LATTICE SEMICONDUCTOR CORP
Form 10-Q
August 09, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JULY 1, 2006

OR

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

FOR THE TRANSITION PERIOD FROM________ TO ________

Commission file number 000-18032

LATTICE SEMICONDUCTOR CORPORATION
(Exact name of Registrant as specified in its charter)

State of Delaware	**93-0835214**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5555 N.E. Moore Court, Hillsboro, Oregon	**97124-6421**
(Address of principal executive offices)	(Zip Code)

(503) 268-8000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer ý Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No ý

Number of shares of common stock outstanding as of July 31, 2006	114,327,235

The information contained in this Form 10-Q is as of August 8, 2006. This Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2005.

LATTICE SEMICONDUCTOR CORPORATION

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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. Any statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. We use words or phrases such as "anticipates," "believes," "estimates," "expects," "intends," "plans," "projec "may," "will," "should," "continue," "ongoing," "future," "potential" and similar words or phrases to identify forward-looking statements.

Forward-looking statements involve estimates, assumptions, risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. The key factors that could cause our actual

results to differ materially from the forward-looking statements include any actions resulting from the Securities and Exchange Commission's ongoing informal inquiry, overall semiconductor market conditions, market acceptance and demand for our new products, our dependencies on our silicon wafer suppliers, the impact of competitive products and pricing, technological and product development risks, and the other risks that are described herein and that are otherwise described from time to time in our filings with the Securities and Exchange Commission, including but not limited to the items discussed in "Risk Factors" in Item 1A of this report. You should not unduly rely on forward-looking statements because our actual results could materially differ from those expressed in any forward-looking statements made by us. Further, any forward-looking statement applies only as of the date on which it is made. We are not required to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LATTICE SEMICONDUCTOR CORPORATION

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

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
Revenue	$ 62,719	$ 52,396	$ 120,171	$ 103,679
Costs and expenses:				
Cost of products sold	27,150	22,862	52,447	45,033
Research and development	21,124	25,065	42,245	50,236
Selling, general and administrative	13,801	16,433	26,417	30,766
Amortization of intangible assets	2,670	3,531	5,483	7,333
Restructuring charges	139	—	139	—
Total costs and expenses	64,884	67,891	126,731	133,368
Loss from operations	(2,165)	(15,495)	(6,560)	(29,689)
Other income, net	4,487	7,436	8,264	10,845
Income (loss) before income tax expense	2,322	(8,059)	1,704	(18,844)
Income tax expense	256	100	445	200
Net income (loss)	$ 2,066	$ (8,159)	$ 1,259	$ (19,044)
Basic net income (loss) per share	$ 0.02	$ (0.07)	$ 0.01	$ (0.17)
Diluted net income (loss) per share	$ 0.02	$ (0.07)	$ 0.01	$ (0.17)
Shares used in per share calculations:				
Basic	114,165	113,469	113,960	113,463
Diluted	115,104	113,469	114,287	113,463

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET
(In thousands, except share and par value data)
(unaudited)

	June 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 42,746	$ 39,336
Marketable securities	219,981	224,856
Accounts receivable, net	33,050	23,577
Inventories	35,750	28,581
Other current assets	24,615	24,614
Total current assets	356,142	340,964
Foundry investments, advances and other assets	60,720	79,432
Property and equipment, net	47,681	45,450
Intangible assets, net	20,979	26,455
Goodwill	223,556	223,556
	$ 709,078	$ 715,857
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 51,500	$ 53,438
Deferred income and allowances on sales to distributors	11,437	10,449
Total current liabilities	62,937	63,887
Zero Coupon Convertible Subordinated Notes due in 2010	123,500	133,500
Other long-term liabilities	18,168	20,386
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, $.01 par value, 10,000,000 shares authorized; none issued and outstanding	—	—
Common stock, $.01 par value, 300,000,000 shares authorized; 114,323,000 and 113,646,000 shares issued and outstanding	1,143	1,136
Paid-in capital	600,024	595,145
Accumulated other comprehensive loss	(244)	(488)
Accumulated deficit	(96,450)	(97,709)
Total stockholders' equity	504,473	498,084
	$ 709,078	$ 715,857

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(In thousands)
(unaudited)

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Cash flows from operating activities:		
Net income (loss)	$ 1,259	$ (19,044)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	13,581	16,446
Gain on sale of UMC common stock	(1,313)	(4,291)
Gain on extinguishment of Zero Coupon Convertible Subordinated Notes	(1,200)	(3,518)
Stock-based compensation	1,345	1,196
Changes in assets and liabilities:		
Accounts receivable	(9,473)	(6,414)
Inventories	(7,169)	4,499
Foundry investments, advances and other assets	8,794	6,082
Accounts payable and accrued expenses	(5,567)	(20,510)
Deferred income and allowances on sales to distributors	988	238
Other liabilities	529	291
Total adjustments	515	(5,981)
Net cash provided by (used in) operating activities	1,774	(25,025)
Cash flows from investing activities:		
Proceeds from sales or maturities of marketable securities	115,095	156,044
Purchase of marketable securities	(110,220)	(118,662)
Proceeds from sale of equity securities (principally UMC common stock)	10,233	27,464
Capital expenditures	(8,215)	(4,654)
Net cash provided by investing activities	6,893	60,192
Cash flows from financing activities:		
Extinguishment of Zero Coupon Convertible Subordinated Notes	(8,738)	(21,682)
Advances on Yen line of credit	607	5,037
Pay down on Yen line of credit	(420)	(3,038)
Proceeds from issuance of common stock	3,294	8
Net cash used in financing activities	(5,257)	(19,675)
Net increase in cash and cash equivalents	3,410	15,492
Beginning cash and cash equivalents	39,336	44,816
Ending cash and cash equivalents	$ 42,746	$ 60,308

Supplemental disclosures of non-cash investing and financing activities:				
Unrealized gain on appreciation of foundry investments included in Accumulated other comprehensive loss	**$**	**1,717**	**$**	**5,664**
Distribution of assets held in deferred compensation plan	**$**	**2,785**	**$**	**—**

See Accompanying Notes to Condensed Unaudited Consolidated Financial Statements.

LATTICE SEMICONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation:

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Lattice Semiconductor Corporation ("the Company") pursuant to the rules and regulations of the Securities and Exchange Commission and in our opinion include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These Condensed Consolidated Financial Statements should be read in conjunction with our audited financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2005. Certain prior period disclosures have been reclassified to the extent required to be consistent with the current period presentation.

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amount of revenue and expenses during the reporting periods. Actual results could differ from these estimates.

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

Note 2 - Revenue Recognition:

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

During the first quarter of 2006, we entered into business arrangements with certain distributors to issue accounts receivable credit adjustments ("distributor advances") to reduce the distributors' working capital required to service our end customers. The distributor advances are for anticipated future price discounts and are recorded as a reduction of Deferred income and allowances on sales to distributors. These arrangements are unsecured, bear no interest, are settled on a quarterly basis and are due upon demand. The distributor advances have no impact on revenue recognition and totaled $6.0 million at June 30, 2006.

Note 3 - Net Income (Loss) Per Share:

Net income (loss) per share is computed based on the weighted average number of shares of common stock and potentially dilutive securities assumed to be outstanding during the period using the treasury stock method. Potentially dilutive securities consist of stock options, warrants to purchase common stock and convertible subordinated notes.

The most significant difference between the computation of basic and diluted net income per share is that basic net income per share does not treat potentially dilutive securities such as stock options, warrants and convertible subordinated notes as outstanding. For all periods presented, the computation of diluted net income (loss) per share includes the effect of stock options and warrants, as they are dilutive. The effects of Zero Coupon Convertible Subordinated Notes due July 1, 2010, are excluded in the computation of basic and diluted earnings per share as the contingent conversion features were not triggered for any of the periods presented. A reconciliation of basic and diluted net income (loss) per share is presented below (in thousands, except for per share data):

	Three Months Ended		Six Months Ended	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
Net income (loss)	$ 2,066	$ (8,159)	$ 1,259	$ (19,044)
Shares used in basic net income (loss) per share calculations	114,165	113,469	113,960	113,463
Dilutive effect of stock options and warrants	939	—	327	—
Shares used in diluted net income (loss) per share	115,104	113,469	114,287	113,463
Basic net income (loss) per share	$ 0.02	$ (0.07)	$ 0.01	$ (0.17)
Diluted net income (loss) per share	$ 0.02	$ (0.07)	$ 0.01	$ (0.17)

Note 4 - Stock-Based Compensation:

Prior to January 1, 2006, the Company accounted for stock options in accordance with the provisions of Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”), and related interpretations, and therefore related compensation expense was limited to the intrinsic value. Accordingly, the Company generally recognized stock-based compensation expense only when it granted options with an exercise price less than the fair value of the stock on the grant date. Any resulting compensation expense was recognized on an accelerated basis in accordance with FASB Interpretation No. 28, “Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans” (“FIN 28”), over the associated service period, which was generally the option vesting term.

