

MAPMAKERS...EXPLORATION. DISCOVERY. INNOVATION.



## FINANCIAL HIGHLIGHTS

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED		
	MARCH 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Revenue	<b>\$245,894</b>	\$204,089	\$198,167
Net income	<b>\$56,567</b>	\$45,005	\$41,784
Basic net income per share	<b>\$2.43</b>	\$2.00	\$2.06
Diluted net income per share	<b>\$2.37</b>	\$1.96	\$1.99
Cash and short-term investments	<b>\$267,110</b>	\$228,647	\$215,170
Total assets	<b>\$489,066</b>	\$403,462	\$342,935
Stockholders' equity	<b>\$434,686</b>	\$360,491	\$298,768

## 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. 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") of communications, computing, industrial controls and military systems. Approximately one-half of Lattice's revenue is derived from international sales, mainly in Europe and Asia. Lattice was founded in 1983 and is based in Hillsboro, Oregon.



They were called Treasure Ships, and they were the pride of a Chinese Grand Fleet that, from 1405 to 1433, made seven voyages into the Indian Ocean and as far as East Africa. Each Treasure Ship was 440 feet long, 180 feet wide and weighed 1,500 tons... 15 times the weight of contemporary Portuguese ships. Each was armed with cannon and sailed by a crew of 700. The largest seagoing vessels in the world, the Treasure Ships were part of a Chinese armada of more than 100 ships and almost 30,000 officers and men. By 1443, when Admiral Cheng Ho led the Fleet on its seventh voyage, more than twenty realms and sultanates from the Indies to East Africa had established relations with the Chinese Emperor Yung-lo, sending tribute and trading for goods. China's global power was beyond dispute.

China's role as a global explorer, discoverer and innovator ended with stunning swiftness, and world history was forever changed. By 1444 Admiral Cheng Ho was dead. Subsequent Emperors regarded exploration as little more than a wasteful extravagance, even making the building of large seagoing vessels illegal. As China turned inward, Portugal, Spain and Western Europe entered a golden era of naval expansion and empire building. Just 64 years after Admiral Cheng's death, the Portuguese Vasco da Gama circled Africa and entered the Indian Ocean, where only moments before, on the calendar of history, the Grand Fleet had reigned supreme. Such is the penalty paid by those who grow complacent and squander their advantage. And such are the rewards granted to those who continually explore and become "mapmakers." —Cyrus Tsui



**Just as “map” is both verb and noun, the mapmaker is both explorer and creator. So it was for those who sailed the great Treasure Ships of China ...**

#### **TO OUR SHAREHOLDERS:**

The “mapmaker” explores remote geographic regions, discovering paths never before traveled. But the making of maps requires more than exploration and discovery. The knowledge gained through exploration must be applied to create a product of enduring value — a map. Maps record and archive past discoveries. Yet the most enduring value of a map is that it invariably encourages and launches new cycles of exploration and discovery. In this way, a map breeds innovation. And those who control the maps control future exploration, discovery and, ultimately, innovation itself.

Lattice Semiconductor has always been a mapmaker, continually investigating “silicon territory.” Our maps chart the progress of semiconductor devices that reconfigure the boundaries and applications of programmable silicon. We explore, discover and innovate in order to prosper as a business within a very competitive environment.

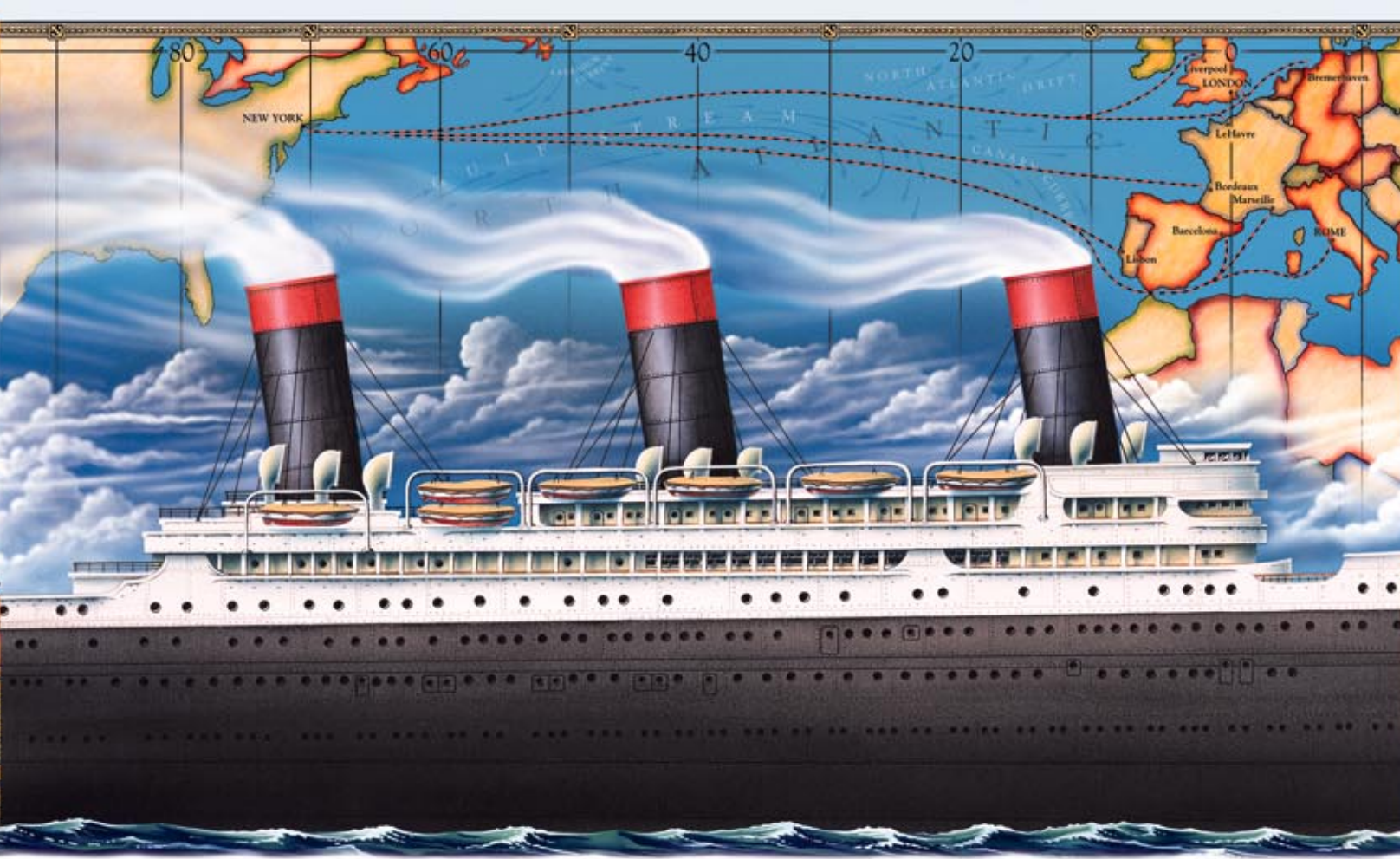
History makes it clear that most explorers fall short in their quests. Similarly, most companies fail to prosper. And so there are always those who choose caution, believing it safer to follow than to lead. But to accept the risk of exploration need not mean traveling a reckless path. Lattice Semiconductor chooses to be a mapmaker in order to reap the rewards of exploration, because we understand that the failure to explore leads to complacency and inevitable decline.

