

LATTICE SEMICONDUCTOR CORPORATION 1997 ANNUAL REPORT

EMERGING PATTERNS: LATTICE SEMICONDUCTOR AS A WORK IN PROGRESS

FINANCIAL HIGHLIGHTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED		
	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995
Revenue	\$204,089	\$198,167	\$144,083
Net income	\$45,005	\$41,784	\$26,966
Net income per share	\$1.96	\$1.99	\$1.41
Cash and short-term investments	\$228,647	\$215,170	\$88,810
Total assets	\$403,462	\$342,935	\$192,917
Stockholders' equity	\$360,491	\$298,768	\$157,797

CORPORATE PROFILE

Lattice Semiconductor Corporation designs, develops and markets high performance programmable logic devices ("PLDs") and related development system software. Lattice is the inventor and world's leading supplier of in-system programmable ("ISP™") logic devices. ISP devices have emerged as the next standard in the high-density PLD market. PLDs are standard semiconductor components that can be configured by the end customer as specific logic functions, enabling shorter design cycle times and reduced development costs. Lattice's end customers are primarily original equipment manufacturers ("OEMs") in the fields of communications, computing, computer peripherals, instrumentation, industrial controls and military systems. Nearly one-half of Lattice's revenue is derived from international sales, mainly in Europe and Asia. Lattice offers products that range in complexity from about 200 to 25,000 gates. Products are offered in 20 to 304 pin packages in a variety of speed, power and temperature grades.

ONLY PART OF
THE CANVAS IS
OURS TO
CONTROL.
THE PATTERNS
ARE
ANTICIPATED,
HOPE
FOR...BUT NOT
ASSURED.

THERE MUST BE
TALENT, HARD
WORK,
DEDICATION...
BUT THERE
MUST ALSO BE
INSPIRATION
IF THE
PATTERNS ARE
TO EMERGE.

WE CAN
CONCENTRATE
ONLY ON THE
TASK BEFORE
US: THE SWIRL
OF COLOR, THE
STROKE OF THE
BRUSH, THE
IMMEDIACY OF
DETAIL.

PERHAPS,
PERHAPS...
STEPPING
BACK, ISOLATED
IMPRESSIONS
CEASE TO BE
DISCONNECTED.

PERHAPS,
PERHAPS...
THE PATTERNS
EMERGE.
THE WORK IN
PROGRESS
BECOMES
MORE DEFINED.
AND MORE
PROMISING
IN ITS
COMPOSITION.

PERHAPS,
PERHAPS...
THIS IS THE
MISSION OF
ART, OF
SCIENCE...AND
OF BUSINESS.

—CYRUS TSUI

Like the orderly design of snowflakes on a window pane, patterns emerge all around us. They emerge in art and in science, and in the lives of both people and businesses. They are comprised both of what we control through our own effort, intuition and hard work, and of what we cannot control: chance events, unexpected developments, and fortune—both good and bad.

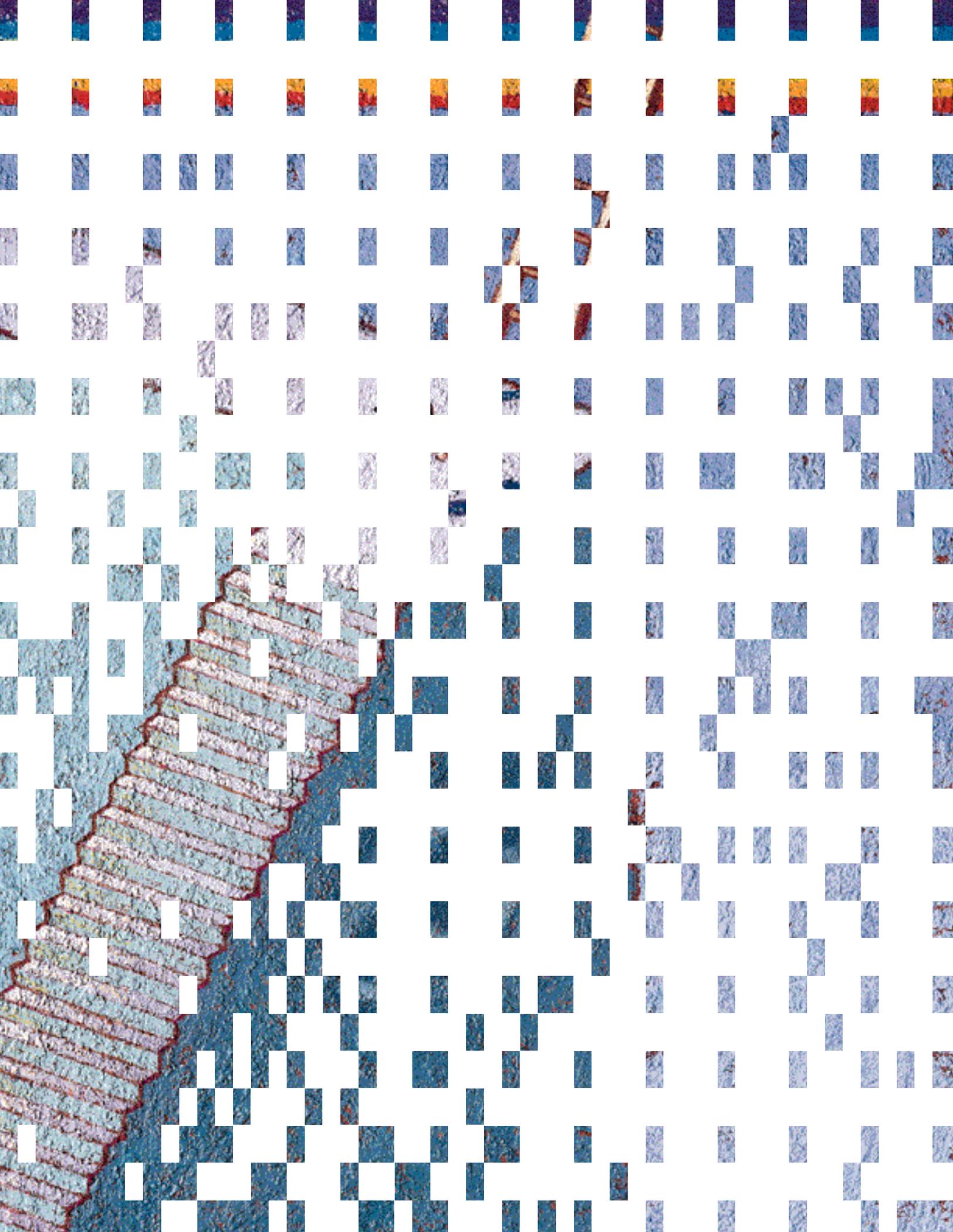
These are patterns that can be viewed, appreciated and comprehended only in retrospect: they are reflected in mirrors that face the past. Yet their existence assures us that they will continue to emerge as consequences of what we do today, and what we will do tomorrow. Upon the conclusion of the Battle of Britain, Winston Churchill remarked that it was not the beginning of the end, but the end of the beginning. In quite a different context, so it is with the emerging patterns defining the work in progress that is Lattice Semiconductor at the intersection of our 1997 and 1998 fiscal years.

Looking back from this intersection, our achievements over the past eight years mark just how far Lattice Semiconductor has progressed. Those years, and the Annual Reports that have accompanied them, seem now to be individual chapters in a novel that has reached a defining, though by no means conclusive, point. Much more remains to be written than has already been documented. Nonetheless, it now seems appropriate to briefly reflect upon Lattice Semiconductor—a work in progress.

What seemed impossible to many less than ten years ago has been accomplished.