Prior to January 1, 2006, the Company provided pro forma disclosure amounts in accordance with SFAS No. 148, “Accounting for Stock-Based Compensation - Transition and Disclosure” (“SFAS 148”), as if the fair value method defined by SFAS No. 123, “Accounting for Stock-Based Compensation,” (“SFAS 123”) had been applied to its stock-based compensation.

Effective January 1, 2006, the Company began recording stock-based compensation expense related to employee and director stock options and the Employee Stock Purchase Plan (“ESPP”) in accordance with “Share Based Payment - a revision of SFAS No. 123, Accounting for Stock-Based Compensation” (“SFAS 123R”), as interpreted by SEC Staff Accounting Bulletin No. 107 (“SAB 107”).

The Company adopted the modified prospective transition method provided for under SFAS 123R, and consequently has not retroactively adjusted results from prior periods. Under this transition method, compensation expense associated with stock options now includes: 1) quarterly amortization related to the remaining unvested portion of all stock option awards granted prior to January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) quarterly amortization related to all stock option awards granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In addition, the Company records expense over the offering period in connection with shares issuable under the ESPP. To calculate the excess tax benefits available for use in offsetting future tax shortfalls as of the date of implementation, the Company followed the alternative transition method discussed in FASB Staff Position No. 123(R)-3. The compensation expense for employee, director and ESPP based compensation awards includes an

estimate for forfeitures and is recognized over the expected term of the options or stock plan offering period, as applicable, using the straight-line method. As a result of the adoption of SFAS 123R, the effect of recording stock-based compensation for the three and six months ended June 30, 2006 was as follows:

	Three Months Ended June 30, 2006		Six Months Ended June 30, 2006	
	(In thousands, except per share data)			
Stock-based compensation expense included in net income by type of award:				
Employee and director stock options	$	587	$	1,213
Employee stock purchase plan		51		102
Related to acquisitions		—		30
Total stock-based compensation	$	638	$	1,345
Effect on earnings per share:				
Basic and diluted - as reported	$	0.01	$	0.01

The tax benefit and the resulting effect on cash flows from operations and financing activities related to stock-based compensation expense was not recognized as the Company currently provides a full valuation allowance for its deferred tax assets.

SFAS 123R also requires that the Company recognize compensation expense for only the portion of employee and director options and ESPP rights that are expected to vest. Therefore, the Company applies estimated forfeiture rates that are derived from historical employee termination behavior using a stratified model based on an employee's position within the Company. If the actual number of forfeitures differs from the number estimated by management, additional adjustments to compensation expense may be required in future periods.

Total stock-based compensation expense was included in the Condensed Consolidated Statement of Operations as follows (in thousands):

	Three Months Ended				Six Months Ended			
Line Item:	June 30, 2006 (SFAS 123R)		June 30, 2005 (APB 25)		June 30, 2006 (SFAS 123R)		June 30, 2005 (APB 25)	
Cost of products sold:	$	54	$	—	$	114	$	—
Research and development		349		582		725		1,196
Selling, general and administrative		235		—		506		—
	$	638	$	582	$	1,345	$	1,196

Employee and Director Stock Options and ESPP

The Company's employee stock option plans include principal plans adopted in 1996 and 2001 ("principal option plans"), as well as various stock option plans assumed through acquisitions under which stock options are outstanding. The principal option plans provide for grants of options to employees to purchase common stock at the fair market value of such shares on the grant date. The options generally vest quarterly over a four-year period beginning on the grant date. Options granted under the principal option plans are generally non-qualified stock options but the principal option plans permit some options granted to qualify as "incentive stock options" under the U.S. Internal Revenue Code. The contractual term of options granted prior to January 31, 2006 is generally ten years, while the contractual term of options granted subsequent to January 31, 2006 is generally seven years.

The Company’s director stock option plan, most recently amended effective as of the May 2, 2006 approval of the amendments by our stockholders, provides that non-employee members of our board of directors receive non-qualified option grants in set amounts and at set times, at option prices equal to the fair market value on the date of grant. Options granted following the May 2, 2006 amendment vest over a period of three years (for initial grants to new directors), or over a period of up to one year following the completion of vesting of all previously granted director options (for subsequent option grants). The contractual term of such options is ten years.

The Company’s ESPP, which was amended and approved most recently by its stockholders in May 2004, permits eligible employees to purchase shares of common stock through payroll deductions, not to exceed 10% of an 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 offering 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. The Company has treated the ESPP as a compensatory plan, and recorded compensation expense of $0.1 million relative to the ESPP in the three and six months ended June 30, 2006.

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. Beginning January 1, 2006, we are estimating the expected term of stock options based on the simplified method provided for under SAB 107. The expected volatility of both stock options and ESPP shares is based on the weekly historical volatility of our stock price, measured over the expected life of the option. The risk- free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that the Company has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

	Grants for			
	Three Months Ended		**Six Months Ended**	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
Employee and Director Stock Options:				
Expected volatility	59.0%	45.4%	58.4%	45.6%
Risk-free interest rate	5.0%	3.7%	4.7%	3.6%
Expected term (in years)	4.8	3.3	4.8	3.3
Dividend yield	0%	0%	0%	0%
Employee Stock Purchase Plan:				
Expected volatility	17.5%	31.0%	17.5%	31.0%
Risk-free interest rate	4.4%	3.4%	4.4%	3.4%
Expected term (in years)	0.5	0.5	0.5	0.5
Dividend yield	0%	0%	0%	0%

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

As of June 30, 2006, there was $3.9 million of total unrecognized compensation cost related to employee and director stock options and purchases related to the ESPP, which are expected to be recognized over a weighted average period of 3.2 years. The Company's current practice is to issue new shares to satisfy option exercises. In conjunction with the adoption of SFAS 123R, the Company changed its method of recognizing the expense of stock-based compensation over the requisite service period from the accelerated approach in accordance with FIN 28 to the straight-line method. Compensation expense for all stock-based compensation awards granted on or prior to December 31, 2005 will continue to be recognized using the accelerated approach, while compensation expense for all stock-based compensation awards granted subsequent to December 31, 2005 will be recognized using the straight-line method.

A summary of stock option activity under the plans for the six months ended June 30, 2006 is presented as follows:

	Shares (In thousands)	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (Years)**	**Aggregate Intrinsic Value (In thousands)**
Balance, January 1, 2006	23,926	$ 7.64		
Granted	488	5.95		

Exercised	(437)		5.13			
Forfeited or expired	(5,281)		8.63			
Balance, June 30, 2006	18,696	$	7.37	6.30	$	10,110
Vested and expected to vest at June 30, 2006	17,644	$	7.53	6.26	$	8,491
Exercisable, June 30, 2006	14,167	$	8.23	5.58	$	3,223

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the Company's closing stock price on the last trading day of the second quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. This amount changes based on the fair market value of the Company's stock. Total intrinsic value of options exercised for the six months ended June 30, 2006 was $0.1 million.

The resultant grant date weighted-average fair values calculated using the Black-Scholes option pricing model and the noted assumptions for stock options granted were $3.49 and $1.58 for the second quarter of 2006 and 2005, respectively, and $2.93 and $1.61 for the first six months of 2006 and 2005, respectively. Fair values for purchases related to the ESPP were $0.53 and $0.54 for both the second quarter and the first six months of 2006 and 2005, respectively.

A total of 10.1 million shares of common stock and rights to purchase common stock were available for grant under the Company's stock option plans as of June 30, 2006. Awards that expire or are cancelled without delivery of shares generally become available for issuance under the plans.

The table below sets out the pro forma amounts of net loss and net loss per share that would have resulted for the six months ended June 30, 2005, if the Company had accounted for its employee stock plans under the fair value recognition provisions of SFAS No. 123. These pro forma effects may not be representative of expense in future periods since the estimated fair value of stock options on the date of grant is amortized to expense over the vesting period, and additional options may be granted or options may be cancelled in future years:

	Six Months Ended June 30, 2005 (In thousands)	
Net loss as reported	$	(19,044)
Add: Stock compensation expense related to acquisitions (attributable to research and development activities) included in reported net loss, net of related tax effects		1,196
Deduct: Total stock-based employee compensation expense, net of estimated forfeitures, determined under fair value based method for all		(4,785)

awards, net of related tax effects		
Pro forma net loss	$	(22,633)
Net loss per share:		
Basic and diluted - as reported	$	(0.17)
Basic and diluted - pro forma	$	(0.20)

For purposes of computing pro forma net loss, the fair value of each option grant and ESPP purchase right was estimated on the date of grant using the Black-Scholes option pricing model. The assumptions used to value the option grants and purchase rights are stated below:

	Years Ended December 31,	
	2005	**2004**
Employee and Director Stock Options:		
Expected term (in years)	3.2	3.4
Volatility	39.6%	48.7%
Risk-free interest rate	4.2%	2.9%
Dividend yield	0%	0%
Employee Stock Purchase Plan:		
Expected life of purchase right (in years)	0.5	0.5
Volatility	32.2%	26.4%
Risk-free interest rate	4.2%	1.3%
Dividend yield	0%	0%

Upon the adoption of SFAS No. 123R effective January 1, 2006, stock compensation expense related to acquisitions (attributable to research and development activities) and previously classified as part of Amortization of intangible assets has been reclassified to Research and development expense. Such deferred stock compensation attributable to research and development activities was completely recognized as of March 31, 2006. Compensation expense was $0.0 million for both the three and six months ended June 30, 2006 compared to $0.6 million and $1.2 million for the three and six months ended June 30, 2005, respectively.