#### **FISCAL 1998 PERFORMANCE**

In our fiscal year, ended March 28, 1998, revenue was a record \$245.9 million, an increase of 20 percent over the \$204.1 million reported last year. Net income for the year was a record \$56.6 million (\$2.37 per share), an increase of 26 percent over the \$45.0 million (\$1.96 per share) reported last year. Annual ISP™ product revenue totaled over \$160 million, up 65 percent as compared to the \$97 million reported in fiscal year 1997. During the year we added \$38 million in cash and short-term investments to our balance sheet while also investing an additional \$49 million in foundry advances to support our long-term product plans.

In fiscal 1998, two external factors caused the market for Programmable Logic Device (PLD) products to grow more slowly than its historic rate. Although our financial performance was exceptional, Lattice Semiconductor was not immune to these factors.

**PLD Price Competitiveness:** As the programmable logic industry learns to better manage its costs, these savings are being passed on to customers in the form of reduced prices. There is nothing new in this. However, in fiscal 1998 the rate of price reduction was considerably more rapid than has historically been the case. These price reductions also reflect a heightened level of competition, as PLD companies seek not only to



...So it was for those who harnessed water and fire and powered their vessels with the pressure of steam...

expand the market and grow their business with improved products, but also to capture market share through cost reduction.

Lattice Semiconductor is very well positioned to cope with price competition of this nature, and ultimately to benefit from it. Our abilities to manage costs and to price products competitively are well documented. Lower cost PLDs will, over time, result in greater demand and expand the applications available to programmable logic, as there is less and less cost incentive for customers to select alternative logic solutions. We should benefit from this increased demand over the next one to two years, as the “new designs” we are winning today are translated into customer shipments.

**The Asian economy:** Asia accounts for some 20-25 percent of the worldwide semiconductor and PLD markets. So its economic difficulties, beginning in the second half of fiscal 1998, have slowed PLD industry growth. It is important, though, to note that Asia’s economic turmoil is an industry-wide concern, not one specific to Lattice Semiconductor. And it is important as well to note the current condition of the Asian economy will not fundamentally affect the longer-term ascendance of programmable logic as the preferred solution in a growing number of applications.

No one can predict what lingering effect price reductions and the Asian economy will have upon the PLD industry and, in turn, on Lattice Semiconductor. However, it is gratifying to report that despite these factors, Lattice Semiconductor in its fiscal year 1998

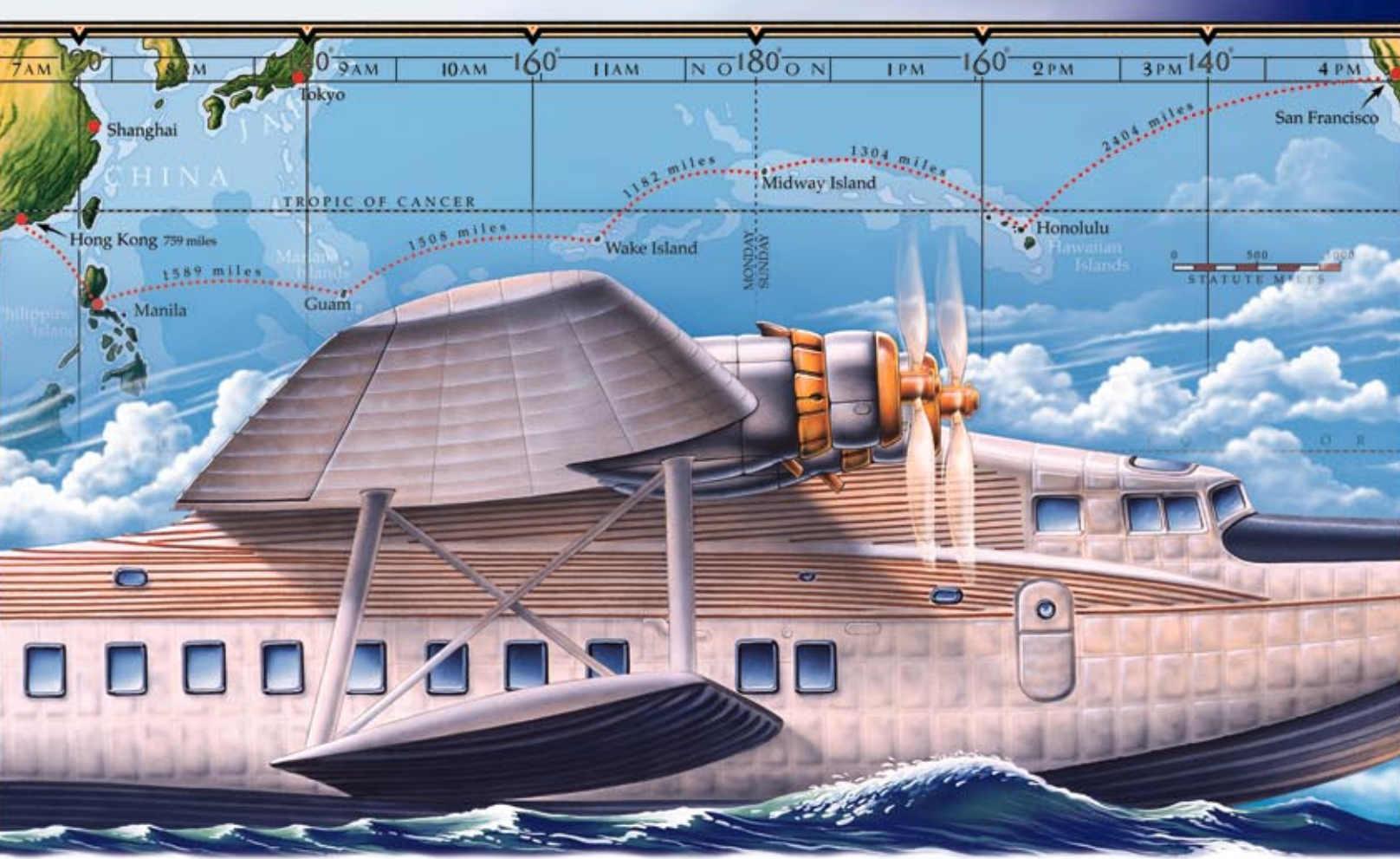
enjoyed its ninth consecutive year of both record revenue and profitability, with profitability continuing to grow faster than revenue. We realized substantial gains in our market share, with a growth of 20 percent in fiscal 1998 compared to an overall market growth of approximately 13 percent. Even with the outlook for our fiscal year 1999 somewhat clouded, we believe growth for Lattice Semiconductor will, in the long run, exceed that of the overall market.

