LATTICE SEMICONDUCTOR CORP
Form 10-Q
November 10, 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 OCTOBER 1, 2016
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 000-18032
LATTICE SEMICONDUCTOR CORPORATION
(Exact name of Registrant as specified in its charter)

State of Delaware	93-0835214
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
111 SW Fifth Ave, Ste 700, Portland, OR	97204
(Address of principal executive offices)	(Zip Code)

(503) 268-8000
(Registrant's telephone number, including area code)
Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [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 as 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. (Check one):
Large accelerated filer [X] Accelerated filer [ ]

Non-accelerated filer [ ] 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]
Number of shares of common stock outstanding as of November 8, 2016 121,153,068

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QUARTERLY REPORT ON FORM 10-Q
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Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Any statements about our expectations, beliefs, plans, objectives, assumptions, or future events or performance are not historical facts and may be forward-looking. We use words or phrases such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “may,” “will,” “should,” “continue,” “ongoing,” “future,” “potential,” and phrases to identify forward-looking statements.

Examples of forward-looking statements include, but are not limited to, statements about: our strategies and beliefs regarding the markets we serve or may serve; growth opportunities and growth in markets we may serve; our future product development and marketing plans; our intention to continually introduce new products and enhancements and reduce manufacturing costs; plans to introduce new product families in high-growth market niches where we believe that we have sustainable and differentiated positions; the anticipation that we will become increasingly dependent on revenue from newer products; our expectations regarding customer preferences and product use; acceptance of our devices; the Asia Pacific market being the primary source of our revenue; a significant portion of our revenue being through our sell-through distributors; our estimates and judgment to reconcile distributors’ inventories; our making significant future investments in research and development; the costs of making and developing various products; our expectation that we will continue to transition to increasingly smaller geometry process technologies; our ability to maintain or develop successful foundry relationships to produce new products; the adequacy of assembly and test capacity commitments; the impact of products, customers and downward pressure on pricing and effects on gross margin; expected synergies from the acquisition of Silicon Image; the expected cost and timing of our internal restructuring plan; our expectations regarding protection of and defenses to claims against our intellectual property; the finalization and settlement of litigation or administrative proceedings; the impact of our global tax structure and expectations regarding taxes and tax adjustments; our expectation regarding the sufficiency of our financial resources to meet our working capital needs through at least the next 12 months; our expectation that we may consider acquisition opportunities to further extend our product or technology portfolios and further expand our product offerings; the impact of new accounting pronouncements; our beliefs concerning the adequacy of our liquidity and facilities, and our ability to meet our operating and capital requirements and obligations; our continued participation in consortia that develop and promote the High-Definition Multimedia Interface ("HDMI"), Mobile High-Definition Link ("MHL") and WirelessHD specifications, and our participation in other standard setting initiatives; the effect of narrowing our agent functions regarding the HDMI consortium and related reduction in adopter fees; our ability to implement a company-wide enterprise resource planning system; any other changes in the agreements relating to various intellectual property or standards consortia and their sharing of past or present fees or royalties; our expectation that a new licensing agent will be appointed on behalf of the HDMI Founders in fiscal 2017; and our expectation that the proposed acquisition of the outstanding shares of the Company by Canyon Bridge Acquisition Company, Inc. will occur in early 2017.

Forward-looking statements involve estimates, assumptions, risks, and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. The key factors, among others, that could cause our actual results to differ materially from the forward-looking statements include global economic conditions and uncertainty, the concentration of our sales in the Mobile & Consumer and Communications & Computing end markets, particularly as it relates to the concentration of our sales in the Asia Pacific region, market acceptance and demand for our new products, our ability to license our intellectual property, any disruption of our distribution channels, the effect of the downturn in the economy on capital markets and credit markets, the impact of competitive products and pricing, unexpected charges, delays or results relating to our restructuring plans, unexpected changes to our implementation of a company-wide enterprise resource planning system, unanticipated taxation requirements or positions of the U.S. Internal Revenue Service, or unexpected impacts of recent accounting guidance. In addition, actual results are subject to other risks and uncertainties that relate more broadly to our overall business, including

those more fully described herein and that are otherwise described from time to time in our filings with the Securities and Exchange Commission, including, but not limited to, the items discussed in “Risk Factors” in Item 1A of Part II of this Quarterly Report on Form 10-Q.

You should not unduly rely on forward-looking statements because our actual results could differ materially from those expressed in any forward-looking statements made by us. In addition, any forward-looking statement applies only as of the date on which it is made. We do not plan to, and undertake no obligation to, update any forward-looking statements to reflect events or circumstances that occur after the date on which such statements are made or to reflect the occurrence of unanticipated events.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LATTICE SEMICONDUCTOR CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

(In thousands, except per share data)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Revenue:				
Product	$102,816	$98,572	$280,374	$280,587
Licensing and services	10,409	11,143	28,572	24,185
Total revenue	113,225	109,715	308,946	304,772
Costs and expenses:				
Cost of product revenue	45,695	49,415	125,412	138,250
Cost of licensing and services revenue	106	451	580	715
Research and development	27,747	37,619	91,270	104,813
Selling, general, and administrative	29,244	23,819	75,857	73,096
Amortization of acquired intangible assets	8,260	8,941	25,292	20,824
Restructuring charges	317	6,818	8,316	15,780
Acquisition related charges	—	610	94	22,078
Impairment of intangible assets	7,866	—	7,866	—
	119,235	127,673	334,687	375,556
Loss from operations	(6,010)	(17,958)	(25,741)	(70,784)
Interest expense	(5,235)	(5,754)	(15,257)	(12,870)
Other income (expense), net	209	(841)	3,558	(1,095)
Loss before income taxes and equity in net loss of an unconsolidated affiliate	(11,036)	(24,553)	(37,440)	(84,749)
Income tax expense	971	309	7,410	29,030
Equity in net loss of an unconsolidated affiliate, net of tax	(407)	—	(1,085)	—
Net loss	$(12,414)	$(24,862)	$(45,935)	$(113,779)
Net loss per share, basic and diluted	$(0.10)	$(0.21)	$(0.38)	$(0.97)
Shares used in per share calculations, basic and diluted	120,584	117,669	119,596	117,151

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited)

(In thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Net loss	$(12,414)	$(24,862)	$(45,935)	$(113,779)
Other comprehensive loss:				
Unrealized loss related to marketable securities, net of tax	(61)	(130)	(88)	(133)
Reclassification adjustment for losses related to marketable securities included in other income (expense), net of tax	—	209	38	443
Translation adjustment, net of tax	(138)	(697)	(579)	(752)
Change in actuarial valuation of defined benefit pension	—	(1)	141	(156)
Comprehensive loss	$(12,613)	$(25,481)	$(46,423)	$(114,377)

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
CONSOLIDATED BALANCE SHEETS
(unaudited)

(In thousands, except share and par value data)	October 1, 2016	January 2, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$87,163	$84,606
Short-term marketable securities	11,751	17,968
Accounts receivable, net of allowance for doubtful accounts	93,946	88,471
Inventories	80,540	75,896
Prepaid expenses and other current assets	18,614	18,922
Total current assets	292,014	285,863
Property and equipment, less accumulated depreciation of $130,968 at October 1, 2016 and $118,943 at January 2, 2016	51,576	51,852
Intangible assets, net of amortization	127,332	162,583
Goodwill	269,771	267,549
Deferred income taxes	473	578
Other long-term assets	15,087	17,495
Total assets	$756,253	$785,920
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses (includes restructuring)	$76,986	$74,298
Accrued payroll obligations	9,009	9,463
Current portion of long-term debt	27,613	7,557
Deferred income and allowances on sales to sell-through distributors	20,933	17,866
Deferred licensing and services revenue	653	1,993
Total current liabilities	135,194	111,177
Long-term debt	307,747	330,870
Other long-term liabilities	39,638	38,353
Total liabilities	482,579	480,400
Contingencies (Note 15)	—	—
Stockholders' equity:		
Preferred stock, $.01 par value, 10,000,000 shares authorized, none issued and outstanding	—	—
Common stock, $.01 par value, 300,000,000 shares authorized; 121,000,000 shares issued and outstanding as of October 1, 2016 and 118,651,000 shares issued and outstanding as of January 2, 2016	1,210	1,187
Additional paid-in capital	674,643	660,089
Accumulated deficit	(398,781)	(352,846)
Accumulated other comprehensive loss	(3,398)	(2,910)
Total stockholders' equity	273,674	305,520
Total liabilities and stockholders' equity	$756,253	$785,920

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

(In thousands)	Nine Months Ended October 1, 2016	October 3, 2015
Cash flows from operating activities:		
Net loss	$(45,935)	$(113,779)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	47,908	42,916
Impairment of intangible assets	7,866	—
Amortization of debt issuance costs and discount	1,212	2,037
Change in deferred income tax provision	—	17,689
Loss on sale or maturity of marketable securities	72	336
Stock-based compensation expense	12,107	13,609
Loss on disposal of fixed assets	263	—
Gain on sale of business unit	(2,646)	—
Equity in net loss of an unconsolidated affiliate, net of tax	1,085	—
Changes in assets and liabilities:		
Accounts receivable, net	(5,728)	7,708
Inventories	(4,644)	6,738
Prepaid expenses and other current assets	(2,227)	(2,776)
Accounts payable and accrued expenses (includes restructuring)	6,295	7,786
Accrued payroll obligations	(454)	(10,309)
Income taxes payable	1,335	971
Deferred income and allowances on sales to sell-through distributors	3,067	5,481
Deferred licensing and services revenue	(258)	967
Net cash provided by (used in) operating activities	19,318	(20,626)
Cash flows from investing activities:		
Proceeds from sales of and maturities of short-term marketable securities	11,977	142,956
Purchases of marketable securities, net	(5,961)	(4,005)
Cash paid for business acquisition, net of cash acquired	—	(431,068)
Capital expenditures	(13,991)	(11,584)
Proceeds from sale of business unit, net of cash sold	1,972	—
Cash paid for a non-marketable equity method investment	(1,000)	(3,000)
Cash paid for software licenses	(7,370)	(5,393)
Net cash used in investing activities	(14,373)	(312,094)
Cash flows from financing activities:		
Proceeds from issuance of restricted stock units, net of withholding taxes	(2,883)	(2,660)
Purchases of treasury stock	—	(6,970)
Net proceeds from issuance of common stock	5,353	3,382
Net proceeds from issuance of long-term debt	—	346,500
Cash paid for debt issuance costs	—	(8,283)
Repayment of debt	(4,279)	(1,750)
Net cash (used in) provided by financing activities	(1,809)	330,219

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
(unaudited)

(In thousands)	Nine Months Ended	
	October 1, 2016	October 3, 2015
Effect of exchange rate change on cash	(579)	(754)
Net increase (decrease) in cash and cash equivalents	2,557	(3,255)
Beginning cash and cash equivalents	84,606	115,611
Ending cash and cash equivalents	$87,163	$112,356
Supplemental cash flow information:		
Change in unrealized gain (loss) related to marketable securities, net of tax, included in Accumulated other comprehensive loss	$(50)	$(133)
Income taxes paid, net of refunds	$7,250	$5,403
Interest paid	$13,849	$6,225
Accrued purchases of plant and equipment	$402	$817

See Accompanying Notes to Unaudited Consolidated Financial Statements.

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LATTICE SEMICONDUCTOR CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Basis of Presentation and Significant Accounting Policies

The accompanying Consolidated Financial Statements are unaudited and have been prepared by Lattice Semiconductor Corporation (“Lattice,” the “Company,” “we,” “us,” or “our”) pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) and in our opinion include all adjustments, consisting only of normal recurring adjustments, necessary for the fair statement of results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") have been condensed or omitted pursuant to such rules and regulations. These Consolidated Financial Statements should be read in conjunction with our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 2, 2016.

Fiscal Reporting Period

We report based on a 52 or 53-week fiscal year ending on the Saturday closest to December 31. Our third quarter of fiscal 2016 and third quarter of fiscal 2015 ended on October 1, 2016 and October 3, 2015, respectively. All references to quarterly, three or nine months ended financial results are references to the results for the relevant 13-week or 39-week fiscal period.

Principles of Consolidation and Presentation

The accompanying Consolidated Financial Statements include the accounts of Lattice and its subsidiaries after the elimination of all intercompany balances and transactions. Our results for the nine months ended October 3, 2015 include the results of Silicon Image, Inc. ("Silicon Image") for the approximately 29-week period from March 11, 2015 through October 3, 2015. Certain balances in prior fiscal years have been reclassified to conform to the presentation adopted in the current year. Net loss attributable to noncontrolling interest amounting to $0.1 million and $0.2 million was reported separately for the third quarter and first nine months, respectively, of fiscal 2015 and is now included in Other income (expense), net.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and classification of assets, such as marketable securities, accounts receivable, inventory, goodwill (including the assessment of reporting units), intangible assets, current and deferred income taxes, accrued liabilities (including restructuring charges and bonus arrangements), deferred income and allowances on sales to sell-through distributors, disclosure of contingent assets and liabilities at the date of the financial statements, amounts used in acquisition valuations and purchase accounting, and the reported amounts of product revenue, licensing and services revenue, and expenses during the fiscal periods presented. Actual results could differ from those estimates.

Cash Equivalents and Marketable Securities

We consider all investments that are readily convertible into cash and have original maturities of three months or less to be cash equivalents. Cash equivalents consist primarily of highly liquid investments in time deposits or money market accounts and are carried at cost. We account for marketable securities as available-for-sale investments, as defined by U.S. GAAP, and record unrealized gains or losses to Accumulated other comprehensive loss on our

Consolidated Balance Sheets, unless losses are considered other than temporary, in which case, those are recorded directly to the Consolidated Statements of Operations and Statements of Comprehensive Loss. Deposits with financial institutions at times exceed Federal Deposit Insurance Corporation insurance limits.

Fair Value of Financial Instruments

We invest in various financial instruments, which may include corporate and government bonds, notes, and commercial paper. We value these instruments at their fair value and monitor the portfolio for impairment on a periodic basis. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other than temporary, we would record an impairment charge and establish a new carrying value. We assess other than temporary impairment of marketable securities in accordance with Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 820, “Fair Value Measurements and Disclosures.” The framework under the provisions of ASC 820 establishes three levels of inputs that may be used to measure fair value. Each level of input has different levels of subjectivity and difficulty involved in determining fair value.