Note 5 - Inventories (in thousands):

	June 30, 2006	December 31, 2005
Work in progress	$ 23,915	$ 20,348
Finished goods	11,835	8,233
	$ 35,750	$ 28,581

Note 6 - Changes in Stockholders' Equity (in thousands):

	Common stock	Paid-in capital	Accumulated other comprehensive loss	Accumulated deficit	Total
Balances, Dec. 31, 2005	$ 1,136	$ 595,145	$ (488)	$ (97,709)	$ 498,084
Common stock issued in connection with exercise of stock options and ESPP	7	3,287	—	—	3,294
Unrealized gain on foundry investments, net (Note 7)	—	—	1,717	—	1,717
Previously unrealized gain on foundry investments sold (Note 7)	—	—	(1,435)	—	(1,435)
Stock-based compensation expense related to employee and director stock options and ESPP	—	1,315	—	—	1,315
Distribution of stock held in deferred compensation plan	—	247	—	—	247
Stock compensation expense related to acquisitions	—	30	—	—	30
Translation adjustment	—	—	(38)	—	(38)
Net income for the six month period	—	—	—	1,259	1,259
Balances, June 30, 2006	$ 1,143	$ 600,024	$ (244)	$ (96,450)	$ 504,473

Total comprehensive income for the first six months of 2006 was approximately $1.5 million and is substantially comprised of net income of $1.3 million along with an unrealized gain on foundry investments of $1.7 million, and a $1.4 million gain on sale of foundry investments previously included in Accumulated other comprehensive loss.

Note 7 - Foundry Investments, Advances and Other Assets (in thousands):

	June 30, 2006	December 31, 2005
Foundry investments and other assets	$ 28,261	$ 42,740
Wafer supply advances	43,458	50,427
	71,719	93,167
Less: UMC common stock available for sale	—	(1,356)
Current portion of wafer advance	(10,999)	(12,379)
	$ 60,720	$ 79,432

We owned 10.0 million shares of UMC common stock as of June 30, 2006. Under the terms of the UMC agreement, sales of these shares may result in a reduction of our rights to guaranteed wafer capacity at UMC based on the number of shares that we sell.

During the second quarter of 2006, we sold approximately 15.7 million shares of UMC common stock for approximately $10.2 million in cash, resulting in a net gain of approximately $1.3 million. If we further liquidate our UMC common stock, it is likely that the amount of any future realized gain or loss will be different from the accounting gain or loss reported in prior periods.

Note 8 - Purchased Intangible Assets:

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

June 30, 2006	**Gross**	**Accumulated amortization**	**Net**
Current technology	$ 273.6	$ (259.2)	$ 14.4
Core technology	7.3	(5.6)	1.7
Licenses	10.2	(6.5)	3.7
Non-compete agreements	14.2	(14.1)	0.1
Workforce	4.7	(3.6)	1.1
Backlog	1.4	(1.4)	—
Customer list	17.4	(17.4)	—
Patents and trademarks	26.8	(26.8)	—
Total	$ 355.6	$ (334.6)	$ 21.0

December 31, 2005	**Gross**	**Accumulated amortization**	**Net**
Current technology	$ 273.6	$ (255.7)	$ 17.9
Core technology	7.3	(4.8)	2.5
Licenses	10.2	(5.8)	4.4
Non-compete agreements	14.2	(14.1)	0.1
Workforce	4.7	(3.1)	1.6
Backlog	1.4	(1.4)	—
Customer list	17.4	(17.4)	—
Patents and trademarks	26.8	(26.8)	—
Total	$ 355.6	$ (329.1)	$ 26.5

The estimated future amortization expense of purchased intangible assets as of June 30, 2006 is as follows (in millions):

Fiscal Year:	**Amount**
2006 (remaining six months)	$ 5.4
2007	9.8
2008	5.6
2009	0.2
	$ 21.0

Note 9 - Restructuring Charges:

During the fourth quarter of 2005, we initiated and completed a restructuring plan implemented to reduce operating expenses. The restructuring encompassed three major components - a streamlining of research and development sites, a voluntary separation program for certain employees and an organizational consolidation within the Company's largest design center. These actions did not significantly impact the Company's product direction or product roll-out strategy, which remain unchanged.

In the fourth quarter of 2005, the Company recorded an initial restructuring charge of $11.9 million. The charge primarily related to separation packages, costs to vacate space under long-term lease arrangements and the write-off of an intellectual property license. All of our restructuring accruals as of June 30, 2006 are related to the fourth quarter 2005 restructuring plan.

The following table displays the current estimate for each major type of cost associated with the restructuring (in thousands):

	Accrual at 12/31/2005	Charged to Expense	Paid or Settled	Adjustments to Reserve	Accrual at 6/30/2006
Severance and related costs	$ 4,924	$ 75	$ (4,891)	$ —	$ 108
Lease loss reserve	2,167	(149)	(109)	235	2,144
Other	240	70	(206)	(92)	12
Total	$ 7,331	$ (4)	$ (5,206)	$ 143	$ 2,264

Included in the above amounts are disposals of leasehold improvements and fixed assets totaling $0.3 million and $0.2 million, respectively. Additionally, the above adjustment to the lease loss reserve resulted from the Company having negotiated both a sublease for its Colorado facility and a preliminary lease buyout agreement for its facility in the United Kingdom. The above restructuring charges are based on estimates that are subject to change. Lease charges change based on our ability to either generate sublease income or terminate lease obligations at the amounts estimated, and are dependent upon lease market conditions at the time we negotiate the potential lease arrangements. Variance from these estimates could alter our ability to achieve anticipated expense reductions in the planned timeframe and modify our expected cash outflows and working capital.

Note 10 - New Accounting Pronouncements:

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation ("Interpretation") No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. We are currently assessing the impact of this Interpretation on our consolidated financial statements.

Note 11 - Legal Matters:

In September and October 2004, three putative class action complaints were filed in the United States District Court for the District of Oregon against Lattice Semiconductor Corporation, our Chief Executive Officer and President Stephen A. Skaggs, and our former Chief Executive Officer Cyrus Y. Tsui. These complaints were filed on behalf of a putative class of investors who purchased our stock between April 22, 2003 and April 19, 2004. They generally alleged violations of federal securities laws arising out of our previously announced restatement of financial results for the first, second and third quarters of 2003. Consistent with the usual procedures for cases of this kind, these cases were amended and consolidated into a single action. In an amended and consolidated complaint filed January 27, 2005 our former President and our former Controller were added as defendants. The complaints generally sought an unspecified amount of damages, as well as attorney fees and costs. The Company has entered into an agreement with the plaintiffs to settle the consolidated action. The agreement, which has preliminary court approval, does not contain any admission of fault or wrongdoing on the part of the Company or any of the individual defendants in the litigation.

The agreement is subject to the completion of the usual and customary documentation for such a settlement, and is subject to, and conditioned upon, final court approval. The agreement provides that plaintiffs will receive an aggregate amount of $3.5 million, inclusive of fees and expenses of counsel, in exchange for a release of the Company and the individual defendants from all claims asserted in the litigation. Subject to final approval by the Court, the Company's insurance carriers have agreed with the Company to pay the entire amount, on behalf of the Company, to settle the suit under the terms of the Company's director and officer liability insurance policy. The Company has recorded a liability in its financial statements for the proposed amount of the settlement. Additionally, because the insurance carriers have agreed to pay the entire $3.5 million settlement amount, a receivable was also recorded for the same amount. Accordingly, there is no impact to the Condensed Consolidated Statement of Operations as the amounts of the settlement and the insurance recovery fully offset each other.

On June 14, 2005, we announced that our Audit Committee, in connection with its responsibilities for financial oversight, was conducting an internal examination. The examination concerned issues primarily associated with executive compensation and several items pertaining to our internal controls. On August 9, 2005, we announced that the Audit Committee had concluded the examination. We have furnished information regarding the matters examined by the Audit Committee to the Securities and Exchange Commission, which is conducting an ongoing informal inquiry into our prior restatement of financial results. On September 30, 2005 the Securities and Exchange Commission issued a Cease and Desist Order concerning our former Controller, and referenced certain events in connection with our prior restatement of financial results. We are cooperating fully with the Securities and Exchange Commission and intend to continue to do so. We cannot predict the duration or outcome of the Securities and Exchange Commission's inquiry. If the Securities and Exchange Commission expands its informal inquiry or decides to pursue enforcement action against us, or any other governmental agency or regulatory body takes similar action, our management could be distracted, we could incur substantial costs and there could be a material adverse effect on our business.