#### FISCAL 1998 ACHIEVEMENTS

Our fiscal 1998 financial performance is the reward for those who would be mapmakers. But while dollars and cents measure our success, they are not the drivers of our success. Rather, in fiscal 1998, we continued to define our business in a way that guides our ongoing exploration, discovery and innovation. Although the PLD industry and marketplace are abundant with opportunities for growth and expansion, we nonetheless have never defined those opportunities in terms of programmable logic products alone.

*The business of Lattice Semiconductor is the business of programmability, not simply the devices that deliver logic to the customer.*

This distinction may appear modest, but its implications for our company are profound. Our focus on the applications of programmability, rather than PLDs alone, has consistently defined our corporate history and success. It led us to develop the original E<sup>2</sup>C<sup>2</sup>MOS<sup>®</sup> GAL<sup>®</sup> device when the bipolar fuse link PLD was, for



...So it was for those who inherited the legacy of the Wright Brothers and forged international exploration with “flying boats”...

ten years, the industry standard for the simple PLD (SPLD) market. Today, there are in effect no bipolar PLD products being produced: Lattice Semiconductor’s E<sup>2</sup>CMOS GAL is the industry standard.

Similarly, Lattice explored, discovered and innovated the in-system programmable (ISP) products that have now become a *de facto* standard for the complex PLD (CPLD) market. In fact, the ispPLD market is forecast to grow over the next 3-5 years at twice the rate of the overall PLD market. As the mapmaker of ispPLDs, Lattice Semiconductor has reaped many rewards. Fiscal year 1998 marked our ascendance to the number three position among the largest worldwide suppliers of PLDs, due in large part to our dominant position in this attractive ISP market.

Several new silicon and software product introductions in fiscal 1998 have reaffirmed our leadership in the ispPLD marketplace. Our portfolio of ISP silicon products is unmatched in both performance and breadth, and our new HDL design software has established new standards for ease of use, silicon utilization and performance.

Even the most courageous of mapmakers must chart a course and rely on a fundamental compass for safe passage. *For Lattice Semiconductor, the way in which we define our business is the means by which we navigate.* Where does this compass lead us? To a vision of programmability that extends beyond chip-level devices. That vision in turn leads us to explore the field programmability and reconfigurability of the circuit board.

It is an exploration, we believe, that can be handsomely rewarded. The printed circuit board (PCB) is populated today primarily by components that are rigid in their functions. These “fixed functionality” devices, once inserted on the board, cannot be altered; instead, they must be replaced by different devices, quite likely requiring that the board itself be redesigned. This is a barrier to electronic design that should be eliminated. Our customers, too, are makers of maps, and the value that Lattice Semiconductor must deliver is to make our customers’ own journeys of exploration as safe, efficient and easy as possible.

The past is so often prelude. As we have continually explored programmability at the chip level, in fiscal 1998 we began to explore devices that provide this capability at the board level. One tangible result of this exploration is the ispGDX™, a new family of digital crosspoint switches that charts a new course for in-system programmable technology at the board level. Based on an innovative new architecture, the ispGDX targets interconnect and interface applications in which the digital signal’s routing and rerouting on the board are either desirable or necessary.

#### THE HORIZON

Call it “BFC”— Bigger. Faster. Cheaper. That is the Siren Song that continually drives the traditional semiconductor business, including PLDs. Devices must deliver more functionality. Be more powerful. And cost less. It is a daunting equation, but one that Lattice Semiconductor is well prepared to solve. Our investments in modern,



**...And so it is now for those who look to the universe, see no obstacle to its exploration and steer the reusable Space Shuttle toward the stars.**

technologically advanced 8-inch wafer foundries position us extremely well. Indeed, over the coming year our new product introductions will clearly establish Lattice Semiconductor as the undisputed leader in this “BFC” segment of the CPLD market.

But the mapmaker can not be content only to sing a Siren Song known to all. Lattice Semiconductor will distinguish itself by accepting the next great challenge: the marriage of programmability with “Intellectual Content.” The theoretical benefits of Intellectual Content are well understood: these “cores” of proven logic can be used and reused to make the design process more efficient. But what is needed is Programmable Intellectual Content (PIC)—the application of programmability to these logic cores.

Bigger/Faster/Cheaper will always be a fact and an absolute necessity of industry life. However, it is, ultimately, programmability that creates value for the customer who might otherwise choose an alternative logic device such as an ASIC. The realization of Programmable Intellectual Content will redefine the conventional race to “BFC” in ways that will benefit both Lattice Semiconductor and its customers.

#### **BEYOND THE HORIZON**

*One does not discover new lands without consenting to lose sight of the shore for a very long time. —Andre Gide, 1869-1951*

We have been successful as mapmakers. But our success must not, as it did six hundred years ago to the Chinese—and still

does today to countless companies—lead to complacency or a sense of completion. Our GAL devices, ISP devices and the extension of in-system programmability to the board level with our ispGDX products embolden us to explore further.

It is time, again, for Lattice Semiconductor to explore, to discover and to innovate. It is a journey that will be undertaken by a company strong in assets, talent and ambition. It is a journey of risk, but not recklessness. It is a journey that must be made in good times and in times that will inevitably be challenging...exploration can not cease because it is difficult.

Lattice Semiconductor will willingly lose sight of the shore, guided by our compass, our vision of programmability and its virtually limitless applications. And we will return from our journey, as we have done so many times, with discoveries and translate them into practical, value added and innovative products that both respond to and drive the requirements of new markets and applications.