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Foreign Exchange and Translation of Foreign Currencies

While our revenues and the majority of our expenses are denominated in U.S. dollars, we have international subsidiary and branch operations that conduct some transactions in foreign currencies. In addition, a portion of our silicon wafer and other purchases were historically denominated in Japanese yen, we billed certain Japanese customers in yen, and we collect a Japanese consumption tax refund in yen. Gains or losses from foreign exchange rate fluctuations on balances denominated in foreign currencies are reflected in Other income (expense), net. Realized and unrealized gains or losses on foreign currency transactions were not significant for the periods presented. We translate accounts denominated in foreign currencies in accord-ance with ASC 830, “Foreign Currency Matters,” using the current rate method under which asset and liability accounts are translated at the current rate, while stockholders' equity accounts are translated at the appropriate historical rates, and revenue and expense accounts are translated at average monthly exchange rates. Translation adjustments related to the consolidation of foreign subsidiary financial statements are reflected in Accumulated other comprehensive loss in Stockholders' equity.

Derivative Financial Instruments

We mitigate foreign currency exchange rate risk by entering into foreign currency forward exchange contracts. At October 1, 2016 and January 2, 2016, we had open contracts for Japanese yen of $1.3 million and $3.3 million, respectively. The one contract outstanding at October 1, 2016 will settle in June 2017. Of the six contracts outstanding at January 2, 2016, two settled in January 2016 and four settled in June 2016. Although these hedges mitigate our foreign currency exchange rate exposure from an economic perspective, they were not designated as "effective" hedges for accounting purposes and as such are adjusted to fair value through Other income (expense), net, with an impact of less than $0.1 million for both the fiscal quarters ended October 1, 2016 and January 2, 2016. We do not hold or issue derivative financial instruments for trading or speculative purposes.

Concentration Risk

Potential exposure to concentration risk may impact revenue, trade receivables, marketable securities, and supply of wafers for our products.

Customer concentration risk may impact revenue. Our top five end customers constituted approximately 32% of our revenue for the third quarter of fiscal 2016, compared to approximately 31% for the third quarter of fiscal 2015. Our top five end customers constituted approximately 25% of our revenue for the first nine months of fiscal 2016, compared to approximately 33% for the first nine months of fiscal 2015.

Our largest end customer accounted for approximately 14% of total revenue in the third quarter of fiscal 2016 and 7% of total revenue in the first nine months of fiscal 2016. In the third quarter and first nine months of fiscal 2015, our largest end customer accounted for approximately 9% and 11%, respectively, of total revenue. No other customers accounted for more than 10% of total revenue during these periods.

Sales through distributors have historically accounted for a significant portion of our total revenue. Revenue attributable to resale of products by our sell-through distributors for the third quarter of fiscal 2016 and fiscal 2015 was 62% and 46%, respectively. Revenue attributable to resale of products by our sell-through distributors for the first nine months of fiscal 2016 and fiscal 2015 was 58% and 45%, respectively. Our two largest distributor groups also account for a substantial portion of our trade receivables. At October 1, 2016 and January 2, 2016, one distributor group accounted for 35% and 29%, respectively, and the other accounted for 31% and 15%, respectively, of gross trade receivables. No other distributor groups or end customers accounted for more than 10% of gross trade receivables at these dates.

Concentration of credit risk with respect to trade receivables is mitigated by our credit and collection process, including active management of collections, credit limits, routine credit evaluations for essentially all customers, and secure transactions with letters of credit or advance payments where appropriate. We regularly review our allowance for doubtful accounts and the aging of our accounts receivable.

Accounts receivable do not bear interest and are shown net of allowances for doubtful accounts of $7.2 million at October 1, 2016 and $0.6 million at January 2, 2016. Towards the end of our fiscal quarter, we received notice from one of our distributor groups that indicated a high likelihood of their bankruptcy. As a result, we wrote off our accounts receivable, net of deferred revenue, from the distributor group resulting in an increase in allowance for doubtful accounts of $6.6 million and bad debt expense of $7.5 million for both the third quarter and first nine months of fiscal 2016. Bad debt expense was negligible for the third quarter and first nine months of fiscal 2015.

We place our investments primarily through one financial institution and mitigate the concentration of credit risk by limiting the maximum portion of the investment portfolio which may be invested in any one instrument. Our investment policy defines approved credit ratings for investment securities. Investments on-hand in marketable securities consisted primarily of money market instruments, “AA” or better corporate notes and bonds and commercial paper, and U.S. government agency obligations. See Note 3 for a discussion of the liquidity attributes of our marketable securities.

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We rely on a limited number of foundries for our wafer purchases, including Fujitsu Limited, Seiko Epson Corporation, Taiwan Semiconductor Manufacturing Company, Ltd, and United Microelectronics Corporation. We seek to mitigate the concentration of supply risk by establishing, maintaining and managing multiple foundry relationships, but certain of our products are sourced from a single foundry.

Revenue Recognition and Deferred Income

Product Revenue

We sell our products directly to end customers, through a network of independent manufacturers' representatives, and indirectly through a network of independent sell-in and sell-through distributors. Distributors provide periodic data regarding the product, price, quantity, and end customer when products are resold, as well as the quantities of our products they still have in stock.

Revenue from sales to original equipment manufacturers ("OEMs") and sell-in distributors is generally recognized upon shipment. Reserves for sell-in stock rotations, where applicable, are estimated based primarily on historical experience and provided for at the time of shipment. Revenue from sales by our sell-through distributors is recognized at the time of reported resale. Under both types of revenue recognition, persuasive evidence of an arrangement exists, the price is fixed or determinable, title has transferred, collection of resulting receivables is reasonably assured, and there are no remaining customer acceptance requirements and no remaining significant performance obligations.

Orders from our sell-through distributors are initially recorded at published list prices; however, for a majority of our sales, the final selling price is determined at the time of resale and in accordance with a distributor price agreement. For this reason, we do not recognize revenue until products are resold by sell-through distributors to an end customer. In certain circumstances, we allow sell-through distributors to return unsold products. At times, we protect our sell-through distributors against reductions in published list prices.

At the time of shipment to sell-through distributors, we (a) record accounts receivable at published list price since there is a legally enforceable obligation from the distributor to pay us currently for product delivered, (b) relieve inventory for the carrying value of goods shipped since legal title has passed to the distributor, and (c) record deferred revenue and deferred cost of sales in deferred income and allowances on sales to sell-through distributors in the liability section of our Consolidated Balance Sheets. Revenue and cost of sales to sell-through distributors are deferred until either the product is resold by the distributor or, in certain cases, return privileges terminate, at which time Revenue and Cost of products sold are reflected in Net loss, and Accounts receivable, net is adjusted to reflect the final selling price.

The components of Deferred income and allowances on sales to sell-through distributors are presented in the following table:

(In thousands)	October 1, 2016	January 2, 2016
Inventory valued at published list prices and held by sell-through distributors with right of return	$ 79,199	$ 47,086
Allowance for distributor advances	(37,910)	(22,290)
Deferred cost of sales related to inventory held by sell-through distributors	(20,356)	(6,930)
Total Deferred income and allowances on sales to sell-through distributors	$ 20,933	$ 17,866

Inventory valued at published list prices and held by sell-through distributors with a right of return was greater at October 1, 2016 compared to January 2, 2016 due to an inventory buildup for new programmable products business for a major mobile handset provider that started in the second quarter of fiscal 2016, as well as due to seasonal

inventory buildup for year-end primarily at our Asian distributors.

A significant portion of our revenue in the third quarter and first nine months of both fiscal years 2016 and 2015 was from sell-through distributors. Resale of products by sell-through distributors as a percentage of total revenue was 62% and 58% for the three and nine months ended October 1, 2016, respectively, and 46% and 45% for the three and nine months ended October 3, 2015, respectively.

We use estimates and apply judgment to reconcile sell-through distributors' inventories. Errors in our estimates or judgments could result in inaccurate reporting of our Revenue, Cost of products sold, Deferred income and allowances on sales to sell-through distributors, and Net loss.

Licensing and Services Revenue

Our licensing and services revenue is comprised of revenue from our intellectual property ("IP") core licensing activity, patent monetization activities, and royalty and adopter fee revenue from our standards activities. These activities are complementary to our product sales and help us monetize our IP and accelerate market adoption curves associated with our technology and standards.

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From time to time, we enter into patent sale and licensing agreements to monetize and license a broad portfolio of our patented inventions. Such licensing agreements may include upfront license fees and ongoing royalties. The contractual terms of the agreements generally provide for payments of upfront license fees over an extended period of time. Revenue from such license fees is recognized when payments become due and payable as long as all other revenue recognition criteria are met, while revenue from royalties is recognized when reported.

We enter into IP licensing agreements that generally provide licensees the right to incorporate our IP components into their products pursuant to terms and conditions that vary by licensee. Revenue earned under these agreements is classified as licensing and services revenue. Our IP licensing agreements generally include multiple elements, which may include one or more off-the-shelf or customized IP licenses bundled with support services covering a fixed period of time, generally one year. If the different elements of a multiple-element arrangement qualify as separate units of accounting, we allocate the total arrangement consideration to each element based on relative selling price.

Amounts allocated to off-the-shelf IP licenses are recognized at the time of sale provided the other conditions for revenue recognition have been met. Amounts allocated to the support services are deferred and recognized on a straight-line basis over the support period, generally one year. Certain licensing agreements provide for royalty payments based on agreed-upon royalty rates, which may be fixed or variable depending on the terms of the agreement. The amount of revenue we recognize is based on a specified time period or on the agreed-upon royalty rate multiplied by the reported number of units shipped by the customer.

From time to time, we enter into IP licensing agreements that involve significant modification, customization or engineering services. Revenues derived from these contracts are accounted for using the percentage-of-completion method or completed contract method. The completed contract method is used for contracts where there is a risk associated with final acceptance by the customer or for short-term contracts.

HDMI royalty revenue is determined by a contractual allocation formula agreed to by the members ("Founders") of the HDMI consortium. Evidence of an arrangement, as it relates to HDMI royalty revenue, is deemed complete when all of the Founders agree on the royalty sharing formula. From time to time, we perform audits on our royalty reporting customers to ensure compliance. As a result of those compliance efforts, we may enter into settlement agreements for the payment of unreported royalties. The contractual terms of those agreements may provide for upfront payment of unreported royalties or payment over a period of time, generally not to exceed one year. Revenue from those arrangements is recognized when the agreement is executed by both parties, as long as price is fixed and determinable and collection is reasonably assured.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed using the straight-line method for financial reporting purposes over the estimated useful lives of the related assets, generally three to five years for equipment and software, one to three years for tooling, and thirty years for buildings. Upon disposal of property and equipment, the accounts are relieved of the costs and related accumulated depreciation and amortization, and resulting gains or losses are reflected in the Consolidated Statements of Operations for recognized gains and losses or in the Consolidated Balance Sheets for deferred gains and losses. Repair and maintenance costs are expensed as incurred.

New Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. In August 2015, the FASB issued ASU 2015-14 deferring the effective date of ASU 2014-09 to periods beginning on or after December 15, 2017, with early adoption permitted for annual reporting periods beginning after

December 15, 2016, and interim periods within that year. With the deferral, we intend to adopt ASU 2014-09 on December 31, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. We are currently evaluating the impact of ASU 2014-09 on our consolidated financial statements and related disclosures and have not yet selected a transition method.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory. Under this ASU, inventory will be measured at the “lower of cost and net realizable value” and options that currently exist for “market value” will be eliminated. The ASU defines net realizable value as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” ASU 2015-11 is effective for interim and annual periods beginning after December 15, 2016. Early application is permitted and should be applied prospectively. We do not expect the adoption of this accounting standard update to have a material impact on our consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, to mainly change the accounting for investments in equity securities and financial liabilities carried at fair value as well as to modify the presentation and disclosure requirements for financial instruments. The ASU is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adoption of the ASU is retrospective with a cumulative adjustment to retained earnings or accumulated deficit as of the adoption date. We are currently evaluating the impact of ASU 2016-01 on our consolidated financial statements and related disclosures.

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In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires that substantially all leases, including today's operating leases, be recognized by lessees on their balance sheet as a right-of-use asset and corresponding lease liability. For public business entities, the standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted for all entities. We are currently evaluating the impact of ASU 2016-02 on our consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation, Improvements to Employee Share-Based payment Accounting (Topic 718). This update is intended to provide simplification of the accounting for share based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The guidance is effective for interim and annual periods beginning after December 15, 2016. Early application is permitted and should be applied prospectively. We are currently evaluating the impact of ASU 2016-09 on our consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The new guidance is intended to reduce diversity in practice in how cash receipts and cash payments are classified in the statement of cash flows. For public business entities, this guidance will be effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted. We are currently evaluating the impact of ASU 2016-15 on our consolidated financial statements and related disclosures.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This update is intended to recognize the income tax consequences of intra-entity transfers of assets other than inventory when they occur by removing the exception to postpone recognition until the asset has been sold to an outside party. For public business entities, this guidance is effective for interim and annual periods beginning after December 15, 2017. Early adoption is permitted, and it is required to be applied on a modified retrospective basis through a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. We have not yet determined the impact of ASU 2016-16 on our consolidated condensed financial statements and related disclosures.

Note 2 - Net Loss per Share

We compute basic net loss per share by dividing net loss by the weighted average number of common shares outstanding during the period. To determine diluted share count, we apply the treasury stock method to determine the dilutive effect of outstanding stock option shares, restricted stock units ("RSUs"), and Employee Stock Purchase Plan ("ESPP") shares. Our application of the treasury stock method includes, as assumed proceeds, the average unamortized stock-based compensation expense for the period and the impact of the pro forma deferred tax benefit or cost associated with stock-based compensation expense. When we are in a net loss position, we do not include dilutive securities as their inclusion would reduce the net loss per share.

A summary of basic and diluted net loss per share is presented below:

(in thousands, except per share data)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Basic and diluted net loss	$(12,414)	$(24,862)	$(45,935)	$(113,779)
Shares used in basic and diluted net loss per share	120,584	117,669	119,596	117,151
Basic and diluted net loss per share	$(0.10)	$(0.21)	$(0.38)	$(0.97)

The computation of diluted net loss per share for the three and nine months ended October 1, 2016 excludes the effects of stock options, RSUs, and ESPP shares, aggregating approximately 8.2 million shares and 8.3 million shares, respectively, which are antidilutive. The computation of diluted net loss per share for the three and nine months ended October 3, 2015 excludes the effects of stock options, RSUs, and ESPP shares aggregating approximately 3.2 million shares and 9.4 million shares, respectively, which are antidilutive. Stock options, RSUs, and ESPP shares are considered antidilutive when the aggregate of exercise price, unrecognized stock-based compensation expense, and excess tax benefit are greater than the average market price for our common stock during the period or when the Company is in a net loss position, as the effects would reduce the loss per share. Stock options, RSUs, and ESPP shares that are antidilutive at October 1, 2016 could become dilutive in the future.