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

Note 12 - Segment and Geographic Information:

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

	Three Months Ended		**Six Months Ended**	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
United States revenue:	$ 14,842	$ 13,092	$ 28,551	$ 24,321
Export revenue:				
Europe	15,736	12,141	31,098	25,051
Asia Pacific (other than China and Japan)	11,839	9,080	21,517	18,953
China	9,000	7,090	16,579	13,046
Japan	7,590	7,553	14,915	14,786
Other	3,712	3,440	7,511	7,522
Total export revenue	47,877	39,304	91,620	79,358
Total revenue	$ 62,719	$ 52,396	$ 120,171	$ 103,679

Resale of product through two distributors accounted for approximately 13% and 10% of revenue in the first six months of 2006, and 14% and 10%, respectively, for the first six months of 2005. More than 90% of our property and equipment is located in the United States.

Note 13 - Income Taxes:

The Internal Revenue Service has examined our income tax returns for 2001 and 2002, and has issued proposed adjustments that would result in payment by the Company of $1.4 million, plus interest. These adjustments relate to the treatment of acquisition costs and a tax accounting method change for prepaid expenses. We do not agree with these proposed adjustments and are appealing, with the first IRS appeal hearing scheduled for September 19, 2006. Although the final resolution of this appeal and other tax issues is uncertain, we believe that adequate amounts have been provided for in the Condensed Consolidated Financial Statements. There is the possibility of either favorable or unfavorable impact on our results of operations in the period in which these matters are ultimately resolved, or in the

period in which our estimates of the outcomes change.

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

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

Overview of Three Month and Six Month Periods Ended June 30, 2006

Revenue in the second quarter and six months ended June 30, 2006 increased to $62.7 million and $120.2 million, respectively, compared to $52.4 million and $103.7 million for the second quarter and six months ended June 30, 2005, respectively. The revenue increase is attributable to overall growth in New*, Mainstream* and Mature* products, which increased 93%, 18% and 6%, respectively, compared to the second quarter of 2005, and 71%, 14% and 6%, respectively, compared to the first six months of 2005. The Company also experienced increased revenue from higher distribution resale of 31% and 21% for the second quarter and six months ended June 30, 2006, respectively, compared to the corresponding periods in 2005, and to a lesser extent, lower distributor price adjustments against distribution resale. We believe our future revenue growth is dependent upon, among other things, favorable market acceptance of our New* products.

Revenue attributable to PLD and FPGA products increased 17% and 33%, respectively, for the second quarter of 2006 compared to the second quarter of 2005. Likewise, PLD and FPGA product revenue increased 14% and 25%, respectively, for the first six months of 2006 compared to the first six months of 2005.

Our gross margin percentage increased to 56.7% in the second quarter of 2006 and decreased to 56.4% for the first six months of 2006, compared to 56.4% and 56.6% in the second quarter and first six months of 2005, respectively. Gross margin changes in the periods presented primarily reflect the effects of lower costs, manufacturing yield enhancements and varying product mix.

Research and development expenses decreased to $21.1 million (34% of revenue) and $42.2 million (35% of revenue) in the second quarter and first six months of 2006, respectively, compared to $25.1 million (48% of revenue) and $50.2 million (48% of revenue) in the second quarter and first six months of 2005, respectively. The decrease in expense is primarily a result of the restructuring plan implemented during the fourth quarter of 2005 and the elimination of stock compensation expense related to acquisitions. Although we experienced a considerable decline in research and development expense this quarter compared to the comparable quarter of 2005, we believe that a continued commitment to research and development is essential in order to achieve and maintain product leadership and provide innovative new product offerings, and therefore we expect to continue to make significant future investments in research and development. As we continue to move to more advanced process technologies such as 90 nanometer and beyond, mask costs are becoming increasingly more expensive and will therefore increasingly represent a greater proportion of total research and development expenses.

Selling, general and administrative expenses decreased to $13.8 million (22% of revenue) and $26.4 million (22% of revenue) in the second quarter and first six months of 2006, respectively, compared to $16.4 million (31% of revenue) and $30.8 million (30% of revenue) in the second quarter and first six months of 2005, respectively. The decrease in expense is primarily attributable to a $4.0 million and $5.5 million decline in the amount of legal expense charged in the second quarter and first six months of 2005, respectively, compared to the same periods in 2006. These legal expenses were related to the shareholder class action suits, the then pending (now settled) derivative suit and related (now concluded) Audit Committee examination and Special Litigation Committee ("SLC") investigation, and the Securities and Exchange Commission's ongoing informal inquiry. These decreases are partially offset by increases primarily in compensation related costs and other miscellaneous costs.

Amortization of intangible assets declined to $2.7 million and $5.5 million in the second quarter and first six months of 2006, respectively, compared to $3.5 million and $7.3 million for the same periods in 2005. Amortization charges related to previously completed acquisitions are expected to be substantially eliminated in 2008.

Other income, net, was $4.5 million and $8.3 million for the second quarter and first six months of 2006, respectively, and included a $1.3 million net gain during the second quarter from the sale of UMC common stock, and interest income of $3.3 million and $6.1 million in the second quarter and first six months of 2006, respectively. Other income, net, for the first six months of 2006 also included a gain on the extinguishment of Zero Coupon Convertible Subordinated Notes due July 1, 2010 ("Convertible Notes") of $1.2 million. These gains were partially offset by amortization of issuance costs on our Convertible Notes. Other income, net, was $7.4 million and $10.8 million in the second quarter and first six months of 2005, respectively, and included a $4.3 million net gain during the second quarter of 2005 from the sale of UMC common stock, gain in the second quarter and first six months of 2005 on the extinguishment of our Convertible Notes of $1.5 million and $3.5 million, respectively, and interest and dividends on short term investments and cash equivalents of $1.9 million and $3.6 million, respectively, partially offset by amortization of issuance costs on our Convertible Notes.

We are paying foreign income taxes which are reflected in the Condensed Consolidated Statement of Operations and are primarily related to the cost of operating our offshore research and development and sales subsidiaries. We expect to continue to pay foreign income taxes at current levels. We are not currently paying federal or state income taxes and do not expect to pay such taxes in 2006. We accrue interest expense on our tax contingency reserve.

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* Product Classification:

New:	LatticeEC/ECP, LatticeXP, MachXO, FPSC, ispXPLD, ispGDX2, Power Manager, ispCLK
Mainstream:	ispMACH 4000/Z, ispXPGA, ispGDX/V, ispMACH 4/LV, ispLSI 2000V, ispLSI 5000V, ispMACH 5000VG, and Other
Mature:	ORCA 2, ORCA 3, ORCA 4, ispPAC, ispLSI 8000V, ispMACH 5000B, ispMACH 2LV, ispMACH 5LV, All 5-Volt CPLDs, all SPLDs

Results of Operations

Key elements of our Condensed Consolidated Statement of Operations, expressed as a percentage of revenue, were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
Revenue	100.0%	100.0%	100.0%	100.0%
Gross margin	56.7%	56.4%	56.4%	56.6%
Research and development expenses	33.7%	47.8%	35.2%	48.5%
Selling, general and administrative expenses	22.0%	31.4%	22.0%	29.7%
Amortization of intangible assets	4.3%	6.7%	4.6%	7.1%
Loss from operations	(3.5)%	(29.6)%	(5.5)%	(28.6)%

Revenue:

Revenue for the second quarter of 2006 increased by $10.3 million, or 20%, as compared to the second quarter of 2005. The composition of our revenue by product classification for the second quarter and first six months of 2006 and 2005 was as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
FPGA	21%	19%	20%	18%
PLD	79%	81%	80%	82%

	Three Months Ended		Six Months Ended	
	June 30, 2006	**June 30, 2005**	**June 30, 2006**	**June 30, 2005**
New	14%	9%	12%	8%
Mainstream	51%	51%	51%	51%
Mature	35%	40%	37%	41%

Beginning with the quarter ended March 31, 2006 we have reclassified our New, Mainstream and Mature product categories to better reflect our current product portfolio. The New product category has been narrowed, and as such several products have been removed from our New product category and are now classified as Mainstream. As part of the change to product categories, we also reclassified certain products from Mainstream to Mature. Prior period ratios have been recalculated to reflect these new product category classifications.

The composition of our revenue by geographical location of our direct and indirect customers is as follows (in thousands):

	Three Months Ended					
	June 30, 2006			**June 30, 2005**		
United States revenue:	$	14,842	24%	$	13,092	25%
Export revenue:						
Europe		15,736	25%		12,141	23%

Asia Pacific (other than China and Japan)		11,839	19%		9,080	17%
China		9,000	14%		7,090	14%
Japan		7,590	12%		7,553	14%
Other		3,712	6%		3,440	7%
Total export revenue		47,877	76%		39,304	75%
Total revenue	$	62,719	100%	$	52,396	100%

	Six Months Ended					
		June 30, 2006			June 30, 2005	
United States revenue:	$	28,551	24%	$	24,321	24%
Export revenue:						
Europe		31,098	26%		25,051	24%
Asia Pacific (other than China and Japan)		21,517	18%		18,953	18%
China		16,579	14%		13,046	13%
Japan		14,915	12%		14,786	14%
Other		7,511	6%		7,522	7%
Total export revenue		91,620	76%		79,358	76%
Total revenue	$	120,171	100%	$	103,679	100%

During the second quarter and first six months of 2006 compared to the same periods in 2005, total units increased 13% and 14%, respectively, and average selling prices increased 6% and 1% for the quarter and six months ended June 30, 2006, respectively, compared to the same periods in 2005. The increase in units sold during the second quarter and first six months of 2006 compared to the same periods in 2005 was predominantly attributable to significantly higher sales of New products based on new product categories as previously described, which was driven by the Company's highest level of quarterly FPGA revenue. The increase in average selling price was primarily due to product mix. Selling prices of our products generally decline over time. Higher selling prices of new products commonly offset some or all of this decline; however, product mix changes can also have a significant effect on average selling prices.

