LAM RESEARCH CORP
Form 10-Q
February 03, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 27, 2015

or

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

For the transition period from to

Commission file number 0-12933

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

Delaware (State or other jurisdiction of incorporation or organization)	94-2634797 (I.R.S. Employer Identification No.)
4650 Cushing Parkway Fremont, California	94538
(Address of principal executive offices)	(Zip Code)

(510) 572-0200
(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 x No ¨

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of January 29, 2016, the Registrant had 158,893,928 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
Revenue	$1,425,534	$1,232,241	$3,025,577	$2,384,609
Cost of goods sold	799,024	695,584	1,676,704	1,342,413
Gross margin	626,510	536,657	1,348,873	1,042,196
Research and development	220,754	196,768	454,963	385,702
Selling, general and administrative	166,922	151,148	319,648	299,455
Total operating expenses	387,676	347,916	774,611	685,157
Operating income	238,834	188,741	574,262	357,039
Other expense, net	(29,935)	(9,799)	(57,056)	(15,447)
Income before income taxes	208,899	178,942	517,206	341,592
Income tax benefit (expense)	14,081	(2,002)	(5,547)	(23,571)
Net income	$222,980	$176,940	$511,659	$318,021
Net income per share:				
Basic	$1.41	$1.11	$3.23	$1.98
Diluted	$1.28	$1.00	$2.94	$1.80
Number of shares used in per share calculations:				
Basic	158,424	159,248	158,388	160,467
Diluted	174,242	177,046	174,308	177,082
Cash dividend declared per common share	$0.30	$0.18	$0.60	$0.36

See Notes to Condensed Consolidated Financial Statements

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LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(in thousands)

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
Net income	$222,980	$176,940	$511,659	$318,021
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustment	(1,022)	(8,843)	(8,844)	(17,802)
Cash flow hedges:				
Net unrealized gains during the period	3,703	7,604	3,159	7,902
Net gains reclassified into earnings	(3,220)	(2,622)	(2,879)	(2,724)
	483	4,982	280	5,178
Available-for-sale investments:				
Net unrealized losses during the period	(5,133)	(2,981)	(2,385)	(4,740)
Net (gains) losses reclassified into earnings	(244)	113	(224)	492
	(5,377)	(2,868)	(2,609)	(4,248)
Defined benefit plans, net change in unrealized component	93	70	188	136
Other comprehensive loss, net of tax	(5,823)	(6,659)	(10,985)	(16,736)
Comprehensive income	$217,157	$170,281	$500,674	$301,285

See Notes to Condensed Consolidated Financial Statements

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LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	December 27, 2015 (unaudited)	June 28, 2015 (1)
ASSETS		
Cash and cash equivalents	$1,967,873	$1,501,539
Investments	2,507,607	2,574,947
Accounts receivable, less allowance for doubtful accounts of $4,904 as of December 27, 2015 and $4,890 as of June 28, 2015	1,089,850	1,093,582
Inventories	879,821	943,346
Prepaid expenses and other current assets	225,046	157,435
Total current assets	6,670,197	6,270,849
Property and equipment, net	643,746	621,418
Restricted cash and investments	207,568	170,969
Goodwill	1,387,082	1,387,509
Intangible assets, net	652,131	728,140
Other assets	189,697	185,763
Total assets	$9,750,421	$9,364,648
LIABILITIES AND STOCKHOLDERS' EQUITY		
Trade accounts payable	$230,974	$300,203
Accrued expenses and other current liabilities	757,260	649,438
Deferred profit	261,049	322,070
Current portion of convertible notes and capital leases	973,697	1,359,650
Total current liabilities	2,222,980	2,631,361
Senior notes, convertible notes, and capital leases, less current portion	1,404,683	1,001,382
Income taxes payable	257,502	202,930
Other long-term liabilities	135,303	184,023
Total liabilities	4,020,468	4,019,696
Commitments and contingencies		
Temporary equity, convertible notes	177,662	241,808
Stockholders' equity:		
Preferred stock, at par value of $0.001 per share; authorized - 5,000 shares, none outstanding	—	—
Common stock, at par value of $0.001 per share; authorized - 400,000 shares; issued and outstanding, 158,568 shares at December 27, 2015 and 158,531 shares at June 28, 2015	159	159
Additional paid-in capital	5,516,129	5,366,773
Treasury stock, at cost, 101,159 shares at December 27, 2015 and 99,562 shares at June 28, 2015	(4,408,777)	(4,302,847)
Accumulated other comprehensive loss	(68,781)	(57,796)
Retained earnings	4,513,561	4,096,855
Total stockholders' equity	5,552,291	5,103,144
Total liabilities and stockholders' equity	$9,750,421	$9,364,648

(1) Derived from audited financial statements

See Notes to Condensed Consolidated Financial Statements

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LAM RESEARCH CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended	
	December 27, 2015	December 28, 2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$511,659	$318,021
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	142,388	137,421
Deferred income taxes	2,613	6,506
Equity-based compensation expense	68,344	62,672
Income tax benefit on equity-based compensation plans	5,713	11,002
Excess tax benefit on equity-based compensation plans	(5,753)	(11,003)
Amortization of note discounts and issuance costs	33,480	18,299
Gain on sale of business	—	(7,431)
Other, net	20,603	7,133
Changes in operating assets and liabilities	(35,505)	(240,220)
Net cash provided by operating activities	743,542	302,400
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures and intangible assets	(77,597)	(103,234)
Business acquisitions, net of cash acquired	—	(1,137)
Purchases of available-for-sale securities	(808,292)	(1,063,863)
Sales and maturities of available-for-sale securities	819,291	751,918
Repayment of notes receivable	8,082	3,978
Proceeds from sale of business	—	41,212
Other, net	(6,246)	122
Net cash used for investing activities	(64,762)	(371,004)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt and capital lease obligations and payments for debt issuance costs	(28,470)	(781)
Excess tax benefit on equity-based compensation plans	5,753	11,003
Treasury stock purchases	(111,183)	(373,958)
Dividends paid	(95,555)	(58,621)
Re-issuance of treasury stock related to employee stock purchase plan	19,245	16,919
Proceeds from issuance of common stock	1,550	8,832
Other, net	(322)	—
Net cash used for financing activities	(208,982)	(396,606)
Effect of exchange rate changes on cash and cash equivalents	(3,464)	(6,192)
Net increase (decrease) in cash and cash equivalents	466,334	(471,402)
Cash and cash equivalents at beginning of period	1,501,539	1,452,677
Cash and cash equivalents at end of period	$1,967,873	$981,275

See Notes to Condensed Consolidated Financial Statements

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LAM RESEARCH CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 27, 2015
(Unaudited)

NOTE 1 — BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The accompanying unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements of Lam Research Corporation ("Lam Research" or the "Company") for the fiscal year ended June 28, 2015, which are included in the Company's Annual Report on Form 10-K as of and for the year ended June 28, 2015 (the "2015 Form 10-K"). The Company's reports on Form 10-K, Form 10-Q and Form 8-K are available online at the Securities and Exchange Commission website on the Internet. The address of that site is www.sec.gov. The Company also posts its reports on Form 10-K, Form 10-Q and Form 8-K on its corporate website at http://investor.lamresearch.com.

The consolidated financial statements include the accounts of Lam Research and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. The Company's reporting period is a 52/53-week fiscal year. The Company's current fiscal year will end June 26, 2016 and includes 52 weeks. The quarters ended December 27, 2015 (the "December 2015 quarter") and December 28, 2014 (the "December 2014 quarter") included 13 weeks.

NOTE 2 — RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB released Accounting Standards Update ("ASU") 2014-9, "Revenue from Contracts with Customers" to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of the standard is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. The new standard defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The Company is required to adopt this standard starting in the first quarter of fiscal year 2019 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the standard; or (ii) retrospective with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per the standard. The Company has not yet selected a transition method, and is in the process of determining the impact that the new standard will have on its consolidated financial statements.

In April 2015, the FASB released ASU 2015-3, "Interest – Imputation of Interest." The amendment requires that debt issuance costs related to recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Company is required to adopt this standard starting in the first quarter of fiscal year 2017 and does not anticipate that implementation will have a material impact on its Consolidated Financial Statements.

In September 2015, the FASB released ASU 2015-16, "Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments", which eliminates the requirement to restate prior period financial statements for measurement period adjustments. Instead, the cumulative impact of measurement period adjustments, including the impact on prior periods, is required to be recognized in the reporting period in which the adjustment is identified. The standard update will be effective for the Company beginning in its first quarter of fiscal year 2017. Early adoption is permitted; the Company is evaluating the timing of its adoption of the standard.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes.” This ASU amends existing guidance to require that deferred income tax assets and liabilities be classified as non-current in a classified balance sheet, and eliminates the prior guidance which required an entity to separate deferred tax assets and liabilities into a current amount and a non-current amount in a classified balance sheet. The amendments in this ASU are effective for the Company beginning in its first quarter of fiscal year 2018. Earlier application is permitted as of the beginning of an interim or annual period. Additionally, the new guidance may be applied either prospectively to all deferred tax assets and liabilities or

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retrospectively to all periods presented. The Company is still in the process of evaluating the timing and impact of adopting the guidance.

In January 2016, FASB released ASU 2016-1, "Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities." The amendment changes the accounting for and financial statement presentation of equity investments, other than those accounted for under the equity method of accounting or those that result in consolidation of the investee. The amendment provides clarity on the measurement methodology to be used for the required disclosure of fair value of financial instruments measured at amortized cost on the balance sheet and clarifies that an entity should evaluate the need for a valuation allowance on deferred tax assets related to available-for-sale securities in combination with the entity's other deferred tax assets, among other changes. The Company is required to adopt this standard starting in the first quarter of fiscal year 2019 and does not anticipate that implementation will have a material impact on its Consolidated Financial Statements.

NOTE 3 — EQUITY-BASED COMPENSATION PLANS

The Company has stock plans that provide for grants of equity-based awards to eligible participants, including stock options, restricted stock units ("RSUs"), and market-based performance RSUs ("market-based PRSUs") of Lam Research common stock ("Common Stock"). An option is a right to purchase Common Stock at a set price. An RSU award is an agreement to issue a set number of shares of Common Stock at the time of vesting. The Company's market-based PRSUs contain both a market condition and a service condition. The Company's options and RSU awards typically vest over a period of three years or less. The Company also has an employee stock purchase plan that allows employees to purchase its Common Stock at a discount through payroll deductions.

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

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands)			
Equity-based compensation expense	$32,570	$30,632	$68,344	$62,672
Income tax benefit related to equity-based compensation expense	$12,651	$6,116	$18,748	$10,840

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

Stock Options and RSUs

The Lam Research Corporation 2015 Stock Incentive Plan, 2007 Stock Incentive Plan, as amended and 2011 Stock Incentive Plan, as amended (collectively the "Stock Plans") provide for the grant of non-qualified equity-based awards to eligible employees, consultants and advisors, and non-employee directors of the Company and its subsidiaries. A summary of stock plan transactions is as follows:

	Options Outstanding		Restricted Stock Units Outstanding	
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Fair Market Value at Grant
June 28, 2015	835,832	$37.44	4,954,088	$ 60.13
Granted	—	$—	151,462	$ 71.46
Exercised	(70,291)	$22.03	N/A	N/A
Canceled	—	$—	(46,193)	$ 65.08
Vested restricted stock	N/A	N/A	(1,247,240)	$ 46.19
December 27, 2015	765,541	$38.86	3,812,117	$ 65.08

As of December 27, 2015, there was $2.0 million of total unrecognized compensation cost related to unvested stock options granted and outstanding; that cost is expected to be recognized over a weighted-average remaining vesting period of 1.8 years.

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As of December 27, 2015, there was $146.5 million of total unrecognized compensation expense related to unvested RSUs granted; that expense is expected to be recognized over a weighted-average remaining period of 1.8 years.

ESPP

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

Purchase rights under the 1999 ESPP were valued using the Black-Scholes option valuation model and the following weighted-average assumptions for the six months ended December 27, 2015 and December 28, 2014:

	Six Months Ended			
	December 27, 2015		December 28, 2014	
Expected term (years)	0.67		0.68	
Expected stock price volatility	31.86	%	29.07	%
Risk-free interest rate	0.19	%	0.07	%
Dividend Yield	0.94	%	0.29	%

There were no ESPP purchases during the quarter ended December 27, 2015. As of December 27, 2015, there was $11.7 million of unrecognized compensation expense related to the 1999 ESPP, which is expected to be recognized over a remaining period of approximately eight months.

NOTE 4 — OTHER EXPENSE, NET

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

	Three Months Ended				Six Months Ended			
	December 27, 2015		December 28, 2014		December 27, 2015		December 28, 2014	
	(in thousands)							
Interest income	$6,729		$4,024		$12,489		$7,312	
Interest expense	(38,577	)	(15,797	)	(63,238	)	(31,501	)
Gains (losses) on deferred compensation plan related assets, net	1,983		2,593		(3,181	)	5,009	
Foreign exchange gains (losses), net	512		(130	)	(186	)	776	
Other, net	(582	)	(489	)	(2,940	)	2,957	
	$(29,935	)	$(9,799	)	$(57,056	)	$(15,447	)

Interest expense in the three and six months ended December 27, 2015 increased, as compared to the three and six months ended December 28, 2014, primarily due to interest expense associated with the $1 billion Senior Note issuance in the March 2015 and the amortization of bridge loan financing issuance costs of approximately $13.6 million (see Note 11 and Note 12 for additional information regarding the Senior Note and bridge loan financing).

NOTE 5 — INCOME TAX EXPENSE

The Company recorded an income tax (benefit) expense of $(14.1) million and $5.5 million for the three and six months ended December 27, 2015, which yielded an effective tax rate of approximately (6.7)% and 1.1%, respectively. The difference between the U.S. federal statutory tax rate of 35% and the Company’s effective tax rate for the three months ended December 27, 2015 is primarily due to estimated higher income in lower tax jurisdictions, extension of the U.S. federal research and development tax credit for part of fiscal year 2015 and all of fiscal year 2016, recognition of previously unrecognized tax benefits due to lapse of statutes of limitation and the tax effect of KLA-Tencor acquisition related expenses, offset by the tax effect of nondeductible stock based compensation and unrecognized tax benefits due to uncertain tax positions. The difference between the U.S. federal statutory tax rate of 35% and the Company’s effective tax rate for the six months ended December 27, 2015 is primarily due to estimated higher income in lower tax jurisdictions, the recognition of a discrete tax

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benefit of the Altera court case, extension of the U.S. federal research and development tax credit for part of fiscal year 2015 and all of fiscal year 2016, recognition of previously unrecognized tax benefits due to lapse of statutes of limitation and the tax effect of KLA-Tencor acquisition related expenses, offset by the tax effect of non-deductible stock-based compensation and unrecognized tax benefits due to uncertain tax positions.