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Note 3 - Marketable Securities

We classify our marketable securities as short-term based on their nature and availability for use in current operations. Our short-term marketable securities currently have contractual maturities of up to two years. The following table summarizes the remaining maturities of our marketable securities at fair value:

(In thousands)	October 1, 2016	January 2, 2016
Short-term marketable securities:		
Maturing within one year	$ 8,742	$ 12,144
Maturing between one and two years	3,009	5,824
Total marketable securities	$ 11,751	$ 17,968

The following table summarizes the composition of our marketable securities at fair value:

(In thousands)	October 1, 2016	January 2, 2016
Short-term marketable securities:		
Corporate and government bonds and notes, and commercial paper	$ 11,672	$ 17,888
Certificates of deposit	79	80
Total marketable securities	$ 11,751	$ 17,968

Note 4 - Fair Value of Financial Instruments

	Fair value measurements as of October 1, 2016				Fair value measurements as of January 2, 2016			
(In thousands)	Total	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3
Short-term marketable securities	$11,751	$11,672	$ 79	$ —	$17,968	$17,888	$80	$ —
Foreign currency forward exchange contracts, net	—	—	—	—	(12)	—	(12)	—
Total fair value of financial instruments	$11,751	$11,672	$ 79	$ —	$17,956	$17,888	$68	$ —

We invest in various financial instruments including corporate and government bonds and notes, commercial paper, and certificates of deposit. In addition, we enter into foreign currency forward exchange contracts to mitigate our foreign currency exchange rate exposure. We carry these instruments at their fair value in accordance with ASC 820, "Fair Value Measurements and Disclosures." The framework under the provisions of ASC 820 establishes three levels of inputs that may be used to measure fair value. Each level of input has different levels of subjectivity and difficulty involved in determining fair value.

Level 1 instruments generally represent quoted prices for identical assets or liabilities in active markets. Therefore, determining fair value for Level 1 instruments generally does not require significant management judgment and the estimation is not difficult. Our Level 1 instruments consist of U.S. Government agency, corporate notes and bonds, and commercial paper that are traded in active markets and are classified as short-term marketable securities on our Consolidated Balance Sheets.

Level 2 instruments include inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices for identical instruments in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Our Level 2 instruments consist of certificates of deposit and foreign currency exchange contracts, entered into to hedge against fluctuation in the Japanese yen.

Level 3 instruments include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. As a result, the determination of fair value for Level 3 instruments requires significant management judgment and subjectivity. We did not hold any Level 3 instruments during the periods presented.

There were no transfers between any of the levels during the first nine months of fiscal 2016 or 2015.

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In accordance with ASC 320, “Investments-Debt and Equity Securities,” we recorded an unrealized loss of less than $0.1 million during the nine months ended October 1, 2016 and approximately $0.1 million during the nine months ended October 3, 2015 on certain short-term marketable securities (Level 1 instruments), which have been recorded in accumulated other comprehensive loss. Future fluctuations in fair value related to these instruments that we deem to be temporary, including any recoveries of previous write-downs, would be recorded to accumulated other comprehensive loss. If we were to determine in the future that any further decline in fair value is other-than-temporary, we would record an impairment charge, which could have a materially adverse effect on our operating results. If we were to liquidate our position in these securities, it is likely that the amount of any future realized gain or loss would be different from the unrealized gain or loss reported in accumulated other comprehensive loss.

Note 5 - Inventories

(In thousands)	October 1, 2016	January 2, 2016
Work in progress	$ 53,772	$ 57,865
Finished goods	26,768	18,031
Total inventories	$ 80,540	$ 75,896

Note 6 - Business Combinations and Goodwill

On March 10, 2015, we acquired 100% of the outstanding equity of Silicon Image, a provider of video, audio, and data connectivity solutions for the mobile, consumer electronics, and personal computer markets. Silicon Image’s results of operations and the acquired cost value of the assets purchased and liabilities assumed are included in Lattice's consolidated financial statements effective March 11, 2015.

The fair value of the purchase price consideration consisted of the following:

(In thousands)	Estimated Fair Value
Cash paid to Silicon Image shareholders	$575,955
Cash paid for options and RSUs	7,383
Fair value of partially vested stock options and RSUs assumed	5,139
Total purchase consideration	$588,477

There was no contingent consideration in this acquisition.

Purchase consideration was allocated to the tangible and intangible assets and liabilities assumed on the basis of the respective estimated fair values on the acquisition date. In the first quarter of 2016, we revised our valuation and allocation of purchase price consideration resulting in $2.1 million of additional long-term liabilities related to an uncertain tax position with an equivalent revision to Goodwill, which is reflected in the Consolidated Balance Sheets for the period ended October 1, 2016. The purchase price allocation has been completed after a final detailed analysis of certain tax matters.

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The final allocation of the total purchase price is as follows:

(In thousands)	Estimated Fair Value
Assets acquired:	
Cash, cash equivalents and short-term investments	$157,923
Accounts receivable	30,677
Inventory	20,839
Other current assets	7,183
Property and equipment	23,429
Other non-current assets	1,573
Intangible assets	192,079
Goodwill	237,608
Total assets acquired	671,311
Less liabilities assumed:	
Accounts payable and other accrued liabilities	47,735
Other current liabilities	1,252
Long-term liabilities	26,675
Redeemable noncontrolling interest	7,172
Total liabilities assumed	82,834
Fair value of net assets acquired	$588,477

The following table presents details of the identified intangible assets acquired through the acquisition of Silicon Image:

(In thousands)	Asset Life in Years	Fair Value
Developed technology	3-5	$125,000
Customer relationships	4-7	29,458
Licensed technology	3-5	1,852
Patents	5	769
Total identified finite-lived intangible assets		157,079
In-process research and development	indefinite	35,000
Total identified intangible assets		$192,079

We do not believe there is any significant residual value associated with these intangible assets. We are amortizing the intangible assets using the straight-line method over their estimated useful lives. The estimation of the fair values of the intangible assets required the use of valuation techniques including the income approach and the cost approach, and entailed consideration of all the relevant factors that might affect the fair value such as present value factors, and estimates of future revenues and costs.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of the underlying net tangible and intangible assets. The goodwill recognized in the acquisition of Silicon Image was derived from expected benefits from cost synergies and knowledgeable and experienced workforce who joined the Company after the acquisition. Goodwill is not amortized, but is instead tested for impairment annually or more frequently if certain indicators of impairment are present. We do not expect goodwill impairment to be tax deductible for income tax purposes. No impairment charges relating to goodwill were recorded for the first nine months of 2016 or 2015 as no indicators of impairment were present. The goodwill balance of $270 million at October 1, 2016 is comprised of $45 million from prior acquisitions

combined with $238 million from the acquisition of Silicon Image, reduced by a goodwill impairment charge of $13 million in the fourth quarter of fiscal 2015.

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Note 7 - Intangible Assets

In connection with our acquisitions of Silicon Image in March 2015 and SiliconBlue in December 2011 we recorded identifiable intangible assets related to developed technology, customer relationships, licensed technology, patents, and in-process research and development based on guidance for determining fair value under the provisions of ASC 820, "Fair Value Measurements and Disclosures." Additionally, during fiscal 2015, we licensed additional third-party technology.

In September 2016, the founders of the HDMI consortium ("Founders"), of which we are a member, updated the Founders Agreement as part of an amendment process resulting in changes to our role as agent for the HDMI consortium and to the model for sharing adopter fee revenues. Lattice has historically served the role of the HDMI Licensing Agent via a wholly owned subsidiary, HDMI Licensing LLC. Under the terms of the amendment agreement, a new independent entity will act as the HDMI Licensing Agent and will be responsible for licensing and the distribution of royalties among Founders; Lattice will continue to serve the role of Agent until the appointment of the new licensing agent, which is expected to occur in fiscal 2017. As a result of the amended model for sharing revenue, we will be entitled to a reduced share of adopter fees paid by parties adopting the HDMI standard. We determined that this modification constituted an impairment indicator related to the intangible assets associated with future HDMI adopter fees. Our assessment of the new value of these intangible assets concluded that they had been impaired as of October 1, 2016, and we recorded a $7.9 million non-cash impairment charge in the Consolidated Statements of Operations. We do not anticipate any future cash expenditures related to this impairment. No impairment charges related to intangible assets were recorded for the first nine months of 2015 as no indicators of impairment were present.

The following table summarizes the details of our total purchased intangible assets as of the end of the third quarter of fiscal 2016:

(In thousands)	Weighted Average Amortization Period (in years)	Gross	Impairment	Accumulated Amortization	Intangible assets, net of amortization October 1, 2016
Developed technology	4.7	$130,859	$ —	$ (48,153)	$ 82,706
Customer relationships	6.1	30,800	(7,866)	(12,751)	10,183
Licensed technology	3.3	2,127	—	(1,053)	1,074
Patents	5	769	—	(241)	528
Total identified finite-lived intangible assets		164,555	(7,866)	(62,198)	94,491
In-process research and development	indefinite	32,841	—	—	32,841
Total identified intangible assets		$197,396	$ (7,866)	$ (62,198)	$ 127,332

We do not believe there is any significant residual value associated with these intangible assets. We are amortizing the intangible assets using the straight-line method over their estimated useful lives. We recorded amortization expense on the Consolidated Statements of Operations as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Research and development	$186	$ 223	$559	$ 507

Amortization of acquired intangible assets	8,260	8,941	25,292	20,824
	$8,446	$ 9,164	$25,851	$ 21,331

The annual expected amortization expense related to acquired intangible assets with finite lives is as follows:

(In thousands)	Amount
2016 (remaining 3 months)	$8,119
2017	31,659
2018	25,777
2019	22,993
2020	5,290
Thereafter	653
Total	$94,491

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Note 8 - Equity Method Investment

In the first and third quarters of fiscal 2015, we purchased a preferred stock ownership interest in a privately-held company that designs human-computer interaction technology for total consideration of $3.0 million. This investment accounted for a 15.8% ownership interest by the end of the third quarter of fiscal 2015 and was accounted for under the cost method as we did not have the ability to exert significant influence over the investee.

In the fourth quarter of fiscal 2015, we increased our ownership interest to 22.7% by making an additional investment of $2.0 million. This increased our gross investment in the investee to $5.0 million. As a result of the change in ownership interest and after considering the changes in the level of our participation in the management of and interaction with the investee, we determined that we have the ability to exert significant influence over the investee. Accordingly, we changed our accounting for the investment from the cost method to the equity method and have hence recognized our proportionate share of the investee’s operating results in the Consolidated Statements of Operations.

In the third quarter of fiscal 2016, we made an additional investment of $1.0 million via a convertible debt instrument, bringing our gross investment in the investee to $6.0 million. We have determined that this additional investment is an in-substance common stock and has been included in our equity method accounting but that, in its unconverted state, it does not change our ownership interest.

Applying the equity method, our proportionate share of the investee's net loss for the third quarter and first nine months of fiscal 2016 was $0.4 million and $1.1 million, respectively, which we have recognized in the Consolidated Statements of Operations. Through October 1, 2016, we have reduced the value of our investment by approximately $1.6 million, representing our proportionate share of the privately-held company’s net loss accumulated to that date. The net balance of our investment amounting to $4.4 million has been included in other long-term assets in the Consolidated Balance Sheets as of October 1, 2016.

Note 9 - Accounts Payable and Accrued Expenses

Included in accounts payable and accrued liabilities as of October 1, 2016 and January 2, 2016 were the following balances:

(In thousands)	October 1, 2016	January 2, 2016
Trade accounts payable	$ 35,230	$18,616
Payable to members of the HDMI and MHL consortia*	8,872	16,643
Other accrued expenses	32,884	39,039
Total accounts payable and accrued expenses	$ 76,986	$74,298

*As an agent of the HDMI and MHL consortia, we administer royalty reporting and distributions to the members of these consortia. This excludes amounts payable to us, and is payable quarterly based on collections from HDMI and MHL customers.

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Note 10 - Changes in Stockholders' Equity and Accumulated Other Comprehensive Loss

(In thousands)	Common stock	Additional Paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total
Balances, January 2, 2016	$ 1,187	$ 660,089	$ (352,846)	$ (2,910)	$ 305,520
Net loss for the nine months ended October 1, 2016	—	—	(45,935)	—	(45,935)
Unrealized loss related to marketable securities, net of tax	—	—	—	(88)	(88)
Reclassification adjustment for losses related to marketable securities included in other income (expense), net of tax	—	—	—	38	38
Translation adjustments, net of tax	—	—	—	(579)	(579)
Common stock issued in connection with the exercise of stock options, ESPP and vested RSUs, net of tax	23	2,448	—	—	2,471
Stock-based compensation expense related to stock options, ESPP and RSUs	—	12,106	—	—	12,106
Defined benefit pension, net of actuarial losses	—	—	—	141	141
Balances, October 1, 2016	$ 1,210	$ 674,643	$ (398,781)	$ (3,398)	$ 273,674

Note 11 - Income Taxes

For the three months ended October 1, 2016 and October 3, 2015, we recorded an income tax provision of approximately $1.0 million and $0.3 million, respectively. For the nine months ended October 1, 2016 and October 3, 2015, we recorded an income tax provision of approximately $7.4 million and $29.0 million, respectively. The income tax provision for the three and nine months ended October 1, 2016 represents tax at the federal, state, and foreign statutory tax rates adjusted for withholding taxes, changes in uncertain tax positions, changes in the U.S. valuation allowance, as well as other non-deductible items in the United States and foreign jurisdictions. The difference between the U.S. federal statutory tax rate of 35% and our negative effective tax rates for the three and nine months ended October 1, 2016 is primarily due to a valuation allowance increase that offsets the otherwise expected tax benefit from the pretax loss in the United States and the zero tax rate in Bermuda which results in no tax benefit for the pretax loss in Bermuda.

During the first quarter of 2015, we concluded that it was more-likely-than-not that we would not be able to realize the benefit of our remaining U.S. deferred tax assets, resulting in an increase to the valuation allowance and an increase to the tax provision of $21.0 million. We based this conclusion on changes to our expected operations in the United States as a result of the acquisition of Silicon Image. We exercised significant judgment and considered estimates about our ability to generate revenue and gross profits sufficient enough to offset expenditures in future periods within the United States.

We are subject to federal income tax as well as income tax of multiple state and foreign jurisdictions. We are no longer subject to income tax examinations for the following jurisdictions and years: federal, for years before 2013, state and local, for years before 2012, or foreign, for years before 2010. However, U.S. federal net operating loss ("NOL") and credit carryforwards from all years are subject to examination and adjustments for at least three years following the year in which we used the attributes.

Our Indian income tax return is currently under examination for the tax year ended March 31, 2016, as well as our Singapore income tax return for 2012. We are not under examination in any other jurisdiction.

We believe that it is reasonably possible that $0.2 million of unrecognized tax benefits and less than $0.1 million of associated interest and penalties could be recognized during the next twelve months. The $0.2 million potential change would represent a decrease in unrecognized tax benefits, comprised of items related to tax filings for years that will no longer be subject to examination under expiring statutes of limitations.