As a percentage of revenue, export revenue was 76% for both the three and six months ended June 30, 2006, and was 75% for the June 30, 2005 quarter and 76% for the six months ended June 30, 2005. Export revenue as a percentage of overall revenue increased in the second quarter of 2006 compared to the same period in 2005 due to more favorable business conditions in Asia.

Our ability to achieve revenue growth is in large part dependent on the continued development, introduction and market acceptance of new products.

Gross Margin:

The gross margin percentage increased from 56.4% in the second quarter of 2005 to 56.7% in the second quarter of 2006. Conversely, our gross margin declined from 56.6% for the first six months of 2005 to 56.4% for the first six months of 2006. Gross margin changes in the periods presented primarily reflect the effects of lower costs, manufacturing yield enhancements and varying product mix.

Research and Development:

Research and development expenses decreased by $3.9 million and $8.0 million in the second quarter and first six months of 2006, respectively, when compared to the same periods in 2005. The change is primarily a result of the restructuring plan implemented during the fourth quarter of 2005. Although we experienced a considerable decline in research and development expense this quarter and for the six months ended June 30, 2006 compared to the comparable periods of 2005, we believe that a continued commitment to research and development is essential in order to achieve and maintain product leadership and provide innovative new product offerings, and therefore we expect to continue to make significant future investments in research and development. As we continue to move to more advanced process technologies such as 90 nanometer and beyond, mask costs are becoming increasingly more expensive and will therefore increasingly represent a greater proportion of total research and development expenses.

Selling, General and Administrative Expense:

Selling, general and administrative expenses decreased approximately $2.6 million and $4.3 million in the second quarter and first six months of 2006, respectively, when compared to the same periods of 2005. The decrease in expense is primarily attributable to a $4.0 million and $5.5 million decline in the amount of legal expense charged in the second quarter and first six months of 2005, respectively, compared to the same periods in 2006. These legal expenses were related to the shareholder class action suits, the then pending (now settled) derivative suit and related (now concluded) Audit Committee examination and SLC investigation, and the Securities and Exchange Commission's ongoing informal inquiry. These decreases are partially offset by increases primarily in compensation related costs and other miscellaneous costs.

Amortization of Intangible Assets:

Amortization of intangible assets is related to acquisitions from 2002 and earlier. Amortization of intangible assets declined to $2.7 million in the second quarter of 2006 compared to $3.5 million in the second quarter of 2005, and $5.5 million in the first six months of 2006 compared to $7.3 million in the first six months of 2005.

Other Income, net:

Interest income was $3.3 million and $6.1 million in the second quarter and first six months of 2006, respectively, compared to $1.9 million and $3.6 million for the same periods of 2005. The increase was a result of higher interest rates on marketable securities.

Other income, net, of $4.5 million in the second quarter of 2006 included a $1.3 million gain on the sale of UMC common stock. Amortization of Convertible Notes issuance costs was $0.1 million during the quarter. For the six month period ended June 30, 2006, other income, net, of $8.3 million included a net gain on the sale of UMC common stock of $1.3 million, and a gain of $1.2 million on the extinguishment of $10.0 million of Convertible Notes for $8.7 million in cash, which required recognition of $0.1 million of unamortized issuance costs. Amortization of Convertible Notes issuance costs was $0.3 million for the first six months of 2006.

Other income, net, of $7.4 million in the second quarter of 2005 included a $4.3 million net gain on the sale of UMC common stock, and a $1.5 million gain on the extinguishment of $10.0 million of our Convertible Notes for $8.4 million in cash, which required recognition of $0.1 million of unamortized issuance costs. Amortization of Convertible Notes issuance costs was $0.2 million in the second quarter of 2005. For the six month period ended June 30, 2005, other income, net, of $10.8 million included a net gain on the sale of UMC common stock of $4.3 million and a gain of $3.5 million on the extinguishment of $25.5 million of Convertible Notes for $21.7 million in cash, which required recognition of $0.3 million of unamortized issuance costs. Amortization of Convertible Notes issuance costs was $0.5 million for the first six months of 2005.

Provision for Income Taxes:

The 2006 tax provision is related to income taxes on our foreign subsidiaries primarily engaged in selling and research and development activities and accrual of interest expense on our tax contingency reserve.

The Internal Revenue Service has examined our income tax returns for 2001 and 2002, and has issued proposed adjustments that would result in payment by the Company of $1.4 million, plus interest. These adjustments relate to the treatment of acquisition costs and a tax accounting method change for prepaid expenses. We do not agree with these proposed adjustments and are appealing, with the first IRS appeal hearing scheduled for September 19, 2006. Although the final resolution of this appeal and other tax issues is uncertain, we believe that adequate amounts have been provided for in the Condensed Consolidated Financial Statements. There is the possibility of either favorable or unfavorable impact on our results of operations in the period in which these matters are ultimately resolved, or in the period in which our estimates of the outcomes change.

Purchased Intangible Assets:

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

June 30, 2006	**Gross**	**Accumulated amortization**	**Net**
Current technology	$ 273.6	$ (259.2)	$ 14.4
Core technology	7.3	(5.6)	1.7
Licenses	10.2	(6.5)	3.7
Non-compete agreements	14.2	(14.1)	0.1
Workforce	4.7	(3.6)	1.1
Backlog	1.4	(1.4)	—
Customer list	17.4	(17.4)	—
Patents and trademarks	26.8	(26.8)	—
Total	$ 355.6	$ (334.6)	$ 21.0

December 31, 2005	**Gross**	**Accumulated amortization**	**Net**
Current technology	$ 273.6	$ (255.7)	$ 17.9
Core technology	7.3	(4.8)	2.5
Licenses	10.2	(5.8)	4.4
Non-compete agreements	14.2	(14.1)	0.1
Workforce	4.7	(3.1)	1.6
Backlog	1.4	(1.4)	—
Customer list	17.4	(17.4)	—
Patents and trademarks	26.8	(26.8)	—
Total	$ 355.6	$ (329.1)	$ 26.5

The estimated future amortization expense of purchased intangible assets as of June 30, 2006 is as follows (in millions):

Fiscal Year:	**Amount**
2006 (remaining six months)	$ 5.4
2007	9.8
2008	5.6
2009	0.2
	$ 21.0

New Accounting Pronouncements:

In June 2006, the Financial Accounting Standards Board (“FASB”) issued Interpretation (“Interpretation”) No. 48, “Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109.” This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification,

interest and penalties, accounting in interim periods, disclosure, and transition. This Interpretation is effective for fiscal years beginning after December 15, 2006. We are currently assessing the impact of this Interpretation on our consolidated financial statements.

Liquidity and Capital Resources

Financial Condition (Sources and Uses of Cash):

Operating

Net cash provided by operating activities increased by approximately $26.8 million in the six months ended June 30, 2006 as compared to the corresponding period in fiscal 2005. The change is due to recognition of net income of $1.3 million for the six months ended June 30, 2006 compared to a net loss of $19.0 million and a $25.0 million payment to Fujitsu Limited ("Fujitsu") pursuant to an advance payment agreement during the six months ended June 30, 2005. This increase was partially offset by higher inventory and accounts receivable balances, increase in usage of wafer advances, and payments related to the restructuring.

Investing

Net cash provided by investing activities decreased by $53.3 million for the six months ended June 30, 2006 as compared to the corresponding period in 2005. The change is due primarily to decreases in both the sale of short-term investments and the sale of equity securities (principally UMC common stock). Net proceeds from short-term investments totaled $4.9 million for the six months ended June 30, 2006 compared to $37.4 million for the same period in 2005. Likewise, net proceeds from sale of equity securities (principally UMC common stock) totaled $10.2 million for the six months ended June 30, 2006 compared to $27.5 million for the same period in 2005. Further, capital expenditures have been greater in the first six months of 2006, totaling $8.2 million compared to $4.7 million in the first six months in 2005, which is primarily related to purchases of new test equipment.

Financing

Net cash used in financing activities decreased by $14.4 million in the six months ended June 30, 2006 as compared to the corresponding period in 2005. The decrease is due primarily to the use of $8.7 million to extinguish our Convertible Notes in 2006 compared to $21.7 million in 2005. Further, net proceeds from the issuance of common stock for 2006 increased $3.3 million over the same period in 2005. These changes were offset by a decrease in net advances on the Yen line of credit of $0.2 million for the first six months of 2006 compared to $2.0 million for the first six months of 2005.