We have endured and prospered; we have battled successfully against all

LIKE SNOWFLAKES ON A WINDOW PANE, PATTERNS EMERGE ALL AROUND US—IN ART AND SCIENCE, AND IN THE LIVES OF PEOPLE AND BUSINESSES. THEY ARE COMPRISED BOTH OF WHAT WE CONTROL THROUGH OUR OWN EFFORT, AND OF WHAT WE CANNOT CONTROL: CHANCE EVENTS, UNEXPECTED DEVELOPMENTS, AND FORTUNE—BOTH GOOD AND BAD.



odds and all competitors; and we have steadily progressed in the programmable logic device (PLD) industry from pretender to contender. We succeeded in the commodity low-density PLD business through grit, hard work and an innovative technology—electrically erasable CMOS (E2CMOS®)—that was superior to the prevailing bipolar and UV CMOS standards. As larger gate count, “high-density” PLD silicon devices clearly defined the future of the PLD industry, we again prevailed with products based on an advanced and proprietary technology: in-system programmability (ISP™). Where Lattice ISP products were once an interesting niche for the high-density PLD market, they have now become the industry standard. Along the way, we also developed and delivered PLD design software that is today without equal in our industry. And beginning as a little-known company, and brand, Lattice Semiconductor is today winning a disproportionately high percentage of new software seats and “design-in's.”

These accomplishments, though, mark only the prelude. This “end of the beginning”, this intersection of 1997 and 1998, simply sets the stage for what we must now set about to accomplish. But, while prelude, it is one that resulted in a business and financial performance with which we are well pleased.

Last year was an especially challenging one for the semiconductor industry, as only a few, select companies managed to grow. We are proud to be among this elite group. In fact, fiscal year 1997 marked our eighth consecutive year of record revenue and net income.

Revenue for the year was a record \$204.1 million, an increase of three percent over the \$198.2 million reported last year. Net income for the year was a record \$45.0 million (\$1.96 per share), an increase of eight percent

LOOKING BACK, OUR ACHIEVEMENTS OVER THE PAST EIGHT YEARS MARK JUST HOW FAR LATTICE SEMICONDUCTOR HAS PROGRESSED. THOSE YEARS SEEM NOW TO BE INDIVIDUAL CHAPTERS IN A NOVEL THAT HAS REACHED A DEFINING, THOUGH BY NO MEANS CONCLUSIVE, POINT. MUCH MORE REMAINS TO BE WRITTEN THAN HAS ALREADY BEEN DOCUMENTED.



over the \$41.8 million (\$1.99 per share) reported last year. During fiscal 1997, we also added \$13.5 million in cash and \$61.7 million in shareholders' equity to an already strong balance sheet that continues to remain debt free.

However, as important as our overall financial performance is, even more notable is the now visible pattern emerging from our results and achievements. Our innovative high-density ISP products, which have served as our growth engine for the past three years, comprised, for the first time, the majority of our revenue. In fiscal year 1997, high-density revenue reached \$109 million, a growth rate of 49 percent over the \$73 million reported in fiscal year 1996. This performance allowed us to gain share in the attractive high-density PLD market for the fifth consecutive year. During fiscal year 1997, we also sold and installed a record number of software seats, sowing the seeds for future silicon design wins and revenue growth.

Given our robust balance sheet, we were also able to continue our pattern of forging deeper business relationships with our foundry partners. In March 1997, we announced the completion of a new advance purchase payment agreement with Seiko Epson Corporation. This \$150 million investment will ensure that we have access to the eight-inch sub-micron technology and wafer capacity that is essential to the continued growth of our high-density business.

It is true that no man is an island, and that no company, no matter how diligent, can by itself completely control its destiny. Our strategies, tactics and efforts are but one, albeit crucial, part of the emerging patterns that have begun to more clearly reveal the future configuration of the PLD industry,

AS IMPORTANT AS OUR OVERALL FINANCIAL PERFORMANCE IS, EVEN MORE NOTABLE IS THE NOW VISIBLE PATTERN EMERGING FROM OUR RESULTS AND ACHIEVEMENTS. OUR INNOVATIVE HIGH-DENSITY ISP PRODUCTS, WHICH HAVE SERVED AS OUR GROWTH ENGINE FOR THE PAST THREE YEARS, COMPRISED, FOR THE FIRST TIME, THE MAJORITY OF OUR REVENUE.



and Lattice Semiconductor's place within it. The dots begin to connect... the details begin to coalesce...the larger pattern is revealed. As we have stood close to the canvas and painted with passion, other swirls of color and texture, not under our control, have also been applied. Now, as we step away, the vista is more colorful, coherent and inviting than we had ever dared thought possible. It is our good fortune that other brushes have touched our canvas, creating emerging patterns that provide Lattice Semiconductor enormous opportunity.

Consider, for example, our pioneering effort in developing and delivering in-system programmability products to the high-density PLD marketplace. Yes, we invented ISP products, and we believed, fervently, that ISP products would provide us a compelling competitive advantage. But the ultimate arbiter of success or failure is not the company but the customer. Today, the pattern is easily seen: the entire PLD industry—driven by customer demand --has adopted ISP products as a high-density PLD industry standard.

Consider design software, the single most important enabling technology for today's complex PLD industry. Lattice Semiconductor was late in providing our own software tools—but that time was well spent in developing open, core software that was highly compatible with today's industry standards and third party electronic design automation (EDA) tools. What once was a weakness is now a formidable strength. As the design community adopts hardware description language (HDL) methodologies, abandoning schematic capture, the demand is suddenly for open, non-proprietary design tools that effectively implement this emerging standard.

THE POTENTIAL FOR A MASSIVE SHIFT IN THE PLD INDUSTRY IS NOW IN PLACE. THAT SHIFT IS ESSENTIALLY THE JOURNEY FROM SILICON... TO SOFTWARE... AND BEYOND. AND, WITH THE MOST COMPREHENSIVE PRODUCT PORTFOLIO OF COMPLEX PLD (CLPD) SILICON, AND HDL-OPTIMIZED SOFTWARE, LATTICE IS EXCEPTIONALLY WELL POSITIONED TO EMBARK UPON THIS JOURNEY.



Abruptly, the existing installed base of proprietary PLD design tools is vulnerable:

no proprietary software can successfully compete in an HDL environment. However, since Lattice Semiconductor's software has always been open, and was designed with HDL synthesis in mind, this “external brushstroke” plays to our advantage. If our ISP products leveled the high-density playing field, then the emergence of HDL now gives Lattice an opportunity to assume the high ground. No longer will we be obligated to assault the formidable barriers of competitors' proprietary software installations.

The implications of converging technologies, shifting demand from commodity,

low-density PLD devices to proprietary, high-density devices, and the resulting evolution of the PLD marketplace, are enormous. The potential for a massive shift in the PLD industry is now in place, and we expect it to play out over the next two years. That shift is essentially the journey from silicon...to software...and beyond. And, with the most comprehensive product portfolio of high-speed, high gate-count complex PLD (CPLD) silicon, and HDL-optimized software suited to the demands of today's designers, Lattice is exceptionally well-positioned to embark upon this journey.

An advantageous position, though, does not by itself assure an advantageous

conclusion. The emerging patterns bode well for Lattice Semiconductor. Nonetheless, while we recognize that not all is within our control, we must first and foremost attend to the business at hand. Programmable logic devices continue to increase in speed, density and capability. In fact, they will soon cease—if they have not already—to be a “niche” of the semiconductor industry, and will assume their rightful place as a main-

PROGRAMMABLE LOGIC DEVICES WILL ASSUME THEIR RIGHTFUL PLACE AS A MAINSTREAM ELECTRONIC DESIGN DEVICE. WHAT IS NOW REQUIRED IS A NEW PRODUCT ARCHITECTURE THAT WILL HARNESS THE POWER OF THE PLD, MAKING IT MORE USEFUL TO THE DESIGNER WHO MUST BE ABLE TO EXECUTE, WITH EASE, EVER MORE COMPLEX LOGIC FUNCTIONS.

