at $13.75 per share, leaving 709,229 shares unexercised as of December 31, 2002, including warrants issued prior to 2000. Expense recorded in conjunction with the vesting of warrants by this vendor was not significant.

Stock Option Plans

As of December 31, 2002, we had authorized 9,000,000 and 17,200,000 shares of common stock for issuance to officers and employees under our 2001 Stock Option Plan and 1996 Stock Option Plan, respectively. The 2001 Plan options are granted at fair value at the date of grant, generally vest over four years in increments as determined by the Board of Directors and have terms up to ten years. The 1996 Plan options are typically granted at fair value at the date of grant, generally vest over four years in increments as determined by the Board of Directors and have terms up to ten years.

In conjunction with the acquisition of Cerdelinx on August 26, 2002, we exchanged 246,540 Lattice stock options for all of the options outstanding under the former Cerdelinx stock option plans. These options generally vest over four years and have terms of ten years. In conjunction with the acquisition of I2P on March 16, 2001, we exchanged 223,276 Lattice stock options for all of the options outstanding under the for I2P stock option plans. These options generally vest over four years and have terms of ten years.

Note 11. Stockholders' Equity (continued):

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

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

	YEAR ENDED DECEMBER 31, 2002		YEAR ENDED DECEMBER 31, 2001		YEAR ENDED DECEMBER 31, 2000	
	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE
	(Number of shares in thousands)					
Options outstanding at beginning of year	20,075	$ 17.71	17,008	$ 14.95	16,444	$ 9.80
Options granted	4,877	8.08	5,713	22.16	5,170	27.31
Options canceled	(721)	17.73	(399)	17.81	(1,306)	13.22
Options exercised	(191)	7.81	(2,247)	8.15	(3,300)	9.32
Options outstanding at end of year	24,040	$ 15.83	20,075	$ 17.71	17,008	$ 14.95

The following table summarizes information about stock options outstanding at December 31, 2002:

(Number of shares in thousands)	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OF SHARES	WEIGHTED-AVERAGE REMAINING CONTRACT LIFE (IN YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
$ 0.41 – $ 7.75	6,341	7.93	$ 6.57	3,084	$ 7.41
$ 7.88 – $11.16	4,355	6.13	9.35	3,960	9.19
$11.89 – $17.08	4,602	7.87	15.40	2,362	15.37
$17.44 – $24.91	4,118	8.46	24.43	1,344	24.39
$24.92 – $32.25	4,624	7.45	27.40	2,695	27.53
	24,040	7.59	$15.83	13,445	$15.06

Stock Purchase Plan

Our employee stock purchase plan, most recently approved by the stockholders in August 1997, permits eligible employees to purchase shares of common stock through payroll deductions, not to exceed 10% of the employee's compensation. The purchase price of the shares is the lower of 85% of the fair market value of the stock at the beginning of each six-month period or 85% of the fair market value at the end of such period, but in no event less than the book value per share at the mid-point of each offering period. Amounts accumulated through payroll deductions during the offering period are used to purchase shares on the last day of the offering period. Of the 3,700,000 shares authorized to be issued under the plan, 347,107, 203,049, and 200,072 shares were issued during 2002, 2001 and 2000, respectively, and 906,612 shares were available for issuance at December 31, 2002.

Note 11. Stockholders' Equity (continued):

Stock Based Compensation

We account for our stock options and employee stock purchase plan in conformity with APB 25 and have adopted the additional pro forma disclosure provisions of SFAS 123, as amended by SFAS 148. The fair value of our stock-based employee compensation cost (see note 1), as defined by SFAS 123, for stock options and employee stock plan purchase rights was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	GRANTS FOR YEARS ENDED		
	DEC. 31, 2002	DEC. 31, 2001	DEC. 31, 2000
Stock options:			
Expected volatility	59.3%	56.1%	53.9%
Risk-free interest rate	2.8%	3.9%	6.3%
Expected life from vesting date	1.7 years	1.9 years	1.8 years
Dividend yield	0%	0%	0%
Stock purchase rights:			
Expected volatility	64.3%	53.3%	46.6%
Risk-free interest rate	3.52%	4.65%	6.3%
Expected life	6 months	6 months	6 months
Dividend yield	0%	0%	0%

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

The resultant grant date weighted-average fair values calculated using the Black-Scholes option pricing model and the noted assumptions for stock options granted was $3.70, $10.29 and $13.13, and for stock purchase rights $5.32, $5.92 and $7.79, for 2002, 2001, and 2000, respectively. For purposes of pro forma disclosures (see note 1), the estimated fair value of the options is amortized to expense over the options' vesting period.

Note 12. Employee Benefit Plans:

Profit Sharing Plan

We initiated a profit sharing plan effective April 1, 1990. Under the provisions of this plan, as approved by the Board of Directors, a percentage of our operating income, as defined and calculated at the end of March and September for the prior six-month period, is paid to qualified employees. In 2002, the provision charged to operations for this plan was not significant. In 2001 and 2000, approximately $2.1 million, and $6.7 million, respectively, was charged against operations in connection with the plan.