Liquidity:

As of June 30, 2006, our principal source of liquidity was $262.7 million of cash and marketable securities, which was $11.7 million less than the balance at June 30, 2005. This decrease was due primarily to the extinguishment of $20.0 million of Convertible Notes for $17.2 million in cash during the twelve month period. Working capital decreased $11.6 million to $293.2 million at June 30, 2006 as compared to the corresponding amount at June 30, 2005. This decrease was primarily attributable to the aforementioned extinguishment of certain Convertible Notes and capital expenditures.

Accounts receivable increased by $7.0 million to $33.1 million at June 30, 2006 compared to the balance of $26.0 million at June 30, 2005. This increase reflects both higher billings in the June 30, 2006 quarter and the timing of billings and more than offset a decrease related to distributor advances to certain distributors of $6.0 million.

Inventories increased $1.6 million to $35.8 million at June 30, 2006 compared to $34.1 million at June 30, 2005 primarily due to management's decision to hold more inventory in finished goods form to minimize the effects of industry supply constraints and to build additional New product inventory in advance of sales orders.

Other current assets increased $0.1 million to $24.6 million at June 30, 2006 as compared to $24.5 million at June 30, 2005. Included within other current assets is a receivable for $3.5 million related to settlement of our consolidated class action lawsuit, as discussed in Note 11 to the financial statements. The Company has recorded a corresponding liability in Accounts payable and accrued expenses for the proposed amount of the settlement.

Foundry investments, advances and other assets decreased by approximately $28.8 million to $60.7 million at June 30, 2006 as compared to $89.5 million at June 30, 2005, primarily related to the sale of UMC common stock totaling $11.2 million, the consumption of wafer prepayments totaling $10.3 million, distributions of deferred compensation assets held in the deferred compensation plan totaling $4.0 million, and the write-off of an intellectual property license recorded at $2.7 million.

Property and equipment, less accumulated depreciation, increased by $2.5 million to $47.7 million at June 30, 2006 compared to $45.2 million at June 30, 2005 due to expenditures for capital equipment being greater than the corresponding depreciation expense. Capital expenditures were $5.5 million for the quarter ended June 30, 2006 and $8.2 million for the six months ended June 30, 2006. We expect to spend approximately $12.0 million to $15.0 million on capital expenditures for the fiscal year ending December 31, 2006.

We believe that our existing liquid resources and expected cash generated from future operations combined with our ability to borrow additional funds will be adequate to meet our operating and capital requirements and obligations for the next 12 months, which includes payments to Fujitsu of $75.0 million based upon the achievement of certain milestones. We currently anticipate that these payments will occur during the second half of 2006. We may in the future seek new or additional sources of funding. In addition, in order to secure additional wafer supply, we 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 we pursue any such additional financing arrangements, additional debt or equity financing may be required. There can be no assurance that such additional financing will be available when needed or, if available, will be on favorable terms. Any future equity financing will decrease existing stockholders' equity percentage ownership and may, depending on the price at which the equity is sold, result in dilution.

Contractual Obligations

Our only significant operating lease, apart from those accrued for in the restructuring, is for our San Jose, California facility and it expires in 2008. Annual rent is $4.0 million and increases approximately 3% annually. Leasehold improvements are amortized over the shorter of the non-cancelable lease term or the estimated useful life of the assets.

There have been no material changes outside of the ordinary course of business in our contractual obligations and rights since the filing of our Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

As of June 30, 2006, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to the quantitative and qualitative disclosures about market risk reported in our Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 4. CONTROLS AND PROCEDURES

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's "disclosure controls and procedures" (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act")) are effective.

In connection with the evaluation described above, we identified no change in our internal control over financial reporting that occurred during the three months ended June 30, 2006, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In September and October 2004, three putative class action complaints were filed in the United States District Court for the District of Oregon against Lattice Semiconductor Corporation, our Chief Executive Officer and President Stephen A. Skaggs, and our former Chief Executive Officer Cyrus Y. Tsui. These complaints were filed on behalf of a putative class of investors who purchased our stock between April 22, 2003 and April 19, 2004. They generally alleged violations of federal securities laws arising out of our previously announced restatement of financial results for the first, second, and third quarters of 2003. Consistent with the usual procedures for cases of this kind, these cases were amended and consolidated into a single action. In an amended and consolidated complaint filed January 27, 2005 our former President and our former Controller were added as defendants. The complaints generally sought an unspecified amount of damages, as well as attorney fees and costs. The Company has entered into an agreement with the plaintiffs to settle the consolidated action. The agreement, which has preliminary court approval, does not contain any admission of fault or wrongdoing on the part of the Company or any of the individual defendants in the litigation. The agreement is subject to the completion of the usual and customary documentation for such a settlement, and is subject to, and conditioned upon, final court approval. The agreement provides that plaintiffs will receive an aggregate amount of $3.5 million, inclusive of fees and expenses of counsel, in exchange for a release of the Company and the individual defendants from all claims asserted in the litigation. Subject to final approval by the Court, the Company's insurance carriers have agreed with the Company to pay the entire amount, on behalf of the Company, to settle the suit under the terms of the Company's director and officer liability insurance policy. The Company has recorded a liability in its financial statements for the proposed amount of the settlement. Additionally, because the insurance carriers have agreed to pay the entire $3.5 million settlement amount, a receivable was also recorded for the same amount. Accordingly, there is no impact to the Condensed Consolidated Statement of Operations as the amounts of the settlement and the insurance recovery fully offset each other.

On June 14, 2005, we announced that our Audit Committee, in connection with its responsibilities for financial oversight, was conducting an internal examination. The examination concerned issues primarily associated with executive compensation and several items pertaining to our internal controls. On August 9, 2005, we announced that the Audit Committee had concluded the examination. We have furnished information regarding the matters examined by the Audit Committee to the Securities and Exchange Commission, which is conducting an ongoing informal inquiry into our prior restatement of financial results. On September 30, 2005 the Securities and Exchange Commission issued a Cease and Desist Order concerning our former Controller, and referenced certain events in connection with our prior restatement of financial results. We are cooperating fully with the Securities and Exchange Commission and intend to continue to do so. We cannot predict the duration or outcome of the Securities and Exchange Commission's inquiry. If the Securities and Exchange Commission expands its informal inquiry or decides to pursue enforcement action against us, or any other governmental agency or regulatory body takes similar action, our management could be distracted, we could incur substantial costs and there could be a material adverse effect on our business.

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

ITEM 1A. RISK FACTORS

The risk factors included herein include any material changes to and supersede the description of the risk factors associated with our business previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005. The following risk factors and other information included in this Quarterly Report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected.

We may be unsuccessful in defining, developing or selling the new FPGA products required to maintain or expand our business.

As a semiconductor company, we operate in a dynamic environment marked by rapid product obsolescence. The programmable logic market is characterized by rapid technology and product evolution and in recent years the market for FPGA products has grown faster than the market for PLD products. Currently we derive a greater proportion of our revenue from PLD products than FPGA products. Consequently, our future success depends on our ability to introduce new FPGA and associated software design tool products that meet evolving customer needs while achieving acceptable margins. We are presently shipping our next generation FPGA product families that are critical to our ability to grow our FPGA product revenue and expand our overall revenue. We also plan to continue upgrading our customer design tool products and increase our offerings of intellectual property cores. If we fail to introduce new products in a timely manner, or if these products or future new products fail to achieve market acceptance, our operating results would be harmed.

Fujitsu has agreed to manufacture our current and future FPGA products on its 130 nanometer and 90 nanometer CMOS process technologies, as well as on 130 nanometer and 90 nanometer technologies with embedded flash memory that we have jointly developed with Fujitsu. We are also developing 65 nanometer CMOS process technology with Fujitsu. The success of our next generation FPGA products is dependent on our ability to successfully partner with Fujitsu. If for any reason we are unsuccessful in our efforts to partner with Fujitsu in connection with these next generation FPGA products, our future revenue growth would be materially adversely affected.

The introduction of new silicon and software design tool products in a dynamic market environment presents significant business challenges. Product development commitments and expenditures must be made well in advance of product sales. The market reception of new products depends on accurate projections of long-term customer demand, which by their nature are uncertain.

Our future revenue growth is dependent on market acceptance of our new silicon and software design tool products and the continued market acceptance of our current products. The success of these products is dependent on a variety of specific technical factors including:

- successful product definition;
- timely and efficient completion of product design;
- timely and efficient implementation of wafer manufacturing and assembly processes;
- product performance;
- product cost; and

- the quality and reliability of the product.

If, due to these or other factors, our new silicon and software products do not achieve market acceptance, our operating results would be harmed.

Our products may not be competitive if we are unsuccessful in migrating our manufacturing processes to more advanced technologies or alternative fabrication facilities.

To develop new products and maintain the competitiveness of existing products, we need to migrate to more advanced wafer manufacturing processes that use larger wafer sizes and smaller device geometries. We also may need to use additional foundries. Because we depend upon foundries to provide their facilities and support for our process technology development, we may experience delays in the availability of advanced wafer manufacturing process technologies at existing or new wafer fabrication facilities. As a result, volume production of our advanced process technologies at the fabrication facilities of Fujitsu, Seiko Epson, UMC or future foundries may not be achieved. This could harm our operating results.