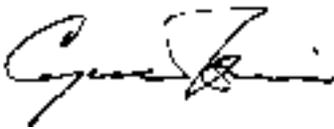


stream electronic design device. What is now required is a new generation of product architecture that will harness the power of the PLD, making it more useful to the designer who must be able to execute, with ease, ever more complex logic functions.

In that design imperative lies the importance of “intellectual property.” This is yet another emerging pattern, and it will be the harbinger of the next successful generation of PLDs. Lattice Semiconductor must, and will, make it even easier for its customers to utilize a PLD. We will build into our products predefined and proven “building blocks” of logic functionality that will drastically reduce the design time and effort required to produce a customer-specified system function. As we succeed in this effort, PLDs themselves will access a broader market as they capture a wider range of system applications.

The patterns emerge...from the original GAL®, to ISP products, and now to in-system programmable PLDs incorporating intellectual property (“ISP/IP”). Not all is within our control. But we will continue, more assiduously than ever, to pursue the path of our success. If we do that well, as we expect to, then the emerging patterns will continue to favor our efforts.

Thank you.



Cyrus Tsui
President, Chief Executive and Chairman of the Board

THE PATTERNS EMERGE...FROM THE ORIGINAL GAL, TO ISP PRODUCTS, AND NOW TO IN-SYSTEM PROGRAMMABLE PLDS INCORPORATING INTELLECTUAL PROPERTY ("ISP/IP"). NOT ALL IS WITHIN OUR CONTROL. BUT WE WILL CONTINUE TO PURSUE THE PATH OF OUR SUCCESS. IF WE DO THAT WELL, THEN THE EMERGING PATTERNS WILL CONTINUE TO FAVOR OUR EFFORTS.



This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Actual results could differ materially from those projected in the forward-looking statements as a result of the factors set forth in the section entitled "Factors Affecting Future Results" and elsewhere in this report.

Lattice Semiconductor Corporation (the "Company"), founded in 1983 and based in Hillsboro, Oregon, designs, develops and markets high performance programmable logic devices ("PLDs") and related development system software. The Company is the inventor and world's leading supplier of in-system programmable ("ISP™") logic devices. PLDs are standard semiconductor components that can be configured by the end customer as specific logic functions, enabling shorter design cycle times and reduced development costs. The Company's end customers are primarily original equipment manufacturers ("OEMs") in the fields of communications, computing, computer peripherals, instrumentation, industrial controls and military systems. Nearly one-half of the Company's revenue is derived from international sales, mainly in Europe and Asia.

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, the percentage of revenue represented by selected items reflected in the Company's consolidated statement of operations.

	YEAR ENDED		
	MAR. 29, 1997	MAR. 30, 1996	APR. 1, 1995
Revenue	100%	100%	100%
Costs and expenses:			
Cost of products sold	41	41	41
Research and development	14	14	16
Selling, general and administrative	16	16	17
	71	71	74
Income from operations	29	29	26
Interest and other income (net)	4	3	2
Income before provision for income taxes	33	32	28
Provision for income taxes	11	11	9
Net income	22%	21%	19%

Revenue Revenue was \$204.1 million in fiscal 1997, an increase of 3% over fiscal 1996. Fiscal 1996 revenue of \$198.2 million represented an increase of 38% from the \$144.1 million recorded in fiscal 1995. The majority of the Company's revenue in fiscal 1997 was derived from the sale of products that address the high-density segment of the programmable logic market. The majority of the Company's revenue growth for the periods presented resulted from the sales of new products, primarily high-density products. Increases in the sales of the Company's high-density products have been significant and have grown consistently as a percentage of the Company's overall revenue for the fiscal periods presented.

Revenue from international sales was approximately 49%, 48% and 47% of total revenue for fiscal 1997, 1996 and 1995, respectively. The Company expects export sales to continue to represent a significant portion of revenue. See "Factors Affecting Future Results."

Overall average selling prices, while remaining relatively constant during the fiscal 1995 period, increased during fiscal 1996 and again during fiscal 1997. This was due primarily to a higher proportion of high-density products in the revenue mix. Although selling prices of mature products generally decline over time, this decline is at times offset by higher selling prices of new products. The Company's ability to maintain its recent trend of revenue growth is in large part dependent on the continued development, introduction and market acceptance of new products.

Gross Margin The Company's gross margin as a percentage of revenue was 59% for all three fiscal years presented. Profit margins on older products tend to decrease over time as selling prices decline, but the Company's strategy has been to offset these decreases by introducing new products with higher margins.

Research and Development Research and development expense was \$27.8 million, \$26.8 million and \$22.9 million in fiscal 1997, 1996 and 1995, respectively. Spending increases were related primarily to the development of new technologies and new products, including the Company's high-density product families and related software development tools. The Company believes that a continued commitment to research and development is essential in order to maintain product leadership in its existing product families and to provide innovative new product offerings, and therefore expects to continue to make significant investments in research and development in the future.

Selling, General and Administrative Selling, general and administrative expense was \$33.6 million, \$31.3 million and \$25.0 million in fiscal 1997, 1996 and 1995, respectively. Spending increases were primarily due to expansion of the Company's sales force, the addition of field applications engineers to provide enhanced customer assistance, and higher sales commissions associated with higher revenue levels. Selling, general and administrative expense as a percentage of revenue was 16% in fiscal 1997 and 1996, a slight decrease from 17% in fiscal 1995.

Income from Operations Income from operations increased 2%, from \$57.8 million to \$59.0 million, from fiscal 1996 to fiscal 1997, and increased 55%, from \$37.3 million, between fiscal 1995 and fiscal 1996. Income from operations increased as a percentage of revenue, from 26% in fiscal 1995 to 29% in fiscal 1996 and fiscal 1997.

Interest and Other Income Interest and other income (net of expense) increased by approximately \$3.3 million from fiscal 1996 to fiscal 1997, and by approximately \$2.1 million from fiscal 1995 to fiscal 1996. The increase in both fiscal years was due to higher cash and investment balances resulting from the Company's follow-on public offering of common stock in November 1995, cash generated from operations and common stock issuance from employee stock option exercises.

Provision for Income Taxes The Company's effective tax rate was 33.5% for fiscal 1997 as compared to 33.9% and 33.6% recorded in fiscal 1996 and 1995, respectively. The fiscal 1997 decrease was primarily due to increased benefit from tax-exempt investment income. The fiscal 1996 increase was due to the absence of tax credit carryforwards available in prior years, although this increase was offset somewhat by lower state taxes.

Deferred tax asset valuation allowances are recorded to offset deferred tax assets that can only be realized by earning taxable income in distant future years. Management established the valuation allowances because it cannot determine if it is more likely than not that such income will be earned.

Net Income Net income increased 8%, from \$41.8 million to \$45.0 million, from fiscal 1996 to fiscal 1997, and increased 55%, from \$27.0 million, between fiscal 1995 and fiscal 1996. Net income increased as a percentage of revenue each fiscal year, from 19% in fiscal 1995 to 21% in fiscal 1996, and then to 22% in fiscal 1997.

FACTORS AFFECTING FUTURE RESULTS

Notwithstanding the objectives, projections, estimates and other forward-looking statements in this Annual Report, the Company's future operating results will continue to be subject to variations based on a wide variety of factors, including, but not limited to, the following: the Company's continued ability to obtain adequate wafer capacity supply commitments under competitive pricing terms, successful implementation of the Company's proprietary process technology, UltraMOS[®], at its wafer manufacturers, successful development and implementation of future new advanced process technologies, attainment of acceptable wafer manufacturing yields, the ability to achieve volume production at Seiko Epson Corporation's ("Seiko Epson") new eight-inch facility or United Integrated Circuit Corporation ("UICC") and potential interruptions in supply from the Company's wafer manufacturers and assembly contractors as a result of work stoppages, political instability or natural or man-made disasters.