Such is the work, and the reward, of the mapmaker.

Thank you.

Cyrus Tsui

President, Chief Executive and Chairman of the Board



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

Lattice Semiconductor Corporation (the "Company") 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. Lattice products are sold worldwide through an extensive network of independent sales representatives and distributors, primarily to original equipment manufacturers ("OEMs") of communications, computing, industrial controls and military systems. Approximately one-half of the Company's revenue is derived from international sales, mainly in Europe and Asia. The Company was founded in 1983 and is based in Hillsboro, Oregon.

#### 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. 28, 1998	MAR. 29, 1997	MAR. 30, 1996
Revenue	<b>100%</b>	100%	100%
Costs and expenses:			
Cost of products sold	<b>40</b>	41	41
Research and development	<b>13</b>	14	14
Selling, general and administrative	<b>16</b>	16	16
	<b>69</b>	71	71
Income from operations	<b>31</b>	29	29
Interest and other income (net)	<b>4</b>	4	3
Income before provision for income taxes	<b>35</b>	33	32
Provision for income taxes	<b>12</b>	11	11
Net income	<b>23%</b>	22%	21%

*Revenue* Revenue was \$245.9 million in fiscal 1998, an increase of 20% over fiscal 1997. Fiscal 1997 revenue of \$204.1 million represented an increase of 3% from the \$198.2 million recorded in fiscal 1996. The majority of the Company's revenue in fiscal 1998 was derived from the sale of products that address the ISP segment of the programmable logic market. All of the Company's revenue growth for the periods presented resulted from sales of ISP products. Revenue from ISP products was approximately 65%, 48% and 28% of total revenue for fiscal 1998, 1997 and 1996, respectively.

Revenue from international sales was approximately 51%, 49% and 48% of total revenue for fiscal 1998, 1997 and 1996, respectively. The Company expects export sales to continue to represent a significant portion of revenue. See "Factors Affecting Future Results."

Overall average selling prices increased in all three fiscal years presented. This was due primarily to a higher proportion of ISP 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 60%, 59% and 59% for fiscal years 1998, 1997 and 1996, respectively. The gross margin improvement in fiscal 1998 was primarily due to changes in product mix and reductions in the Company's manufacturing costs. Profit margins on older products tend to decrease over time as selling prices decline, however 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 \$32.0 million, \$27.8 million and \$26.8 million in fiscal 1998, 1997 and 1996, respectively. Spending increases were related primarily to the development of new products, including the Company's ISP product families and related software development tools. The Company believes that a continued commitment to research and development is essential in order to maintain a competitive offering in existing products and to introduce innovative new products, 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 \$39.9 million, \$33.6 million and \$31.3 million in fiscal 1998, 1997 and 1996, respectively. Spending increases were primarily due to expansion of the Company's sales force and increased sales commissions associated with higher revenue levels. Selling, general and administrative expense as a percentage of revenue was approximately 16% for all fiscal years presented.

*Income from Operations* Income from operations increased 27%, from \$59.0 million to \$75.1 million, from fiscal 1997 to fiscal 1998, and increased 2%, from \$57.8 million, between fiscal 1996 and fiscal 1997. Income from operations increased as a percentage of revenue, from 29% in fiscal 1996 and fiscal 1997 to 31% in fiscal 1998.

*Interest and Other Income* Interest and other income (net of expense) increased by approximately \$1.9 million from fiscal 1997 to fiscal 1998, and by approximately \$3.3 million from fiscal 1996 to fiscal 1997. 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 issuances from employee stock option exercises.

*Provision for Income Taxes* The Company's effective tax rate was 34.0% for fiscal 1998 as compared to 33.5% and 33.9% recorded in fiscal 1997 and 1996, respectively. The fiscal 1998 and 1997 rate increase and decrease, respectively, was due primarily to variation in the benefit from tax-exempt investment income.

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 26%, from \$45.0 million to \$56.6 million, from fiscal 1997 to fiscal 1998, and increased 8%, from \$41.8 million, between fiscal 1996 and fiscal 1997. Net income increased as a percentage of revenue each fiscal year, from 21% in fiscal 1996 to 22% in fiscal 1997, and then to 23% in fiscal 1998.

#### 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 quarterly variations based on a wide variety of competitive factors, including, but not limited to, the following: timely introduction of new products that meet market needs at competitive prices with acceptable margins, market acceptance of the Company's new products and proprietary software development tools, 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.

In addition, the Company's operating results are subject to variations based upon the following factors: the Company's continued ability to obtain adequate wafer capacity supply commitments under competitive pricing terms, successful development and implementation of future new advanced process technologies at its wafer manufacturers, attainment of acceptable wafer manufacturing yields, the ability to achieve volume production at Seiko Epson's and UICC's new eight-inch wafer fabs, 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 and specific conditions in countries where the Company's products are sold, the cyclical nature of both the semiconductor industry and the end markets served by the Company's products, sudden price fluctuations, general price erosion and substantial adverse currency change movements. 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, 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, financial and 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 or 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.

The Company is currently working to address the potential impact of the Year 2000 on the processing of date-sensitive information by the Company's internal computer systems, including its electronic interfaces to distributor, customer and supplier systems. At present, the Company has completed an initial assessment of its potential exposure. Based on this assessment, the Company does not anticipate that resolution of potential internal Year 2000 issues will have a material adverse impact on the Company's operating results. However, there can be no assurance that the Company's computer systems or the systems of the company's major distributors, suppliers, customers or financial service providers will completely address all Year 2000 issues in a timely manner. In the event that Year 2000 issues create significant disruption in the operations of the Company or any of the Company's major distributors, suppliers, customers or financial service providers, the Company's operating results could be materially adversely affected.

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 28, 1998.