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We have U.S. federal NOL carryforwards (pretax) of approximately $339.9 million at January 2, 2016 that expire at various dates between 2023 and 2035. We have state net operating loss carryforwards (pretax) of approximately $239.9 million at January 2, 2016 that expire at various dates from 2016 through 2035. We also have federal and state credit carryforwards of $48.2 million and $55.9 million, respectively at January 2, 2016, of which $53.4 million do not expire. The remaining credits expire at various dates from 2016 through 2034.

Our liability for uncertain tax positions (including penalties and interest) was $29.4 million and $26.9 million at October 1, 2016 and January 2, 2016, respectively, and is recorded as a component of other long-term liabilities on our Consolidated Balance Sheets. The remainder of our uncertain tax position exposure is netted against deferred tax assets.

We are not currently paying U.S. federal income taxes and do not expect to pay such taxes until we fully utilize our tax NOL and credit carryforwards. We expect to pay a nominal amount of state income tax. We are paying foreign income and withholding taxes, which are reflected in income tax expense in our Consolidated Statements of Operations and are primarily related to the cost of operating offshore activities and subsidiaries. We accrue interest and penalties related to uncertain tax positions in income tax expense.

Note 12 - Restructuring

In March 2015, our Board of Directors approved an internal restructuring plan (the "March 2015 Plan"), in connection with our acquisition of Silicon Image. The March 2015 Plan was designed to realize synergies from the acquisition by eliminating redundancies created as a result of combining the two companies. This included reductions in our worldwide workforce, consolidation of facilities, and cancellation of software contracts and engineering tools. The March 2015 Plan is substantially complete subject to certain remaining expected costs that we do not expect to be material and which will be expensed as incurred under U.S. GAAP rules through the first quarter of fiscal 2017, and any changes in sublease assumptions should they occur. Under this plan, approximately $0.3 million and $6.3 million of expense was incurred during the three and nine months, respectively, ended October 1, 2016, and $1.4 million and $10.3 million of expense was incurred during the three and nine months, respectively, ended October 3, 2015. Approximately $19.6 million of total expense has been incurred through October 1, 2016 under the March 2015 Plan. We expect the total cost of the March 2015 Plan to be approximately $21.0 million.

In September 2015, we implemented a further reduction of our worldwide workforce (the "September 2015 Reduction") separate from the March 2015 Plan. The September 2015 Reduction was designed to resize the company in line with the market environment and to better balance our workforce with the long-term strategic needs of our business. The September 2015 Reduction is substantially complete subject to certain remaining expected costs, which we do not expect to be material but which will be expensed as incurred under U.S. GAAP rules through the first quarter of fiscal 2017. Under this reduction, no expense and approximately $2.0 million of expense was incurred during the three and nine months, respectively, ended October 1, 2016 and $5.5 million expense was incurred during the three and nine months ended October 3, 2015 due to the timing of implementation. Approximately $8.0 million of total expense has been incurred through October 1, 2016 under the September 2015 Reduction. We expect the total cost of the September 2015 Reduction to be approximately $9.0 million.

These expenses were recorded to restructuring charges on our Consolidated Statements of Operations. The restructuring accrual balance is presented in accounts payable and accrued expenses (includes restructuring) on our Consolidated Balance Sheets.

The following table displays the combined activity related to the restructuring actions described above:

(In thousands)	Other	Total

	Severance and related	Lease Termination	Software Contracts & Engineering Tools*		
Balance at January 3, 2015	$ —	$ 43	$ —	$ 139	$ 182
Restructuring charges	12,491	1,107	2,000	182	15,780
Costs paid or otherwise settled	(5,825)	(560)	(1,551)	(321)	(8,257)
Balance at October 3, 2015	$ 6,666	$ 590	$ 449	$ —	$ 7,705
Balance at January 2, 2016	$ 3,696	$ 1,005	$ 377	$ —	$ 5,078
Restructuring charges	1,863	2,343	1,917	2,193	8,316
Costs paid or otherwise settled	(4,688)	(2,315)	(2,211)	(2,066)	(11,280)
Balance at October 1, 2016	$ 871	$ 1,033	$ 83	$ 127	$ 2,114

*Includes cancellation of contracts, asset impairments, and accelerated depreciation on certain enterprise resource planning and customer resource management systems

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Note 13 - Long-Term Debt

On March 10, 2015, we entered into a secured credit agreement (the "Credit Agreement") with Jefferies Finance, LLC and certain other lenders for purposes of funding, in part, our acquisition of Silicon Image. The Credit Agreement provided for a $350 million term loan (the "Term Loan") maturing on March 10, 2021 (the "Term Loan Maturity Date"). We received $346.5 million net of an original issue discount of $3.5 million and we paid debt issuance costs of $8.3 million. The Term Loan bears variable interest equal to the 3-month LIBOR as of October 1, 2016, subject to a 1.00% floor, plus a spread of 4.25%. The current effective interest rate on the Term Loan is 5.97%.

The Term Loan is payable through a combination of (i) quarterly installments of approximately $0.9 million, which began on July 4, 2015, (ii) annual excess cash flow payments as defined in the Credit Agreement, which are due 95 days after the last day of our fiscal year, and (iii) any payments due upon certain issuances of additional indebtedness and certain asset dispositions, with any remaining outstanding principal amount due and payable on the Term Loan Maturity Date. The percentage of excess cash flow we are required to pay ranges from 0% to 75%, depending on our leverage and other factors as defined in the Credit Agreement. Currently, the Credit Agreement would require a 75% excess cash flow payment. In the second quarter of fiscal 2016, we made a required additional principal payment of $1.7 million due to the sale of Qterics. Over the next twelve months, our principal payments will be comprised mainly of regular quarterly installments along with an expected annual excess cash flow payment. While the Credit Agreement does not contain financial covenants, it does contain informational covenants and certain restrictive covenants, including limitations on liens, mergers and consolidations, sales of assets, payment of dividends, and indebtedness. We were in compliance with all such covenants at October 1, 2016.

The original issue discount and the debt issuance costs have been accounted for as a reduction to the carrying value of the Term Loan on our Consolidated Balance Sheets and are being amortized to interest expense in our Consolidated Statements of Operations over the contractual term, using the effective interest method.

The fair value of the Term Loan approximates the carrying value, which is reflected in our Consolidated Balance Sheets as follows:

(In thousands)	October 1, 2016	January 2, 2016
Principal amount	$343,096	$347,375
Unamortized original issue discount and debt costs	(7,736)	(8,948)
Less: Current portion of long-term debt	(27,613)	(7,557)
Long-term debt	$307,747	$330,870

Interest expense related to the Term Loan was included in Interest expense on our Consolidated Statements of Operations as follows:

	Three Months Ended		Nine Months Ended	
(In thousands)	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Contractual interest	$4,563	$ 4,633	$13,798	$ 10,553
Amortization of original issue discount and debt costs	553	932	1,212	2,037
Total Interest expense related to the Term Loan	$5,116	$ 5,565	$15,010	$ 12,590

As of October 1, 2016, minimum expected future principal payments on the Term Loan were as follows:

Fiscal year	(in thousands)
2016 (remaining 3 months)	$ 875
2017	38,008
2018	52,895
2019	60,247
2020	64,794
Thereafter	126,277
	$ 343,096

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Note 14 - Stock-Based Compensation

Total stock-based compensation expense included in our Consolidated Statements of Operations was as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Cost of products sold	$231	$ 406	$656	$ 1,044
Research and development	2,024	2,789	5,951	6,644
Selling, general and administrative	2,054	1,004	5,500	4,874
Acquisition related charges	—	402	—	4,293
Total stock-based compensation	$4,309	$ 4,601	$12,107	$ 16,855

Of the $16.9 million total stock-based compensation for the nine months ended October 3, 2015, $3.9 million was paid in cash during the period as a result of the acquisition of Silicon Image on March 10, 2015. There have been no cash payments related to stock compensation in fiscal 2016.

We have granted stock options and RSUs with a market condition to certain executives, amounting to approximately 327,200 stock options and 70,000 RSUs during the first and second quarters of fiscal 2015 and approximately 321,900 stock options in the second quarter of fiscal 2016. The options and RSUs have a two year vesting and vest between 0% and 200% of the target amount, based on the Company's relative Total Shareholder Return (TSR) when compared to the TSR of a component of companies of the PHLX Semiconductor Sector Index over a two year period. TSR is a measure of stock price appreciation plus dividends paid, if any, in the performance period. The fair values of the options were determined and fixed on the date of grant using a lattice-based option-pricing valuation model, which incorporates a Monte-Carlo simulation, and considered the likelihood that we would achieve the market condition. Of these grants with a market condition, approximately 596,600 stock options were outstanding as of October 1, 2016. We incurred stock compensation expense related to these market condition awards of approximately $0.2 million and approximately $0.4 million in the third quarter and first nine months, respectively, of fiscal 2016 and approximately $0.1 million and approximately $0.4 million in the third quarter and first nine months, respectively, of fiscal 2015.

Note 15 - Contingencies

Legal Matters

In February 2016, we filed a complaint against Technicolor SA and its affiliates in the United States District Court for the Northern District of California alleging that Technicolor had on infringed certain patents relating to the HDMI specification. Technicolor filed an answer to our complaint on April 11, 2016, which included various defenses to the alleged patent infringement. Technicolor also has informed us that it may attempt to raise as a counterclaim or in separate litigation a claim for payment to Technicolor and other Founders their respective share of any HDMI adopters’ fees not used by Lattice and its predecessor in interest, Silicon Image, in the marketing and other activities in furtherance of the HDMI standard. Technicolor previously has indicated its belief that the Founders enjoy a right to these funds but has never pursued such claims. At this stage of the proceedings, we do not have an estimate of the likelihood or the amount of any financial consequences to us.

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

significant matter and assess its potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and a range of possible losses can be estimated, we then accrue a liability for the estimated loss based on the provisions of FASB ASC 450, “Contingencies" (“ASC 450”). Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to pending claims and litigation and may revise estimates.

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Note 16 - Segment and Geographic Information

Segment Information

As of October 1, 2016, Lattice had one operating segment: the core Lattice business, which includes IP and semiconductor devices. Qterics, a discrete software-as-a-service business unit, was previously an immaterial operating segment in the Lattice legal entity structure. In April 2016, we sold Qterics to an unrelated third party for net proceeds of $2.0 million, net of cash sold, resulting in a gain of $2.6 million. The gain has been included in Other income (expense), net in the Consolidated Statements of Operations.

Geographic Information

Our revenue by major geographic area, based on ship-to location, was as follows:

	Three Months Ended				Nine Months Ended			
(In thousands)	October 1, 2016		October 3, 2015		October 1, 2016		October 3, 2015	
Asia	$83,797	74 %	$86,443	79 %	$216,964	70 %	$232,372	76 %
Europe	13,111	12	13,061	12	43,849	14	43,005	14
Americas	16,317	14	10,211	9	48,133	16	29,395	10
Total revenue	$113,225	100%	$109,715	100%	$308,946	100%	$304,772	100%

We assign revenue to geographies based on the customer ship-to address at the point where revenue is recognized. In the case of sell-in distributors and OEM customers, revenue is typically recognized, and geography is assigned, when products are shipped to our distributor or customer. In the case of sell-through distributors, revenue is recognized when resale occurs and geography is assigned based on the customer location on the resale reports provided by the distributor.

There were no material changes to property and equipment by major geographic area as of October 1, 2016 as compared to January 2, 2016.

Note 17 - Subsequent Event

On November 3, 2016, Lattice Semiconductor Corporation and Canyon Bridge Capital Partners, Inc. (“Canyon Bridge”) announced that the Company and Canyon Bridge Acquisition Company, Inc. (“Parent”), an affiliate of Canyon Bridge, have signed a definitive agreement under which Parent will acquire all outstanding shares of Lattice for approximately $1.3 billion inclusive of Lattice’s net debt, or $8.30 per share in cash. The transaction has been unanimously approved by both companies’ boards of directors and is expected to close in early 2017 subject to customary closing conditions, regulatory approvals and approval by Lattice’s shareholders. Upon the completion of the transaction, Lattice will be a wholly owned subsidiary of Parent.

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

Overview

Lattice Semiconductor (“Lattice,” the “Company,” “we,” “us,” or “our”) engages in smart connectivity solutions, providing intellectual property ("IP") and low-power, small form-factor devices that enable global customers to quickly deliver innovative and differentiated cost and power efficient products. The Company's broad end-market exposure extends from mobile devices and consumer electronics to industrial and automotive equipment, communications and computing infrastructure, and licensing.

Lattice was founded in 1983 and is headquartered in Portland, Oregon. The Company acquired Silicon Image, Inc. ("Silicon Image") in March 2015. Silicon Image was engaged in setting industry standards including the HDMI®, DVI®, MHL® and WirelessHD® standards. Our prior fiscal year results for the nine months ended October 3, 2015 include the results of Silicon Image for the approximately 29-week period from March 11, 2015 through October 3, 2015.

Plan of Merger and Reorganization

On November 3, 2016, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Canyon Bridge Acquisition Company, Inc., a Delaware corporation (“Parent”), and Canyon Bridge Merger Sub, Inc., a Delaware corporation and wholly owned subsidiary of Parent (“Merger Sub”), providing for the merger of Merger Sub with and into the Company (the “Merger”), with the Company surviving the Merger as a wholly owned subsidiary of Parent.

At the effective time of the Merger, each share of common stock, par value $0.01 per share, of the Company (the “Shares”) that is outstanding immediately prior to such time (other than (i) Shares owned by Parent, Merger Sub, the Company (including any Shares held in the treasury of the Company) or by any direct or indirect wholly owned subsidiary of Parent, Merger Sub or the Company, or (ii) Shares held by stockholders of the Company who not have voted in favor of the Merger and who are entitled to demand and properly demand their statutory rights of appraisal in accordance with the Delaware General Corporation Law) will be canceled and extinguished and automatically converted into the right to receive cash in an amount equal to $8.30 per share (without interest and subject to deduction for any required withholding tax).

Completion of the Merger is subject to various conditions, including the receipt on a timely basis or at all of any required regulatory clearances related to the Merger, including under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR) and from the Committee on Foreign Investment in the United States ("CFIUS").

Critical Accounting Policies and Estimates

Critical accounting policies are those that are both most important to the portrayal of a company's financial condition and results and require management's most difficult, subjective, and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Management believes that there have been no significant changes to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on form 10-K for the fiscal year ended January 2, 2016.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts and classification

of assets, such as marketable securities, accounts receivable, inventory, goodwill (including the assessment of reporting unit), intangible assets, current and deferred income taxes, accrued liabilities (including restructuring charges and bonus arrangements), deferred income and allowances on sales to sell-through distributors, disclosure of contingent assets and liabilities at the date of the financial statements, amounts used in acquisition valuations and purchase accounting, and the reported amounts of product revenue, licensing and services revenue, and expenses during the fiscal periods presented. Actual results could differ from those estimates.