In July 2015, the United States Tax Court (the “Court”) issued an opinion favorable to Altera Corporation (“Altera”) with respect to Altera’s litigation with the Internal Revenue Service (“IRS”). The litigation relates to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera’s foreign subsidiary. In its opinion, the Court accepted Altera’s position of excluding stock based compensation from its inter-company cost-sharing arrangement. The Company is including the impact of the Altera court ruling in its income tax expense calculations. However, the U.S Department of the Treasury has not withdrawn the requirement to include stock-based compensation from its regulations. The Company will continue to monitor this matter and related potential impacts to its financial statements.

NOTE 6 — NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of shares of Common Stock outstanding during the period. Diluted net income per share is computed using the treasury stock method, for dilutive stock options, RSUs, convertible notes, and warrants. Dilutive shares outstanding include the effect of the convertible notes. Refer to Note 11 for additional information regarding the Company's convertible notes. The following table reconciles the numerators and denominators of the basic and diluted computations for net income per share.

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands, except per share data)			
Numerator:				
Net income	$222,980	$176,940	$511,659	$318,021
Denominator:				
Basic average shares outstanding	158,424	159,248	158,388	160,467
Effect of potential dilutive securities:				
Employee stock plans	2,034	3,304	2,289	3,432
Convertible notes	13,363	13,744	13,242	12,805
Warrants	421	750	389	378
Diluted average shares outstanding	174,242	177,046	174,308	177,082
Net income per share - basic	$1.41	$1.11	$3.23	$1.98
Net income per share - diluted	$1.28	$1.00	$2.94	$1.80

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

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands)			
Number of options and RSUs excluded	79	—	85	—

Diluted shares outstanding do not include any effect resulting from the note hedges associated with the Company’s 2016 or 2018 Notes as their impact would have been anti-dilutive.

NOTE 7 — FINANCIAL INSTRUMENTS

The Company maintains an investment portfolio of various holdings, types, and maturities. The Company's mutual funds, which are related to the Company's obligations under the deferred compensation plan, are classified as trading securities. Investments classified as trading securities are recorded at fair value based upon quoted market prices. Differences between the cost and fair value of trading securities are recognized as other income (expense) in the Condensed Consolidated Statements of Operations. All of the Company's other investments are classified as available-for-sale and consequently are recorded in the

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Consolidated Balance Sheets at fair value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax.

Fair Value

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

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

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

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

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

The Company’s primary financial instruments include its cash, cash equivalents, investments, restricted cash and investments, long-term investments, accounts receivable, accounts payable, long-term debt and capital leases, and derivative instruments. The estimated fair value of cash, accounts receivable and accounts payable approximates their carrying value due to the short period of time to their maturities. The estimated fair values of capital lease obligations approximate their carrying value as the substantial majority of these obligations have interest rates that adjust to market rates on a periodic basis. Refer to Note 11 for additional information regarding the fair value of the Company’s convertible notes.

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The following tables set forth the Company's cash, cash equivalents, investments, restricted cash and investments, and other assets measured at fair value on a recurring basis as of December 27, 2015 and June 28, 2015:

	December 27, 2015				(Reported Within)			
	Cost	Unrealized Gain	Unrealized (Loss)	Fair Value	Cash and Cash Equivalents	Investments	Restricted Cash & Investments	Other Assets
	(in thousands)							
Cash	$389,483	$—	$—	$389,483	$384,789	$—	$4,694	$—
Level 1:								
Time Deposit	175,259	—	—	175,259	42,438	—	132,822	—
Money Market Funds	1,540,647	—	—	1,540,647	1,540,646	—	—	—
U.S. Treasury and Agencies	345,105	2	(1,941)	343,166	—	273,114	70,052	—
Mutual Funds	33,995	2,733	(573)	36,155	—	—	—	36,155
Level 1 Total	$2,095,006	$2,735	$(2,514)	$2,095,227	$1,583,084	$273,114	$202,874	$36,155
Level 2:								
Municipal Notes and Bonds	643,087	408	(317)	643,178	—	643,178	—	—
U.S. Treasury and Agencies	8,028	—	(110)	7,918	—	7,918	—	—
Government-Sponsored Enterprises	47,944	—	(270)	47,674	—	47,674	—	—
Foreign Government Bonds	46,394	1	(229)	46,166	—	46,166	—	—
Corporate Notes and Bonds	1,343,415	328	(5,401)	1,338,342	—	1,338,342	—	—
Mortgage Backed Securities — Residential	35,611	65	(371)	35,305	—	35,305	—	—
Mortgage Backed Securities — Commercial	116,662	7	(759)	115,910	—	115,910	—	—
Level 2 Total	$2,241,141	$809	$(7,457)	$2,234,493	$—	$2,234,493	$—	$—
Total	$4,725,630	$3,544	$(9,971)	$4,719,203	$1,967,873	$2,507,607	$207,568	$36,155

	June 28, 2015				(Reported Within)			
	Cost	Unrealized Gain	Unrealized (Loss)	Fair Value	Cash and Cash Equivalents	Investments	Restricted Cash & Investments	Other Assets
	(in thousands)							
Cash	$276,663	$—	$—	$276,663	$271,452	$—	$5,211	$—
Level 1:								
Time Deposit	177,567	—	—	177,567	44,738	—	132,829	—
Money Market Funds	1,177,875	—	—	1,177,875	1,177,875	—	—	—
U.S. Treasury and Agencies	349,009	72	(861)	348,220	—	315,291	32,929	—
Mutual Funds	30,584	2,926	(47)	33,463	—	—	—	33,463
Level 1 Total	$1,735,035	$2,998	$(908)	$1,737,125	$1,222,613	$315,291	$165,758	$33,463

Level 2:								
Municipal Notes and Bonds	659,550	429	(335)	659,644	7,474	652,170	—	—
U.S. Treasury and Agencies	4,007	—	(4)	4,003	—	4,003	—	—
Government-Sponsored Enterprises	53,612	2	(249)	53,365	—	53,365	—	—
Foreign Government Bonds	50,336	31	(161)	50,206	—	50,206	—	—
Corporate Notes and Bonds	1,329,587	685	(3,797)	1,326,475	—	1,326,475	—	—
Mortgage Backed Securities — Residential	32,231	72	(292)	32,011	—	32,011	—	—
Mortgage Backed Securities — Commercial	141,988	44	(606)	141,426	—	141,426	—	—
Level 2 Total	$2,271,311	$1,263	$(5,444)	$2,267,130	$7,474	$2,259,656	$—	$—
Total	$4,283,009	$4,261	$(6,352)	$4,280,918	$1,501,539	$2,574,947	$170,969	$33,463

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The Company accounts for its investment portfolio at fair value. Realized gains (losses) for investment sales are specifically identified. Management assesses the fair value of investments in debt securities that are not actively traded through consideration of interest rates and their impact on the present value of the cash flows to be received from the investments. The Company also considers whether changes in the credit ratings of the issuer could impact the assessment of fair value. The Company did not recognize any losses on investments due to other-than-temporary impairments during the three and six months ended December 27, 2015 or December 28, 2014. Additionally, gross realized gains and gross realized (losses) from sales of investments were approximately $0.6 million and $(1.4) million, respectively, in the three months ended December 27, 2015 and $0.4 million and $(0.4) million, respectively, in the three months ended December 28, 2014. Gross realized gains and gross realized (losses) from sales of investments were approximately $0.8 million and $(2.0) million, respectively, in the six months ended December 27, 2015 and $0.9 million and $(1.0) million, respectively, in the six months ended December 28, 2014.

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

	December 27, 2015					
	Unrealized Losses Less Than 12 Months		Unrealized Losses 12 Months or Greater		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
	(in thousands)					
Municipal Notes and Bonds	$256,272	$(313)	$1,816	$(4)	$258,088	$(317)
U.S. Treasury & Agencies	347,138	(2,051)	—	—	347,138	(2,051)
Mutual Funds	22,053	(573)	—	—	22,053	(573)
Government-Sponsored Enterprises	47,507	(270)	—	—	47,507	(270)
Foreign Government Bonds	39,895	(229)	—	—	39,895	(229)
Corporate Notes and Bonds	1,107,398	(5,252)	39,808	(149)	1,147,206	(5,401)
Mortgage Backed Securities — Residential	23,303	(279)	1,669	(92)	24,972	(371)
Mortgage Backed Securities — Commercial	93,913	(654)	12,421	(105)	106,334	(759)
	$1,937,479	$(9,621)	$55,714	$(350)	$1,993,193	$(9,971)

The amortized cost and fair value of cash equivalents, investments and restricted investments with contractual maturities are as follows as of December 27, 2015:

	Cost	Estimated Fair Value
	(in thousands)	
Due in one year or less	$2,260,834	$2,260,815
Due after one year through five years	1,837,148	1,829,956
Due in more than five years	204,170	202,794

	$4,302,152	$4,293,565

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

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Derivative Instruments and Hedging

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

Cash Flow Hedges

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

In addition, during fiscal year ended June 28, 2015, the Company entered into and settled a series of forward-starting interest rate swap agreements, with a total notional value of $375 million, to hedge against the variability of cash flows due to changes in the benchmark interest rate of fixed rate debt. These instruments were designated as cash flow hedges at inception and were settled in conjunction with the issuance of debt during the three months ended March 29, 2015. The effective portion of the contracts' loss is included in accumulated other comprehensive (loss) and will amortize into income as the hedged item impacts earnings.

At inception and at each quarter end, hedges are tested prospectively and retrospectively for effectiveness using regression analysis. Changes in the fair value of the forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in revenue or expense in the current period. The change in time value related to these contracts was not material for all reported periods. Changes in the fair value of foreign exchange options due to changes in time value are included in the assessment of effectiveness. To qualify for hedge accounting, the hedge relationship must meet criteria relating both to the derivative instrument and the hedged item. These criteria include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows will be measured. There were no material gains or losses during the three or six months ended December 27, 2015 and December 28, 2014 associated with ineffectiveness or forecasted transactions that failed to occur.

To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge and the hedges must be tested to demonstrate an expectation of providing highly effective offsetting changes to future cash flows on hedged transactions. When derivative instruments are designated and qualify as effective cash flow hedges, the Company recognizes effective changes in the fair value of the hedging instrument within accumulated other comprehensive income (loss) until the hedged exposure is realized. Consequently, with the exception of excluded time value associated with the forward contracts and hedge ineffectiveness recognized, the Company's results of operations are not subject to fluctuation as a result of changes in the fair value of the derivative instruments. If hedges are not highly effective or if the Company does not believe that the underlying hedged forecasted transactions will occur, the Company may not be able to account for its derivative instruments as cash flow hedges. If this were to occur, future changes in the fair values of the Company's derivative instruments would be recognized in earnings. Additionally, related amounts previously recorded in other comprehensive income would be reclassified to income immediately. As of December 27, 2015, the Company had losses of $3.0 million accumulated in other comprehensive income, net of tax, related to interest rate contracts which it expects to reclassify from other comprehensive income into earnings over the next 9.3 years. Additionally, the Company had gains of $0.4 million accumulated in other comprehensive income, net of tax, related to cash flow hedges which it expects to reclassify

from other comprehensive income into earnings over the next 12 months.

Balance Sheet Hedges

The Company also enters into foreign currency forward contracts to hedge fluctuations associated with foreign currency denominated monetary assets and liabilities, primarily third party accounts receivables, accounts payables and intercompany receivables and payables. These forward contracts are not designated for hedge accounting treatment. Therefore, the change in

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fair value of these derivatives is recorded as a component of other income (expense) and offsets the change in fair value of the foreign currency denominated assets and liabilities, which are also recorded in other income (expense).
As of December 27, 2015, the Company had the following outstanding foreign currency contracts that were entered into under its cash flow and balance sheet hedge program:

	Notional Value Derivatives Designated as Hedging Instruments: (in thousands)		Derivatives Not Designated as Hedging Instruments:	
Foreign Currency Forward Contracts				
	Buy Contracts	Sell Contracts	Buy Contracts	Sell Contracts
Japanese yen	$—	$99,765	$—	$94,636
Swiss franc	—	—	4,881	—
Euro	20,065	—	15,276	—
Korean won	5,515	—	8,483	—
Singapore dollar	—	—	5,674	—
Taiwan dollar	—	—	24,410	—
	$25,580	$99,765	$58,724	$94,636
Foreign Currency Option Contracts				
	Buy Contracts	Sell Contracts	Buy Contracts	Sell Contracts
Japanese yen	$—	$39,135	$—	$—

The fair value of derivative instruments in the Company's Condensed Consolidated Balance Sheets as of December 27, 2015 and June 28, 2015 were as follows:

	December 27, 2015 Fair Value of Derivative Instruments (Level 2)				June 28, 2015 Fair Value of Derivative Instruments (Level 2)			
	Asset Derivatives		Liability Derivatives		Asset Derivatives		Liability Derivatives	
	Balance Sheet Location (in thousands)	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:								
Foreign exchange forward contracts	Prepaid expense and other assets	$1,732	Accrued liabilities	$237	Prepaid expense and other assets	$3,388	Accrued liabilities	$957
Derivatives not designated as hedging instruments:								
Foreign exchange forward contracts	Prepaid expense and other assets	84	Accrued liabilities	77	Prepaid expense and other assets	8	Accrued liabilities	960
Total derivatives		$1,816		$314		$3,396		$1,917

Under the master netting agreements with the respective counterparties to the Company’s derivative contracts, subject to applicable requirements, the Company is allowed to net settle transactions of the same currency with a single net amount payable by one party to the other. However, the Company has elected to present the derivative assets and derivative liabilities on a gross basis on its balance sheet. As of December 27, 2015, the potential effect of rights of off-set associated with the above foreign exchange contracts would be an offset to assets and liabilities by $0.3 million, resulting in a net derivative asset of $1.5 million. As of June 28, 2015, the potential effect of rights of set-off associated with the above foreign exchange contracts would be an offset to both assets and liabilities by $1.9 million, resulting in a net derivative asset of $1.5 million. The Company is not required to pledge, nor is the Company entitled to receive, cash collateral for these derivative transactions.