The potential impact of customer design-in activity on future revenue is inherently uncertain because it is unknown whether any particular customer design-in will ultimately result in sales of a significant volume, and, if a particular customer design-in does result in such sales, when such sales will ultimately occur and the amount of such sales.

We face uncertainties relating to the potential impact of customer design-in activity because it is unknown whether any particular customer design activity will ultimately result in sales of significant volume, and, if customer design activity does result in such sales, when such sales will ultimately occur and what the amount of such sales will be. Measurements of customer design-in activity, such as "design-ins" and "design-wins," are inherently imprecise as it is not possible to predict which designs will ultimately be mass produced, when such production may occur, or whether our products will be used in volume production. We may not be able to accurately manage production of products or predict sales of products, and, thus, our revenue levels may not match our product production.

Our supply of assembled and tested products could be interrupted or reduced, which may result in a shortage of products available for sale.

We do not assemble our finished products or perform all testing of our products. Currently, our finished products are assembled and tested by Amkor in the Philippines and South Korea, ASE in Malaysia, STATS/ChipPAC in China, Fujitsu in Japan, AIT in Indonesia, and other independent contractors in Asia. If any of our current or future assembly or test contractors significantly interrupts or reduces our supply of assembled and tested devices, our operating results could be harmed.

In the past, we have experienced delays in obtaining assembled and tested products and in securing assembly and test capacity commitments from our suppliers. At present, we anticipate that our assembly and test capacity commitments are adequate. However, these existing commitments may not be sufficient for us to satisfy customer demand in future periods. Additionally, notwithstanding our assembly and test capacity commitments we may still have difficulty in obtaining deliveries of finished products consistent with the capacity commitments. We negotiate assembly and test prices and capacity commitments from our contractors on a periodic basis. If any of our assembly or test contractors were to reduce its capacity commitment or increase its prices, and we cannot find alternative sources, our operating results could be harmed.

Many other factors that could disrupt our supply of finished products are beyond our control. Since worldwide capacity for assembly and testing of semiconductor products is limited and inelastic, we could be harmed by significant industry-wide increases in overall demand or interruptions in supply. The assembly of complex packages requires a consistent supply of a variety of raw materials such as substrates, leadframes, and mold compound. The worldwide manufacturing capacity for these materials is limited and inelastic. A significant industry-wide increase in demand, or interruptions in the supply of these materials to our assembly or test contractors, could harm our operating results. Additionally, a future disruption of any of our assembly or test contractors' operations as a result of a fire, earthquake, act of terrorism, political unrest, governmental uncertainty, war, or other natural disaster or catastrophic event could disrupt our supply of assembled and tested devices and could harm our operating results.

In addition, our quarterly revenue levels may be affected to a significant extent by our ability to match inventory and current production mix with the product mix required to fulfill orders. The large number of individual parts we sell and the large number of customers for our products, combined with limitations on our and our customer's ability to forecast orders accurately and our relatively lengthy manufacturing cycles, may make it difficult to achieve a match of inventory on hand, production units, and shippable orders sufficient to realize quarterly or annual revenue projections.

Our wafer supply could be interrupted or reduced, which may result in a shortage of products available for sale.

We do not manufacture finished silicon wafers and many of our products, including all of our newest FPGA products, are manufactured by a sole source. Currently, our silicon wafers are manufactured by Fujitsu in Japan, Seiko Epson in Japan, UMC in Taiwan and Chartered Semiconductor in Singapore. If any of our current or future foundry partners significantly interrupts or reduces our wafer supply, our operating results could be harmed.

In the past, we have experienced delays in obtaining wafers and in securing supply commitments from our foundries. At present, we anticipate that our supply commitments are adequate. However, these existing supply commitments may not be sufficient for us to satisfy customer demand in future periods. Additionally, notwithstanding our supply commitments, we may still have difficulty in obtaining wafer deliveries consistent with the supply commitments. We negotiate wafer prices and supply commitments from our suppliers on at least an annual basis. If any of our foundry partners were to reduce its supply commitment or increase its wafer prices, and we cannot find alternative sources of wafer supply, our operating results could be harmed.

Many other factors that could disrupt our wafer supply are beyond our control. Since worldwide manufacturing capacity for silicon wafers is limited and inelastic, we could be harmed by significant industry-wide increases in overall wafer demand or interruptions in wafer supply. Additionally, a future disruption of any of our foundry partners' foundry operations as a result of a fire, earthquake, act of terrorism, political unrest, governmental uncertainty, war, or other natural disaster or catastrophic event could disrupt our wafer supply and could harm our operating results.

If our foundry partners experience quality or yield problems, we may face a shortage of products available for sale.

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

The reliable manufacture of high performance programmable logic devices is a complicated and technically demanding process requiring:

- a high degree of technical skill;
- state-of-the-art equipment;
- the availability of certain basic materials and supplies, such as chemicals, gases, polysilicon, silicon wafers and ultra-pure metals;
- the absence of defects in production wafers;
- the elimination of minute impurities and errors in each step of the fabrication process; and
- effective cooperation between the wafer supplier and us.

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

If our assembly and test supply contractors experience quality or yield problems, we may face a shortage of products available for sale.

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

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

- a high degree of technical skill;
- state-of-the-art equipment;
- the absence of defects in assembly and packaging manufacturing;
- the elimination of raw material impurities and errors in each step of the process; and

- effective cooperation between the assembly contractor and us.

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

Product quality problems could lead to reduced revenue, gross margins, and net income.

We generally warrant our products for varying lengths of time against non-conformance to our specifications and certain other defects. Because our products, including hardware and software, are highly complex and incorporate leading-edge technology, our quality assurance programs may not detect all defects, whether manufacturing defects in individual products or systematic defects that could affect numerous shipments. On occasion we have elected to or been required to repair or replace certain components and software or refund the purchase price or license fee paid by our customers due to product defects. If there are material increases in warranty claims or the costs to resolve warranty claims compared with our historical experience, our revenue, gross margins, and net income may be adversely affected. For example, an inability to cure a product defect in a timely manner could result in product reengineering expenses, increased inventory costs, or damage to our reputation, any of which could materially impact our revenue, gross margins, and net income.

The cyclical nature of the semiconductor industry may limit our ability to maintain revenue levels and operating results during industry downturns.

The semiconductor industry is highly cyclical, to a greater extent than other less technology-driven industries. Our financial performance has periodically been negatively affected by downturns in the semiconductor industry. Factors that contribute to these industry downturns include:

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

Historically, the semiconductor industry has experienced periodic downturns of varying degrees of severity and duration. Typically, after such downturns, semiconductor industry conditions improve, although such improvement may not be significant or sustainable. Increased demand for semiconductor industry products may not proportionately increase demand for programmable logic products in general, or our products in particular. Even if demand for our products increases, average selling prices for our products may not increase, and could decline. Whenever adverse semiconductor industry conditions or other similar conditions exist, there is likely to be an adverse effect on our operating results.

Further, our ability to predict end-user demand is limited. Typically, the majority of our revenue comes from “turns orders,” which are orders placed and filled within the same quarter. By definition, turns orders are not captured in a backlog measurement at the beginning of a quarter. Accordingly, we cannot use backlog as a reliable measure of predicting revenue.

A downturn in the communications equipment end market or computing end market could cause a reduction in demand for our products and limit our ability to maintain revenue levels and operating results.

The majority of our revenue is derived from customers in the communications equipment and computing end markets. Any deterioration in these end markets or any reduction in technology capital spending could lead to a reduction in demand for our products. For example, in the past, a general weakening in demand for programmable logic products from customers in the communications end market has adversely affected our revenue. Whenever adverse economic or end market conditions exist, there is likely to be an adverse effect on our operating results.

Conditions in Asia may disrupt our existing supply arrangements and result in a shortage of finished products available for sale.

All of our major silicon wafer suppliers operate fabrication facilities located in Asia. Additionally, our finished silicon wafers are assembled and tested by independent contractors located in China, Indonesia, Japan, Malaysia, the Philippines and South Korea. Economic, financial, social and political conditions in Asia have historically been volatile. Financial difficulties, the effects of currency fluctuation, governmental actions or restrictions, prolonged work stoppages, political unrest, war, natural disaster, disease or any other difficulties experienced by our suppliers may disrupt our supply and could harm our operating results.

Export sales account for the majority of our revenue and may decline in the future due to economic and governmental uncertainties.

Our export sales are affected by unique risks, including:

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

Our future quarterly operating results may fluctuate and therefore may fail to meet expectations.

Our quarterly operating results have fluctuated in the past and may continue to fluctuate. Consequently, our operating results may fail to meet the expectations of analysts and investors. As a result of industry conditions and the following specific factors, our quarterly operating results are more likely to fluctuate and are more difficult to predict than a typical non-technology company of our size and maturity:

- general economic conditions in the countries where we sell our products;
- conditions within the end markets into which we sell our products;
- the cyclical nature of demand for our customers' products;
- excessive inventory accumulation by our end customers;
- the timing of our and our competitors' new product introductions;
- product obsolescence;
- the scheduling, rescheduling and cancellation of large orders by our customers;
- the willingness and ability of our customers and distributors to make payment to us in a timely manner;
- our ability to develop new process technologies and achieve volume production at the fabrication facilities of Fujitsu, Seiko Epson, UMC, Chartered Semiconductor or at other foundries;
- changes in manufacturing yieldsincluding delays in achieving target yields on new products;
- adverse movements in exchange rates, interest rates or tax rates; and

- the availability of adequate supply commitments from our wafer foundries and assembly and test subcontractors.