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Results of Operations*

Key elements of our Consolidated Statements of Operations were as follows:

	Three Months Ended				Nine Months Ended			
(In thousands)	October 1, 2016		October 3, 2015		October 1, 2016		October 3, 2015	
Revenue	$113,225	100.0 %	$109,715	100.0 %	$308,946	100.0 %	$304,772	100.0 %
Gross margin	67,424	59.5	59,849	54.5	182,954	59.2	165,807	54.4
Research and development	27,747	24.5	37,619	34.3	91,270	29.5	104,813	34.4
Selling, general and administrative	29,244	25.8	23,819	21.7	75,857	24.6	73,096	24.0
Amortization of acquired intangible assets	8,260	7.3	8,941	8.1	25,292	8.2	20,824	6.8
Restructuring charges	317	0.3	6,818	6.2	8,316	2.7	15,780	5.2
Acquisition related charges	—	—	610	0.6	94	—	22,078	7.2
Impairment of intangible assets	7,866	6.9	—	—	7,866	2.5	—	—
Loss from operations	$(6,010)	(5.3)%	$(17,958)	(16.4)%	$(25,741)	(8.3)%	$(70,784)	(23.2)%

* Lattice acquired Silicon Image on March 10, 2015. Results of Operations for the nine months ended October 3, 2015 include the financial results of Silicon Image for the approximately 29-week period from March 11, 2015 through October 3, 2015.

Revenue by End Market

The end market data below is derived from data provided to us by our distributors and end customers. With a diverse base of customers who may manufacture end products spanning multiple end markets, the assignment of revenue to a specific end market requires the use of estimates and judgment. Therefore, actual results may differ from those reported. With our acquisition of Silicon Image, we added a Licensing and services end market to report Licensing and services revenue, which includes the licensing of our IP, the collection of certain royalties, patent sales, the revenue related to our participation in consortia and standard-setting activities, and services. While Licensing products are primarily sold into the Mobile and Consumer market, Licensing and services revenue is reported separately as it has characteristics that differ from other categories, most notably its higher gross margin.

The following are examples of end market applications:

Communications and Computing	Mobile and Consumer	Industrial and Automotive	Licensing and Services
Wireless	Smartphones	Security & Surveillance	IP Royalties
Wireline	Cameras	Machine Vision	Adopter Fees
Data Backhaul	Displays	Industrial Automation	IP Licenses
Computing	Tablets	Human Machine Interface	Patent Sales
Servers	Wearables	Automotive	Testing Services
Data Storage	Televisions	Drones	
	Home Theater		

The composition of our revenue by end market for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

	Three Months Ended *				Nine Months Ended *			
(In thousands)	October 1, 2016		October 3, 2015		October 1, 2016		October 3, 2015	
Communications and Computing	$30,260	27 %	$35,805	33 %	$91,809	30 %	$108,488	36 %

Mobile and Consumer	35,641	31	36,944	34	84,817	27	95,846	31
Industrial and Automotive	36,915	33	25,823	23	103,748	34	76,253	25
Licensing and Services	10,409	9	11,143	10	28,572	9	24,185	8
Total revenue	$113,225	100%	$109,715	100%	$308,946	100%	$304,772	100%

*During the first quarter of fiscal 2016, we realigned our end market categories to group Computing with Communications rather than with Industrial, as had been the previous grouping. Prior periods have been reclassified to match current period presentation.

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Revenue from the Communications and Computing end market decreased by 15% for both the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, and for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015. For both periods the decline was primarily in programmable products, and was across a general cross section of communications and modestly in our largest computing customer. We also saw a significant decline, from the third quarter of fiscal 2015 to the third quarter of fiscal 2016, for application specific standard products ("ASSPs") in a wireless application. The decrease for the first nine months of fiscal 2016 is predominately due to a decrease in demand for programmable products, as the China 4G-LTE build out, which carried into 2015, was not repeated in 2016.

Revenue from the Mobile and Consumer end market decreased 4% for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, and decreased 12% for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015. The decrease for both periods was predominately due to a decrease in ASSP shipments offset by an increase in new programmable production volume for a major mobile handset provider that started in second quarter of fiscal 2016 and ramped to full production in third quarter of fiscal 2016.

Revenue from the Industrial and Automotive end market increased approximately 43% for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, and increased 36% for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015. For both periods this increase is due to line item reduction and complex programmable logic device ("CPLD") conversions affecting both Americas and Europe.

Revenue from the Licensing and Services end market decreased 7% for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015. The increase of 18% for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015 was due to the inclusion of Licensing and Services revenue for the full period of the first nine months of fiscal 2016 relative to only an approximately 29-week period in the first nine months of fiscal 2015 as a result of Silicon Image acquisition timing. As a result of the amended model for sharing revenue and the change to our role as agent for the HDMI consortium, we will be entitled to a reduced share of adopter fees paid by parties adopting the HDMI standard in 2017.

Revenue by Geography

We assign revenue to geographies based on customer ship-to address at the point where revenue is recognized. In the case of sell-in distributors and OEM customers, revenue is typically recognized, and geography is assigned, when products are shipped to our distributor or OEM customer. In the case of sell-through distributors, revenue is recognized when resale to the end customer occurs and geography is assigned based on the end customer location on the resale reports provided by the distributor. Both foreign and domestic sales are denominated in U.S. dollars, with the exception of certain historical sales in Japan, which were denominated in yen.

The composition of our revenue by geography for the third quarter and first nine months of fiscal 2016 and fiscal 2015, based on ship-to location, was as follows:

	Three Months Ended				Nine Months Ended			
(In thousands)	October 1, 2016		October 3, 2015		October 1, 2016		October 3, 2015	
Asia	$83,797	74 %	$86,443	79 %	$216,964	70 %	$232,372	76 %
Europe	13,111	12	13,061	12	43,849	14	43,005	14
Americas	16,317	14	10,211	9	48,133	16	29,395	10
Total revenue	$113,225	100%	$109,715	100%	$308,946	100%	$304,772	100%

Revenue in Asia decreased 3% for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, and decreased 7% for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015. Asia revenue

for both periods is heavily affected by revenue from both the Mobile and Consumer and the Communications and Computing end markets. The Mobile and Consumer end market in Asia was affected by declines in Digital Television ("DTV") and Home Theater related devices that was substantially offset by mobile handset production volumes for a major handset provider using programmable products.

Revenue in Europe was relatively flat for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, and increased 2% for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015. Modest revenue increases in both periods were predominantly due to packaging line item reduction and related CPLD conversions.

Revenue from the Americas increased 60% for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, and increased 64% for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015. Revenue increases in both periods were predominantly due to packaging line item reduction and related CPLD conversions.

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Revenue from End Customers

Our top five end customers constituted approximately 32% of our revenue for the third quarter of fiscal 2016, compared to approximately 31% for the third quarter of fiscal 2015. Our top five end customers constituted approximately 25% of our revenue for the first nine months of fiscal 2016, compared to approximately 33% for the first nine months of fiscal 2015, primarily due to a more diverse customer base.

Our largest end customer accounted for approximately 14% of total revenue in the third quarter of fiscal 2016 and 7% of total revenue in the first nine months of fiscal 2016. Our largest end customer accounted for approximately 9% of total revenue in the third quarter of fiscal 2015 and approximately 11% of total revenue first nine months of fiscal 2015. No other customers accounted for more than 10% of total revenue during these periods.

Revenue from Sell-Through Distributors

Sales through distributors have historically accounted for a significant portion of our total revenue. Revenue attributable to resale of products by our primary sell-through distributors for the third quarter of fiscal 2016 and fiscal 2015, respectively, was as follows:

	% of Total Revenue Three Months Ended		% of Total Revenue Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Arrow Electronics Inc.	20%	19%	25%	20%
Weikeng Group	26	13	18	13
All others	16	14	15	12
All sell-through distributors	62%	46%	58%	45%

Revenue from sell-through distributors increased to 62% of total revenue in the third quarter of fiscal 2016 from 46% in the third quarter of fiscal 2015. Revenue from sell-through distributors increased to 58% of total revenue in the first nine months of fiscal 2016 from 45% in the first nine months of fiscal 2015. In each case, the increase on a percentage basis of revenue from sell-through distributors was due to an increase in new programmable production volume for a major mobile handset provider through a sell-through distributor in 2016, as well as declines in channels other than sell-through distributors from 2015 levels, mainly due to declines in DTV and Home Theater related devices and handset content revenues.

Gross Margin

The composition of our gross margin, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015, respectively, was as follows:

(In thousands)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Gross margin	$67,424	$59,849	$182,954	$165,807
Percentage of net revenue	59.5%	54.5%	59.2%	54.4%
Product gross margin %	55.6%	49.9%	55.3%	50.7%

Licensing and services gross margin	%	99.0	%	96.0	%	98.0	%	97.0	%

For the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, gross margin increased by 5.0 percentage points. For the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015, gross margin increased by 4.8 percentage points. In both periods, the primary contributor to the increase in product gross margin was the reduced amortization in the current year of purchase price accounting adjustments (now substantially completed) associated with the sell-through of acquired inventory and deferred revenue, along with a more favorable mix among our product groups, partially resulting from packaging line item reduction and related CPLD conversions.

For the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, decreases in the effective overhead accounted for approximately 3.4 percentage points of the improvement while a one-time recovery of pre-production materials expensed in earlier quarters accounted for approximately 1.1 percentage points of the improvement. Additionally, the three-month comparison benefited from the reduced amortization in the current year of purchase price accounting adjustments (now completed) associated with the sell-through of acquired inventory and deferred revenue, which added approximately 0.8 percentage points to the gross margin.

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For the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015, improved mix added 1.5 percentage points to gross margin while lower overhead rates contributed another 1.4 percentage points to the improvement. Additionally, the nine-month comparison benefited from the reduced amortization in the current year of purchase price accounting adjustments (now completed) associated with the sell-through of acquired inventory and deferred revenue, which added 1.7 percentage points to the gross margin.

Because of its higher margin, the licensing and services portion of our overall revenue can have a disproportionate impact on gross margin and profitability. For programmable and standard products, we expect that product, end market, and customer mix will subject our gross margin to fluctuation, while we expect downward pressure on average selling price to adversely affect our gross margin in the future. If we are unable to realize additional or sufficient product cost reductions in the future to balance changes in product and customer mix, we may experience degradation in our product gross margin.

Operating Expenses

Research and Development Expense

The composition of our research and development expense, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015, respectively, was as follows:

	Three Months Ended			Nine Months Ended		
(In thousands)	October 1, 2016	October 3, 2015	% change	October 1, 2016	October 3, 2015	% change
Research and development	$27,747	$37,619	(26)	$91,270	$104,813	(13)
Percentage of net revenue	24.5 %	34.3 %		29.5 %	34.4 %	
Mask costs included in Research and development	$388	$2,415	(84)	$2,932	$5,360	(45)

Research and development expense includes costs for compensation and benefits, stock compensation, development masks, engineering wafers, depreciation, licenses, and outside engineering services. These expenditures are for the design of new products, IP cores, processes, packaging, and software to support new products.

The decrease in research and development expense for both the third quarter and first nine months of fiscal 2016 compared to the third quarter and first nine months of fiscal 2015 is due mainly to the restructuring and integration of operations undertaken since the acquisition of Silicon Image, predominantly headcount reductions and site consolidations, along with reductions in mask costs, time-based licenses, and outside services, partially offset by higher bonus expenses.

We believe that a continued commitment to research and development is essential to maintaining product leadership and providing innovative new product offerings and, therefore, we expect to continue to make significant future investments in research and development.

Selling, General, and Administrative Expense

The composition of our selling, general, and administrative expense, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

	Three Months Ended			Nine Months Ended		
(In thousands)	October 1, 2016	October 3, 2015	% change	October 1, 2016	October 3, 2015	% change
Selling, general, and administrative	$29,244	$23,819	23	$75,857	$73,096	4

Percentage of revenue	25.8 %	21.7 %	24.6 %	24.0 %

Selling, general, and administrative expense includes costs for compensation and benefits related to selling, general, and administrative employees, commissions, depreciation, professional and outside services, trade show, and travel expenses.

The increase in selling, general, and administrative expense for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, as well as in the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015, is due mainly an increase in bad debt expense related to the bankruptcy of one of our distributor groups, partially offset by the restructuring and integration of operations undertaken since the acquisition of Silicon Image, predominantly headcount reductions and site consolidations.

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Amortization of Acquired Intangible Assets

The composition of our amortization of acquired intangible assets, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

	Three Months Ended			Nine Months Ended		
(In thousands)	October 1, 2016	October 3, 2015	% change	October 1, 2016	October 3, 2015	% change
Amortization of acquired intangible assets	$8,260	$8,941	(8)	$25,292	$20,824	21
Percentage of revenue	7.3 %	8.1 %		8.2 %	6.8 %	

For the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, amortization of acquired intangible assets decreased due to the reduction of certain intangibles as a result of an impairment charge in late 2015 and the sale of Qterics in April 2016. For the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015, amortization of acquired intangible assets increased due to the inclusion of additional amortization expense from new intangible assets acquired in con-nection with our acquisition of Silicon Image for the full period of the first six months of fiscal 2016 relative to only an approximately 29-week period in the first six months of fiscal 2015, partially offset by the reduction of certain intangibles previously described.

Restructuring Charges

The composition of our restructuring charges, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

	Three Months Ended			Nine Months Ended		
(In thousands)	October 1, 2016	October 3, 2015	% change	October 1, 2016	October 3, 2015	% change
Restructuring charges	$317	$6,818	(95)	$8,316	$15,780	(47)
Percentage of revenue	0.3 %	6.2 %		2.7 %	5.2 %	

Restructuring charges include expenses resulting from reductions in our worldwide workforce and consolidation of our facilities, cancellation of software contracts, and engineering tools.

In March 2015, our Board of Directors approved an internal restructuring plan (the "March 2015 Plan"), in connection with our acquisition of Silicon Image. The March 2015 Plan was designed to realize synergies from the acquisition by eliminating redundancies created as a result of combining the two companies. The March 2015 Plan is substantially complete subject to certain remaining expected costs that we do not expect to be material and which will be expensed as incurred under U.S. GAAP rules through the first quarter of fiscal 2017, and any changes in sublease assumptions should they occur. The March 2015 Plan has incurred approximately $19.6 million of total expense through October 1, 2016. We expect the total cost of the March 2015 Plan to be approximately $21.0 million.

In September 2015, we implemented a further reduction of our worldwide workforce (the "September 2015 Reduction") separate from the March 2015 Plan. The September 2015 Reduction was designed to resize the company in line with the market environment and to better balance our workforce with the long-term strategic needs of our business. The September 2015 Plan is substantially complete, subject to certain remaining expected costs, which we do not expect to be material but which will be expensed as incurred under U.S. GAAP rules through the first quarter of fiscal 2017. The September 2015 Reduction has incurred approximately $8.0 million of total expense through October 1, 2016. We expect the total cost of the September 2015 Plan to be approximately $9.0 million.