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

		Three Months Ended December 27, 2015			Six Months Ended December 27, 2015		
		Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness	Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness
	Location of Gain (Loss) Recognized in or Reclassified into Income	(Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Income	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Income
Derivatives Designated as Hedging Instruments		(in thousands)					
Foreign Exchange Contracts	Revenue	$4,256	$(4,808)	$215	$4,187	$(6,186)	$247
Foreign Exchange Contracts	Cost of goods sold	(223)	1,052	(14)	(638)	2,557	(36)
Foreign Exchange Contracts	Selling, general, and administrative	147	111	(12)	(26)	369	(19)
Interest Rate Contracts	Other expense, net	—	(95)	—	—	(189)	—
		$4,180	$(3,740)	$189	$3,523	$(3,449)	$192

		Three Months Ended December 28, 2014			Six Months Ended December 28, 2014		
		Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness	Effective Portion		Ineffective Portion and Amount Excluded from Effectiveness
	Location of Gain (Loss) Recognized in or Reclassified into Income	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Income	Gain (Loss) Recognized in AOCI	Gain (Loss) Reclassified from AOCI into Income	Gain (Loss) Recognized in Income
Derivatives Designated as Hedging Instruments		(in thousands)					
Foreign Exchange Contracts	Revenue	$8,765	$4,967	$81	$11,789	$5,436	$124
Foreign Exchange Contracts	Cost of goods sold	(1,264)	(1,557)	(19)	(3,287)	(1,833)	(25)
		(555)	(604)	(9)	(1,421)	(709)	(11)

Foreign Exchange Contracts	Selling, general, and administrative						
Foreign Exchange Contracts	Other expense, net	2,071	—	—	2,071	—	—
		$9,017	$2,806	$ 53	$9,152	$2,894	$ 88

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

		Three Months Ended		Six Months Ended	
		December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
Derivatives Not Designated as Hedging Instruments:	Location of Gain Recognized in Income	Gain Recognized in Income	Gain Recognized in Income	Gain Recognized in Income	Gain Recognized in Income
		(in thousands)			
Foreign Exchange Contracts	Other income	$1,561	$1,118	$7,568	$2,086

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Concentrations of Credit Risk

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

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

The Company is exposed to credit losses in the event of nonperformance by counterparties on foreign currency forward hedge contracts that are used to mitigate the effect of exchange rate fluctuations, and on contracts related to structured share repurchase arrangements. These counterparties are large global financial institutions and, to date, no such counterparty has failed to meet its financial obligations to the Company.

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

NOTE 8 — INVENTORIES

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

	December 27, 2015	June 28, 2015
	(in thousands)	
Raw materials	$546,892	$566,645
Work-in-process	118,161	141,264
Finished goods	214,768	235,437
	$879,821	$943,346

NOTE 9 — GOODWILL AND INTANGIBLE ASSETS

Goodwill

The balance of Goodwill is approximately $1.4 billion as of December 27, 2015 and June 28, 2015. Of the $1.4 billion goodwill balance, $61.1 million is tax deductible and the remaining balance is not tax deductible due to purchase accounting and applicable foreign law.

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Intangible Assets

The following table provides the Company's intangible assets as of December 27, 2015:

	Gross	Accumulated Amortization	Net
	(in thousands)		
Customer relationships	$615,414	$(267,855)	$347,559
Existing technology	643,750	(357,344)	286,406
Patents	36,053	(27,476)	8,577
Other intangible assets	35,914	(35,425)	489
Intangible assets subject to amortization	1,331,131	(688,100)	643,031
Development rights	9,100		9,100
Intangible assets not subject to amortization	9,100		9,100
Total intangible assets	$1,340,231	$(688,100)	$652,131

The following table provides the Company's intangible assets as of June 28, 2015:

	Gross	Accumulated Amortization	Net
	(in thousands)		
Customer relationships	$615,490	$(234,968)	$380,522
Existing technology	643,919	(313,071)	330,848
Patents	33,553	(26,431)	7,122
Other intangible assets	35,914	(35,366)	548
Intangible assets subject to amortization	1,328,876	(609,836)	719,040
Development rights	9,100		9,100
Intangible assets not subject to amortization	9,100		9,100
Total intangible assets	$1,337,976	$(609,836)	$728,140

The Company recognized $39.3 million and $40.0 million in intangible asset amortization expense during the three months ended December 27, 2015 and December 28, 2014, respectively. The Company recognized $78.3 million and $79.2 million in intangible asset amortization expense during the six months ended December 27, 2015, and December 28, 2014, respectively.

The estimated future amortization expense of intangible assets, excluding those with indefinite lives, as of December 27, 2015 was as follows:

Fiscal Year	Amount
	(in thousands)
2016 (6 months)	$77,954
2017	154,356
2018	153,152
2019	115,203
2020	50,054
Thereafter	92,312
	$643,031

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NOTE 10 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities consist of the following:

	December 27, 2015	June 28, 2015
	(in thousands)	
Accrued compensation	$375,937	$314,516
Warranty reserves	97,334	93,209
Income and other taxes payable	68,072	39,275
Dividend payable	47,539	47,659
Other	168,378	154,779
	$757,260	$649,438

NOTE 11 — LONG-TERM DEBT AND OTHER BORROWINGS

Convertible Senior Notes

In May 2011, the Company issued and sold $450 million in aggregate principal amount of 0.50% Convertible Senior Notes due May 2016 (the "2016 Notes") at par. At the same time, the Company issued and sold $450 million in aggregate principal amount of 1.25% Convertible Senior Notes due May 2018 (the "2018 Notes") at par. The Company pays cash interest at an annual rate of 0.50% and 1.25%, respectively, on the 2016 Notes and the 2018 Notes, on a semi-annual basis on May 15 and November 15 of each year.

In June 2012, with the acquisition of Novellus, the Company assumed $700 million in aggregate principal amount of 2.625% Convertible Senior Notes due May 2041 (the "2041 Notes," and collectively with the 2016 Notes and the 2018 Notes, the "Convertible Notes"). The Company pays cash interest at an annual rate of 2.625%, on a semi-annual basis on May 15 and November 15 of each year on the 2041 Notes. The 2041 Notes also have a contingent interest payment provision that may require the Company to pay additional interest, up to 0.60% per year, based on certain thresholds, beginning with the semi-annual interest payment on May 15, 2021, and upon the occurrence of certain events, as outlined in the indenture governing the 2041 Notes.

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

Under certain circumstances, the Convertible Notes may be converted into shares of the Company's Common Stock. The number of shares each debenture is convertible into is based on conversion rates, disclosed in the following table. The conversion rates are adjusted for certain corporate events, including dividends on the Company's Common Stock. The Company will settle any conversion of the Convertible Notes in cash up to the face value, and any amount in excess of face value will be settled in Common Stock.

At December 27, 2015, the market value of the Company's Common Stock was greater than 130% of the 2041 Notes conversion prices for 20 or more of the 30 consecutive trading days preceding the quarter end. As a result, the 2041 Notes are convertible at the option of the bondholder. The carrying amount of the 2041 Notes was classified in current liabilities and a portion of the equity component, representing the unamortized debt discount, was classified in temporary equity on the Company's Condensed Consolidated Balance Sheets. Upon closure of the conversion period, the 2041 Notes not converted will be reclassified back into non-current liabilities, and the temporary equity will be reclassified into permanent equity. The conversion window closed for the 2016 Notes and 2018 Notes as of September 27, 2015. As such, the 2018 Notes were reclassified into non-current liabilities, and the temporary equity for the 2016 Notes and 2018 Notes was reclassified back into permanent equity. The 2016 Notes remain in current liabilities due to their scheduled maturity. During the period ending December 27, 2015, 83 of the Convertible Notes, with a total par value of $83,000, were settled at the note holders' option. In conjunction with the conversion, 264 shares of common stock were issued. Additionally, during the period ended December 27, 2015, the Company

received notice of note holders' intention to convert 10 additional Convertible Notes, the Company expects those conversions to settle in the period ended March 27, 2016.

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As of December 27, 2015 and June 28, 2015, the Convertible Notes consisted of the following:

	December 27, 2015			June 28, 2015		
	2016 Notes	2018 Notes	2041 Notes	2016 Notes	2018 Notes	2041 Notes
	(in thousands, except years, percentages, conversion rate, and conversion price)					
Carrying value, long-term	$—	$410,067	$—	$—	$—	$—
Carrying value, current portion	443,704	—	522,249	435,493	402,320	520,313
Unamortized discount	6,283	39,887	177,662	14,507	47,680	179,622
Principal amount	$449,987	$449,954	$699,911	$450,000	$450,000	$699,935
Carrying amount of permanent equity component, net of tax	$76,228	$104,886	$150,415	$61,723	$57,215	$148,487
Carrying amount of temporary equity component, net of tax	$—	$—	$177,662	$14,507	$47,679	$179,622
Remaining amortization period (years)	0.4	2.4	25.4			
Effective interest rate on liability component	4.29 %	5.27 %	4.28 %			
Fair Value of Notes (Level 2)	$583,858	$643,434	$1,634,292			
Conversion rate (shares of common stock per $1,000 principal amount of notes)	16.2107	16.2107	29.0921			
Conversion price (per share of common stock)	$61.69	$61.69	$34.37			
If-converted value in excess of par value	$136,426	$136,416	$936,978			
Estimated share dilution using average quarterly stock price $74.11 per share	1,223	1,223	10,918			

Convertible Note Hedges and Warrants

Concurrent with the issuance of the 2016 Notes and 2018 Notes, the Company purchased a convertible note hedge and sold warrants. At expiration, the Company may, at its option, elect to settle the warrants on a net share basis. As of December 27, 2015, the warrants had not been exercised and remained outstanding. The exercise price is adjusted for certain corporate events, including dividends on the Company's Common Stock.

In conjunction with the convertible note hedge, counterparties agreed to sell to the Company shares of Common Stock equal to the number of shares issuable upon conversion of the 2016 Notes and 2018 Notes in full. The convertible note hedge transactions will be settled in net shares and will terminate upon the earlier of the maturity date or the first day none of the respective notes remain outstanding due to conversion or otherwise. Settlement of the convertible note hedge in net shares, based on the number of shares issued upon conversion of the 2016 and 2018 Notes, on the expiration date would result in the Company receiving net shares equivalent to the number of shares issuable by the Company upon conversion of the 2016 Notes and 2018 Notes. The Company exercised the convertible note hedge in the three months ended December 27, 2015, to offset the impact of the 2016 note and 2018 note conversions during the period and received 79 shares of Common Stock. The exercise price is adjusted for certain corporate events, including dividends on the Company's Common Stock.

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The following table presents the details of the warrants and convertible note hedge arrangements as of December 27, 2015:

	2016 Notes	2018 Notes
	(shares in thousands)	
Warrants:		
Underlying shares	7,295	7,295
Estimated share dilution using average quarterly stock price $74.11 per share	421	—
Exercise price	$69.83	$74.49
Expiration date range	August 15 - October 21, 2016	August 15 - October 23, 2018
Convertible Note Hedge:		
Number of shares available from counterparties	7,295	7,295
Exercise price	$61.69	$61.69

Senior Notes

On March 12, 2015, the Company completed a public offering of $500 million aggregate principal amount of the Company’s Senior Notes due March, 2020 (the “2020 Notes”) and $500 million aggregate principal amount of the Company’s Senior Notes due March, 2025 (the “2025 Notes” and, together with the 2020 Notes, the “Senior Notes”). The Company pays interest at an annual rate of 2.75% and 3.80%, respectively, on the 2020 Notes and 2025 Notes, on a semi-annual basis on March 15 and September 15 of each year.

The Company may redeem the Senior Notes at a redemption price equal to 100% of the principal amount of such series (“par”), plus a “make whole” premium as described in the indenture in respect of the Senior Notes and accrued and unpaid interest before February 15, 2020, for the 2020 Notes and before December 15, 2024 for the 2025 Notes. The Company may redeem the Senior Notes at par, plus accrued and unpaid interest at any time on or after February 15, 2020 for the 2020 Notes and on or after December 24, 2024 for the 2025 Notes. In addition, upon the occurrence of certain events, as described in the indenture, the Company will be required to make an offer to repurchase the Senior Notes at a price equal to 101% of the principal amount of the Senior Notes, plus accrued and unpaid interest.

As of December 27, 2015 and June 28, 2015 the Senior Notes consisted of the following:

	December 27, 2015		June 28, 2015	
	2020 Notes	2025 Notes	2020 Notes	2025 Notes
	(in thousands, except years)			
Carrying value, long-term	$497,348	$497,025	$497,053	$496,907
Unamortized discount	2,652	2,975	2,947	3,093
Principal amount	$500,000	$500,000	$500,000	$500,000
Remaining amortization period (years)	4.2	9.2		
Fair Value of Notes (Level 2)	$484,030	$473,785		

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Interest Cost

The following table presents the amount of interest cost recognized relating to both the contractual interest coupon and amortization of the debt discount, issuance costs, and effective portion of interest rate contracts with respect to the Senior Notes and the Convertible Notes during the three months ended December 27, 2015 and December 28, 2014.

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands)			
Contractual interest coupon	$14,750	$6,562	$29,577	$13,124
Amortization of interest discount	9,258	8,610	18,380	17,119
Amortization of issuance costs	14,391	590	15,043	1,181
Amortization of interest rate contract	95	—	189	—
Total interest cost recognized	$38,494	$15,762	$63,189	$31,424

Term Loan Agreement

On November 10, 2015, the Company entered into an unsecured term loan agreement with a syndicate of lenders (the "Term Loan Agreement"). The Term Loan Agreement provides for a $900 million senior unsecured term loan facility composed of two tranches; (i) a $375 million tranche of 3-year senior unsecured loans (the "3-Year Tranche") maturing on November 10, 2018; and (ii) a $525 million tranche of 5-year senior unsecured loans (the "5-Year Tranche") maturing on November 10, 2020.

Interest on amounts borrowed under the Term Loan Agreement is, at the Company’s option, based on (i) a base rate, defined as the greatest of (a) prime rate, (b) Federal Funds rate plus 0.50%, or (c) one-month LIBOR plus 1.00%, plus a spread of 0.00% to 0.75% for the 3-Year Tranche or 0.125% to 1.000% for the 5-Year Tranche or (ii) LIBOR plus 1.000% and a spread of 1.000% to 1.750% for the 3-Year Tranche or 1.125% to 2.000% for the 5-Year Tranche, in each case as the applicable spread is determined based on the rating of the Company’s non-credit enhanced, senior unsecured long-term debt.