The Company's operating results also depend in large part on various factors outside the Company's control such as general economic conditions, the cyclical nature of both the semiconductor industry and the markets addressed by the Company's products, sudden price fluctuations, general price erosion, substantial adverse currency exchange movements and changes in effective tax rates. The semiconductor industry is highly cyclical and has been subject to significant downturns at various times that have been characterized by diminished product demand, production overcapacity and accelerated

erosion of average selling prices. The Company's rate of growth in recent periods has been positively and negatively impacted by trends in the semiconductor industry. Any material imbalance in industry-wide production capacity relative to demand, shift in industry capacity toward products competitive with the Company's products, reduced demand or reduced growth in demand or other factors could result in a decline in the demand for or the prices of the Company's products and have a material adverse effect on the Company's operating results. The Company's operating results are also dependent upon international revenues which may be adversely affected by the imposition of government controls, export license requirements, trade restrictions, political instability, changes in tariffs and other factors outside the Company's control. Due to these and other factors, the Company's past results are a less useful predictor of future results than is the case in more mature and stable industries. The market price of the Company's common stock could be subject to significant fluctuations due to the inherent volatility of the semiconductor industry combined with the aforementioned and other factors, including variations in the Company's quarterly operating results and shortfalls in revenues or earnings from levels expected by securities analysts. In addition, the stock market can experience significant price fluctuations, which often are unrelated to the operating performance of the specific companies whose stocks are traded. Broad market fluctuations, as well as economic conditions generally and in the semiconductor industry specifically, may adversely affect the market price of the Company's common stock.

In addition, the Company's operating results are subject to variations based upon the following competitive factors: introduction of new products on a timely basis that meet market needs at competitive prices with acceptable margins, market acceptance of the Company's new and proprietary products and proprietary software development tools, variations in product mix, scheduling, rescheduling and cancellation of large orders, successful protection of the Company's intellectual property rights, potential litigation relating to competitive patents and intellectual property and the Company's ability to attract and retain highly qualified technical and management personnel.

For further explanation of the factors set forth above, see "Factors Affecting Future Results" in Item 1 of the Company's Annual Report on Form 10-K for the fiscal year ended March 29, 1997.

LIQUIDITY AND CAPITAL RESOURCES

As of March 29, 1997, the Company's principal source of liquidity was \$228.6 million of cash and short-term investments, an increase of \$13.5 million from the balance of \$215.2 million at March 30, 1996. This increase was primarily the result of cash generated from operations and common stock issuance from employee stock option exercises in excess of cash required for foundry investments and wafer supply advances made in fiscal 1997 as further described below. The Company also has available an unsecured \$10 million demand bank credit facility with interest due on outstanding balances at a money market rate. This facility has not been used.

Accounts receivable and deferred income on sales to distributors increased \$3.1 million and \$1.4 million, or 13% and 8%, respectively, as compared to the balances at March 30, 1996. These increases were primarily due to higher revenue levels in the fiscal 1997 fourth quarter and the timing of billings to end customers and distributors. Inventories increased by \$6.0 million, or 28%, versus amounts recorded at March 30, 1996 due to increased production in anticipation of future requirements. Prepaid expenses and other current assets decreased by \$2.8 million, or 14%, as compared to the balance at March 30, 1996 due primarily to a decrease in the current portion of wafer supply advances. The \$36.8 million increase in Foundry investments, advances and other assets was primarily due to the \$25.8 million paid in January 1997 in the second of three planned payments representing the Company's investment in UICC. In March 1997, the Company paid approximately \$17.0 million to Seiko Epson pursuant to a second advance payment purchase agreement. This advance offset the decline in wafer supply advances related to fiscal 1997 wafer deliveries. See below and Note 4 of Notes to Consolidated Financial Statements. Accrued payroll obligations increased \$2.2 million, or 29%, as compared to the balance at March 30, 1996 due to higher variable compensation, increased headcount and timing of payments. Income taxes payable decreased \$4.0 million, or 84%, as compared to the balance at March 30, 1996 due to the timing of tax deductions and payments.

Stockholders' equity increased by approximately \$61.7 million, primarily due to net income of approximately \$45.0 million for fiscal 1997 and net proceeds from common stock issuance.

Capital expenditures were approximately \$10.6 million, \$12.6 million and \$6.3 million for fiscal years 1997, 1996 and 1995, respectively. These expenditures consisted primarily of manufacturing test equipment, lab equipment, engineering workstations, buildings and building improvements. The increase in fiscal 1997 and 1996 capital expenditures over fiscal 1995 was associated with higher production levels noted above and included increased investment in manufacturing test equipment to support the growth in revenue of high-density products.

The Company currently anticipates capital expenditures of approximately \$20 million to \$30 million for the fiscal year ending March 28, 1998. A significant portion of these expenditures is planned for improvements and expansions to the Company's facilities and manufacturing capacity.

The majority of the Company's silicon wafer purchases are denominated in Japanese yen. The Company maintains yen-denominated bank accounts and bills its Japanese customers in yen. The yen bank deposits utilized to hedge yen-denominated wafer purchases are accounted for as identifiable hedges against specific and firm wafer purchases.

The Company entered into a series of agreements with United Microelectronics Corporation ("UMC") in September 1995 pursuant to which the Company has agreed to join UMC and several other companies to form a separate Taiwanese Company, UICC, for the purpose of building and operating an advanced semiconductor manufacturing facility in Taiwan, Republic of China. Under the terms of the agreements, the Company will invest approximately \$53 million, payable in three installments over two years, for an approximately 10% equity interest in UICC and the right to receive a percentage of the facility's wafer production at market prices. The timing of the payments is related to certain milestones in the development of the advanced semiconductor manufacturing facility. The first payment, in the amount of approximately \$13.7 million, was paid in January 1996, the second payment, in the amount of approximately \$25.8 million, was paid in January 1997, and the final payment is anticipated to be required within the six-month period ending December 1997.

In March 1997, the Company entered into a second advance payment production agreement with Seiko Epson and its affiliated U.S. distributor, S-MOS Systems Inc. ("SMOS") under which it agreed to advance approximately \$90 million, payable over two years, 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. The agreement calls for wafers to be supplied by Seiko Epson through SMOS pursuant to purchase agreements with SMOS. The Company also has an option under this agreement to advance Seiko Epson an additional \$60 million for additional wafer supply under similar terms. The first payment pursuant to this agreement, approximately \$17.0 million, was made during March 1997. As a result of the future payments to UICC and Seiko Epson, the Company's cash and short-term investments will be reduced by a minimum of approximately \$86.5 million over the time period of the remaining payments.

The Company believes that its existing sources of liquidity and expected cash generated from operations will be adequate to fund the Company's anticipated cash needs for at least the next twelve months, including the anticipated required payments to UICC and Seiko Epson during this time period.

In an effort to secure additional wafer supply, the Company may from time to time consider various financial arrangements including joint ventures with, minority investments in, advance purchase payments to, loans to, or similar arrangements with independent wafer manufacturers in exchange for committed wafer capacity. To the extent that the Company pursues any such additional financial arrangements, additional debt or equity financing may be required. There can be no assurance that any such additional funding could be obtained when needed or, if available, on terms acceptable to the Company.