The $6.5 million decrease in restructuring expense in the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015 is driven by significant headcount-related, lease and systems restructuring charges in the prior year quarter under the March 2015 Plan and the September 2015 Reduction, not recurring in the current quarter.

The $7.5 million decrease in restructuring expense for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015 is primarily the result of decreased headcount related restructuring charges in the current year partially offset by the final charge for the full vacancy of our Sunnyvale site, restructuring expenses related to asset sales and other costs expensed as incurred under U.S. GAAP accounting rules, all occurring in the current year.

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Acquisition Related Charges

The composition of our acquisition related charges, including as a percentage of revenue, for the third quarter of fiscal 2016 and 2015 was as follows:

(In thousands)	Three Months Ended October 1, 2016	October 3, 2015	% change	Nine Months Ended October 1, 2016	October 3, 2015	% change
Acquisition related charges	$—	$ 610	(100)	$94	$22,078	(100)
Percentage of revenue	—%	0.6 %		— %	7.2 %	

Acquisition related charges include severance and professional fees directly related to acquisitions. For the third quarter and first nine months of fiscal 2016, acquisition related charges were negligible. This is compared to the third quarter and first nine months of fiscal 2015 where, in addition to professional fees, we also incurred substantial fees for severance and stock compensation costs related to change of control payments to departing executives.

Impairment of Intangible Assets

In September 2016, the founders of the HDMI consortium ("Founders"), of which we are a member, updated the Founders Agreement as part of a regular amendment process resulting in changes to our role as agent for the HDMI consortium and to the model for sharing adopter fee revenues. Lattice has historically served the role of the HDMI Licensing Agent via a wholly owned subsidiary, HDMI Licensing LLC. Under the terms of the amendment agreement, a new independent entity will act as the HDMI Licensing Agent and will be responsible for licensing and the distribution of royalties among Founders; Lattice will continue to serve the role of Agent until the appointment of the new licensing agent, which is expected to occur in fiscal 2017. As a result of the amended model for sharing revenue, we will be entitled to a reduced share of adopter fees paid by parties adopting the HDMI standard. We determined that this modification constituted an impairment indicator related to the intangible assets associated with future HDMI adopter fees. Our assessment of the new value of these intangible assets concluded that they had been impaired as of October 1, 2016, and we recorded a $7.9 million non-cash impairment charge in the Consolidated Statements of Operations. We do not anticipate any future cash expenditures related to this impairment. No impairment charges related to intangible assets were recorded for the first nine months of 2015 as no indicators of impairment were present.

Interest Expense

Interest expense, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

(In thousands)	Three Months Ended October 1, 2016	October 3, 2015	% change	Nine Months Ended October 1, 2016	October 3, 2015	% change
Interest expense	$(5,235)	$(5,754)	(9)	$(15,257)	$(12,870)	19
Percentage of revenue	(4.6)%	(5.2)%		(4.9)%	(4.2)%	

The slight decrease in interest expense for the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015 was primarily driven by decreased amortization of the original issue discount and debt issuance costs related to our long-term debt. This amortization is based on the effective interest method and the decrease was the result of a change in the expected annual excess cash flow payments on the debt. See the Credit Arrangements section under Liquidity and Capital Resources for further discussion of the debt.

The increase in interest expense for the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015 was primarily driven by the interest expense related to our debt acquired to partially fund the Silicon Image acquisition. This interest expense is comprised of contractual interest and amortization of original issue discount and debt issuance costs and was recognized for the first nine months of fiscal 2016 versus only an approximately 29-week period in the first nine months of fiscal 2015. The latter shorter period was the result of the Silicon Image acquisition date late in the first quarter of fiscal 2015.

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Other Income (Expense), Net

The composition of our other income (expense), net, including as a percentage of revenue, for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

	Three Months Ended			Nine Months Ended		
(In thousands)	October 1, 2016	October 3, 2015	% change	October 1, 2016	October 3, 2015	% change
Other income (expense), net	$209	$(841)	+100%	$3,558	$(1,095)	+100%
Percentage of revenue	0.2 %	(0.8)%		1.2 %	(0.4)%	

For the third quarter of fiscal 2016 compared to the third quarter of fiscal 2015, the increase in other income (expense), net is primarily driven by the loss on sale of assets in the prior year quarter, not recurring in the current quarter, combined with decreased foreign exchange losses in the current quarter. For the first nine months of fiscal 2016 compared to the first nine months of fiscal 2015, the increase in other (expense) income, net is driven by a combination of the $2.6 million gain on the sale of Qterics to an unrelated third party in the second quarter of fiscal 2016, decreased foreign exchange losses in the current quarter, proceeds received from the bankruptcy settlement distribution of a prior customer in the first quarter of fiscal 2016, and the loss on sale of assets in the prior year, not recurring in the current year.

Income Taxes

The composition of our income taxes for the third quarter and first nine months of fiscal 2016 and 2015 was as follows:

	Three Months Ended			Nine Months Ended		
(In thousands)	October 1, 2016	October 3, 2015	% change	October 1, 2016	October 3, 2015	% change
Income tax expense	$971	$ 309	214	$7,410	$ 29,030	(74)

Our tax expense for the third quarter of fiscal 2016 increased as compared to the third quarter of fiscal 2015 primarily due to the timing of the recognition of foreign withholding taxes. Our overall tax expense for the first nine months of fiscal 2016, compared to the first nine months of fiscal 2015 decreased primarily due to the recording of a valuation allowance in 2015 resulting in an increase to the tax provision of $21 million.

We are not currently paying U.S. federal income taxes and do not expect to pay such taxes until we fully utilize our tax net operating loss and credit carryforwards. We expect to pay a nominal amount of state income tax. We are paying foreign income taxes, which are primarily related to withholding taxes on income from foreign royalties, and to a lesser extent related to foreign sales and to the cost of operating offshore research and development, marketing, and sales subsidiaries. We accrue interest and penalties related to uncertain tax positions in income tax expense on our Consolidated Statements of Operations.

The inherent uncertainties related to the geographical distribution and relative level of profitability among various high and low tax jurisdictions make it difficult to estimate the impact of the global tax structure on our future effective tax rate.

Equity in net loss of an unconsolidated affiliate

As of October 1, 2016, we held a 22.7% preferred stock ownership interest in a privately-held company that designs human-computer interaction technology for a total investment of $6.0 million. Due to the level of our ownership interest and after considering the nature of our participation in the management of and interaction with the investee, we have determined that we have the ability to exert significant influence over the investee. Accordingly, we have accounted for the investment using the equity method and have recognized our proportionate share of the investee's net loss, amounting to $0.4 million and $1.1 million for the third quarter and first nine months of fiscal 2016, respectively, in the Consolidated Statements of Operations. Through October 1, 2016, we have reduced the value of our investment by approximately $1.6 million, representing our proportionate share of the privately-held company’s net loss accumulated to that date.

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Liquidity and Capital Resources

The following sections discuss the effects of changes in our Consolidated Balance Sheets and the effects of our credit arrangements and contractual obligations on our liquidity and capital resources, as well as our non-GAAP measures.

We classify our marketable securities as short-term based on their nature and availability for use in current operations. Our cash equivalents and short-term marketable securities consist primarily of high quality, investment-grade securities.

We have historically financed our operating and capital resource requirements through cash flows from operations. Cash provided by or used in operating activities will fluctuate from period to period due to fluctuations in operating results, the timing and collection of accounts receivable, and required inventory levels, among other things.

We believe that our financial resources will be sufficient to meet our working capital needs through at least the next 12 months. As of October 1, 2016, we did not have significant long-term commitments for capital expenditures. In the future, and to the extent our Credit Agreement permits, we may continue to consider acquisition opportunities to further extend our product or technology portfolios and further expand our product offerings. In connection with funding capital expenditures, completing other acquisitions, securing additional wafer supply, or increasing our working capital, we may seek to obtain equity or additional debt financing, or advance purchase payments or similar arrangements with wafer manufacturers. We may also need to obtain equity or additional debt financing if we experience downturns or cyclical fluctuations in our business that are more severe or longer than we anticipated when determining our current working capital needs, which financing may now be more difficult to obtain in light of our indebtedness related to the Credit Agreement.

Cash and cash equivalents and Short-term marketable securities

(In thousands)	October 1, 2016	January 2, 2016	$ Change
Cash and cash equivalents	$ 87,163	$ 84,606	$ 2,557
Short-term marketable securities	11,751	17,968	(6,217)
Total Cash and cash equivalents and Short-term marketable securities	$ 98,914	$ 102,574	$ (3,660)

As of October 1, 2016, we had total cash and cash equivalents and short-term marketable securities of $98.9 million, of which approximately $57.6 million in cash and cash equivalents was held by our foreign subsidiaries. We manage our global cash requirements considering (i) available funds among the subsidiaries through which we conduct business, (ii) the geographic location of our liquidity needs, and (iii) the cost to access international cash balances. The repatriation of non-U.S. earnings may have adverse tax consequences as we may be required to pay and record income tax expense on those funds to the extent they were previously considered permanently reinvested. As of October 1, 2016, we could access all cash held by our foreign subsidiaries without incurring significant additional expense.

The net decrease in cash and cash equivalents and short-term marketable securities of $3.7 million between January 2, 2016 and October 1, 2016 was primarily driven by $19.3 million in cash provided by operations and $2.0 million in proceeds received from the sale of the Qterics business unit, offset by $21.4 million of cash used in capital expenditures and payment for software licenses and $4.3 million cash used in the repayment of debt.

Accounts receivable, net

(In thousands)	October 1, 2016	January 2, 2016	Change

Accounts receivable, net	$ 93,946	$ 88,471	$5,475
Days sales outstanding - Overall	76	80	(4)
Days sales outstanding - Product	75	70	5
Days sales outstanding - Licensing and services	83	149	(66)

Accounts receivable, net as of October 1, 2016 increased by $5.5 million, or 6%, compared to January 2, 2016 due to an increase in revenues booked at the end of the quarter as compared to the last quarter of the prior year, partially offset by a $6.6 million increase in Allowance for Doubtful Accounts as a result of the notice from one of our distributor groups indicating a high likelihood of their bankruptcy. Overall days sales outstanding at October 1, 2016 was 76 days, a decrease of 4 days from 80 days at January 2, 2016. Days sales outstanding at October 1, 2016 related to Product revenue was 75 days, an increase of 5 days from 70 days at January 2, 2016. Days sales outstanding at October 1, 2016 related to Licensing and services revenue was 83 days, a decrease of 66 days from 149 days at January 2, 2016.

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Inventories

(In thousands)	October 1, 2016	January 2, 2016	Change
Inventories	$ 80,540	$ 75,896	$ 4,644
Months of inventory on hand	5.3	4.8	0.5

Inventories as of October 1, 2016 increased $4.6 million, or 6%, compared to January 2, 2016 as a result of buildup in inventory for new product introductions, partially offset by reductions from packaging line item reduction and related CPLD conversions and from the consumption of older product line stocks. Months of inventory on hand increased to 5.3 months at October 1, 2016 from 4.8 months at January 2, 2016.

Credit Arrangements

On March 10, 2015, we entered into a secured credit agreement (the "Credit Agreement") with Jefferies Finance, LLC and certain other lenders for purposes of funding, in part, our acquisition of Silicon Image. The Credit Agreement provided for a $350 million term loan (the "Term Loan") maturing on March 10, 2021 (the "Term Loan Maturity Date"). We received $346.5 million, net of an original issue discount of $3.5 million and we paid debt issuance costs of $8.3 million. The Term Loan bears variable interest equal to the LIBOR, subject to a 1.00% floor, plus a spread of 4.25%. The current effective interest rate on the Term Loan is 5.97%.

The Term Loan is payable through a combination of (i) quarterly installments of approximately $0.9 million which began on July 4, 2015, (ii) annual excess cash flow payments as defined in the Credit Agreement, which are due 95 days after the last day of our fiscal year, and (iii) any payments due upon certain issuances of additional indebtedness and certain asset dispositions, with any remaining outstanding principal amount due and payable on the Term Loan Maturity Date. The percentage of excess cash flow we are required to pay ranges from 0% to 75%, depending on our leverage and other factors as defined in the Credit Agreement. Currently, the Credit Agreement would require a 75% excess cash flow payment. In the second quarter of fiscal 2016, we made a required additional principal payment of $1.7 million due to the sale of Qterics. Over the next twelve months, our principal payments will be comprised mainly of regular quarterly installments along with an expected annual excess cash flow payment. While the Credit Agreement does not contain financial covenants, it does contain informational covenants and certain restrictive covenants, including limitations on liens, mergers and consolidations, sales of assets, payment of dividends, and indebtedness. We were in compliance with all such covenants at October 1, 2016.

As of October 1, 2016, we had no significant long-term purchase commitments for capital expenditures or existing used or unused credit arrangements.

Contractual Cash Obligations

There have been no significant changes to our contractual obligations outside of the ordinary course of business in the first nine months of fiscal 2016 as summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended January 2, 2016.

Off-Balance Sheet Arrangements

As of October 1, 2016, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

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Non-GAAP Financial Measures

To supplement our consolidated financial results presented in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), we also present non-GAAP financial measures which are adjusted from the most directly comparable U.S. GAAP financial measures. The non-GAAP measures set forth below exclude charges and adjustments primarily related to stock-based compensation, restructuring charges, acquisition-related charges, amortization of acquired intangible assets, purchase accounting adjustments, and the estimated tax effect of these items. These charges and adjustments may or may not be infrequent or nonrecurring in nature but are a result of periodic or non-core operating activities of the company.

Management believes that these non-GAAP financial measures provide an additional and useful way of viewing aspects of our performance that, when viewed in conjunction with our U.S. GAAP results, provide a more comprehensive understanding of the various factors and trends affecting our ongoing financial performance and operating results than GAAP measures alone. In particular, investors may find the non-GAAP measures useful in reviewing our operating performance without the significant accounting charges resulting from the Silicon Image acquisition, alongside the comparably adjusted prior year results. Management also uses these non-GAAP measures for strategic and business decision-making, internal budgeting, forecasting, and resource allocation processes and believes that investors should have access to similar data when making their investment decisions. In addition, these non-GAAP financial measures facilitate management’s internal comparisons to our historical operating results and comparisons to competitors’ operating results.

These non-GAAP measures are included solely for informational and comparative purposes and are not meant as a substitute for GAAP and should be considered together with the consolidated financial information located in this report. Pursuant to the requirements of Regulation S-K and to make clear to our investors the adjustments we make to U.S. GAAP measures, we have provided the following reconciliations of the non-GAAP measures to the most directly comparable U.S. GAAP financial measures.