Principal and accrued and unpaid interest is due and payable in equal quarterly amounts as set forth in the Term Loan Agreement, with any remaining balance due and accrued and unpaid interest due at maturity. Additionally, the Company will pay the lenders a quarterly commitment fee that varies based on the Company’s rating described above. The Term Loan Agreement also contains financial covenants that require the Company to maintain (i) a consolidated debt to capitalization ratio of no more than 0.50 to 1.00 (the “Capitalization Covenant”), provided that, until and including the earlier of (x) the end of the first two consecutive full fiscal quarters following the Term Loan Agreement's closing date that the Company is in compliance with the Capitalization Covenant and (y) December 31, 2017, if the Company is not in compliance with the Capitalization Covenant, the Company will be deemed not to have violated the Capitalization Covenant so long as the Company’s consolidated debt to adjusted EBITDA ratio is less than or equal to 4.50 to 1.00 for the period of four fiscal quarters then ended, and (ii) liquidity of no less than $1.0 billion, in each case determined in accordance with the Term Loan Agreement. The funding of the loans under the Term Loan Agreement will be on the closing date of the acquisition of KLA-Tencor subject to several conditions.

Revolving Credit Facility

On November 10, 2015, the Company entered into an Amendment and Restatement Agreement (the “Restated Credit Agreement”), which amends and restates the Company's unsecured Credit Agreement, dated March 12, 2014. The Restated Credit Agreement provides for an increase to the Company's revolving unsecured credit facility, from $300 million to $750 million with a syndicate of lenders. It includes an option, subject to certain requirements, for the Company to request an increase in the facility of up to an additional $250 million, for a potential total commitment of $1 billion. Proceeds from the credit facility can be used for general corporate purposes. The facility matures on November 10, 2020.

Interest on amounts borrowed under the credit facility is, at the Company’s option, based on (i) a base rate, defined as the greatest of (a) prime rate, (b) Federal Funds rate plus 0.5%, or (c) one-month LIBOR plus 1.0%, plus a spread of 0.0% to 0.5%, or (ii) LIBOR plus a spread of 0.9% to 1.5%, in each case as the applicable spread is determined based

on the rating of the Company’s non-credit enhanced, senior unsecured long-term debt. Principal and any accrued and unpaid interest is due and payable upon maturity. Additionally, the Company will pay the lenders a quarterly commitment fee that varies based on the Company’s credit rating. The Restated Credit Agreement contains affirmative covenants, negative covenants, financial covenants and events of default that are substantially similar to those in the Term Loan Agreement. As of December 27, 2015, the Company had no borrowings outstanding under the credit facility and was in compliance with all financial covenants.

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NOTE 12 — COMMITMENTS AND CONTINGENCIES

Operating Leases and Related Guarantees

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

The Company has operating leases regarding certain improved properties in Fremont and Livermore, California (the "Operating Leases"). The Company was required to maintain cash collateral in an aggregate of approximately $132.8 million in separate interest-bearing accounts, and marketable securities collateral in an aggregate of approximately $70.1 million, as security for the Company's obligations. These amounts are recorded with other restricted cash and investments in the Company's Condensed Consolidated Balance Sheet as of December 27, 2015.

During the term of the Operating Leases and when the terms of the Operating Leases expire, the property subject to those Operating Leases may be remarketed. The Company has guaranteed to the lessor that each property will have a certain minimum residual value. The aggregate guarantee made by the Company under the Operating Leases is generally no more than approximately $191.2 million; however, under certain default circumstances, the guarantee with regard to an Operating Lease may be 100% of the lessor's aggregate investment in the applicable property, which in no case will exceed $220 million, in the aggregate.

Debt Commitment

On October 20, 2015, the Company obtained a commitment for $4.20 billion of bridge financing from Goldman Sachs Bank USA and Goldman Sachs Lending Partners, LLC. ("the Commitment Parties") to finance, in part, the acquisition of KLA-Tencor. The Commitment Parties' commitment to provide financing (the "Bridge Facility") is subject to certain conditions, including consummation of the merger with KLA-Tencor. On November 10, 2015, the Company entered into the Term Loan Agreement for $0.9 billion and the Bridge Facility was reduced to $3.3 billion, correspondingly, both with a syndicate of lenders. Borrowings under the Bridge Facility mature 364 days from the closing of the respective loan facility. Interest on amounts borrowed under the Bridge Facility is, at the Company's option, based on (i) a base rate plus 0.00% to 1.50%, or (ii) LIBOR plus 1.00% to 2.50%, in each case as the applicable spread is determined based on the rating of the Company's non-credit enhanced, senior unsecured long-term debt.

Other Guarantees

The Company has issued certain indemnifications to its lessors for taxes and general liability under some of its agreements. The Company has entered into certain insurance contracts that are intended to limit its exposure to such indemnifications. As of December 27, 2015, the Company had not recorded any liability in connection with these indemnifications, as it does not believe, based on information available, that it is probable that any amounts will be paid under these guarantees.

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

The Company provides guarantees and standby letters of credit to certain parties as required for certain transactions initiated during the ordinary course of business. As of December 27, 2015, the maximum potential amount of future payments that it could be required to make under these arrangements and letters of credit was $15.6 million. The Company does not believe, based on historical experience and information currently available, that it is probable that any amounts will be required to be paid.

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Warranties

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

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

	Three Months Ended		Six Months Ended	
	December 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands)			
Balance at beginning of period	$98,968	$70,452	$93,209	$69,385
Warranties issued during the period	26,173	28,700	59,486	53,236
Settlements made during the period	(27,691)	(23,988)	(55,154)	(48,056)
Changes in liability for pre-existing warranties	(115)	3,867	(206)	4,466
Balance at end of period	$97,335	$79,031	$97,335	$79,031

Legal proceedings

While the Company is not currently a party to any legal proceedings that it believes material, the Company is either a defendant or plaintiff in various actions that have arisen from time to time in the normal course of business, including intellectual property claims. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company believes that the amount of any such additional loss would be immaterial to the Company's business, financial condition, and results of operations.

NOTE 13 — STOCK REPURCHASE PROGRAM

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

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

Period	Total Number of Shares Repurchased	Total Cost of Repurchase	Average Price Paid Per Share	Amount Available Under Repurchase Program
	(in thousands, except share and per share data)			
Available balance as of June 28, 2015				$316,587
Quarter ended September 27, 2015	1,205	$87,493	$72.61	$229,094
Quarter ended December 27, 2015	—	$—	$—	$229,094

During the three and six months ended December 27, 2015, the Company acquired 183,381 shares at a total cost of $12.8 million and 392,005 shares at a total cost of $28.1 million, respectively, which the Company withheld through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company's equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company's equity compensation plan.

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NOTE 14 — ACCUMULATED OTHER COMPREHENSIVE LOSS

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

	Accumulated foreign currency translation adjustment	Accumulated unrealized holding gain (loss) on cash flow hedges	Accumulated unrealized holding gain (loss) on available-for-sale investments	Accumulated unrealized components of defined benefit plans	Total
	(in thousands)				
Balance as of June 28, 2015	$(35,125)	$ (2,859)	$ (3,761)	$(16,051)	$(57,796)
Other comprehensive income (loss) before reclassifications	(8,728)	3,159	(2,385)	188	(7,766)
(Gains) losses reclassified from accumulated other comprehensive income (loss) to net income	(116) (2)	(2,879) (1)	(224) (2)	—	(3,219)
Net current-period other comprehensive income (loss)	$(8,844)	$ 280	$ (2,609)	$188	$(10,985)
Balance as of December 27, 2015	$(43,969)	$ (2,579)	$ (6,370)	$(15,863)	$(68,781)

(1) Amount of after tax gain reclassified from AOCI into net income located in revenue: $5,498 gain; cost of goods sold: $2,220 loss; selling, general and administrative expenses: $281 loss; and other income and expense: $118 loss

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

NOTE 15 – BUSINESS COMBINATIONS

On October 20, 2015, the Company entered into an Agreement and Plan of Merger and Reorganization with KLA-Tencor Corporation ("KLA-Tencor"), under which KLA-Tencor will ultimately become (assuming satisfaction or waiver of all conditions to closing) a direct or indirect wholly-owned subsidiary of Lam Research.

Each KLA-Tencor stockholder may elect to receive, for all shares of KLA-Tencor common stock they hold at the closing of the transaction, one of the following, determined on a per-share basis: (1) mixed consideration, consisting of both (i) 0.5 of a share of Common Stock and (ii) $32.00 in cash; (2) all-stock consideration, consisting of a number of shares of Common Stock equal to (i) 0.5 plus (ii) the quotient of $32.00 divided by the five day volume weighted average price of Common Stock over a five trading day period ending shortly before the closing of the transaction ("the five day VWAP"); or (3) all-cash consideration, consisting of (i) $32.00 plus (ii) the product of 0.5 times the five day VWAP. KLA-Tencor stockholders who do not make an election will be deemed to have elected the mixed consideration. All-cash and all-stock elections will be subject to proration in accordance with the terms of the merger agreement. The stock component of the consideration is expected to represent a tax-free exchange. Completion of the transaction is subject to certain closing conditions, including but not limited to approval of the transaction by KLA-Tencor's stockholders, approval of the issuance of Common Stock by the Company's Stockholders, receipt of all required regulatory approvals, and other customary conditions.

The Company has entered into (1) a senior unsecured term loan agreement which provides up to $900 million in term loans, subject to certain conditions; and (2) a debt commitment letter which provides for a senior unsecured 364-day bridge facility in a principal amount of up to $3.3 billion, subject to certain conditions. The Company has also entered into an amendment and restatement of its existing revolving credit agreement pursuant to which, among other things, the revolving lenders agreed to increase their aggregate commitments under the revolving credit agreement from $300

million to $750 million.

The Company intends to fund the cash component of the merger consideration and related fees and expenses and to prepay KLA-Tencor’s term loan with a combination of the combined companies’ balance sheet cash and proceeds of approximately $4.0 billion under the term loans, the revolving credit agreement and from the issuance of debt securities or, to the extent necessary, borrowings under the bridge facility. The Company also expects to guarantee KLA-Tencor’s existing notes in the aggregate principal amount of $2.5 billion.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY STATEMENT REGARDING FORWARD LOOKING STATEMENTS

With the exception of historical facts, the statements contained in this discussion are forward-looking statements, which are subject to the safe harbor provisions created by the Private Securities Litigation Reform Act of 1995. Certain, but not all, of the forward-looking statements in this report are specifically identified as forward-looking, by use of phrases and words such as "believe," "anticipate," "intend,""expect," "may," "should," "could," "will," and other future terms. The identification of certain statements as "forward-looking" is not intended to mean that other statements not specifically identified are not forward-looking. Forward-looking statements include, but are not limited to, statements that relate to: our ability to close the acquisition of KLA-Tencor and; trends in the global economic environment and the semiconductor industry; the anticipated levels of, and rates of change in future shipments, margins, market share, capital expenditures, revenue and operating expenses generally; management's plans and objectives for our current and future operations and business focus; volatility in our quarterly results; customer and end user requirements, and our ability to satisfy those requirements; our ability to address critical steps in the fabrication process; our ability to develop technologies and productivity solutions that benefit our customers, and to facilitate our customers' ability to meet more stringent performance or design standards; customer capital spending and their demand for our products; the reliability of indicators of change in customer spending and demand; the effect of variability in our customers' business plans on demand for our equipment and services; changes in demand for our products and in our market share resulting from, among other things, increases in our customers' proportion of capital expenditures (with respect to certain technology inflections); our ability to defend our market share and to gain new market share; factors that affect our tax rates; anticipated growth in the industry and the total market for wafer-fabrication equipment and our growth relative to such growth; levels of research and development expenditures; outsourced activities; the estimates we make, and the accruals we record, in order to implement our critical accounting policies (including but not limited to the adequacy of prior tax payments, future tax liabilities and the adequacy of our accruals relating to them); our access to capital markets; our intention to pay quarterly dividends and the amounts thereof, if any; our ability and intention to repurchase our shares; our ability to manage and grow our cash position; and the sufficiency of our financial resources to support future business activities (including but not limited to operations, investments, debt service requirements and capital expenditures). Such statements are based on current expectations and are subject to risks, uncertainties, and changes in condition, significance, value, and effect, including without limitation those discussed below under the heading "Risk Factors" within Part II Item 1A and elsewhere in this report and other documents we file from time to time with the Securities and Exchange Commission ("SEC"), such as our annual report on Form 10-K for the year ended June 28, 2015 (our "2015 Form 10-K"), our quarterly report on Form 10-Q for the fiscal quarter ended September 27, 2015, and our current reports on Form 8-K. Such risks, uncertainties and changes in condition, significance, value, and effect could cause our actual results to differ materially from those expressed in this report and in ways not readily foreseeable. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof and are based on information currently and reasonably known to us. We do not undertake any obligation to release the results of any revisions to these forward-looking statements, which may be made to reflect events or circumstances that occur after the date of this report or to reflect the occurrence or effect of anticipated or unanticipated events.

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

For a full understanding of our financial position and results of operations for the three and six months ended December 27, 2015, and the related Management's Discussion and Analysis of Financial Condition and Results of Operations below, you should also read the Condensed Consolidated Financial Statements and notes presented in this Form 10-Q and the financial statements and notes in our 2015 Form 10-K.

EXECUTIVE SUMMARY

Lam Research Corporation ("Lam Research," "Lam," "we," or "our") has been an innovative supplier of wafer fabrication equipment and services to the semiconductor industry for more than 35 years. Our customers include semiconductor manufacturers that make memory, microprocessors, and other logic integrated circuits for a wide range of electronics;

including cell phones, computers, tablets, storage devices, and networking equipment.

Our market-leading products are designed to help our customers build the smaller, faster, and more powerful devices that are necessary to power the capabilities required by end users. The process of integrated circuits fabrication consists of a complex series of process and preparation steps, and our product offerings in deposition, etch, and clean address a number of the most critical steps in the fabrication process. We leverage our expertise in semiconductor processing to develop technology and/or

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productivity solutions that typically benefit our customers through lower defect rates, enhanced yields, faster processing time, and reduced cost as well as by facilitating their ability to meet more stringent performance and design standards.