Our quarterly results may also fluctuate as a result of the legal expenses accrued in any given period in connection with the Securities and Exchange Commission's ongoing informal inquiry. As a result of these factors, our past financial results are not necessarily a good predictor of our future results.

We may have failed to adequately insure against certain risks, and, as a result, our financial condition and results may be adversely affected.

We carry insurance customary for companies in our industry, including, but not limited to, liability, property and casualty, worker's compensation and business interruption insurance. We also carry basic medical insurance, subject to a true insurance stop loss for catastrophic illness. In addition, we have insurance contracts that provide director and officer liability coverage for our directors and officers. Other than the specific areas mentioned above, we are self-insured with respect to most other risks and exposures, and the insurance we carry in many cases is subject to a significant policy deductible or other limitation before coverage applies. Based on management's assessment and judgment, we have determined that it is more cost effective to self-insure against certain risks than to incur the insurance premium costs. The risks and exposures for which we self-insure include, but are not limited to, natural disasters, product defects, political risk, theft, patent infringement and some employment practice matters. Should there be a catastrophic loss due to an uninsured event such as an earthquake or a loss due to adverse occurrences in any area in which we are self-insured, our financial condition, results of operations and liquidity may be adversely affected.

We face risks related to litigation and an ongoing informal inquiry by the Securities and Exchange Commission.

On June 14, 2005, we announced that our Audit Committee, in connection with its responsibilities for financial oversight, was conducting an internal examination. The examination concerned issues primarily associated with executive compensation and several items pertaining to our internal controls. On August 9, 2005, we announced that the Audit Committee had concluded the examination. We have furnished information regarding the matters examined by the Audit Committee to the Securities and Exchange Commission, which is conducting an ongoing informal inquiry into our prior restatement of financial results. On September 30, 2005 the Securities and Exchange Commission issued a Cease and Desist Order concerning our former Controller, and referenced certain events in connection with our prior restatement of financial results. We are cooperating fully with the Securities and Exchange Commission and intend to continue to do so. We cannot predict the duration or outcome of the Securities and Exchange Commission's inquiry. If the Securities and Exchange Commission expands its informal inquiry or decides to pursue enforcement action against us, or any other governmental agency or regulatory body takes similar action, our management could be distracted, we could incur substantial costs and there could be a material adverse effect on our business.

We are exposed to certain asserted and unasserted potential claims. There can be no assurance that, with respect to potential claims made against us, we could resolve such claims under terms and conditions that would not have a material adverse effect on our business, our liquidity or our financial results. We have been and may in the future be subject to various other legal proceedings, including, as discussed in greater detail hereafter, claims that involve possible infringement of patent and other intellectual property rights of third parties. It is inherently difficult to assess the outcome of litigation matters, and there can be no assurance that we will prevail in any litigation. Any such litigation could result in a substantial diversion of our efforts and the use of substantial management and financial resources, which by itself could have a material adverse effect on our financial condition and operating results. Further, an adverse determination in any such litigation could result in a material adverse impact on our financial position and the results of operations for the period in which the effect of an unfavorable final outcome becomes probable and reasonably estimable.

If we are unable to effectively and efficiently implement our plan to improve our internal controls there could be a material adverse effect on our operations or financial results.

During our 2004 year-end financial statement closing, we identified a significant deficiency in our internal controls relating to a mechanical error in calculating a unique inventory allowance, which occurred because newly assigned employees did not recognize that the required allowance had been calculated and recorded by existing procedures. The error was not present in previously issued financial statements and was corrected before the year-end financial statements were issued. Additional training and review procedures have been instituted to remedy this deficiency. During 2005, we performed additional training as well as identified ways to modify and automate our inventory compilation processes to make them less vulnerable to manual errors. We are continuing to pursue methods to better automate these processes.

On August 9, 2005, we announced that our Audit Committee had completed its previously announced examination, which concerned issues primarily associated with executive compensation and several items pertaining to our internal controls. In connection with the completion of its examination, the Audit Committee recommended, and the Board of Directors adopted, a number of recommended enhancements to our policies and procedures, including internal control procedures, which are described in Item 9A of our Annual Report on Form 10-K for the year ended December 31, 2005.

No assurance can be given that we will be able to successfully implement our revised internal controls and procedures and the recently adopted enhancements, or that our revised controls and procedures or enhancements will have the

desired effect. In addition, we may be required to hire additional employees, and may experience higher than anticipated capital expenditures and operating expenses, during the implementation of these changes and thereafter. Furthermore, future assessments of our internal controls and procedures may reveal new material weaknesses or significant deficiencies. If we are unable to implement these changes to our internal controls and procedures effectively or efficiently, or if we discover additional material weaknesses or significant deficiencies, there could be a material adverse effect on our operations or financial results.

Changes in accounting for equity compensation will adversely affect our consolidated statement of operations and could adversely affect our ability to attract and retain employees.

We have historically used stock options as a key component of employee compensation in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board has adopted changes to generally accepted accounting principles that require us and other companies to record a charge to earnings for employee stock option grants and other equity incentives beginning in the quarter ended March 31, 2006. For the three and six month periods ended June 30, 2006 we recorded $0.6 million and $1.3 million of stock-based compensation expense, respectively. To the extent that these or other new regulations make it more difficult or expensive to grant options to employees, we will incur increased compensation costs. We may also change our equity compensation strategy, and this could make it difficult to attract, retain and motivate employees. Any of these results could materially and adversely affect our business.

Our stock price may continue to experience large fluctuations.

Historically, the price of our common stock has at times experienced rapid and severe price fluctuations that have left investors little time to react. The price of our common stock may continue to fluctuate greatly in the future due to a variety of company specific factors, including:

- quarter-to-quarter variations in our operating results;
- shortfalls in revenue or earnings from levels expected by investors;
- announcements of technological innovations or new products by other companies; and
- any developments in the Securities and Exchange Commission's informal inquiry.

At June 30, 2006, our book value per share was $4.41 compared to our stock price, which has ranged from a low of $4.20 per share to a high of $7.19 per share for the six months ended June 30, 2006. Presently, our stock price is trading above our consolidated book value. Should our stock price drop below book value for a sustained period, it may become necessary to record an impairment charge to goodwill, which would negatively impact our results of operations.

We may not be able to successfully compete in the highly competitive semiconductor industry.

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

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

We may fail to retain or attract the specialized technical and management personnel required to successfully operate our business.

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

If we are unable to adequately protect our intellectual property rights, our financial results and competitive position may suffer.

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

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

Companies in the semiconductor industry vigorously pursue their intellectual property rights. If we become involved in protracted intellectual property disputes or litigation we may be forced to use substantial financial and management resources, which could have an adverse effect on our operating results.

Our industry is characterized by frequent claims regarding patents and other intellectual property rights of others. We have been, and from time to time expect to be, notified of claims that we are infringing the intellectual property rights of others. If any third party makes a valid claim against us, we could face significant liability and could be required to make material changes to our products and processes. In response to any claims of infringement, we may seek licenses under patents that we are alleged to be infringing. However, we may not be able to obtain a license on favorable terms, or at all, without our operating results being adversely affected.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

a) Our annual meeting of stockholders was held on May 2, 2006.

b) The following directors were elected at the meeting to serve a term of three years:

Daniel S. Hauer
Balaji Krishnamurthy

The following directors are continuing to serve their terms:

David E. Coreson
Gerhard H. Parker
Patrick S. Jones
Harry A. Merlo
Stephen A. Skaggs

c) The matters voted upon at the meeting and results of the voting with respect to those matters are as follows:

	For	**Withheld**
(1) Election of directors:		
Daniel S. Hauer	91,910,697	12,293,867
Balaji Krishnamurthy	102,706,694	1,497,870

	For	**Against**	**Abstain**	**Not Voted**
(2) Approval of amendments to the 2001 Outside Directors' Stock Option Plan to, among other things, increase the number of shares initially granted to each director from 72,000 to 90,000, to increase the number of shares granted each year thereafter from 18,000 to 22,500, and to change the vesting schedules for such option grants.	76,128,136	11,964,592	465,645	25,161,883

	For	**Against**	**Abstain**	**Not Voted**
(3) Ratification of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2006	97,652,736	6,510,388	41,440	9,515,692

The foregoing matters are described in further detail in our definitive proxy statement dated April 3, 2006 for the Annual Meeting of Stockholders held on May 2, 2006.

ITEM 6. EXHIBITS

Exhibits

31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

LATTICE SEMICONDUCTOR CORPORATION
(Registrant)

/s/ JAN
JOHANNESSEN
Jan Johannessen
Senior Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial
and Accounting Officer)

Date: August 8, 2006