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Reconciliation of U.S. GAAP to Non-GAAP Financial Measures

(In thousands, except per share data) (unaudited)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Revenue Reconciliation				
GAAP Revenue	$113,225	$109,715	$308,946	$304,772
Acquisition related deferred revenue effect (1)	—	361	—	5,091
Non-GAAP Revenue	$113,225	$110,076	$308,946	$309,863
Gross Margin Reconciliation				
GAAP Gross margin	$67,424	$59,849	$182,954	$165,807
Acquisition related net deferred revenue effect (1) (2)	—	314	—	3,595
Acquisition related inventory fair value effect (3)	—	716	523	5,362
Stock-based compensation expense - gross margin	231	406	656	1,044
Non-GAAP Gross margin	$67,655	$61,285	$184,133	$175,808
Gross Margin % Reconciliation				
GAAP Gross margin %	59.5 %	54.5 %	59.2 %	54.4 %
Cumulative effect of non-GAAP Gross Margin adjustments	0.3 %	1.2 %	0.4 %	2.3 %
Non-GAAP Gross margin %	59.8 %	55.7 %	59.6 %	56.7 %
Operating Expenses Reconciliation				
GAAP Operating expenses	$73,434	$77,807	$208,695	$236,591
Amortization of acquired intangible assets	(8,260)	(8,941)	(25,292)	(20,824)
Restructuring charges	(317)	(6,818)	(8,316)	(15,780)
Acquisition related charges (4)	—	(610)	(94)	(22,078)
Impairment of intangible assets	(7,866)	—	(7,866)	—
Stock-based compensation expense - operations	(4,078)	(3,793)	(11,451)	(11,518)
Non-GAAP Operating expenses	$52,913	$57,645	$155,676	$166,391
Income (Loss) from Operations Reconciliation				
GAAP Loss from operations	$(6,010)	$(17,958)	$(25,741)	$(70,784)
Acquisition related net deferred revenue effect (1) (2)	—	314	—	3,595
Acquisition related inventory fair value effect (3)	—	716	523	5,362
Stock-based compensation expense - gross margin	231	406	656	1,044
Amortization of acquired intangible assets	8,260	8,941	25,292	20,824
Restructuring charges	317	6,818	8,316	15,780
Acquisition related charges (4)	—	610	94	22,078
Impairment of intangible assets	7,866	—	7,866	—
Stock-based compensation expense - operations	4,078	3,793	11,451	11,518
Non-GAAP Income (loss) from operations	$14,742	$3,640	$28,457	$9,417

(1) Fair value adjustment to deferred revenue from purchase accounting
(2) Fair value adjustment to deferred cost of sales from purchase accounting
(3) Fair value adjustment for inventory step-up from purchase accounting
(4) Includes stock-based compensation and severance costs related to change in control

(5) During the second quarter of fiscal 2016, we refined our calculation of non-GAAP tax expense by applying our tax provision model to year-to-date and projected income after adjusting for non-GAAP items. The difference between calculated values for GAAP and non-GAAP tax expense has been included as the “Estimated tax effect of non-GAAP adjustments.” Prior periods have been similarly recalculated to conform to the current presentation.

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Reconciliation of U.S. GAAP to Non-GAAP Financial Measures

(In thousands, except per share data) (unaudited)	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Income (Loss) from Operations % Reconciliation				
GAAP Loss from operations %	(5.3)%	(16.4)%	(8.3)%	(23.2)%
Cumulative effect of non-GAAP Gross Margin and Operating adjustments	18.3 %	19.7 %	17.5 %	26.2 %
Non-GAAP Income (loss) from operations %	13.0 %	3.3 %	9.2 %	3.0 %
Income Tax Expense Reconciliation				
GAAP Income tax expense	$971	$309	$7,410	$29,030
Estimated tax effect of non-GAAP Adjustments (5)	2,389	2,182	438	(19,941)
Non-GAAP Income tax expense	$3,360	$2,491	$7,848	$9,089
Net Income (Loss) Reconciliation				
GAAP Net loss	$(12,414)	$(24,862)	$(45,935)	$(113,779)
Acquisition related net deferred revenue effect (1) (2)	—	314	—	3,595
Acquisition related inventory fair value effect (3)	—	716	523	5,362
Stock-based compensation expense - gross margin	231	406	656	1,044
Amortization of acquired intangible assets	8,260	8,941	25,292	20,824
Restructuring charges	317	6,818	8,316	15,780
Acquisition related charges (4)	—	610	94	22,078
Impairment of intangible assets	7,866	—	7,866	—
Stock-based compensation expense - operations	4,078	3,793	11,451	11,518
Gain on sale of Qterics	—	—	(2,646)	—
Estimated tax effect of non-GAAP Adjustments (5)	(2,389)	(2,182)	(438)	19,941
Non-GAAP Net income (loss)	$5,949	$(5,446)	$5,179	$(13,637)
Net Income (Loss) Per Share Reconciliation				
GAAP Net loss per share - basic and diluted	$(0.10)	$(0.21)	$(0.38)	$(0.97)
Cumulative effect of Non-GAAP adjustments	0.15	0.16	0.42	0.85
Non-GAAP Net income (loss) per share - basic and diluted	$0.05	$(0.05)	$0.04	$(0.12)
Shares used in per share calculations:				
Basic	120,584	117,669	119,596	117,151
Diluted - GAAP	120,584	117,669	119,596	117,151
Diluted - non-GAAP (6)	122,236	117,669	121,232	117,151

(1) Fair value adjustment to deferred revenue from purchase accounting
(2) Fair value adjustment to deferred cost of sales from purchase accounting
(3) Fair value adjustment for inventory step-up from purchase accounting
(4) Includes stock-based compensation and severance costs related to change in control
(5) During the second quarter of fiscal 2016, we refined our calculation of non-GAAP tax expense by applying our tax

provision model to year-to-date and projected income after adjusting for non-GAAP items. The difference between calculated values for GAAP and non-GAAP tax expense has been included as the “Estimated tax effect of non-GAAP adjustments.” Prior periods have been similarly recalculated to conform to the current presentation.
(6) Diluted shares are calculated using the GAAP treasury stock method. In a loss position, diluted shares equal basic shares.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Rate Risk

A portion of our silicon wafer and other purchases were historically denominated in Japanese yen, we billed our Japanese customers in yen, and we collect a Japanese consumption tax refund in yen. As a result of this, as well as having various international subsidiary and branch operations, our financial position and results of operations are subject to foreign currency exchange rate risk.
We mitigate the resulting foreign currency exchange rate exposure by entering into foreign currency forward exchange contracts. Although these hedges mitigate our foreign currency exchange rate exposure from an economic perspective, they were not designated as "effective" hedges under U.S. GAAP and as such are adjusted to fair value through Other income (expense), net. We do not engage in speculative trading in any financial or capital market.

At October 1, 2016 and January 2, 2016, we had forward contracts for Japanese yen of $1.3 million and $3.3 million, respectively. The net fair value of these contracts was unfavorable by less than $0.1 million at both October 1, 2016 and January 2, 2016. A hypothetical 10% unfavorable exchange rate change in the yen against the U.S. dollar would have resulted in an unfavorable change in net fair value of $0.2 million and $0.4 million at October 1, 2016 and January 2, 2016, respectively. Changes in fair value resulting from foreign exchange rate fluctuations would be substantially offset by the change in value of the underlying hedged transactions.

Interest Rate Risk

At October 1, 2016, we had $343.1 million outstanding on the $350 million gross term loan outstanding under our Credit Agreement, with a variable contractual interest rate based on the 3-month LIBOR as of October 1, 2016, subject to a 1.00% floor, plus a spread of 4.25%. A hypothetical 10% increase in the 3-month LIBOR would not have increased the 3-month LIBOR above this 1.00% floor used in the interest rate calculation, and thus would not have had an impact on Interest expense for the nine month period ended October 1, 2016.

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Based on management’s evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the “Exchange Act”)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

On March 10, 2015, we acquired Silicon Image, which operated under its own set of systems and internal controls. Management excluded the Silicon Image control environment from its assessment of internal controls over financial reporting for the fiscal year ended January 2, 2016. During the current period, the full control environment includes Silicon Image's systems and much of its continuing control environment, which we are maintaining until we are able

to incorporate those processes into our planned implementation of a new company-wide enterprise resource planning ("ERP") system at the beginning of fiscal 2017. We are currently preparing for updates to our control environment in anticipation of this integration and ERP transition. This plan was reviewed as part of management's evaluation and conclusion noted in "Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures" above in Item 4.

Other than as described above, there were no changes in our internal controls over financial reporting (as defined in Rules 13a - 15(f) and 15(d) - 15(f) under the Exchange Act) that occurred during the third quarter or first nine months of fiscal 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth above under Note 15 contained in the "Notes to Consolidated Financial Statements" is incorporated herein by reference.

ITEM 1A. Risk Factors

The following risk factors and other information included in this Report include any material changes to and supersede the description of the risk factors associated with our business previously disclosed in our Annual Report on Form 10-K for the year ended January 2, 2016 and should be carefully considered before making an investment decision relating to our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results, and cash flows could be materially adversely affected.

The announcement and pendency of our proposed acquisition by Parent could materially adversely affect our business, financial condition, and results of operations.

The announcement and pendency of our proposed acquisition by Parent could disrupt our business and create uncertainty about our future, which could have a material and negative impact on our business, financial condition, and results of operations, regardless of whether the acquisition is completed. These risks to our business, all of which could be exacerbated by any delay in the closing of the acquisition, include:

- restrictions in the Merger Agreement on the conduct of our business prior to the closing of the acquisition, which prevent us from taking specified actions without the prior consent of Parent, which actions we might otherwise take in the absence of the Merger Agreement;
- the attention of our management may be directed towards the closing of the acquisition and may be diverted from our day-to-day business operations, and matters related to the acquisition may require commitments of time and resources that could otherwise have been devoted to other opportunities that might have been beneficial to us;
- our customers, suppliers and other third parties may decide not to renew or seek to terminate, change or renegotiate their relationships with us, whether pursuant to the terms of their existing agreements with us or otherwise;
- our employees may experience uncertainty regarding their future roles, which might adversely affect our ability to retain, recruit and motivate key personnel; and
- potential litigation relating to the merger and the related costs.

Any of these matters could adversely affect our stock price, business, financial condition, results of operations, or business prospects.

The parties may be unable to satisfy the conditions to the closing of our acquisition by Parent and the acquisition may not be consummated, and the failure of the acquisition to be completed may adversely affect our business and our share price.

Consummation of our acquisition by Parent is subject to various closing conditions, including, among other things, (i) the adoption of the Merger Agreement by our stockholders, (ii) the absence of any legal restraints or prohibitions on the consummation of the Merger, and (iii) approval from the Committee on Foreign Investment in the United States (CFIUS), expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust

Improvements Act of 1976, and other regulatory approvals. The obligation of each party to consummate the Merger is also conditioned upon the other party's representations and warranties being true and correct (subject to certain materiality exceptions), the other party having performed in all material respects its obligations under the Merger Agreement and the obligation of Parent to consummate the Merger is also conditioned upon our not having suffered a Company Material Adverse Effect (as defined in the Merger Agreement). These and other conditions to the consummation of the Merger may fail to be satisfied. In addition, satisfying the conditions to the Merger may take longer than we and Parent currently expect. The satisfaction of all of the required conditions could delay the completion of the Merger for a significant period of time or prevent it from occurring. Thus, there can be no assurance that the conditions to the Merger will be satisfied or waived or that the Merger will be consummated.

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In addition, the Merger Agreement may be terminated under specified circumstances, including by Parent upon a change in the recommendation of our board of directors in connection with our entering into an acquisition agreement with respect to a Superior Proposal (as defined in the Merger Agreement). Failure to complete the Merger could adversely affect our business and the market price of our common stock in a number of ways, including:

- our current stock price likely reflects a market assumption that the proposed acquisition will occur, meaning that a failure to complete the proposed transaction could result in a decline in the price of our common stock;
- we may be subject to legal proceedings related to the Merger;
- the failure of the Merger to be consummated may result in negative publicity and a negative impression of us in the investment community;
- any disruptions to our business resulting from the announcement and pendency of the Merger, including any adverse changes in our relationships with our customers, vendors and employees, may continue or intensify in the event the Merger is not consummated;
- we may not be able to take advantage of alternative business opportunities or effectively respond to competitive pressures;
- we may be required to pay a termination fee of $34.18 million if the Merger Agreement is terminated under certain circumstances;
- we expect to incur substantial transaction costs in connection with the proposed transaction, whether or not it is completed; and
- we may not be entitled to receive a termination payment from Parent in all circumstances where the Merger Agreement is terminated due to Parent’s breach of its obligations under the Merger Agreement or where we fail to obtain CFIUS approval.

Litigation challenging the Merger Agreement may prevent the Merger from being consummated at all or within the expected timeframe.

Lawsuits may be filed against us, our Board of Directors and other parties to the Merger Agreement, challenging our acquisition by Parent. Such lawsuits may be brought by our purported stockholders and may seek, among other things, to enjoin consummation of the Merger. One of the conditions to the consummation of the Merger is that no order will be in effect that prevents, makes illegal or prohibits the consummation of the Merger. As such, if the plaintiffs in such potential lawsuits are successful in obtaining an injunction prohibiting the defendants from completing the Merger on the agreed upon terms, then such injunction may prevent the Merger from becoming effective, or from becoming effective within the expected timeframe.

We rely on a limited number of independent suppliers for the manufacture of all of our products and a failure by our suppliers to provide timely, cost-effective, and quality products could adversely affect our operations and financial results.

We depend on independent foundries to supply silicon wafers for our products. These foundries include Fujitsu in Japan and United Microelectronics Corporation in Taiwan, which supply the majority of our programmable logic wafers, and Taiwan Semiconductor Manufacturing, which supplies most of our HDMI and MHL integrated circuits. We negotiate wafer volumes, prices, and other terms with our foundry partners and their respective affiliates on a periodic basis typically resulting in short-term agreements which do not ensure long-term supply or allocation commitments. We rely on our foundry partners to produce wafers with competitive performance attributes. If the foundries that supply our wafers experience manufacturing problems, including unacceptable yields, delays in the realization of the requisite process technologies, or difficulties due to limitations of new and existing process technologies, our operating results could be adversely affected. If for any reason the foundries are unable to, or do not manufacture sufficient quantities of our products or continue to manufacture a product for the full life of the product, we may be required to prematurely limit or discontinue the sales of certain products or incur significant costs to

transfer products to other foundries, and our customer relationships and operating results could be adversely affected. In addition, weak economic conditions may adversely impact the financial health and viability of the foundries and cause them to limit or discontinue their business operations, resulting in shortages of supply and an inability to meet their commitments to us, which could adversely affect our financial condition and operating results.