The semiconductor capital equipment industry has been highly competitive and characterized by rapid changes in demand. This cyclicality has been mitigated in recent years by market demands and consolidation among our customers. With a reduced number of customers, variability in their business plans leads to changes in demand for Lam's equipment and services. The variability in our customers' investments during any particular period is dependent on several factors including but not limited to electronics demand, economic conditions (both general and in the semiconductor and electronics industries), industry supply and demand, prices for semiconductors, and our customers' ability to develop and manufacture increasingly complex and costly semiconductor devices.

Demand for our products was strong throughout calendar year 2015 as semiconductor device manufacturers made capacity and technology investments. Technology inflections in our industry, including FinFET transistors, 3D NAND, multiple patterning and advanced packaging have led to an increase in the deposition and etch market sizes. The capacity and technology spending of our customers have contributed to increased revenue in the 2015 calendar year as compared to the 2014 calendar year. We achieved record levels of shipments and revenues of approximately $5.9 billion in calendar year 2015. We believe that, over the longer term, demand for our products should increase as the proportion of customers' capital expenditures rises in these technology inflection areas, and we continue to gain market share.

In October, as further described in Note 15 to our Condensed Consolidated Financial Statements, we announced that we had entered into an agreement to acquire KLA-Tencor Corporation ("KLA-Tencor").

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

	Three Months Ended		
	December 27, 2015	September 27, 2015	December 28, 2014
	(in thousands, except per share data and percentages)		
Revenue	$1,425,534	$1,600,043	$1,232,241
Gross margin	$626,510	$722,363	$536,657
Gross margin as a percent of total revenue	43.9 %	45.1 %	43.6 %
Total operating expenses	$387,676	$386,935	$347,916
Net income	$222,980	$288,679	$176,940
Diluted net income per share	$1.28	$1.66	$1.00

In the December 2015 quarter, revenue decreased compared to the quarter ended September 27, 2015 (the "September 2015 quarter"), primarily as a result of a slow-down in investment from our memory and foundry customers in the second half of 2015. Gross margin as a percentage of revenue in the December 2015 quarter decreased as compared to the September 2015 quarter due to lower factory utilization as a result of lower shipment levels. Operating expenses in the December quarter increased slightly compared to the September 2015 quarter.

Our cash and cash equivalents, investments, and restricted cash and investments balances increased to approximately $4.7 billion as of December 27, 2015 as compared to $4.5 billion as of September 27, 2015. Cash generated by operations was approximately $295 million during the December 2015 quarter. We used cash during the December 2015 quarter to purchase $28 million of capital expenditures, and we paid $48 million of dividends to our stockholders. Employee headcount as of December 27, 2015 is approximately 7,300 people.

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RESULTS OF OPERATIONS

Shipments

	Three Months Ended		
	December 27, 2015	September 27, 2015	December 28, 2014
Shipments (in millions)	$1,288	$1,579	$1,247
Taiwan	38 %	26 %	23 %
Japan	21 %	17 %	13 %
China	9 %	25 %	7 %
Korea	15 %	13 %	30 %
United States	8 %	8 %	16 %
Southeast Asia	5 %	8 %	4 %
Europe	4 %	3 %	7 %

Shipments for the December 2015 quarter decreased 18% from the September 2015 quarter level and increased 3% compared to the December 2014 quarter, reflecting changes in customer demand for semiconductor equipment. The decrease in the December 2015 quarter from the September 2015 quarter was mainly driven by a slow-down in memory and foundry investments.

The percentages of system shipments to each of the markets we serve were as follows for the periods presented:

	Three Months Ended		
	December 27, 2015	September 27, 2015	December 28, 2014
Memory	65 %	72 %	53 %
Foundry	25 %	18 %	32 %
Logic/integrated device manufacturing	10 %	10 %	15 %

Revenue

	Three Months Ended			Six Months Ended	
	December 27, 2015	September 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
Revenue (in millions)	$1,426	$1,600	$1,232	$3,026	$2,385
Taiwan	31 %	28 %	25 %	29 %	22 %
Japan	22 %	18 %	12 %	20 %	11 %
China	17 %	16 %	8 %	17 %	8 %
Korea	15 %	17 %	24 %	16 %	21 %
United States	7 %	9 %	18 %	8 %	23 %
Southeast Asia	5 %	8 %	7 %	6 %	8 %
Europe	3 %	4 %	6 %	4 %	7 %

Revenue for the December 2015 quarter decreased 11% compared to the September quarter as a result of changes in demand for semiconductor equipment. Revenue for the December 2015 quarter increased 16% as compared to the December 2014 quarter and increased 27% for the six months ended December 27, 2015 as compared to the same period in 2014 as a result of overall wafer fabrication market spending increases and our market share gains. Our deferred revenue balance decreased to $395 million as of December 27, 2015 compared to $517 million as of September 27, 2015. Our deferred revenue balance does not include system shipments to Japanese customers, for which title does not transfer until customer acceptance. Shipments to Japanese customers are classified as inventory at cost until the time of acceptance. The estimated future revenue value from shipments to Japanese customers was approximately $109 million as of December 27, 2015 and $147 million as of September 27, 2015.

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Gross Margin

	Three Months Ended			Six Months Ended	
	December 27, 2015	September 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands, except percentages)				
Gross margin	$626,510	$722,363	$536,657	$1,348,873	$1,042,196
Percent of total revenue	43.9 %	45.1 %	43.6 %	44.6 %	43.7 %

The decline in gross margin as a percentage of revenue during the December 2015 quarter as compared to the September 2015 quarter was primarily due to lower factory utilization as a result of lower shipment levels.

Gross margin as a percentage of revenue during the December 2015 quarter increased when compared to the December 2014 quarter primarily due to favorable product and customer mix.

The increase in gross margin as a percentage of revenue during the six months ended December 27, 2015 as compared to the same period in 2014 is primarily due to favorable product and market mix as well as improved factory efficiency and field absorption.

Research and Development

	Three Months Ended			Six Months Ended	
	December 27, 2015	September 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands, except percentages)				
Research & development (“R&D”)	$220,754	$234,209	$196,768	$454,963	$385,702
Percent of total revenue	15.5 %	14.6 %	16.0 %	15.0 %	16.2 %

We continue to make significant R&D investments focused on leading-edge deposition, plasma etch, single-wafer clean and other semiconductor manufacturing requirements. The decreased spending in the December 2015 quarter from the September 2015 quarter was primarily due to a $6 million decrease in supplies spending, and a $4 million charge related to the clean reporting unit restructuring activities in the September 2015 quarter.

The increase in R&D expenses during the December 2015 quarter compared to the same period in the prior year was mainly due to a $13 million increase in salaries and benefits from higher headcount, reflecting an increase in our product development efforts, a $2 million increase in supplies, a $2 million increase in depreciation/amortization, and a $3 million increase in outside services.

The increase in R&D expenses for the six months ended December 27, 2015 as compared to the same period in 2014 is due to increases in employee compensation from higher headcount, supplies spending, facility and information technology related spending and restructuring charges for the clean reporting unit.

Selling, General and Administrative

	Three Months Ended			Six Months Ended	
	December 27, 2015	September 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands, except percentages)				
Selling, general & administrative (“SG&A”)	$166,922	$152,726	$151,148	$319,648	$299,455
Percent of total revenue	11.7 %	9.5 %	12.3 %	10.6 %	12.6 %

The increase in SG&A expenses for all comparable periods presented was mainly due to $17 million in acquisition costs related to the announcement of the agreement to acquire KLA-Tencor.

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Other Expense, Net

Other expense, net consisted of the following:

	Three Months Ended			Six Months Ended	
	December 27, 2015	September 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands)				
Interest income	$6,729	$5,760	$4,024	$12,489	$7,312
Interest expense	(38,577)	(24,661)	(15,797)	(63,238)	(31,501)
Gains (losses) on deferred compensation plan related assets, net	1,983	(5,164)	2,593	(3,181)	5,009
Foreign exchange gains (losses), net	512	(698)	(130)	(186)	776
Other, net	(582)	(2,358)	(489)	(2,940)	2,957
	$(29,935)	$(27,121)	$(9,799)	$(57,056)	$(15,447)

Interest income increased in the December 2015 quarter, as compared to the September 2015 quarter, as a result of higher yield. Interest income increased in the December 2015 quarter, as compared to the December 2014 quarter, and for the six months ended December 27, 2015 as compared to the six months ended December 28, 2014, as a result of higher cash and investment balances and higher yield.

Interest expense increased in the December 2015 quarter, as compared to the December 2014 quarter, primarily due to the $1 billion Senior Note issuance in the March 2015 quarter. Additionally, interest expense increased in the December 2015 quarter, as compared to the September 2015 and December 2014 quarter, due to the amortization of bridge loan financing issuance costs of approximately $14 million. Interest expense increased in the six months ended December 27, 2015 as compared to the six months ended December 28, 2014, primarily due to interest cost associated with the $1 billion Senior Note issuance in the March 2015 quarter and the amortization of bridge loan financing issuance costs of approximately $14 million in the December 2015 quarter.

We recognized gains on assets that are related to obligations under our deferred compensation plan in the December 2015 quarter, as compared to losses in the September 2015 quarter, due to changes in the market value of securities in the portfolio. Similarly the change in market value of the securities in the portfolio resulted in losses in the six months ended December 27, 2015 as compared to December 28, 2014.

Foreign exchange gains in the December 2015 quarter and in the six months ended December 28, 2014 were related to volatility in the foreign currency market and its impact on un-hedged portions of the balance sheet exposures.

Other, net in the December 2015 quarter decreased as compared to the September 2015 quarter is primarily due to $2 million of charitable contributions made in the September 2015 quarter. Other, net was higher during the six months ended December 27, 2014, as compared to the six months ended December 27, 2015, primarily due to a net gain associated with the disposition of Peter Wolters.

Income Tax Expense

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

	Three Months Ended			Six Months Ended	
	December 27, 2015	September 27, 2015	December 28, 2014	December 27, 2015	December 28, 2014
	(in thousands, except percentages)				
Income tax (benefit) expense	$(14,081)	$19,628	$2,002	$5,547	$23,571
Effective tax rate	(6.7)%	6.4%	1.1%	1.1%	6.9%

The change in the effective tax rate for the three months ended December 27, 2015 compared to the three months ended September 27, 2015 was primarily due to the change in geographic mix of income, extension of the U.S. federal

research and

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development tax credit for part of fiscal year 2015 and all of fiscal year 2016 and the tax effect of KLA-Tencor acquisition related expenses.

The change in the effective tax rate for the three months ended December 27, 2015 compared to the three months ended December 28, 2014 was primarily due to the change in geographic mix of income and the tax effect of KLA-Tencor acquisition related expenses offset by the recognition of previously unrecognized tax benefits due to lapse of statutes of limitation.

The change in the effective tax rate for the six months ended December 27, 2015 compared to the six months ended December 28, 2014 was primarily due to the change in geographic mix of income, recognition of a discrete tax benefit of the Altera court ruling and the tax effect of KLA-Tencor acquisition related expenses.

International revenues account for a significant portion of our total revenues, such that a material portion of our pre-tax income is earned and taxed outside the United States at rates that are generally lower than in the United States. Please refer to Note 7 of the Notes to Consolidated Financial Statements in our 2015 Form 10-K.

Uncertain Tax Positions

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

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

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

costs are recorded in deferred profit on our Condensed Consolidated Balance Sheet.

Inventory Valuation: Inventories are stated at the lower of cost or market using standard costs that approximate actual costs on a first-in, first-out basis. Finished goods are reported as inventories until the point of title transfer to the customer. Unless

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specified in the terms of sale, title generally transfers at the physical transfer of the products to the freight carriers. Transfer of title for shipments to Japanese customers occurs at the time of customer acceptance.

Management evaluates the need to record adjustments for impairment of inventory at least quarterly. Our policy is to assess the valuation of all inventories including manufacturing raw materials, work-in-process, finished goods, and spare parts in each reporting period. Obsolete inventory or inventory in excess of management's estimated usage requirement is written down to its estimated market value if less than cost. Estimates of market value include, but are not limited to, management's forecasts related to our future manufacturing schedules, customer demand, technological and/or market obsolescence, general semiconductor market conditions, and possible alternative uses. If future customer demand or market conditions are less favorable than our projections, additional inventory write-downs may be required and would be reflected in cost of goods sold in the period in which we make the revision.

Warranty: Typically, the sale of semiconductor capital equipment includes providing parts and service warranties to customers as part of the overall price of the system. We provide standard warranties for our systems. We record a provision for estimated warranty expenses to cost of sales for each system when we recognize revenue. We do not maintain general or unspecified reserves; all warranty reserves are related to specific systems. All actual or estimated parts and labor costs incurred in subsequent periods are charged to those established reserves on a system-by-system basis.

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

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

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

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

than not that the deferred tax assets would be realized, then the previously provided valuation allowance would be reversed.

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

Goodwill and Intangible Assets: The valuation of intangible assets acquired in a business combination requires the use of management estimates including but not limited to estimating future expected cash flows from assets acquired and determining discount rates. Management’s estimates of fair value are based upon assumptions believed to be reasonable, but which are

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inherently uncertain and unpredictable and, as a result, actual results may differ from estimates. Estimates associated with the accounting for acquisitions may change as additional information becomes available.
Goodwill represents the amount by which the purchase price in each business combination exceeds the fair value of the net tangible and identifiable intangible assets acquired. Each component of the Company for which discrete financial information is available and for which management regularly reviews the results of operations is considered a reporting unit. All goodwill acquired in a business combination is assigned to one or more reporting units as of the acquisition date. Goodwill is assigned to our reporting units that are expected to benefit from the synergies of the combination. The goodwill assigned to a reporting unit is the difference between the acquisition consideration assigned to the reporting unit on a relative fair value basis and the fair value of acquired assets and liabilities that can be specifically attributed to the reporting unit. We test goodwill and identifiable intangible assets with indefinite useful lives for impairment at least annually. We amortize intangible assets with estimable useful lives over their respective estimated useful lives, and we review for impairment whenever events or changes in circumstances indicate that the carrying amount of the intangible asset may not be recoverable and the carrying amount exceeds its fair value.