SELECTED FINANCIAL DATA

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED				
	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995	APRIL 2, 1994	APRIL 3, 1993
STATEMENT OF OPERATIONS DATA:					
Revenue	\$204,089	\$198,167	\$ 144,083	\$ 126,241	\$ 103,391
Costs and expenses:					
Cost of products sold	83,736	82,216	58,936	53,266	43,650
Research and development	27,829	26,825	22,859	20,636	16,530
Selling, general and administrative	33,558	31,323	25,020	22,299	20,465
	145,123	140,364	106,815	96,201	80,645
Income from operations	58,966	57,803	37,268	30,040	22,746
Interest and other income, net	8,712	5,442	3,349	2,566	2,470
Income before provision for income taxes	67,678	63,245	40,617	32,606	25,216
Provision for income taxes	22,673	21,461	13,651	10,116	7,817
Net income	\$ 45,005	\$ 41,784	\$ 26,966	\$ 22,490	\$ 17,399
Net income per share	\$ 1.96	\$ 1.99	\$ 1.41	\$ 1.19	\$ 0.94
Weighted average common and common equivalent shares outstanding	22,973	20,979	19,164	18,946	18,458

BALANCE SHEET DATA:

Working capital	\$267,669	\$244,649	\$ 106,021	\$ 105,007	\$ 79,878
Total assets	403,462	342,935	192,917	146,093	128,876
Stockholders' equity	360,491	298,768	157,797	125,068	98,481

	YEAR ENDED MARCH 29, 1997				YEAR ENDED MARCH 30, 1996			
	FOURTH QUARTER	THIRD QUARTER	SECOND QUARTER	FIRST QUARTER	FOURTH QUARTER	THIRD QUARTER	SECOND QUARTER	FIRST QUARTER
Revenue	\$56,268	\$51,015	\$48,638	\$48,168	\$53,008	\$51,538	\$48,608	\$45,013
Gross profit	\$33,332	\$30,048	\$28,643	\$28,330	\$31,094	\$30,195	\$28,418	\$26,244
Net income	\$12,819	\$11,278	\$10,460	\$10,448	\$12,097	\$11,063	\$ 9,778	\$ 8,846
Net income per share	\$ 0.55	\$ 0.49	\$ 0.46	\$ 0.46	\$ 0.54	\$ 0.52	\$ 0.49	\$ 0.45

ALL SHARE AND PER SHARE AMOUNTS HAVE BEEN ADJUSTED TO REFLECT THE THREE-FOR-TWO STOCK SPLIT EFFECTED IN THE FORM OF A STOCK DIVIDEND WHICH WAS PAID ON JULY 6, 1993.

CONSOLIDATED BALANCE SHEET

(IN THOUSANDS, EXCEPT SHARE AND PAR VALUE AMOUNTS)

MARCH 29,
1997

MARCH 30,
1996

Assets

Current assets:

Cash and cash equivalents	\$ 53,949	\$ 54,600
Short-term investments	174,698	160,570
Accounts receivable, net	25,940	22,884
Inventories (note 2)	27,809	21,761
Prepaid expenses and other current assets (note 9)	16,519	19,301
Deferred income taxes (note 7)	11,725	9,700
Total current assets	310,640	288,816
Foundry investments, advances and other assets (notes 4 and 9)	65,419	28,648
Property and equipment, less accumulated depreciation (note 3)	27,403	25,471
	\$403,462	\$342,935

Liabilities and Stockholders' Equity

Current liabilities:

Accounts payable and accrued expenses (note 9)	\$ 14,276	\$ 15,015
Accrued payroll obligations	9,648	7,456
Income taxes payable (note 7)	782	4,800
Deferred income	18,265	16,896
Total current liabilities	42,971	44,167
Commitments and contingencies (notes 4, 6, 9, 10 and 11)	—	—
Stockholders' equity (note 8):		
Preferred stock, \$.01 par value, 10,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$.01 par value, 100,000,000 shares authorized; 22,877,724 and 22,123,069 shares issued and outstanding	229	221
Paid-in capital	198,667	181,957
Retained earnings	161,595	116,590
	360,491	298,768
	\$403,462	\$342,935

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED		
	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995
Revenue	\$204,089	\$198,167	\$144,083
Costs and expenses:			
Cost of products sold (note 9)	83,736	82,216	58,936
Research and development	27,829	26,825	22,859
Selling, general and administrative (note 12)	33,558	31,323	25,020
	145,123	140,364	106,815
Income from operations	58,966	57,803	37,268
Other income (expense):			
Interest income	8,886	5,570	3,437
Other expense, net	(174)	(128)	(88)
Income before provision for income taxes	67,678	63,245	40,617
Provision for income taxes (note 7)	22,673	21,461	13,651
Net income	\$ 45,005	\$ 41,784	\$ 26,966
Net income per share	\$ 1.96	\$ 1.99	\$ 1.41
Weighted average number of common and common equivalent shares outstanding	22,973	20,979	19,164

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(IN THOUSANDS, EXCEPT PAR VALUE)	COMMON STOCK		PAID-IN CAPITAL	RETAINED EARNINGS	TOTAL
	(\$.01 PAR VALUE) SHARES	AMOUNT			
Balances, April 2, 1994	18,411	\$ 184	\$ 77,044	\$ 47,840	\$ 125,068
Common stock issued	479	5	3,659	—	3,664
Tax benefit of option exercises	—	—	2,133	—	2,133
Other	—	—	(34)	—	(34)
Net income for fiscal 1995	—	—	—	26,966	26,966
Balances, April 1, 1995	18,890	189	82,802	74,806	157,797
Net proceeds from public offering	2,500	25	86,676	—	86,701
Other common stock issued	733	7	5,416	—	5,423
Tax benefit of option exercises	—	—	6,961	—	6,961
Other	—	—	102	—	102
Net income for fiscal 1996	—	—	—	41,784	41,784
Balances, March 30, 1996	22,123	221	181,957	116,590	298,768
Common stock issued	755	8	10,516	—	10,524
Tax benefit of option exercises	—	—	6,179	—	6,179
Other	—	—	15	—	15
Net income for fiscal 1997	—	—	—	45,005	45,005
Balances, March 29, 1997	22,878	\$ 229	\$198,667	\$161,595	\$360,491

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF CASH FLOWS

(IN THOUSANDS)	YEAR ENDED		
	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995
Cash flow from operating activities:			
Net income	\$ 45,005	\$ 41,784	\$ 26,966
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Depreciation and amortization	8,629	7,137	6,007
Deferred income taxes	(2,025)	(2,398)	(1,781)
Changes in assets and liabilities:			
Accounts receivable	(3,056)	(4,737)	(6,486)
Inventories	(6,048)	(7,630)	(284)
Prepaid expenses and other current assets	(750)	(450)	(100)
Foundry investments, advances and other assets	(33,239)	(3,087)	(42,673)
Accounts payable and accrued expenses	(739)	2,241	6,516
Accrued payroll obligations	2,192	2,067	1,799
Income taxes payable	(4,018)	(406)	1,115
Deferred income	1,369	5,145	4,665
Net cash provided (used) by operating activities	7,320	39,666	(4,256)
Cash flow from investing activities:			
Purchase of short-term investments, net	(14,128)	(79,457)	(5,874)
Proceeds from sale of fixed assets	—	98	—
Capital expenditures	(10,561)	(12,591)	(6,299)
Net cash used by investing activities	(24,689)	(91,950)	(12,173)
Cash flow from financing activities:			
Net proceeds from issuance of common stock	16,718	99,187	5,763
Net cash provided by financing activities	16,718	99,187	5,763
Net (decrease) increase in cash and cash equivalents	(651)	46,903	(10,666)
Beginning cash and cash equivalents	54,600	7,697	18,363
Ending cash and cash equivalents	\$ 53,949	\$ 54,600	\$ 7,697

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

NOTE 1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations Lattice Semiconductor Corporation (the “Company”), founded in 1983 and based in Hillsboro, Oregon, designs, develops and markets high performance programmable logic devices (“PLDs”) and related development system software. The Company is the inventor and world’s leading supplier of in-system programmable (“ISP™”) logic devices. PLDs are standard semiconductor components that can be configured by the end customer as specific logic functions, enabling shorter design cycle times and reduced development costs. The Company’s end customers are primarily original equipment manufacturers (“OEMs”) in the fields of communications, computing, computer peripherals, instrumentation, industrial controls and military systems. Nearly one-half of the Company’s revenue is derived from international sales, mainly in Europe and Asia.