## LIQUIDITY AND CAPITAL RESOURCES

As of March 28, 1998, the Company's principal source of liquidity was \$267.1 million of cash and short-term investments, an increase of \$38.5 million from the balance of \$228.6 million at March 29, 1997. This increase was primarily the result of cash generated from operations and common stock issuances in excess of cash required for foundry investments and wafer supply advances made in fiscal 1998. 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 \$2.3 million and \$2.5 million, or 9% and 14%, respectively, as compared to the balances at March 29, 1997. These increases were primarily due to higher revenue levels in the fiscal 1998 fourth quarter and the timing of billings to end customers and distributors. Inventories decreased by \$5.2 million, or 19%, versus amounts recorded at March 29, 1997 in response to shorter lead time of supply, availability of manufacturing capacity and anticipated customer requirements. Prepaid expenses and other current assets decreased by \$10.9 million, or 66%, as compared to the balance at March 29, 1997 due primarily to a decrease in the current portion of wafer supply advances. The \$48.9 million increase in Foundry investments, advances and other assets resulted primarily from the payment of approximately \$34.2 million to Seiko Epson in fiscal 1998 pursuant to an advance payment purchase agreement. Additionally, in fiscal 1998 the Company paid approximately \$10.2 million, the last of three planned payments, to fund the Company's investment in United Integrated Circuits Corporation ("UICC"). See below and note 4 of notes to consolidated financial statements. Accounts payable and other accrued expenses increased by \$3.9 million, or 27%, due primarily to increased cash payments for wafers. Accrued payroll obligations increased \$1.6 million, or 16%, as compared to the balance at March 29, 1997 due to increased headcount and timing of payments. Income taxes payable increased \$3.4 million, or 438%, as compared to the balance at March 29, 1997 due to the timing of tax deductions and payments.

Stockholders' equity increased by approximately \$74.2 million, primarily due to net income of approximately \$56.6 million for fiscal 1998 and net proceeds from common stock issuances.

Capital expenditures were approximately \$18.8 million, \$10.6 million and \$12.6 million for fiscal years 1998, 1997 and 1996, respectively. These expenditures consisted primarily of manufacturing test equipment, engineering equipment, buildings and building improvements. The increase in fiscal 1998 capital expenditures as compared to fiscal 1997 and 1996 was associated with construction in progress of additional corporate facilities and increased investment in manufacturing test equipment to support the growth in revenue from ISP products.

The Company currently anticipates capital expenditures of approximately \$20 million to \$25 million for the fiscal year ending April 3, 1999.

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 are utilized to hedge yen-denominated wafer purchases and 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 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 invested approximately \$49.7 million, for an approximate 10% equity interest in UICC and the right to receive a percentage of the facility's wafer production at market prices.

In March 1997, the Company entered into an advance payment production agreement with Seiko Epson Corporation ("Seiko Epson") and its affiliated U.S. distributor, S MOS Systems Inc. ("S MOS") under which it agreed to advance approximately \$86 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 S MOS pursuant to purchase agreements with S MOS. 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. During fiscal 1998, the Company made two additional payments aggregating approximately \$34.2 million. As a result of future payments to Seiko Epson, the Company's working capital will be reduced by approximately \$35 million during fiscal 1999.

On June 12, 1998, the Company's Board of Directors authorized management to repurchase up to 1.2 million shares of the Company's common stock. As of June 16, 1998, the Company had not repurchased any shares.

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 the next fiscal year.

In an effort to secure additional wafer supply, the Company may from time to time consider various financial arrangements including joint ventures, equity investments, advance purchase payments, loans, or similar arrangements with independent wafer manufacturers in exchange for committed wafer capacity. To the extent that the Company pursues any such additional 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 28, 1998	MARCH 29, 1997	MARCH 30, 1996	APRIL 1, 1995	APRIL 2, 1994
STATEMENT OF OPERATIONS DATA:					
Revenue	<b>\$245,894</b>	\$204,089	\$198,167	\$144,083	\$126,241
Costs and expenses:					
Cost of products sold	<b>98,883</b>	83,736	82,216	58,936	53,266
Research and development	<b>32,012</b>	27,829	26,825	22,859	20,636
Selling, general and administrative	<b>39,934</b>	33,558	31,323	25,020	22,299
	<b>170,829</b>	145,123	140,364	106,815	96,201
Income from operations	<b>75,065</b>	58,966	57,803	37,268	30,040
Interest and other income, net	<b>10,643</b>	8,712	5,442	3,349	2,566
Income before provision for income taxes	<b>85,708</b>	67,678	63,245	40,617	32,606
Provision for income taxes	<b>29,141</b>	22,673	21,461	13,651	10,116
Net income	<b>\$ 56,567</b>	\$ 45,005	\$ 41,784	\$ 26,966	\$ 22,490
Basic net income per share	<b>\$ 2.43</b>	\$ 2.00	\$ 2.06	\$ 1.45	\$ 1.24
Diluted net income per share	<b>\$ 2.37</b>	\$ 1.96	\$ 1.99	\$ 1.41	\$ 1.19
Shares used in per share calculations:					
Basic net income	<b>23,239</b>	22,460	20,327	18,627	18,182
Diluted net income	<b>23,894</b>	22,973	20,979	19,164	18,946

BALANCE SHEET DATA:

Working capital	<b>\$283,678</b>	\$267,669	\$244,649	\$106,021	\$105,007
Total assets	<b>489,066</b>	403,462	342,935	192,917	146,093
Stockholders' equity	<b>434,686</b>	360,491	298,768	157,797	125,068

	YEAR ENDED MARCH 28, 1998				YEAR ENDED MARCH 29, 1997			
	FOURTH QUARTER	THIRD QUARTER	SECOND QUARTER	FIRST QUARTER	FOURTH QUARTER	THIRD QUARTER	SECOND QUARTER	FIRST QUARTER
UNAUDITED QUARTERLY DATA:								
Revenue	<b>\$60,168</b>	<b>\$60,038</b>	<b>\$64,068</b>	<b>\$61,620</b>	\$56,268	\$51,015	\$48,638	\$48,168
Gross profit	<b>\$36,071</b>	<b>\$36,183</b>	<b>\$38,165</b>	<b>\$36,592</b>	\$33,332	\$30,048	\$28,643	\$28,330
Net income	<b>\$13,818</b>	<b>\$13,651</b>	<b>\$14,930</b>	<b>\$14,168</b>	\$12,819	\$11,278	\$10,460	\$10,448
Basic net income per share	<b>\$ 0.59</b>	<b>\$ 0.58</b>	<b>\$ 0.64</b>	<b>\$ 0.62</b>	\$ 0.56	\$ 0.50	\$ 0.47	\$ 0.47
Diluted net income per share	<b>\$ 0.58</b>	<b>\$ 0.57</b>	<b>\$ 0.62</b>	<b>\$ 0.60</b>	\$ 0.55	\$ 0.49	\$ 0.46	\$ 0.46

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 28,  
1998

MARCH 29,  
1997

*Assets*

Current assets:

Cash and cash equivalents	\$ 60,344	\$ 53,949
Short-term investments	206,766	174,698
Accounts receivable, net	28,229	25,940
Inventories (note 2)	22,647	27,809
Prepaid expenses and other current assets	5,572	16,519
Deferred income taxes (note 7)	14,500	11,725
Total current assets	<b>338,058</b>	310,640
Foundry investments, advances and other assets (notes 4 and 9)	<b>114,338</b>	65,419
Property and equipment, less accumulated depreciation (note 3)	<b>36,670</b>	27,403
	<b>\$489,066</b>	\$403,462

*Liabilities and Stockholders' Equity*

Current liabilities:

Accounts payable and accrued expenses (note 9)	\$ 18,196	\$ 14,276
Accrued payroll obligations	11,231	9,648
Income taxes payable (note 7)	4,210	782
Deferred income	20,743	18,265
Total current liabilities	<b>54,380</b>	42,971
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; 23,428,072 and 22,877,724 shares issued and outstanding	234	229
Paid-in capital	216,290	198,667
Retained earnings	218,162	161,595
	<b>434,686</b>	360,491
	<b>\$489,066</b>	\$403,462

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)	YEAR ENDED		
	MARCH 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Revenue	<b>\$245,894</b>	\$204,089	\$198,167
Costs and expenses:			
Cost of products sold (note 9)	<b>98,883</b>	83,736	82,216
Research and development	<b>32,012</b>	27,829	26,825
Selling, general and administrative (note 12)	<b>39,934</b>	33,558	31,323
	<b>170,829</b>	145,123	140,364
Income from operations	<b>75,065</b>	58,966	57,803
Other income (expense):			
Interest income	<b>10,277</b>	8,886	5,570
Other income (expense), net	<b>366</b>	(174)	(128)
Income before provision for income taxes	<b>85,708</b>	67,678	63,245
Provision for income taxes (note 7)	<b>29,141</b>	22,673	21,461
Net income	<b>\$ 56,567</b>	\$ 45,005	\$ 41,784
Basic net income per share	<b>\$ 2.43</b>	\$ 2.00	\$ 2.06
Diluted net income per share	<b>\$ 2.37</b>	\$ 1.96	\$ 1.99
Shares used in per share calculations:			
Basic net income	<b>23,239</b>	22,460	20,327
Diluted net income	<b>23,894</b>	22,973	20,979

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 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
Common stock issued	550	5	12,546	—	12,551
Tax benefit of option exercises	—	—	5,225	—	5,225
Other	—	—	(148)	—	(148)
Net income for fiscal 1998	—	—	—	56,567	56,567
Balances, March 28, 1998	<b>23,428</b>	<b>\$ 234</b>	<b>\$ 216,290</b>	<b>\$ 218,162</b>	<b>\$ 434,686</b>

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THIS STATEMENT.

CONSOLIDATED STATEMENT OF CASH FLOWS

(IN THOUSANDS)	YEAR ENDED		
	MARCH 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Cash flow from operating activities:			
Net income	\$ 56,567	\$ 45,005	\$ 41,784
Adjustments to reconcile net income to net cash provided (used) by operating activities:			
Depreciation and amortization	9,558	8,629	7,137
Deferred income taxes	(2,775)	(2,025)	(2,398)
Changes in assets and liabilities:			
Accounts receivable	(2,289)	(3,056)	(4,737)
Inventories	5,162	(6,048)	(7,630)
Prepaid expenses and other current assets	(2,654)	(750)	(450)
Foundry investments, advances and other assets	(35,318)	(33,239)	(3,087)
Accounts payable and accrued expenses	3,920	(739)	2,241
Accrued payroll obligations	1,583	2,192	2,067
Income taxes payable	3,428	(4,018)	(406)
Deferred income	2,478	1,369	5,145
Net cash provided by operating activities	<u>39,660</u>	<u>7,320</u>	<u>39,666</u>
Cash flow from investing activities:			
Purchase of short-term investments, net	(32,068)	(14,128)	(79,457)
Proceeds from sale of property and equipment	—	—	98
Capital expenditures	(18,825)	(10,561)	(12,591)
Net cash used by investing activities	<u>(50,893)</u>	<u>(24,689)</u>	<u>(91,950)</u>
Cash flow from financing activities:			
Net proceeds from issuance of common stock	17,628	16,718	99,187
Net cash provided by financing activities	<u>17,628</u>	<u>16,718</u>	<u>99,187</u>
Net increase (decrease) in cash and cash equivalents	6,395	(651)	46,903
Beginning cash and cash equivalents	53,949	54,600	7,697
Ending cash and cash equivalents	<u>\$ 60,344</u>	<u>\$ 53,949</u>	<u>\$ 54,600</u>

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”) 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”) of communications, computing, industrial controls and military systems. Approximately one-half of the Company’s revenue is derived from international sales, mainly in Europe and Asia. The Company was founded in 1983 and is based in Hillsboro, Oregon.

*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 intercompany 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 (\$110.2 million), government obligations (\$70.2 million), commercial paper (\$6.9 million) and time deposits (\$19.5 million) at March 28, 1998.

The Company categorizes its short-term investments as held-to-maturity, which 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 28, 1998.

*Financial Instruments* All of the Company’s significant financial assets and liabilities are recognized in the Consolidated Balance Sheet as of March 28, 1998 and March 29, 1997. The carrying value of the Company’s financial instruments approximate current market value except foundry equity investments in Taiwan which are either not readily marketable or where market prices are not necessarily indicative of realizable value. 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* 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 28, 1998, 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 are utilized to hedge yen-denominated wafer purchases and 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 \$797,000 and \$874,000 at March 28, 1998 and March 29, 1997, respectively.

No individual customer or distributor accounted for more than 10% of revenue in fiscal 1998 or 1997. Revenue from one distributor was \$21.1 million for fiscal 1996. Export revenue was approximately \$125.6 million, \$99.8 million and \$95.1 million for fiscal 1998, 1997 and 1996, respectively. Sales to Europe were approximately \$61.2 million, \$39.9 million and \$37.9 million, and to Asia \$55.9 million, \$52.6 million and \$52.4 million in fiscal 1998, 1997 and 1996, 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 Statement of Financial Accounting Standards 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 SFAS 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.

*Stock-Based Compensation* The Company accounts for its 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." During 1995, the Financial Accounting Standards Board ("FASB") issued 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 FASB issued SFAS 128, "Earnings Per Share," which is effective for the Company for periods ending after December 15, 1997. Accordingly, the Company adopted this pronouncement in the quarter ended December 27, 1997. Primary net income per share as previously reported has been replaced by "basic net income per share" and "diluted net income per share." Prior period results have been restated to conform to the new presentation.