We review goodwill at least annually for impairment. If certain events or indicators of impairment occur between annual impairment tests, we will perform an impairment test at that date. In testing for a potential impairment of goodwill, we: (1) allocate goodwill to the reporting units to which the acquired goodwill relates; (2) estimate the fair value of our reporting units; and (3) determine the carrying value (book value) of those reporting units. Prior to this allocation of the assets to the reporting units, we assess long-lived assets for impairment. Furthermore, if the estimated fair value of a reporting unit is less than the carrying value, we must estimate the fair value of all identifiable assets and liabilities of that reporting unit, in a manner similar to a purchase price allocation for an acquired business. This can require independent valuations of certain internally generated and unrecognized intangible assets such as in-process R&D and developed technology. Only after this process is completed can the amount of goodwill impairment, if any, be determined. In our goodwill impairment process we first assess qualitative factors to determine whether it is necessary to perform a quantitative analysis. We do not calculate the fair value of a reporting unit unless we determine, based on a qualitative assessment, that it is more likely than not that the reporting unit's fair value is less than its carrying amount. Our most recent annual goodwill impairment analysis, which was performed as of the first day of our fourth quarter of fiscal year 2015, March 30, 2015, resulted in the recognition of a $79.4 million goodwill impairment charge on our single-wafer clean systems reporting unit. We did not record any goodwill impairment in the three months ended September 27, 2015 or September 28, 2014.
The process of evaluating the potential impairment of goodwill is subjective and requires significant judgment at many points during the analysis. We determine the fair value of our reporting units by using an income approach. Under the income approach, we determine fair value based on estimated future cash flows of each reporting unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn.
In estimating the fair value of a reporting unit, we make estimates and judgments about the future cash flows of our reporting units, including estimated growth rates and assumptions about the economic environment. Although our cash flow forecasts are based on assumptions that are consistent with the plans and estimates it is using to manage the underlying businesses, there is significant judgment involved in determining the cash flows attributable to a reporting unit. In addition, we make certain judgments about allocating shared assets to the estimated balance sheets of our reporting units. Changes in judgment on these assumptions and estimates could result in a goodwill impairment charge.
As a result, several factors could result in an impairment of a material amount of our goodwill balance in future periods, including, but not limited to: (1) weakening of the global economy, weakness in the semiconductor equipment industry, or our failure to reach internal forecasts, which could impact our ability to achieve our forecasted levels of cash flows and reduce the estimated discounted cash flow value of our reporting units; and (2) a decline in our common stock price and resulting market capitalization, and to the extent we determine that the decline is sustained and indicates a reduction in the fair value of our reporting units below their carrying value. Further, the

value assigned to intangible assets, other than goodwill, is based on estimates and judgments regarding expectations such as the success and life cycle of products and technology acquired. If actual product acceptance differs significantly from the estimates, we may be required to record an impairment charge to write down the asset to its realizable value.

Recent Accounting Pronouncements

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

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expected to be received for those goods or services. The new standard defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. We are required to adopt this standard starting in the first quarter of fiscal year 2019 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the standard; or (ii) retrospective with the cumulative effect of initially applying the standard recognized at the date of initial application and providing certain additional disclosures as defined per the standard. We have not yet selected a transition method, and are in the process of determining the impact that the new standard will have on our Consolidated Financial Statements.

In April 2015, the FASB released ASU 2015-3, "Interest — Imputation of Interest." The amendment requires that debt issuance costs related to recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. We are required to adopt this standard starting in the first quarter of fiscal year 2017; we do not anticipate that adoption will have a material impact on our Consolidated Financial Statements.

In September 2015, the FASB released ASU 2015-16, "Business Combinations - Simplifying the Accounting for Measurement-Period Adjustments," which eliminates the requirement to restate prior period financial statements for measurement period adjustments. Instead, the cumulative impact of measurement period adjustments, including the impact on prior periods, is required to be recognized in the reporting period in which the adjustment is identified. The standard update will be effective beginning in our first quarter of fiscal year 2017. Early adoption is permitted; we are evaluating the timing of the adoption of this standard.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." This ASU amends existing guidance to require that deferred income tax assets and liabilities be classified as non-current in a classified balance sheet, and eliminates the prior guidance which required an entity to separate deferred tax assets and liabilities into a current amount and a non-current amount in a classified balance sheet. The amendments in this ASU will be effective beginning in our first quarter of fiscal year 2018. Earlier application is permitted as of the beginning of an interim or annual period. Additionally, the new guidance may be applied either prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. We are in the process of evaluating the timing and impact of adopting the guidance.

In January 2016, FASB released ASU 2016-1, "Financial Instruments - Overall - Recognition and Measurement of Financial Assets and Financial Liabilities." The amendment changes the accounting for and financial statement presentation of equity investments, other than those accounted for under the equity method of accounting or those that result in consolidation of the investee. The amendment provides clarity on the measurement methodology to be used for the required disclosure of fair value of financial instruments measured at amortized cost on the balance sheet and clarifies that an entity should evaluate the need for a valuation allowance on deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets, among other changes. We are required to adopt this standard starting in the first quarter of fiscal year 2019 and do not anticipate that implementation will have a material impact on our Consolidated Financial Statements.

LIQUIDITY AND CAPITAL RESOURCES

As of December 27, 2015, we had $4.7 billion in gross cash and cash equivalents, investments, and restricted cash and investments (together comprising total cash and investments) compared to $4.2 billion as of June 28, 2015. Approximately $2.5 billion and $2.2 billion of our total cash and investments as of December 27, 2015 and June 28, 2015, respectively, was held outside the United States in our foreign subsidiaries, the majority of which is held in U.S. Dollars and, of which, substantially all would be subject to tax at U.S. rates if it were to be repatriated.

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Cash Flows from Operating Activities

Net cash provided by operating activities of $743.5 million during the six months ended December 27, 2015 consisted of (in millions):

Net income	$511.7
Non-cash charges:	
Depreciation and amortization	142.4
Equity-based compensation	68.3
Deferred income taxes	2.6
Amortization of note discounts and issuance costs	33.5
Changes in operating asset and liability accounts	(35.5)
Other	20.5
	$743.5

Changes in operating asset and liability accounts, net of foreign exchange impact, included the following uses of cash: increases in prepaid expense and other assets of $50.3 million, decrease in trade accounts payable of $69.3 million and decrease in deferred profit $61.0 million. The uses of cash are offset by sources of cash resulting from decreases in accounts receivable of $3.0 million and inventories of $48.3 million; as well as increases in accrued expenses and other liabilities of $93.8 million.

Cash Flows from Investing Activities

Net cash used for investing activities during the six months ended December 27, 2015 was $64.8 million, primarily consisting of and capital expenditures of $77.6 million offset by net sales of available-for-sale securities of $11.0 million.

Cash Flows from Financing Activities

Net cash used for financing activities during the six months ended December 27, 2015 was $209.0 million, primarily consisting of $111.2 million in treasury stock repurchases, $95.6 million of dividends paid, and $28.5 million of principal payments on debt and payments for debt issuance costs, partially offset by $20.8 million of stock issuance and treasury stock reissuances associated with our employee stock-based compensation plans.

Liquidity

Given that the semiconductor equipment industry is highly competitive and has experienced rapid changes in demand historically, we believe that maintaining sufficient liquidity reserves is important to support sustaining levels of investment in R&D and capital infrastructure. Anticipated cash flows from operations based on our current business outlook, combined with our current levels of cash, cash equivalents, and short term investments as of December 27, 2015, are expected to be sufficient to support our anticipated levels of operations, investments, debt service requirements, capital expenditures, capital redistributions, and dividends, through at least the next 12 months. However, uncertainty in the global economy and the semiconductor industry, as well as disruptions in credit markets, have in the past, and could in the future, impact customer demand for our products, as well as our ability to manage normal commercial relationships with our customers, suppliers, and creditors.

On October 20, 2015, we obtained a commitment for $4.20 billion of bridge financing from Goldman Sachs Bank USA and Goldman Sachs Lending Partners, LLC. ("the Commitment Parties") to finance, in part, the acquisition of KLA-Tencor. The Commitment Parties' commitment to provide financing (the "Bridge Facility") is subject to certain conditions, including consummation of the merger with KLA-Tencor. On November 10, 2015, we entered into an unsecured term loan agreement (the "Term Loan Agreement") with a syndicate of lenders for $900 million and the Bridge Facility was reduced to $3.3 billion. Borrowings under the Bridge Facility mature 364 days from the closing of the respective loan facility. Interest on amounts borrowed under the Bridge Facility is, at our option, based on (i) a base rate plus 0.00% to 1.50%, or (ii) LIBOR plus 1.00% to 2.50%, in each case as the applicable spread is determined based on the rating of our non-credit enhanced, senior unsecured long-term debt.

On November 10, 2015, we entered into a term loan agreement with a syndicate of lenders. The Term Loan Agreement provides for a $900 million senior unsecured term loan facility composed of two tranches; (i) a $375 million tranche of 3-year senior unsecured loans (the "3-Year Tranche") maturing on November 10, 2018; and (ii) a

$525 million tranche of 5-year senior unsecured loans (the "5-Year Tranche") maturing on November 10, 2020.

Interest on amounts borrowed under the Term Loan Agreement is, at our option, based on (i) a base rate, defined as the greatest of (a) prime rate, (b) Federal Funds rate plus 0.50%, or (c) one-month LIBOR plus 1.00%, plus a spread of 0.00% to 0.75% for the 3-Year Tranche or 0.125% to 1.000% for the 5-Year Tranche or (ii) LIBOR plus 1.000% and a spread of 1.000% to 1.750% for the 3-Year Tranche or 1.125% to 2.000% for the 5-Year Tranche, in each case as the applicable spread is determined based on the rating of our non-credit enhanced, senior unsecured long-term debt.

On November 10, 2015, we entered into an Amendment and Restatement Agreement, which amends and restates our unsecured Credit Agreement, dated March 12, 2014. The Restated Credit Agreement provides for an increase to our revolving unsecured credit facility, from $300 million to $750 million. The facility matures on November 10, 2020 and includes an option, subject to certain requirements, allowing us to request an increase in the facility of up to an additional $250 million, for a potential total commitment of $1 billion. Proceeds from the credit facility can be used for general corporate purposes.

Interest on amounts borrowed under the Restated Credit Agreement is, at our option, based on (i) a base rate, defined as the greatest of (a) prime rate, (b) Federal Funds rate plus 0.5%, or (c) one-month LIBOR plus 1.0%, plus a spread of 0.0% to 0.5%, or (ii) LIBOR plus a spread of 0.9% to 1.5%, in each case as the applicable spread is determined based on the rating of our non-credit enhanced, senior unsecured long-term debt. Principal and any accrued and unpaid interest is due and payable upon maturity. Additionally, we will pay the lenders a quarterly commitment fee that varies based on our rating described above.

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

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

For financial market risks related to changes in interest rates, marketable equity security prices, and foreign currency exchange rates, refer to Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk”, in our 2015 Form 10-K. Other than noted below, our exposure related to market risk has not changed materially since June 28, 2015. All of the potential changes noted below are based on sensitivity analyses performed on our financial position as of December 27, 2015. Actual results may differ materially.

Fixed Income Securities

Our investments in various interest earning securities carry a degree of market risk for changes in interest rates. At any time, a sharp rise in interest rates could have a material adverse impact on the fair value of our fixed income investment portfolio. Conversely, declines in interest rates could have a material adverse impact on interest income for our investment portfolio. We target to maintain a conservative investment policy, which focuses on the safety and preservation of our capital by limiting default risk, market risk, reinvestment risk, and concentration risk. The following table presents the hypothetical fair values of fixed income securities that would result from selected potential decreases and increases in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points (“BPS”), 100 BPS, and 150 BPS. The hypothetical fair values as of December 27, 2015 were as follows:

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	Valuation of Securities Given an Interest Rate Decrease of X Basis Points			Fair Value as of December 27, 2015	Valuation of Securities Given an Interest Rate Increase of X Basis Points		
	(150 BPS)	(100 BPS)	(50 BPS)	0.00%	50 BPS	100 BPS	150 BPS
	(in thousands)						
Time Deposit	$175,259	$175,259	$175,259	$ 175,259	$175,259	$175,259	$175,259
Municipal Notes and Bonds	648,829	648,340	646,444	643,178	639,794	636,411	633,028
U.S. Treasury & Agencies	361,123	359,084	355,221	351,084	346,923	342,762	338,602
Government-Sponsored Enterprises	49,131	48,787	48,235	47,674	47,115	46,556	45,996
Foreign Government Bonds	47,306	47,018	46,593	46,166	45,737	45,310	44,882
Bank and Corporate Notes	1,368,455	1,359,294	1,348,862	1,338,342	1,327,819	1,317,296	1,306,774
Mortgage Backed Securities - Residential	36,137	35,906	35,611	35,305	35,000	34,694	34,388
Mortgage Backed Securities - Commercial	117,550	117,022	116,466	115,910	115,353	114,796	114,240
Total	$2,803,790	$2,790,710	$2,772,691	$ 2,752,918	$2,733,000	$2,713,084	$2,693,169

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

ITEM 4. Controls and Procedures

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

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

Disclosure Controls and Procedures

As required by Exchange Act Rule 13a-15(b), as of December 27, 2015, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15(e). Based upon that evaluation, our Chief Executive Officer, along with our Chief Financial Officer, concluded that our disclosure controls and procedures are effective at the reasonable assurance level.

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

Changes in Internal Control over Financial Reporting

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

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Effectiveness of Controls

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

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

While the Company is not currently a party to any legal proceedings that it believes material, the Company is either a defendant or plaintiff in various actions that have arisen from time to time in the normal course of business, including intellectual property claims. The Company accrues for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Significant judgment is required in both the determination of probability and the determination as to whether a loss is reasonably estimable. To the extent there is a reasonable possibility that the losses could exceed the amounts already accrued, the Company believes that the amount of any such additional loss would be immaterial to the Company's business, financial condition, and results of operations.

ITEM 1A. Risk Factors

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

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

The semiconductor capital equipment industry has historically been characterized by rapid changes in demand. The industry environment has moved toward an environment more characterized by variability across segments and customers accentuated by consolidation within the industry. Variability in our customers' business plans may lead to changes in demand for our equipment and services which could negatively impact our results. The variability in our customers' investments during any particular period is dependent on several factors including but not limited to electronics demand, economic conditions (both general and in the semiconductor and electronics industries), industry supply and demand, prices for semiconductors, and our customers' ability to develop and manufacture increasingly complex and costly semiconductor devices. The changes in demand may require our management to adjust spending and other resources allocated to operating activities.