Fiscal Reporting Period and Principles of Consolidation The Company reports on a 52- or 53-week fiscal year, which ends on the Saturday closest to March 31. The accompanying consolidated financial statements include the accounts of Lattice Semiconductor Corporation and its wholly owned foreign subsidiaries, Lattice GmbH, Lattice Semiconducteurs SARL, Lattice Semiconductor KK, Lattice Semiconductor Shanghai Co., Ltd., Lattice Semiconductor Asia Ltd., Lattice Semiconductor International Ltd., Lattice Semiconductor UK Ltd. and Lattice Semiconductor AB. The assets, liabilities, and results of operations of these entities were not material for any of the years presented in the consolidated financial statements and all inter-company accounts and transactions have been eliminated.

Cash Equivalents and Short-Term Investments The Company considers 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 have maturities greater than three months and less than one year, are composed of money market preferred stocks (\$109.0 million), government obligations (\$57.8 million), commercial paper (\$4.3 million) and time deposits (\$3.6 million) at March 29, 1997.

Effective beginning in fiscal 1995, the Company adopted Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (SFAS No. 115), which creates certain classification categories for such investments based on the nature of the securities and intent of the Company. SFAS No. 115 was adopted on a prospective basis, and the cumulative effect of adoption was not material. Pursuant to adoption, the Company has categorized its investments as held-to-maturity. Securities classified as held-to-maturity are stated at amortized cost with corresponding premiums or discounts amortized over the life of the investment to interest income. Amortized cost approximates market value at March 29, 1997.

Financial Instruments All of the Company’s significant financial assets and liabilities are recognized in the Consolidated Balance Sheet as of March 29, 1997 and March 30, 1996. The value reflected in the Consolidated Balance Sheet (carrying value) approximates fair value for the Company’s financial assets and liabilities. The Company estimates the fair value of its 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 Effective beginning in the first quarter of fiscal 1995, the Company adopted Statement of Financial Accounting Standards No. 119, “Disclosures about Derivative Financial Instruments and Fair Value of Financial Instruments” (SFAS 119). In order to minimize exposure to foreign exchange risk with respect to its long-term investments made with foreign currencies as further described in note 4 of notes to consolidated financial statements, the Company has at times entered into foreign forward exchange contracts in order to hedge these transactions. These contracts are accounted for as identifiable hedges against firm Company commitments. Realized gain or loss with respect to these contracts for the fiscal periods presented was not material. As of March 29, 1997, the Company had no open foreign exchange contracts for the purchase or sale of foreign currencies.

The Company does not enter into derivative financial instruments for trading purposes.

Foreign Exchange The majority of the Company’s silicon wafer purchases are denominated in Japanese yen. The Company maintains yen-denominated bank accounts and bills its Japanese customers in yen. The yen bank deposits utilized to hedge yen-denominated wafer purchases are accounted for as identifiable hedges against specific and firm wafer purchases. Gains or losses from foreign exchange rate fluctuations on unhedged balances denominated in foreign currencies are reflected in other income. Realized and unrealized gains or losses were not significant for the fiscal periods presented.

Concentrations of Credit Risk Financial instruments which potentially expose the Company to concentrations of credit risk consist primarily of short-term investments and trade receivables. The Company places its investments through several financial institutions and mitigates 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 the Company’s credit and collection process. The

Company performs credit evaluations for all customers and secures transactions with letters of credit or advance payments where necessary. Write-offs for uncollected trade receivables have not been significant to date.

Revenue Recognition and Accounts Receivable Revenue from sales to OEM customers is recognized upon shipment. Certain of the Company's sales are made to distributors under agreements providing price protection and right of return on unsold merchandise. Revenue and cost relating to such distributor sales are deferred until the product is sold by the distributor and related revenue and costs are then reflected in income. Accounts receivable are shown net of allowance for doubtful accounts of \$874,000 and \$800,000 at March 29, 1997 and March 30, 1996, respectively.

No individual customer or distributor accounted for more than 10% of revenue in fiscal 1997. Revenue from one distributor was \$21.1 million for fiscal 1996. Revenue from two distributors was \$17.3 and \$16.1 million for fiscal 1995. Export revenue was approximately \$99.8 million, \$95.1 million and \$68.4 million for fiscal 1997, 1996 and 1995, respectively. Sales to Europe were approximately \$39.9 million, \$37.9 million and \$24.5 million, and to Asia \$52.6 million, \$52.4 million and \$40.6 million in fiscal 1997, 1996 and 1995, respectively.

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

Long-Lived Assets During the fiscal year ended March 29, 1997, the Company adopted the Financial Accounting Standards Board Statement No. 121 (SFAS 121), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", which requires the Company 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. The adoption of SFAS 121 did not have a material impact on the Company's financial condition or results of operations.

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 thirty years for buildings. Accelerated methods of computing depreciation are generally used for income tax purposes.

Translation of Foreign Currencies The Company translates accounts denominated in foreign currencies in accordance with Statement of Financial Accounting Standards No. 52, "Foreign Currency Translation." Translation adjustments related to the consolidation of foreign subsidiary financial statements have not been significant to date.

Research and Development Research and development costs are expensed as incurred.

Income Taxes Income taxes are calculated in accordance with SFAS No. 109, "Accounting for Income Taxes," which the Company adopted on a prospective basis in the first quarter of fiscal 1994. The cumulative effect of the adoption of SFAS 109 was not material.

Stock-Based Compensation The Company accounts for its employee and director stock options and employee stock purchase plan in accordance with provisions of the Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees." During 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (SFAS 123), "Accounting for Stock-Based Compensation." SFAS 123, effective for fiscal years beginning after December 31, 1995, provides an alternative to APB 25, but allows companies to account for employee and director stock-based compensation under the current intrinsic value method as prescribed by APB 25. The Company has continued to account for its employee and director stock plans in accordance with APB 25. Additional pro forma disclosures as required under SFAS 123 are presented in note 8 of notes to consolidated financial statements.

Net Income Per Share Net income per share is computed based on the weighted average number of shares of common stock and common stock equivalents assumed to be outstanding during the period (using the treasury stock method). Common stock equivalents consist of stock options and warrants to purchase common stock. All share and per share amounts presented in the accompanying consolidated financial statements and notes thereto have been adjusted to reflect the three-for-two stock split effected in the form of a stock dividend which was paid on July 6, 1993.

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128 (SFAS 128), "Earnings Per Share." In accordance with this pronouncement, the Company will adopt the new standard for periods ending after December 15, 1997.

Statement of Cash Flows Income taxes paid approximated \$22.6 million, \$17.3 million and \$11.9 million in fiscal 1997, 1996, and 1995, respectively. Interest paid does not differ materially from interest expense, which aggregated approximately \$152,000, \$42,000 and \$28,000 in fiscal 1997, 1996 and 1995, respectively.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the fiscal periods presented. Actual results could differ from those estimates.

Financial Presentation Certain prior year amounts in the consolidated financial statements have been reclassified to conform to the fiscal 1997 presentation.

NOTE 2. INVENTORIES

(IN THOUSANDS)	MARCH 29, 1997	MARCH 30, 1996
Work in progress	\$ 20,286	\$ 13,174
Finished goods	7,523	8,587
	\$ 27,809	\$ 21,761

NOTE 3. PROPERTY AND EQUIPMENT

(IN THOUSANDS)	MARCH 29, 1997	MARCH 30, 1996
Land	\$ 2,098	\$ 1,455
Buildings	7,132	5,892
Computer and test equipment	52,204	44,333
Office furniture and equipment	2,881	2,712
Leasehold and building improvements	2,501	2,465
	66,816	56,857
Accumulated depreciation and amortization	(39,413)	(31,386)
	\$ 27,403	\$ 25,471

NOTE 4. FOUNDRY INVESTMENTS, ADVANCES AND OTHER ASSETS

(IN THOUSANDS)	MARCH 29, 1997	MARCH 30, 1996
Foundry investments and other assets	\$ 48,399	\$ 14,141
Wafer supply advances	17,020	14,507
	\$ 65,419	\$ 28,648

The Company entered into a series of agreements with United Microelectronics Corporation ("UMC") in September 1995 pursuant to which the Company agreed to join UMC and several other companies to form a separate Taiwanese corporation, United Integrated Circuit 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, the Company will invest approximately \$53 million, payable in three installments over two years, for an approximately 10% equity interest in the corporation and the right to receive a percentage of the facility's wafer production at market prices. This investment is accounted for at cost. The timing of the payments is related to certain milestones in the development of the advanced semiconductor manufacturing facility. The first payment, in the amount of approximately \$13.7 million, was paid in January 1996, the second payment, in the amount of approximately \$25.8 million, was paid during January 1997, and the final payment is anticipated to be required within the six-month period ending December 1997.