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 options and warrants as outstanding. For the Company, there is no difference between diluted net income per share and primary net income per share as previously reported. A reconciliation of the numerators and denominators of basic and diluted net income per share is presented below:

	YEAR ENDED		
	MARCH 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Basic and diluted net income	<b>\$56,567</b>	\$45,005	\$41,784
Shares used in basic net income per share calculations	<b>23,239</b>	22,460	20,327
Dilutive effect of stock options and warrants	<b>655</b>	513	652
Shares used in diluted net income per share calculations	<b>23,894</b>	22,973	20,979
Basic net income per share	<b>\$ 2.43</b>	\$ 2.00	\$ 2.06
Diluted net income per share	<b>\$ 2.37</b>	\$ 1.96	\$ 1.99

*Statement of Cash Flows* Income taxes paid approximated \$23.1 million, \$22.6 million and \$17.3 million in fiscal 1998, 1997, and 1996, respectively. Interest paid does not differ materially from interest expense, which aggregated approximately \$83,000, \$152,000 and \$42,000 in fiscal 1998, 1997 and 1996, 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.

*New Accounting Pronouncements* In June 1997, the FASB issued SFAS 130, "Reporting Comprehensive Net Income." Under SFAS 130, the Company is required to report comprehensive income and its components in its consolidated financial statements, in addition to net income.

Also in June 1997, the FASB issued SFAS 131, "Disclosures About Segments of an Enterprise and Related Information." This pronouncement establishes standards for the way companies report information about operating segments for the fiscal years beginning after December 15, 1997. It also establishes standards for related disclosures about products and services, geographic areas and major customers.

The Company will adopt these two new pronouncements in the fiscal year ending April 3, 1999. It is expected that adoption will not have a significant impact on the consolidated financial statements.

#### NOTE 2. INVENTORIES

(IN THOUSANDS)	MARCH 28, 1998	MARCH 29, 1997
Work in progress	<b>\$ 12,675</b>	\$ 20,286
Finished goods	<b>9,972</b>	7,523
	<b>\$ 22,647</b>	\$ 27,809

#### NOTE 3. PROPERTY AND EQUIPMENT

(IN THOUSANDS)	MARCH 28, 1998	MARCH 29, 1997
Land	<b>\$ 2,098</b>	\$ 2,098
Buildings	<b>7,135</b>	7,132
Construction in progress	<b>6,750</b>	—
Computer and test equipment	<b>62,863</b>	52,204
Office furniture and equipment	<b>3,054</b>	2,881
Leasehold and building improvements	<b>2,547</b>	2,501
	<b>84,447</b>	66,816
Accumulated depreciation and amortization	<b>(47,777)</b>	(39,413)
	<b>\$ 36,670</b>	\$ 27,403

#### NOTE 4. FOUNDRY INVESTMENTS, ADVANCES AND OTHER ASSETS

(IN THOUSANDS)	MARCH 28, 1998	MARCH 29, 1997
Foundry investments and other assets	<b>\$ 63,076</b>	\$ 48,399
Wafer supply advances	<b>51,262</b>	17,020
	<b>\$114,338</b>	\$ 65,419

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 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 invested approximately \$49.7 million, paid in three installments, 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. This investment is accounted for at cost. 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 of approximately \$10.2 million was made in December 1997.

In October 1997, the UICC foundry was substantially destroyed by fire. UMC, the majority owner of UICC, has informed the Company that this loss is insured and has begun the process of rebuilding the foundry. Further, alternative capacity arrangements have been made available to the Company. Based on these assurances from UMC, management believes the Company will not be materially adversely affected by this event.

In July 1994, the Company signed an agreement with Seiko Epson Corporation ("Seiko Epson") and its affiliated U.S. distributor, S MOS Systems Inc. ("S MOS"), 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 \$15,425,000, \$18,042,000 and \$10,713,000 during fiscal 1998, 1997 and 1996, respectively.

In March 1997, the Company entered into a second advance payment production agreement with Seiko Epson and S MOS under which it agreed to advance approximately \$86 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 S MOS pursuant to purchase agreements with S MOS. 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 under this agreement, approximately \$17.0 million, was made during fiscal 1997. During fiscal 1998, the Company made two additional payments aggregating approximately \$34.2 million.

#### 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 2001. Rental expense under the operating leases was approximately \$1,026,000, \$984,000 and \$993,000 for fiscal 1998, 1997 and 1996, respectively. Future minimum lease commitments at March 28, 1998 are as follows:

FISCAL YEAR	(IN THOUSANDS)
1999	\$ 884
2000	892
2001	703
	<u>\$2,479</u>

#### NOTE 7. INCOME TAXES

The components of the provision for income taxes for fiscal 1998, 1997 and 1996 are presented in the following table:

(IN THOUSANDS)	YEAR ENDED		
	<u>MARCH 28, 1998</u>	MARCH 29, 1997	MARCH 30, 1996
Current:			
Federal	<b>\$29,204</b>	\$22,308	\$21,550
State	<b>2,712</b>	2,390	2,309
	<u><b>31,916</b></u>	<u>24,698</u>	<u>23,859</u>
Deferred:			
Federal	<b>(2,539)</b>	(1,829)	(2,166)
State	<b>(236)</b>	(196)	(232)
	<u><b>(2,775)</b></u>	<u>(2,025)</u>	<u>(2,398)</u>
	<u><b>\$29,141</b></u>	<u>\$22,673</u>	<u>\$21,461</u>

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 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Computed income tax expense at the statutory rate	<b>\$29,998</b>	\$23,687	\$22,136
Adjustments for tax effects of:			
State taxes, net	<b>2,402</b>	2,048	1,636
Research and development credits	<b>(154)</b>	(62)	(196)
Nontaxable investment income	<b>(3,009)</b>	(2,579)	(1,506)
Other	<b>(96)</b>	(421)	(609)
	<b>\$29,141</b>	\$22,673	\$21,461

The components of the Company's net deferred tax asset are as follows:

(IN THOUSANDS)	MARCH 28, 1998	MARCH 29, 1997
Deferred income	<b>\$ 7,934</b>	\$ 7,102
Expenses and allowances not currently deductible	<b>8,357</b>	6,619
Total deferred tax assets	<b>16,291</b>	13,721
Valuation allowance	<b>(1,791)</b>	(1,996)
	<b>\$ 14,500</b>	\$ 11,725

The valuation allowances are recorded to reduce 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* As of March 28, 1998, the Company has issued to a vendor warrants to purchase 583,094 shares of common stock. Of this amount, 464,125 warrants were issued and 340,500 exercised prior to fiscal 1996. During fiscal 1997, 67,419 warrants were issued and none were exercised. During fiscal 1998, a warrant was issued to purchase 51,550 shares of common stock, earned ratably from March 1997 through February 1998. Additionally, the vendor exercised warrants for 123,625 shares at an average exercise price of \$18.77 per share.