During periods of rapid growth or decline in demand for our products and services, we face significant challenges in maintaining adequate financial and business controls, management processes, information systems, procedures for training and managing our work force, and in appropriately sizing our supply chain infrastructure, work force, and other components of our business on a timely basis. If we do not adequately meet these challenges during periods of demand decline, our gross margins and earnings may be negatively impacted.

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

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

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

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

- a decline in demand for our products or services;
- an increase in reserves on accounts receivable due to our customers' inability to pay us;
- an increase in reserves on inventory balances due to excess or obsolete inventory as a result of our inability to sell such inventory;
- valuation allowances on deferred tax assets;
- restructuring charges;
- asset impairments including the potential impairment of goodwill and other intangible assets;
- a decline in the value of our investments;
- exposure to claims from our suppliers for payment on inventory that is ordered in anticipation of customer purchases that do not come to fruition;
- a decline in the value of certain facilities we lease to less than our residual value guarantee with the lessor; and
- challenges maintaining reliable and uninterrupted sources of supply.

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

Our Quarterly Revenues and Operating Results Are Variable

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

- economic conditions in the electronics and semiconductor industries in general and specifically the semiconductor equipment industry;
- the size and timing of orders from customers;
- consolidation of the customer base may result in the investment decisions of one customer or market having a significant effect on demand for our products or services;
- procurement shortages;
- the failure of our suppliers or outsource providers to perform their obligations in a manner consistent with our expectations;

- manufacturing difficulties;
- customer cancellations or delays in shipments, installations, and/or customer acceptances;
- the extent that customers continue to purchase and use our products and services in their business;
- our customers' reuse of existing and installed products, to the extent that such reuse decreases their need to purchase new products or services;
- changes in average selling prices, customer mix, and product mix;
- our ability in a timely manner to develop, introduce and market new, enhanced, and competitive products;
- our competitors' introduction of new products;
- legal or technical challenges to our products and technology;

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- transportation, communication, demand, information technology or supply disruptions based on factors outside our control such as strikes, acts of God, wars, terrorist activities, and natural or man-made disasters;
- legal, tax, accounting, or regulatory changes (including but not limited to change in import/export regulations) or changes in the interpretation or enforcement of existing requirements;
- changes in our estimated effective tax rate;
- foreign currency exchange rate fluctuations; and
- convertibility and the dilutive impact of our Convertible Notes and related warrants on our earnings per share.

We May Incur Impairments to Goodwill or Long-Lived Assets

We review our long-lived assets, including goodwill and other intangible assets, for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable. Negative industry or economic trends, including reduced market prices of our Common Stock, reduced estimates of future cash flows, disruptions to our business, slower growth rates, or lack of growth in our relevant business units, could lead to impairment charges against our long-lived assets, including goodwill and other intangible assets. If, in any period, our stock price decreases to the point where our fair value, as determined by our market capitalization, is less than the book value of our assets, this could also indicate a potential impairment, and we may be required to record an impairment charge in that period, which could adversely affect our result of operations. During the 2015 fiscal year, our goodwill and long-lived asset impairment assessments resulted in an impairment charge of $79.4 million associated with the single-wafer clean reporting unit and $9.8 million related to an intangible asset.

Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely heavily on projections of future operating performance. We operate in a highly competitive environment and projections of future operating results and cash flows may vary significantly from actual results. Additionally, if our analysis indicates potential impairment to goodwill in one or more of our business units, we may be required to record additional charges to earnings in our financial statements, which could negatively affect our results of operations.

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

As a result of the issuance of our 2020 and 2025 Senior Notes, our 2016 and 2018 Convertible Notes, and the assumption of the 2041 Convertible Notes in connection with our acquisition of Novellus Systems, Inc. (collectively the "Notes"), we have a greater amount of debt than we have maintained in the past. Furthermore, in November 2015 we entered into a Term Loan Agreement that provides for $900 million of senior unsecured term loans. In addition, we also entered into a Restated Credit Agreement which increases our revolving unsecured credit facility from $300 million to $750 million. We may, in the future, decide to borrow amounts under the revolving unsecured credit facility, or to enter into additional debt arrangements, including as described below in "Following the merger, our substantial leverage and debt service obligations could adversely affect our business."

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

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

- increased risk associated with any inability to satisfy our obligations;
- increasing the portion of our cash flows that may have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes; and
- impaired ability to obtain additional financing in the future.

Our ability to meet our expenses and debt obligations will depend on our future performance, which will be affected by financial, business, economic, regulatory, and other factors. Furthermore, our operations may not generate sufficient cash flows to enable us to meet our expenses and service our debt. As a result, we may need to enter into new financing arrangements to obtain the necessary funds. If we determine it is necessary to seek additional funding

for any reason, we may not be able to obtain such funding or, if funding is available, obtain it on acceptable terms. If we fail to make a payment on our debt, we could be in default on such debt, and this default could cause us to be in default on our other outstanding indebtedness.

Conversion of our Convertible Notes and resulting exercise of the related warrants may cause dilution to our stockholders and to our earnings per share. The number of shares of our Common Stock into which the Convertible Notes are convertible for and

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

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

We may be unable to respond to changes in business and economic conditions, engage in transactions that might otherwise be beneficial to us, or obtain additional financing, because our debt agreements contain, and any of our other future similar agreements such as any we may enter into in connection with our proposed acquisition of KLA-Tencor may contain, covenant restrictions that limit our ability to, among other things:

- incur additional debt, assume obligations in connection with letters of credit, or issue guarantees;
- create liens;
- enter into transactions with our affiliates;
- sell certain assets; and
- merge or consolidate with any person.

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

We Have a Limited Number of Key Customers

Sales to a limited number of large customers constitute a significant portion of our overall revenue, shipments, cash flows, collections, and profitability. For the six months ended December 27, 2015 and the years ended June 29, 2015, and June 28, 2014, three customers accounted for 45%, 51%, and 52% of total revenue, respectively. As a result, the actions of even one customer may subject us to variability in those areas that are difficult to predict. In addition, large customers may be able to negotiate requirements that result in decreased pricing; increased costs and/or lower margins for us; compliance to specific environmental, social and corporate governance standards; and limitations on our ability to share jointly developed technology with others. Similarly, significant portions of our credit risk may, at any given time, be concentrated among a limited number of customers, so that the failure of even one of these key customers to pay its obligations to us could significantly impact our financial results.

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

Rapid technological changes in semiconductor manufacturing processes subject us to increased pressure to develop technological advances that enable those processes. We believe that our future success depends in part upon our ability to develop and offer new products with improved capabilities and to continue to enhance our existing products. If new products or existing products have reliability, quality, design, or safety problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may be unable to develop and manufacture products successfully, or products that we introduce may fail in the marketplace. For over 25 years the primary driver of technology advancement in the semiconductor industry has been to shrink the lithography that prints the circuit design on

semiconductor chips. That driver could be approaching its technological limit, leading semiconductor manufacturers to investigate more complex changes in multiple technologies in an effort to continue technology development. In the face of uncertainty on which technology solutions will become successful, we will need to focus our efforts on developing the technology changes that are ultimately successful in supporting our customer requirements. Our failure to develop and offer the correct technology solutions in a timely manner with productive and cost-effective products could adversely affect our business in a material way. Our failure to commercialize new products in a timely manner could result in loss of market share, unanticipated costs, and inventory obsolescence, which would adversely affect our financial results.

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

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

We derive a substantial percentage of our revenues from a limited number of products. System sales constitute a significant portion of our total revenue. Our systems are priced up to approximately $9 million per system, and our revenues in any given quarter are dependent upon customer acceptance of a limited number of systems. As a result, the inability to recognize revenue on even a few systems can cause a significantly adverse impact on our revenues for a given quarter, and, in the longer term, the continued market acceptance of these products is critical to our future success. Our business, operating results, financial condition, and cash flows could therefore be adversely affected by:

- a decline in demand for even a limited number of our products;
- a failure to achieve continued market acceptance of our key products;
- export restrictions or other regulatory or legislative actions that could limit our ability to sell those products to key customers or customers within certain markets;
- an improved version of products being offered by a competitor in the markets in which we participate;
- increased pressure from competitors that offer broader product lines;
- technological changes that we are unable to address with our products; or
- a failure to release new or enhanced versions of our products on a timely basis.

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

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

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

Similarly, our customers may partner with, or follow the lead of, educational or research institutions that establish processes for accomplishing various tasks or manufacturing steps. If those institutions utilize a competitor's equipment when they establish those processes, it is likely that customers will tend to use the same equipment in setting up their

own manufacturing lines. Even if they select our equipment, the institutions and the customers that follow their lead could impose conditions on acceptance of that equipment, such as adherence to standards and requirements or limitations on how we license our proprietary rights that increase our costs or require us to take on greater risk. These actions could adversely impact our market share and financial results.

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

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

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

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

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

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

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

We Face a Challenging and Complex Competitive Environment

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

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

equipment similar to ours. For these reasons, we may fail to continue to compete successfully worldwide.
In addition, our competitors may be able to develop products comparable or superior to those we offer or may adapt more quickly to new technologies or evolving customer requirements. In particular, while we continue to develop product enhancements that we believe will address future customer requirements, we may fail in a timely manner to complete the development or introduction of these additional product enhancements successfully, or these product enhancements may not

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achieve market acceptance or be competitive. Accordingly, competition may intensify, and we may be unable to continue to compete successfully in our markets, which could have a material adverse effect on our revenues, operating results, financial condition, and/or cash flows.

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

Non-U.S. sales accounted for approximately 92%, 86%, and 80% of total revenue for the six months ended December 27, 2015, fiscal years 2015, and 2014, respectively. We expect that international sales will continue to account for a substantial majority of our total revenue in future years.

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

- trade balance issues;
- tariffs and other barriers;
- global or national economic and political conditions;
- changes in currency controls;
- differences in the enforcement of intellectual property and contract rights in varying jurisdictions;
- our ability to respond to customer and foreign government demands for locally sourced systems, spare parts and services and develop the necessary relationships with local suppliers;
- compliance with U.S. and international laws and regulations affecting foreign operations; including U.S. and international trade restrictions and sanctions, anti-bribery, anti-corruption, environmental, and labor laws;
- fluctuations in interest and foreign currency exchange rates;
- our ability to repatriate cash in a tax-efficient manner;
- the need for technical support resources in different locations; and
- our ability to secure and retain qualified people, and effectively manage people, in all necessary locations for the successful operation of our business.

Certain international sales depend on our ability to obtain export licenses from the U.S. government. Our failure or inability to obtain such licenses would substantially limit our markets and severely restrict our revenues. Many of the challenges noted above are applicable in China, which is a fast developing market for the semiconductor equipment industry and therefore an area of potential significant growth for our business. As the business volume between China and the rest of the world grows, there is inherent risk, based on the complex relationships among China, Taiwan, Japan, South Korea, and the United States, that political and diplomatic influences might lead to trade disruptions. This would adversely affect our business with China, Taiwan, Japan, and/or South Korea and perhaps the entire Asia Pacific region. A significant trade disruption in these areas could have a materially adverse impact on our future revenue and profits. In addition, there are risks that the Chinese government may, among other things: insist on the use of local suppliers; compel companies that do business in China to partner with local companies to design and supply equipment on a local basis, requiring the transfer of intellectual property rights and/or local manufacturing; and provide special incentives to government-backed local customers to buy from local competitors, even if their products are inferior to ours; all of which could adversely impact our revenues and margins.

We are exposed to potentially adverse movements in foreign currency exchange rates. The majority of our sales and expenses are denominated in U.S. dollars. However, we are exposed to foreign currency exchange rate fluctuations primarily related to revenues denominated in Japanese yen and expenses denominated in euro and Korean won. Currently, we enter into foreign currency forward contracts to minimize the short-term impact of the foreign currency exchange rate fluctuations on certain foreign currency monetary assets and liabilities; primarily third party accounts receivables, accounts payables and intercompany receivables and payables. In addition, we hedge certain anticipated foreign currency cash flows, primarily anticipated revenues denominated in Japanese yen or Euro and Korean won-denominated expenses. We believe these are our primary exposures to currency rate fluctuation. We expect to continue to enter into hedging transactions, for the purposes outlined, for the foreseeable future. However, these hedging transactions may not achieve their desired effect because differences between the actual timing of the underlying exposures and our forecasts of those exposures may leave us either over-or under-hedged on any given

transaction. Moreover, by hedging these foreign currency denominated revenues, expenses, monetary assets and liabilities with foreign currency forward contracts, we may miss favorable currency trends that would have been advantageous to us but for the hedges. Additionally, we are exposed to short-term foreign currency exchange rate fluctuations on non-U.S. dollar-denominated monetary assets and liabilities (other than those currency exposures previously discussed) and currently we do not enter into foreign currency hedge contracts against these exposures. Therefore, we are subject to both favorable and unfavorable foreign currency exchange rate fluctuations to the extent that we transact business (including intercompany transactions) for these currencies.

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

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

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

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

We maintain and rely upon certain critical information systems for the effective operation of our business. These information systems include telecommunications, the internet, our corporate intranet, various computer hardware and software applications, network communications, and e-mail. These information systems may be owned and maintained by us, our outsourced providers or third parties such as vendors and contractors. Many of these information systems and outsourced service providers, including certain hosted software applications that we use for confidential data storage, employ “cloud computing” technology for such storage (which refers to an information technology hosting and delivery system in which data is not stored within the user’s physical infrastructure but instead is delivered to and consumed by the user as an Internet-based service). All of these information systems are subject to attacks, failures, and access denials from a number of potential sources including viruses, destructive or inadequate code, power failures, and physical damage to computers, hard drives, communication lines, and networking equipment. Confidential and/or sensitive information stored on these information systems or transmitted to or from cloud storage could be intentionally or unintentionally compromised, lost and/or stolen. While we have implemented security procedures, such as virus protection software and emergency recovery processes, to mitigate the outlined risks with respect to information systems that are under our control, they cannot be guaranteed to be failsafe and our inability to use or access these information systems at critical points in time, or unauthorized releases of proprietary or confidential information, could unfavorably impact the timely and efficient operation of our business and our reputation.