In July 1994, the Company signed an agreement with Seiko Epson Corporation ("Seiko Epson") and its affiliated U.S. distributor, S-MOS Systems Inc. ("SMOS"), under which it advanced \$44 million to be used to finance additional sub-micron wafer manufacturing capacity and technological development. The advance is being repaid in the form of semiconductor wafers over a multi-year period. No interest income is recorded. Total wafer receipts under this agreement aggregated approximately \$18,042,000, \$10,713,000 and \$1,430,000 during fiscal 1997, 1996 and 1995, respectively. The balance sheet caption "Prepaid expenses and other current assets" at March 29, 1997 includes the remaining amount of such wafers to be received under this agreement, aggregating \$13,729,000.

In March 1997, the Company entered into a second advance payment production agreement with Seiko Epson and SMOS under which it agreed to advance approximately \$90 million, payable over two years, 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 SMOS pursuant to purchase agreements with SMOS. The Company also has an option under the agreement to advance Seiko Epson an additional \$60 million for additional wafer supply under similar terms. The first payment pursuant to this agreement, approximately \$17.0 million, was made during March 1997.

NOTE 5. CREDIT FACILITIES

The Company has available an unsecured \$10 million demand bank credit facility with interest due on outstanding balances at a money market rate. This facility has not been used.

NOTE 6. LEASE OBLIGATIONS

Certain facilities and equipment of the Company are leased under operating leases, which expire at various times through fiscal 2000. Rental expense under the operating leases was approximately \$984,000, \$993,000 and \$815,000 for fiscal 1997, 1996 and 1995, respectively.

Future minimum lease commitments at March 29, 1997 are as follows:

FISCAL YEAR	(IN THOUSANDS)
1998	\$ 691
1999	271
2000	45
	\$1,007

NOTE 7. INCOME TAXES

The components of the provision for income taxes for fiscal 1997, 1996 and 1995 are presented in the following table:

(IN THOUSANDS)	YEAR ENDED		
	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995
Current:			
Federal	\$22,308	\$21,550	\$13,849
State	2,390	2,309	1,583
	24,698	23,859	15,432
Deferred:			
Federal	(1,829)	(2,166)	(1,598)
State	(196)	(232)	(183)
	(2,025)	(2,398)	(1,781)
	\$22,673	\$21,461	\$13,651

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

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

(IN THOUSANDS)	YEAR ENDED		
	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995
Computed income tax expense at the statutory rate	\$23,687	\$22,136	\$14,216
Adjustments for tax effects of:			
State taxes, net	2,048	1,636	1,625
Research and development credits, current	(62)	(196)	(193)
Research and development and investment tax credit carryforwards	—	—	(243)
Nontaxable investment income	(2,579)	(1,506)	(1,020)
Other	(421)	(609)	(734)
	\$22,673	\$21,461	\$13,651

The components of the Company's net deferred tax asset under SFAS No. 109 were as follows:

(IN THOUSANDS)	MARCH 29, 1997	MARCH 30, 1996
Deferred income	\$ 7,102	\$ 6,343
Expenses and allowances not currently deductible	6,619	5,693
Total deferred tax assets	13,721	12,036
Valuation allowance	(1,996)	(2,336)
	\$11,725	\$ 9,700

The valuation allowances are recorded to offset deferred tax assets which can only be realized by earning taxable income in distant future years. Management established the valuation allowances because it cannot determine if it is more likely than not that such income will be earned.

NOTE 8. STOCKHOLDERS' EQUITY

Common Stock In November 1995, the Company completed its third public offering, consisting of 2,500,000 shares of common stock at \$36.63 per share. Net proceeds to the Company were approximately \$86.7 million after underwriting discount and offering expenses.

Stock Warrants The Company has issued to a vendor warrants to purchase 464,125 shares of common stock. Of this amount, 402,000 warrants were issued and 295,500 exercised prior to fiscal 1995. During fiscal 1995, the Company issued an additional 62,125 shares at \$17.38 per share. During fiscal 1996, the vendor exercised warrants for 45,000 shares, at an exercise price of \$20.17 per share. The rights to the remaining 123,625 warrants were forfeited in exchange for the issuance of a warrant to purchase 67,419 shares of common stock which were earned ratably from March 1996 through February 1997.

Stock Option Plans As of March 29, 1997, the Company had reserved 2,000,000 and 5,775,000 shares of common stock for issuance to officers and key employees under the 1996 Stock Option Plan and 1988 Stock Option Plan, respectively. The 1996 Plan options generally vest over four years in increments as determined by the Board of Directors and may have terms up to ten years. The 1988 Plan options are exercisable immediately and expire five years from the date of grant. The transfer of certain shares of common stock acquired through the exercise of 1988 Plan stock options is restricted under stock vesting agreements that grant the Company the right to repurchase unvested shares at the exercise price if employment is terminated. Generally, the Company's repurchase rights lapse quarterly over four years.

The 1993 Directors Stock Option Plan provides for the issuance of stock options to members of the Company's Board of Directors who are not employees of the Company; 225,000 shares of the Company's common stock are reserved for issuance thereunder. These options are granted at fair market value at the date of grant and generally become exercisable quarterly over a four-year period beginning on the date of grant and expire five years from the date of grant.

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

(NUMBER OF SHARES IN THOUSANDS)	YEAR ENDED					
	MARCH 29, 1997		MARCH 30, 1996		APRIL 1, 1995	
	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES UNDER OPTION	WEIGHTED-AVERAGE EXERCISE PRICE
Options outstanding at beginning of fiscal year	2,330	\$22.20	2,340	\$14.15	2,322	\$11.92
Options granted	827	30.82	807	33.37	548	18.54
Options canceled	(176)	28.31	(196)	14.90	(127)	16.77
Options exercised	(691)	13.31	(621)	8.79	(403)	6.33
Options outstanding at end of fiscal year	2,290	27.50	2,330	22.20	2,340	14.15

The following table summarizes information about stock options outstanding at March 29, 1997:

RANGE OF EXERCISE PRICES (NUMBER OF SHARES IN THOUSANDS)	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	NUMBER OF SHARES	WEIGHTED-AVERAGE REMAINING CONTRACT LIFE (IN YEARS)	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER OF SHARES	WEIGHTED-AVERAGE EXERCISE PRICE
\$10.17 – \$15.00	86	0.07	\$12.31	82	\$12.25
\$16.37 – \$23.50	439	1.27	18.38	275	18.38
\$23.75 – \$32.88	1,425	2.41	28.35	454	26.77
\$34.00 – \$51.88	340	2.96	39.76	70	36.50
	2,290	2.18	27.52	881	23.55

Stock Purchase Plan The Company's employee stock purchase plan was approved by the stockholders in August 1990, and became effective January 1, 1991. The plan 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 450,000 shares authorized to be issued under the plan, 57,421, 54,239 and 70,973 shares were issued during fiscal 1997, 1996 and 1995, respectively, and 57,809 shares were available for issuance at March 29, 1997.

Pro forma Disclosures The Company accounts for its stock options and employee stock purchase plan in conformity with APB 25 and has adopted the additional proforma disclosure provisions of SFAS 123.