Qualified Investment Plan

In 1990, we adopted a 401(k) plan, which provides participants with an opportunity to accumulate funds for retirement. Under the terms of the plan, eligible participants may contribute up to 15% of their eligible earnings to the plan Trust. The plan does not allow investments in our securities. The plan allows for us to make discretionary matching contributions in cash. For the years presented, matching contributions of up to 5% of base pay, vesting over four years, were made through the second quarter of 2001. There was no expense recorded related to matching contributions in 2002. Expense related to our matching contributions was approximately $1.0 million and $1.8 million, respectively, for 2001 and 2000.

Executive Deferred Compensation Plan

Our Executive Deferred Compensation Plan enables certain senior managers to annually defer up to 75% of their salary and up to 100% of their incentive compensation. The return on deferred funds is based upon the performance of designated mutual funds or our publicly traded common stock. There is no guaranteed return or matching contribution.

Note 13. Commitments and Contingencies:

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

Note 14. Related Party:

Larry W. Sonsini is a member of our Board of Directors and is presently the Chairman and CEO of Wilson Sonsini Goodrich & Rosati, Professional Corporation, a law firm that provides us with corporate legal services. Legal services billed to Lattice aggregated approximately $885,000, $1,314,000, and $373,000, respectively, for 2002, 2001 and 2000. Amounts payable to the law firm were not significant at December 31, 2002 or 2001, respectively.

Note 15. Segment and Geographic Information:

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

	YEARS ENDED DECEMBER 31,		
	2002	2001	2000
	(In thousands)		
United States	$ 92,086	$135,832	$245,882
Export sales:			
Europe	58,871	81,177	158,591
Asia	67,324	62,582	120,285
Other	10,845	15,735	43,001
	137,040	159,494	321,877
	$229,126	$295,326	$567,759

Resale of product through two distributors accounted for approximately 22% and 29%, 20% and 19%, and 18% and 20% of total worldwide revenue for 2002, 2001, and 2000, respectively. No individual customer accounted for more than 10% of revenue for any of the years presented. More than 90% of our property and equipment is located in the United States. Other long-lived assets located outside the United States consist primarily of foundry investments and advances (see note 7).

Note 16. Subsequent Events:

During the first quarter of 2003, we have extinguished an additional $32.8 million of our convertible subordinated notes (see note 10) for approximately $29.9 million in cash, resulting in a gain of approximately $2.9 million.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Lattice Semiconductor Corporation

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, of changes in stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Lattice Semiconductor Corporation and its subsidiaries (the Company) at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, on January 1, 2002 the Company changed its method of accounting for goodwill.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Portland, Oregon
February 14, 2003

CORPORATE DIRECTORY

BOARD OF DIRECTORS

Cyrus Y. Tsui
Chairman and
Chief Executive Officer

Steven A. Laub
President

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

Daniel S. Hauer[2]
Business Consultant

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

Harry A. Merlo[1]
President,
Merlo Corporation

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

OFFICERS

Cyrus Y. Tsui
Chairman and
Chief Executive Officer

Steven A. Laub
President

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

Frank J. Barone
Corporate Vice President,
Product Operations

Stephen M. Donovan
Corporate Vice President,
Sales

Jonathan K. Yu
Corporate Vice President,
Business Development

Martin R. Baker
Vice President and
General Counsel

Jan Johannessen
Vice President,
Investments

Rodney F. Sloss
Vice President,
Finance

Kenneth K. Yu
Vice President and Managing
Director, Lattice Asia

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

CORPORATE HEADQUARTERS

Lattice Semiconductor Corporation
5555 N.E. Moore Court
Hillsboro, Oregon 97124-6421
Telephone: (503) 268-8000
Facsimile: (503) 268-8347

LEGAL COUNSEL

Wilson, Sonsini, Goodrich & Rosati
Palo Alto, California

INDEPENDENT ACCOUNTANTS

PricewaterhouseCoopers LLP
Portland, Oregon

REGISTRAR AND TRANSFER AGENT

Mellon Investor Services LLC
Shareholder Relations
P.O. Box 3315
South Hackensack, NJ 07606
Telephone: (800) 522-6645
(201) 329-8660
Web: www.melloninvestor.com

ANNUAL MEETING

Our annual meeting of stockholders will be held at our corporate headquarters on Tuesday, May 6, 2003, at 1:00 PM.

FORM 10-K AND ADDITIONAL INFORMATION

Our website is www.latticesemi.com. We make available free of charge through our website, via a link to the SEC's website at http://www.sec.gov, our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after such materials are electronically filed with, or furnished to, the SEC. You may also obtain free copies of these materials by contacting our Investor Relations Department at 5555 N.E. Moore Court, Hillsboro, Oregon 97124-6421, Telephone (503) 268-8000.

COMMON STOCK

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

STOCK PRICE HISTORY

	Low	High
2001:		
March	$ 16.75	$ 27.25
June	15.88	27.64
September	14.04	25.85
December	14.36	22.65
2002:		
March	$ 17.06	$ 24.14
June	6.94	18.49
September	5.35	9.36
December	4.08	10.79

Design: Lawrence Bender & Associates

Lattice Semiconductor Corporation

5555 N.E. Moore Court
Hillsboro, Oregon 97124-6421
U.S.A.