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

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

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

We are subject to a variety of domestic and international governmental regulations related to the handling, discharge, and disposal of toxic, volatile, or otherwise hazardous chemicals. Failure to comply with present or future environmental regulations could result in fines being imposed on us, require us to suspend production, or cease operations, or cause our customers to not accept our products. These regulations could require us to alter our current operations, acquire significant additional equipment, incur substantial other expenses to comply with environmental

regulations, or take other actions. Any failure to comply with regulations governing the use, handling, sale, transport or disposal of hazardous substances could subject us to future liabilities that may adversely affect our operating results, financial condition and ability to operate our business.

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

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

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

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

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

- general market, semiconductor, or semiconductor equipment industry conditions;
- economic or political events and trends occurring globally or in any of our key sales regions;
- variations in our quarterly operating results and financial condition, including our liquidity;
- variations in our revenues, earnings or other business and financial metrics from forecasts by us or securities analysts, or from those experienced by other companies in our industry;
- announcements of restructurings, reductions in force, departure of key employees, and/or consolidations of operations;
- government regulations;
- developments in, or claims relating to, patent or other proprietary rights;
- technological innovations and the introduction of new products by us or our competitors;
- commercial success or failure of our new and existing products;
- disruptions of relationships with key customers or suppliers; or
- convertibility and dilutive impacts of our Convertible Notes and related warrants.

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

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

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

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

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

We Are Exposed to Various Risks from Our Regulatory Environment

We are subject to various risks related to (i) new, different, inconsistent or even conflicting laws, rules and regulations that may be enacted by legislative bodies and/or regulatory agencies in the countries that we operate;
(ii) disagreements or disputes between national or regional regulatory agencies related to international trade; and
(iii) the interpretation and application of laws, rules and regulations. As a public company with global operations, we are subject to the laws of multiple jurisdictions and the rules and regulations of various governing bodies, including those related to financial and other disclosures, corporate governance, privacy, anti-corruption, such as the Foreign Corrupt Practices Act and other local laws prohibiting corrupt payments to governmental officials, conflict minerals or other social responsibility legislation, and antitrust regulations, among others. Each of these laws, rules and regulations imposes costs on our business, including financial costs and potential diversion of our management's attention associated with compliance, and may present risks to our business, including potential fines, restrictions on

our actions, and reputational damage if we are unable to fully comply.

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

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

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

If We are Unable to Complete Our Contemplated Acquisition of KLA-Tencor Corporation, Our Expected Financial Results and the Market Value of our Common Stock Could Be Adversely Affected

On October 20, 2015, we entered into an Agreement and Plan of Merger and Reorganization (the “merger agreement”) with KLA-Tencor Corporation (“KLA-Tencor”) to acquire all of KLA-Tencor’s issued and outstanding stock through a merger of KLA-Tencor with our subsidiaries, Topeka Merger Sub 1, Inc. and Topeka Merger Sub 2, Inc. (the “merger”). Consummation of the merger is subject to customary conditions to closing, including the receipt of required regulatory approvals, the approval of the issuance of our common stock to KLA-Tencor’s stockholders in the merger by our stockholders, and the approval of the merger by KLA-Tencor’s stockholders. If any condition to the merger is not satisfied or waived, the merger will not be completed. We and KLA-Tencor also may terminate the merger agreement under certain circumstances. Any or all of the preceding could jeopardize our ability to consummate the merger on the already negotiated terms. To the extent the merger is not completed for any reason, we would have devoted substantial resources and management attention to the transaction without realizing the accompanying benefits expected by our management, and our financial condition and results of operations and the market value of our stock may be adversely affected. Additional risks and uncertainties associated with the merger include:

- various conditions to the closing of the merger may not be satisfied or waived;
- the failure to consummate the merger may result in negative publicity and a negative impression of us in the investment community;
- we and KLA-Tencor are subject to litigation related to the merger, and may be subject to additional proceedings in the future;
- required regulatory approvals from governmental entities may delay the merger or result in the imposition of conditions that could cause the abandonment of the merger;
- the merger agreement may be terminated in circumstances that would require us to pay KLA-Tencor a termination fee of up to $290 million;
- the merger agreement contains provisions that could discourage a potential acquirer of the Company;
- our ability to attract, recruit, retain and motivate current and prospective employees who may be uncertain about their future roles and relationships with us following the completion of the merger may be adversely affected;
- the increase in our leverage and debt service obligations as a result of the assumption of KLA-Tencor’s debt and the incurrence of additional financing in connection with the merger may adversely affect the combined company’s financial condition, results of operations and earnings per share;
- the attention of our employees and management may be diverted due to activities related to the merger; and
- disruptions from the merger, whether completed or not, may harm our relationships with our employees, customers, distributors, suppliers or other business partners, and may result in a loss of or a substantial decrease in purchases by our customers.

Even if the KLA-Tencor Merger is Consummated, We May Not Be Able to Integrate the Business of KLA-Tencor Successfully With our Own or Realize the Anticipated Benefits of the Merger.

The merger involves the combination of two companies that currently operate as independent public companies. The combined company will be required to devote significant management attention and resources to integrating our business practices with those of KLA-Tencor. Potential difficulties that the combined company may encounter as part of the integration process include the following:

- the inability to successfully combine our business with KLA-Tencor in a manner that permits the combined company to achieve the full revenue and cost synergies and other benefits anticipated to result from the merger;

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- complexities associated with managing the combined businesses, including difficulty addressing possible differences in corporate cultures and management philosophies and the challenge of integrating complex systems, technology, networks and other assets of each of the companies in a seamless manner that minimizes any adverse impact on customers, suppliers, employees and other constituencies; and
- potential unknown liabilities and unforeseen increased expenses or delays associated with the merger.

In addition, we have operated and, until the completion of the merger will continue to operate, independently. It is possible that the integration process could result in:

- diversion of the attention of our management; and
- the disruption of, or the loss of momentum in, our ongoing business or inconsistencies in standards, controls, procedures or policies,

any of which could adversely affect our ability to maintain relationships with customers, suppliers, employees and other constituencies or our ability to achieve the anticipated benefits of the merger, or could reduce our earnings or otherwise adversely affect the business and financial results of the combined company.

There Can Be No Assurance that We Will be able to Secure the Financing We Intend to Use to Pay the Cash Portion of the Consideration for the Merger.

We have entered into (1) a senior unsecured term loan agreement which provides up to $900 million in term loans, subject to certain conditions; and (2) a debt commitment letter which provides for a senior unsecured 364-day bridge facility in a principal amount of up to $3.3 billion, subject to certain conditions. We have also entered into an amendment and restatement of our existing revolving credit agreement pursuant to which, among other things, the revolving lenders agreed to increase their aggregate commitments under the revolving credit agreement from $300 million to $750 million.

We intend to fund the cash component of the merger consideration and related fees and expenses and to prepay KLA-Tencor’s term loan with a combination of the combined companies’ balance sheet cash and proceeds of approximately $4.0 billion under the term loans, the revolving credit agreement and from the issuance of debt securities or, to the extent necessary, borrowings under the bridge facility. We also expect to guarantee KLA-Tencor’s existing notes in the aggregate principal amount of $2.5 billion. We intend to pursue financing that would replace or supplement financing available under the bridge facility.

The availability of the term loans and any debt financing pursuant to the bridge commitment letter is, and other financing we might arrange will be, subject to certain conditions precedent. In addition, the commitments under the bridge facility commitment letter will terminate upon the first to occur of (i) the execution and delivery of definitive financing documentation for the bridge facility; (ii) the consummation of the merger without using the bridge facility; (iii) the termination of the obligations of the Company or Topeka Merger Sub 1, Inc. to consummate the merger pursuant to the merger agreement, and (iv) July 20, 2016 (or, to the extent this date is extended in accordance with the merger agreement, such extended date occurring on or prior to October 20, 2016). Therefore, no assurance can be given that the financing pursuant to the term loans, the bridge facility or debt securities described above will be available.

Our obligation to complete the merger is not subject to a financing contingency. In the event that the term loans, bridge facility or the replacement financing is not available, other financing may not be available on acceptable terms, in a timely manner, or at all. If we are unable to secure alternative financing, the merger may not be completed and we could be liable to KLA-Tencor for breach of the merger agreement in connection with its failure to consummate the merger.

The Future Results of the Combined Company Will Suffer if the Combined Company Does Not Effectively Manage its Expanded Operations Following the Merger.

Following the merger, the size of the business of the combined company will increase significantly beyond the current size of either our or KLA-Tencor’s business. The combined company’s future success depends, in part, upon its ability

to manage this expanded business, which will pose substantial challenges for management, including challenges related to the management and monitoring of new operations and associated increased costs and complexity. There can be no assurances that the combined company will be successful or that it will realize the expected operating efficiencies, cost savings, revenue enhancements or other benefits currently anticipated from the merger.

The Combined Company is Expected to Incur Substantial Expenses Related to the Merger With and the Integration of KLA-Tencor.

We expect to incur substantial expenses in connection with the merger with and the integration of KLA-Tencor. There are a large number of processes, policies, procedures, operations, technologies and systems that may need to be integrated, including

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purchasing, accounting and finance, sales, payroll, pricing, marketing and benefits. While we have assumed that a certain level of expenses will be incurred, there are many factors beyond our or their control that could affect the total amount or the timing of the integration expenses. Moreover, many of the expenses that will be incurred are, by their nature, difficult to estimate accurately. These expenses could, particularly in the near term, exceed the savings that the combined company expects to achieve from the elimination of duplicative expenses and the realization of economies of scale and cost savings. These integration expenses likely will result in the combined company taking significant charges against earnings following the completion of the merger, and the amount and timing of such charges are uncertain at present.

The Merger May Result In a Loss of Customers or Strategic Alliances.

As a result of the merger, some of the customers, potential customers or strategic partners of ours or KLA-Tencor may terminate or scale back their business relationship with the combined company. Some customers may not wish to source a larger percentage of their needs from a single company, or may feel that we or KLA-Tencor, as applicable, and thus the combined company is too closely allied with one of their competitors. Potential customers or strategic partners may delay entering into, or decide not to enter into, a business relationship with the combined company because of the merger. If customer relationships or strategic alliances are adversely affected by the merger, the combined company’s business and financial performance could suffer.

Third Parties May Terminate or Alter Existing Contracts with KLA-Tencor.

KLA-Tencor has contracts with suppliers, distributors, customers, licensors, licensees, lessors and other business partners that have “change of control” or similar clauses that allow the counterparty to terminate or change the terms of their contract upon the closing of the transactions contemplated by the merger agreement. We or KLA-Tencor may seek to obtain consent from these other parties, but if these third party consents are not obtained, or are obtained on unfavorable terms, the combined company may lose the benefit of such contracts, including benefits that may be material to the business of the combined company.

Our Indebtedness Following Completion of the Merger Will Be Substantially Greater than Our indebtedness on a Stand-alone Basis and Greater Than Our or KLA-Tencor's Combined Indebtedness Existing Prior to the Merger. This Increased Level of Indebtedness Could Adversely Affect Us, Including by Decreasing Our business Flexibility, And will Increase Our Borrowing Costs. Downgrades in Our Ratings Could Adversely Affect Our Business, Cash Flows, Financial Condition and Operating Results.

We intend to fund the cash component of the merger consideration and related fees and expenses and to prepay KLA-Tencor’s term loan with a combination of the combined companies’ balance sheet cash and proceeds of approximately $4.0 billion under the term loans, the revolving credit agreement and from the issuance of debt securities or, to the extent necessary, borrowings under the bridge facility. We also expect to guarantee KLA-Tencor’s existing notes in the aggregate principal amount of $2.5 billion. Our substantially increased indebtedness and higher debt-to-equity ratio following completion of the merger in comparison to that prior to the merger will have the effect, among other things, of reducing our flexibility to respond to changing business and economic conditions and will increase our borrowing costs. In addition, the amount of cash required to service our increased indebtedness levels and thus the demands on our cash resources will be greater than the amount of cash flows required to service our indebtedness or that of KLA-Tencor individually prior to the merger. The increased levels of indebtedness could also reduce funds available for our investments in product development as well as capital expenditures, dividends, share repurchases and other activities and may create competitive disadvantages for us relative to other companies with lower debt levels.

In addition, our credit ratings impact the cost and availability of future borrowings, and, as a result, our cost of capital. Our ratings reflect each rating organization’s opinion of our financial strength, operating performance and ability to meet our debt obligations or obligations to our insureds. Each of the ratings organizations reviews our ratings periodically, and there can be no assurance that our current ratings will be maintained in the future. Downgrades in our ratings could adversely affect our business, cash flows, financial condition and operating results.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Repurchases of Company Shares

On April 29, 2014, the Board of Directors authorized us to repurchase up to $850 million of common stock, which included the remaining value available under our prior authorization. These repurchases can be conducted on the open market or as private purchases and may include the use of derivative contracts with large financial institutions, in all cases subject to compliance

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with applicable law. Repurchases will be funded using our on-shore cash and on-shore cash generation. This repurchase program has no termination date and may be suspended or discontinued at any time.

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

Period	Total Number of Shares Repurchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Amount Available Under Repurchase Program
	(in thousands, except share and per share data)			
Amount available at June 28, 2015				$316,587
Quarter ended September 27, 2015	1,413	$72.69	1,205	$229,094
September 28, 2015 - October 25, 2015	121	$65.72	—	229,094
October 26, 2015 - November 22, 2015	5	$76.74	—	229,094
November 23, 2015 - December 27, 2015	58	$77.59	—	229,094
Total Quarter Ended December 27, 2015	184	$69.76	—	$229,094

(1) During the three and six months ended December 27, 2015, the Company acquired 183,381 shares at a total cost of $12.8 million and 392,005 shares at a total cost of $28.1 million, respectively, which the Company withheld through net share settlements to cover minimum tax withholding obligations upon the vesting of restricted stock unit awards granted under the Company's equity compensation plans. The shares retained by the Company through these net share settlements are not a part of the Board-authorized repurchase program but instead are authorized under the Company's equity compensation plan.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

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

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LAM RESEARCH CORPORATION
SIGNATURES

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

Date: February 3, 2016

LAM RESEARCH CORPORATION
(Registrant)

/s/ Douglas R. Bettinger
Douglas R. Bettinger
Executive Vice President, Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Description
10.1	Chairman’s Agreement with Stephen G. Newberry, dated December 14, 2015
31.1	Rule 13a-14(a)/15d-14(a) Certification (Principal Executive Officer)
31.2	Rule 13a-14(a)/15d-14(a) Certification (Principal Financial Officer)
32.1	Section 1350 Certification (Principal Executive Officer)
32.2	Section 1350 Certification (Principal Financial Officer)
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document