The fair value, as defined by SFAS 123, for stock options and employee stock plan purchase rights was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	GRANTS FOR YEARS ENDED	
	MARCH 29, 1997	MARCH 30, 1996
Stock options:		
Expected volatility	46.4%	46.4%
Risk-free interest rate	6.1%	5.9%
Expected term	3 years	3 years
Dividend yield	0%	0%
Stock purchase rights:		
Expected volatility	36.7%	36.7%
Risk-free interest rate	5.3%	6.2%
Expected term	6 months	6 months
Dividend yield	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. The Company's stock options have characteristics which significantly differ 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. The Company's 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 was \$11.54 and \$12.44, and for stock purchase rights \$6.80 and \$5.49, for fiscal 1997 and 1996, respectively.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information is as follows:

	YEAR ENDED	
	MARCH 29, 1997	MARCH 30, 1996
Pro forma net income	\$40,681	\$ 38,836
Pro forma earnings per share	\$ 1.78	\$ 1.86

Because the SFAS 123 pro forma disclosure applies only to options granted subsequent to April 1, 1995, its pro forma effect will not be fully reflected until subsequent years. The effects on pro forma disclosures of applying SFAS 123 are not likely to be representative of the effects on pro forma disclosures in future years.

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

NOTE 9. TRANSACTIONS WITH PRINCIPAL SUPPLIERS

The majority of the Company's silicon wafers are currently manufactured by Seiko Epson in Japan and are sold to the Company through Seiko Epson's affiliated U.S. distributor, SMOS. The Chairman of the Board of SMOS is a member of the Company's Board of Directors.

The Company has signed two advance payment production agreements with Seiko Epson and SMOS, in July 1994 and March 1997, respectively, under which it has advanced or will advance cash to be used in conjunction with the construction of additional wafer capacity, with the advances being repaid in the form of semiconductor wafers over a multi-year period. These transactions are more fully described in note 4 of notes to consolidated financial statements.

The Company continues to purchase a portion of its wafer supply from Seiko Epson for cash using commercial terms. Cash wafer purchases totaled \$22.8 million, \$34.7 million and \$27.8 million for fiscal 1997, 1996 and 1995, respectively. Accounts payable and accrued expenses at March 29, 1997 and March 30, 1996 include \$1.9 and \$4.0 million, respectively, due this vendor. Open purchase commitments to this vendor approximated \$8.8 million at March 29, 1997.

In connection with the series of agreements recently entered into with UMC as described in note 4 of notes to consolidated financial statements, the Company currently receives production wafers. A significant interruption in supply from Seiko Epson through SMOS, or from UMC, would have a material adverse effect on the Company's business.

NOTE 10. EMPLOYEE BENEFIT PLANS

Profit Sharing Plan The Company 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 the operating income of the Company, as defined and calculated at the end of the second and fourth quarter of each fiscal year for each respective six-month period, is paid equally to qualified employees. In fiscal 1997, 1996 and 1995, approximately \$2.4 million, \$2.3 million and \$1.4 million, respectively, were charged against operations in connection with the plan.

Qualified Investment Plan In 1990, the Company adopted a 401(k) plan, which provides participants with an opportunity to accumulate funds for retirement. Under the terms of the plan, eligible participants may contribute up to 15% of their eligible earnings to the plan Trust. The plan allows for discretionary matching contributions by the Company; no such contributions occurred through fiscal 1996. Beginning in fiscal 1997, the Company matched eligible employee contributions of up to 5% of base pay. Company contributions are discretionary and vest over four years.

NOTE 11. COMMITMENTS AND CONTINGENCIES

The Company is exposed to certain asserted and unasserted potential claims. Patent and other proprietary rights infringement claims are common in the semiconductor industry and the Company has received a letter from a semiconductor manufacturer stating that it believes certain patents held by it cover products previously sold by the Company. While this manufacturer has offered to license certain of such patents to the Company, there can be no assurance that, on this or any other claim which may be made against the Company, the Company could obtain a license on terms or under conditions that would not have a material adverse effect to the Company.

NOTE 12. RELATED PARTY

Larry W. Sonsini is a member of the Company's Board of Directors and is presently the Chairman of the Executive Committee of Wilson, Sonsini, Goodrich & Rosati, a law firm that provides corporate legal services to the Company. Legal services billed to the Company aggregated approximately \$61,000, \$177,000 and \$46,000, respectively, for fiscal 1997, 1996 and 1995. Amounts payable to the law firm were not significant at March 29, 1997 or March 30, 1996.

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 at March 29, 1997 and March 30, 1996, and the results of their operations and their cash flows for each of the three years in the period ended March 29, 1997, in conformity with generally accepted accounting principles. 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 generally accepted auditing standards 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 the opinion expressed above.

Patricia Waterhouse CPA

Portland, Oregon
April 16, 1997

BOARD OF DIRECTORS

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

Mark O. Hatfield
Former U.S. Senator

Daniel S. Hauer¹
Chairman of the Board,
S-MOS Systems Inc.

Harry A. Merlo^{1,2}
President,
Merlo Corporation

Douglas C. Strain²
Vice Chairman and Founder,
Electro Scientific Industries, Inc.

Larry W. Sonsini
Partner and Chairman of the
Executive Committee,
Wilson, Sonsini, Goodrich & Rosati

OFFICERS

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

Steven A. Laub
Senior Vice President and
Chief Operating Officer

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

Jonathan K. Yu
Corporate Vice President,
Business Development

Martin R. Baker
Vice President and General Counsel

Randy D. Baker
Vice President, Manufacturing

Albert L. Chan
Vice President,
California Product Development

Stephen M. Donovan
Vice President, International Sales

Paul T. Kollar
Vice President, Sales

Rodney F. Sloss
Vice President, Finance

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

CORPORATE HEADQUARTERS

Lattice Semiconductor Corporation
5555 N.E. Moore Court
Hillsboro, Oregon 97124-6421
Telephone: 503/681-0118
Facsimile: 503/681-0347

LEGAL COUNSEL

Wilson, Sonsini, Goodrich & Rosati
Palo Alto, California

INDEPENDENT ACCOUNTANTS

Price Waterhouse LLP
Portland, Oregon

REGISTRAR AND TRANSFER AGENT

ChaseMellon Shareholder Services
520 Pike St., Suite 1220
Seattle, Washington 98101
800/522-6645

ANNUAL MEETING

The annual meeting of stockholders for
Lattice Semiconductor Corporation will
be held at the Portland Hilton Hotel,
921 S.W. Sixth Avenue, Portland,
Oregon 97204 on Monday, August 11,
1997, at 1:00 pm.

FORM 10-K

Financial information, including the
Company's Annual Report on Form 10-K,
as filed with the Securities and Exchange
Commission, and quarterly operating
results is available by accessing
<http://www.lsc.com> or by written or
telephone request to the Lattice share-
holder relations department.

COMMON STOCK

Lattice Semiconductor Corporation's
common stock is traded on the Nasdaq
National Market System under the symbol
"LSCC."

STOCK PRICE HISTORY

The following table sets forth the low
and high sale prices of the Company's
common stock for the last two fiscal years.

	Low	High
Fiscal 1996:		
First Quarter	23	37 ^{1/8}
Second Quarter	28 ^{7/8}	43
Third Quarter	27 ^{3/8}	42 ^{1/8}
Fourth Quarter	26 ^{3/8}	37 ^{3/8}
Fiscal 1997:		
First Quarter	21 ^{3/8}	36 ^{1/4}
Second Quarter	19 ^{3/4}	31 ^{1/2}
Third Quarter	27 ^{1/2}	47
Fourth Quarter	39 ^{3/4}	54 ^{7/8}

¹ MEMBER OF THE AUDIT COMMITTEE

² MEMBER OF THE COMPENSATION COMMITTEE



5555 N.E. Moore Court
Hillsboro, Oregon
97124-6421
USA