*Stock Option Plans* As of March 28, 1998, 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 Incentive Plan and 1988 Stock Incentive Plan, respectively. The 1996 Plan options generally vest over four years in increments as determined by the Board of Directors and have terms up to ten years. The 1988 Plan options are exercisable immediately and have terms up to ten years. 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 have been 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 28, 1998	WEIGHTED- AVERAGE EXERCISE PRICE	MARCH 29, 1997	WEIGHTED- AVERAGE EXERCISE PRICE	MARCH 30, 1996	WEIGHTED- AVERAGE EXERCISE PRICE
	NUMBER OF SHARES UNDER OPTION		NUMBER OF SHARES UNDER OPTION		NUMBER OF SHARES UNDER OPTION	
Options outstanding at beginning of fiscal year	2,290	\$27.50	2,330	\$22.20	2,340	\$14.15
Options granted	983	63.13	827	30.82	807	33.37
Options canceled	(134)	39.78	(176)	28.31	(196)	14.90
Options exercised	(383)	21.76	(691)	13.31	(621)	8.79
Options outstanding at end of fiscal year	2,756	\$40.38	2,290	\$27.50	2,330	\$22.20

The following table summarizes information about stock options outstanding at March 28, 1998:

RANGE OF EXERCISE PRICES	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
\$14.88 – \$17.38	131	0.27	\$17.02	118	\$17.04
\$17.83 – \$28.13	989	1.52	25.26	574	23.77
\$31.63 – \$51.75	743	1.86	36.44	353	33.50
\$51.88 – \$66.25	893	3.36	63.76	105	63.44
	2,756	2.15	\$40.38	1,150	\$29.69

*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 700,000 shares authorized to be issued under the plan, 34,945, 57,421 and 54,239 shares were issued during fiscal 1998, 1997 and 1996, respectively, and 272,864 shares were available for issuance at March 28, 1998.

*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 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Stock options:			
Expected volatility	48.6%	46.4%	46.4%
Risk-free interest rate	5.6%	6.1%	5.9%
Expected life from vesting date	1.2 years	0.9 years	0.9 years
Dividend yield	0%	0%	0%
Stock purchase rights:			
Expected volatility	36.0%	36.7%	36.7%
Risk-free interest rate	5.9%	5.3%	6.2%
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. 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 granted was \$25.20, \$11.54 and \$12.44, and for stock purchase rights \$12.30, \$6.80 and \$5.49, for fiscal 1998, 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 28, 1998	MARCH 29, 1997	MARCH 30, 1996
Pro forma net income	\$ 48,777	\$ 40,681	\$ 38,836
Pro forma basic earnings per share	\$ 2.10	\$ 1.81	\$ 1.91
Pro forma diluted earnings per share	\$ 2.05	\$ 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, S MOS. The Chairman of the Board of S MOS is a member of the Company's Board of Directors. The Company also receives wafers in connection with the series of agreements entered into with UMC as described in note 4 of notes to consolidated financial statements. A significant interruption in supply from Seiko Epson through S MOS, or from UMC, would have a material adverse effect on the Company's business.

The Company has signed two advance payment production agreements with Seiko Epson and S MOS, 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. Wafer purchases totaled \$20.9 million, \$22.8 million and \$34.7 million for fiscal 1998, 1997 and 1996, respectively. Accounts payable and accrued expenses at March 28, 1998 and March 29, 1997 include \$4.5 and \$1.9 million, respectively, due this vendor. Open purchase commitments to this vendor approximated \$6.8 million at March 28, 1998.

#### 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 1998, 1997 and 1996, approximately \$3.0 million, \$2.4 million and \$2.3 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. There can be no assurance that, with respect to any such claims made against the Company, the Company could obtain a license on terms or under conditions that would not have a material adverse effect on 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 \$51,000, \$61,000 and \$177,000, respectively, for fiscal 1998, 1997 and 1996. Amounts payable to the law firm were not significant at March 28, 1998 or March 29, 1997.

#### 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 28, 1998 and March 29, 1997, and the results of their operations and their cash flows for each of the three years in the period ended March 28, 1998, 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.

*Price Waterhouse LLP*

Portland, Oregon  
April 15, 1998



## BOARD OF DIRECTORS

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

Mark O. Hatfield  
Former U.S. Senator

Daniel S. Hauer<sup>1</sup>  
Chairman of the Board,  
S MOS Systems Inc.

Harry A. Merlo<sup>1, 2</sup>  
President,  
Merlo Corporation

Douglas C. Strain<sup>2</sup>  
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

Stephen M. Donovan  
Corporate Vice President, Sales

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 and General Manager  
Lattice Silicon Valley

Thomas J. Kingzett  
Vice President, Reliability and  
Quality Assurance

Stanley J. Kopec  
Vice President, Corporate Marketing

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 Greenwood Inn,  
10700 S.W. Allen Blvd., Beaverton,  
Oregon 97005 on Monday,  
August 10, 1998, at 1:00 pm,  
Pacific Time.

## 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 Semiconductor shareholder  
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 1997:		
First Quarter	21 <sup>3</sup> / <sub>8</sub>	36 <sup>1</sup> / <sub>4</sub>
Second Quarter	19 <sup>3</sup> / <sub>4</sub>	31 <sup>1</sup> / <sub>2</sub>
Third Quarter	27 <sup>1</sup> / <sub>2</sub>	47
Fourth Quarter	39 <sup>3</sup> / <sub>4</sub>	54 <sup>7</sup> / <sub>8</sub>
Fiscal 1998:		
First Quarter	41 <sup>1</sup> / <sub>2</sub>	62 <sup>3</sup> / <sub>8</sub>
Second Quarter	54 <sup>7</sup> / <sub>8</sub>	74 <sup>1</sup> / <sub>2</sub>
Third Quarter	45	67 <sup>1</sup> / <sub>2</sub>
Fourth Quarter	39 <sup>3</sup> / <sub>4</sub>	57

<sup>1</sup> MEMBER OF THE AUDIT COMMITTEE  
<sup>2</sup> MEMBER OF THE COMPENSATION COMMITTEE



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