A disruption of one or more of our foundry partners' operations as a result of a fire, earthquake, act of terrorism, political or labor unrest, governmental uncertainty, war, disease, or other natural disaster or catastrophic event, or any other reason, could disrupt our wafer supply and could adversely affect our operating results.

Establishing, maintaining and managing multiple foundry relationships requires the investment of management resources as well as additional costs. If we fail to maintain our foundry relationships, or elect or are required to change foundries, we will incur significant costs and manufacturing delays. The success of certain of our next generation products is dependent upon our ability to successfully partner with Fujitsu, Taiwan Semiconductor and other foundry partners. If for any reason one or more of our foundry partners does not provide its facilities and support for our development efforts, we may be unable to effectively develop new products in a timely manner.

Should a change in foundry relationships be required, we may be unsuccessful in establishing new foundry relationships for our current or next generation products, or we may incur substantial cost and or manufacturing delays until we form and ramp relationships and migrate products, each of which could adversely affect our operating results.

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The Mobile and Consumer end market is rapidly changing and cyclical, and a downturn in this end market or our failure to accurately predict the frequency, duration, timing, and severity of these cycles could adversely affect our financial condition and results.

With the acquisition of Silicon Image, the Mobile and Consumer end market has increased in importance to us. Revenue from the Mobile and Consumer end market accounted for 31% of our revenue in fiscal 2015. Revenue from the Mobile Consumer end market consists primarily of revenue from our products designed and used in a broad range of consumer electronics products including smartphones, tablets and e-readers, wearables, accessories such as chargers and docks, Ultra High-Definition (UHD) TVs, Digital SLR cameras, drones, and other connected devices. This market is characterized by rapidly changing requirements and product features and volatility in consumer demand. Our success in this market will depend principally on our ability to:

- meet the market windows for consumer products;
- predict technology and market trends;
- develop IP cores to meet emerging market needs;
- develop products on a timely basis;
- maintain multiple design wins across different markets and customers to dampen the effects of market volatility;
- be designed into our customers' products; and
- avoid cancellations or delay of products.

Our inability to accomplish any of the foregoing, or to offset the volatility of this end market through diversification into other markets, could materially and adversely affect our business, financial condition, and results of operations. Cyclicality in the Mobile and Consumer end market could periodically result in higher or lower levels of revenue and revenue concentration with a single or small number of customers. In addition, rapid changes in this market may affect demand for our products, and may cause our revenue derived from sales in this market to vary significantly over time, adversely affecting our financial results.

A downturn in the Communications and Computing end market could cause a meaningful reduction in demand for our products and limit our ability to maintain revenue levels and operating results.

Revenue from the Communications and Computing end market accounted for 35% of our revenue in fiscal 2015. Three of our top five programmable logic customers participate primarily in the Communications and Computing end market. In the past, cyclical weakening in demand for programmable logic products from customers in the Communications and Computing end market has adversely affected our revenue and operating results. In addition, telecommunication equipment providers are building network infrastructure for which we compete for product sales. Any deterioration in the Communications and Computing end market, our end customers' reduction in spending, or a reduction in spending by their customers to support this end market or use of our competitors’ products could lead to a reduction in demand for our products which could adversely affect our revenue and results of operations. This type of decline impacted our results during 2015 and could do so again in the future.

We depend on a concentrated group of customers for a significant portion of our revenues. If any of these customers reduce their use of our products, our revenue could decrease significantly.

A significant portion of our revenue depends on sales to a limited number of customers. To date in fiscal 2016, our top two end customers, Huawei Technologies Co. Ltd. and a major mobile handset provider, account for 7% and 6%, respectively, of our total revenue. During fiscal 2015, our top two end customers, Samsung Electronics Co., Ltd. and Huawei Technologies Co. Ltd, accounted for 9% and 8%, respectively, of our total revenue. Additionally, to date in fiscal 2016, our top five end customers account for approximately 25% of our total revenue, which is up from fiscal 2015, during which our top five end customers accounted for approximately 32% of our total revenue. If any of these

relationships were to diminish, if these customers were to develop their own solutions or adopt alternative solutions or competitors' solutions, or if our relationship with any future customer which accounts for a significant portion of our revenue were to diminish due to these factors, our results could be adversely affected.

While we strive to maintain strong relationships with our customers, their continued use of our products is frequently reevaluated, as certain of our customers' product life cycles are relatively short and they continually develop new products. The selection process for our products to be included in our customers' new products is highly competitive. There are no guarantees that our products will be included in the next generation of products introduced by these customers. For example, in December 2014, one of its largest customers informed Silicon Image that the customer had decided not to include Silicon Image’s MHL functionality in certain designs in order to reduce costs. Any significant loss of, or a significant reduction in purchases by, one or more of these customers or their failure to meet their commitments to us, could have an adverse effect on our financial condition and results of operations. If any one or more of our concentrated groups of customers were to experience significantly adverse financial conditions, our financial condition and business could be adversely affected as well, as occurred when Silicon Image’s fiscal 2014 mobile product revenue decreased as a result of a significant production slowdown by one of its key customers.

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Acquisitions, strategic investments and strategic partnerships present risks, and we may not realize the goals that were contemplated at the time of a transaction.

On March 10, 2015, we acquired Silicon Image, and we may make further acquisitions and strategic investments in the future. Acquisitions and strategic investments, including our acquisition of Silicon Image, present risks, including:

- our ongoing business may be disrupted and our management's attention may be diverted by investment, acquisition, transition, or integration activities;
- an acquisition or strategic investment may not perform as well or further our business strategy as we expected, and we may not integrate an acquired company or technology as successfully as we expected;
- we may incur unexpected costs, claims, or liabilities that we assume from an acquired company or technology or that are otherwise related to an acquisition;
- we may discover adverse conditions post-acquisition that are not covered by representations and warranties;
- we may increase some of our risks, such as increasing customer or end product concentration;
- we may have difficulty incorporating acquired technologies or products with our existing product lines;
- we may have higher than anticipated costs in continuing support and development of acquired products, and in general and administrative functions that support such products;
- we may have difficulty integrating and retaining key personnel;
- we may have difficulty integrating business systems, processes, and tools, such as accounting software, inventory management systems, or revenue systems which may have an adverse effect on our business;
- our liquidity and/or capital structure may be adversely impacted;
- our strategic investments may not perform as expected;
- we may experience unexpected changes in how we are required to account for our acquisitions and strategic investments pursuant to U.S. GAAP;
- we may have difficulty integrating acquired entities into our global tax structure with potentially negative impacts on our effective tax rate;
- if the acquisition or strategic investment does not perform as projected, we might take a charge to earnings due to impaired goodwill;
- we may divest certain assets of acquired businesses, leading to charges against earnings;
- we may experience unexpected negative responses from vendors or customers to the acquisition, which may adversely impact our operations; and
- we may have difficulty integrating the processes and control environment from Silicon Image.

The occurrence of any of these risks could have a material adverse effect on our business, results of operations, financial condition, or cash flows, particularly in the case of a larger acquisition or several concurrent acquisitions or strategic investments. In addition, we may enter into strategic partnerships with third parties with the goal of gaining access to new and innovative products and technologies. Strategic partnerships pose many of the same risks that acquisitions or investments pose.

We cannot guarantee that we will be able to complete any future acquisitions or that we will realize any anticipated benefits from any of our past or future acquisitions, strategic investments, or strategic partnerships. We may not be able to find suitable acquisition opportunities that are available at attractive valuations, if at all. A sustained decline in the price of our common stock may make it more difficult and expensive to initiate or complete additional acquisitions on commercially acceptable terms.

We are required under U.S. GAAP to test goodwill for possible impairment on an annual basis and to test goodwill and long-lived assets, including amortizable intangible assets, for impairment at any other time that circumstances arise indicating the carrying value may not be recoverable. For purposes of testing for impairment, the Company

operates as one reporting unit: the core Lattice ("Core") business, which includes intellectual property and semiconductor devices. Qterics, a discrete software-as-a-service business unit, was previously an immaterial operating segment in the Lattice legal entity structure. Following our assessment of goodwill and long-lived asset impairment in the fourth quarter of 2015, we concluded that goodwill and long-lived assets had been impaired in the Qterics segment. As a result, we recorded impairment charges related to goodwill and intangible assets in the Qterics segment amounting to $12.7 million and $9.0 million, respectively, in the Consolidated Statements of Operations for the year ended January 2, 2016. In the third quarter of 2016, we determined that the amendment to the HDMI Founders Agreement constituted an impairment indicator in the Core segment related to the intangible assets associated with future HDMI adopter fees. Our assessment of the new value of these intangible assets concluded that they had been impaired as of October 1, 2016, and we recorded a $7.9 million non-cash impairment charge in the Consolidated Statements of Operations. No impairment charges were recorded for the Core segment in fiscal 2015. There is no assurance that future impairment tests will indicate that goodwill will be deemed recoverable.

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We depend on distributors to generate a significant portion of our revenue and complete order fulfillment and any adverse change in our relationship or our distributors' financial health, reduction of selling efforts, or inaccuracy in resale reports could harm our sales or result in misreporting our results.

We depend on our distributors to sell our products to end customers, complete order fulfillment, and maintain sufficient inventory of our products. Our distributors also provide technical support and other value-added services to our end customers. Resales of product through distributors accounted for 45% of our revenue in 2015, with two distributors accounting for 32% of our revenue in 2015. With the acquisition of Silicon Image, we expect that distributors will continue to generate a significant portion of our revenue.

We expect our distributors to generate a significant portion of our revenue in the future. Any adverse change to our relationships with our distributors or a failure by one or more of our distributors to perform its obligations to us could have a material impact on our business. In addition, a significant reduction of effort by a distributor to sell our products or a material change in our relationship with one or more distributors may reduce our access to certain end customers and adversely affect our ability to sell our products.

The financial health of our distributors is important to our success. Economic conditions may adversely impact the financial health of one or more of our distributors. This could result in the inability of distributors to finance the purchase of our products or cause the distributors to delay payment of their obligation to us and increase our credit risk. If the financial health of our distributors impairs their performance and we are unable to secure alternate distributors, our financial condition and results of operations may be negatively impacted.

Since we have limited ability to forecast inventory levels of our end customers, it is possible that there may be significant build-up of inventories in the distributor channel, with the OEM or the OEM’s contract manufacturer. Such a buildup could result in a slowdown in orders, requests for returns from customers, or requests to move out planned shipments. This could adversely affect our revenues and profits. Any failure to manage these challenges could disrupt or reduce sales of our products and unfavorably impact our financial results.

We depend on the timeliness and accuracy of resale reports from our distributors. Late or inaccurate resale reports could have a detrimental effect on our ability to properly recognize revenue and our ability to predict future sales.

Our outstanding indebtedness could reduce our strategic flexibility and liquidity and may have other adverse effects on our results of operations.

In connection with our acquisition of Silicon Image, we entered into a secured Credit Agreement providing for a $350 million term loan. Our obligations under the Credit Agreement are guaranteed by our U.S. subsidiaries. Our obligations include a requirement to pay up to 75% of our excess cash flow toward repayment of the facility. The Credit Agreement also contains certain restrictive covenants, including limitations on liens, mergers and consolidations, sales of assets, payment of dividends, and additional indebtedness. The amount and terms of our indebtedness, as well as our credit rating, could have important consequences, including the following:

- we may be more vulnerable to economic downturns, less able to withstand competitive pressures, and less flexible in responding to changing business and economic conditions;
- our cash flow from operations may be allocated to the payment of outstanding indebtedness, and not to research and development, operations or business growth;
- we might not generate sufficient cash flow from operations or other sources to enable us to meet our payment obligations under the facility and to fund other liquidity needs;
- our ability to make distributions to our stockholders in a sale or liquidation may be limited until any balance on the facility is repaid in full; and

- our ability to incur additional debt, including for working capital, acquisitions, or other needs, is more limited.

If we breach a loan covenant, the lenders could accelerate the repayment of the term loan. We might not have sufficient assets to repay such indebtedness upon acceleration. If we are unable to repay the indebtedness, the lenders could initiate a bankruptcy proceeding against us or collection proceedings with respect to our assets and subsidiaries securing the facility, which could materially decrease the value of our common stock.

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Our success and future revenue depends on our ability to innovate, develop and introduce new products that achieve customer and market acceptance and to successfully compete in the highly competitive semiconductor industry, and failure to do so could have a material adverse effect on our financial condition and results of operations.

The semiconductor industry is highly competitive and many of our direct and indirect competitors have substantially greater financial, technological, manufacturing, marketing, and sales resources. Consolidation in our industry may increasingly mean that our competitors have greater resources, or other synergies, that could put us at a competitive disadvantage. We currently compete directly with companies that have licensed our technology or have developed similar products, as well as numerous semiconductor companies that offer products based on alternative solutions, such as applications processor, application specific standard product, microcontroller, analog, and digital signal processing technologies. Competition from these semiconductor companies may intensify as we offer more products in any of our end markets. These competitors include established, multinational semiconductor companies, as well as emerging companies.

The markets in which we compete are characterized by rapid technology and product evolution, generally followed by a relatively longer process of ramping up to volume production on advanced technologies. Our markets are also characterized by evolving industry standards, frequent new product introduction, short product life cycles, and increased demand for higher levels of integration and smaller process geometry. Our competitive position and success depends on our ability to innovate, develop, and introduce new products that compete effectively on the basis of price, density, functionality, power consumption, form factor, and performance addressing the evolving needs of the markets we serve. These new products typically are more technologically complex than their predecessors.

Our future growth and the success of new product introductions depend upon numerous factors, including:

- timely completion and introduction of new product designs;
- ability to generate new design opportunities and design wins, including those which result in sales of significant volume;
- availability of specialized field application engineering resources supporting demand creation and customer adoption of new products;
- ability to utilize advanced manufacturing process technologies;
- achieving acceptable yields and obtaining adequate production capacity from our wafer foundries and assembly and test subcontractors;
- ability to obtain advanced packaging;
- availability of supporting software design tools;
- utilization of predefined IP logic;
- market acceptance of our MHL-enabled and wireless mobile products, and our 60 GHz wireless products;
- customer acceptance of advanced features in our new products;
- availability of competing alternative technologies; and
- market acceptance of our customers' products.

Our product innovation and development efforts may not be successful; our new products, MHL-enabled products, and 60GHz wireless products may not achieve market or customer acceptance; and we may not achieve the necessary volume of production to achieve acceptable cost. Revenue relating to our mature products is expected to decline in the future, which is normal for our product life cycles. As a result, we may be increasingly dependent on revenue derived from our newer products as well as anticipated cost reductions in the manufacture of our current products. We rely on obtaining yield improvements and corresponding cost reductions in the manufacture of existing products and on introducing new products that incorporate advanced features and other price/performance factors that enable us to increase revenues while maintaining acceptable margins. To the extent such cost reductions and new product introductions do not occur in a timely manner, or that our products do not achieve market acceptance or market

acceptance at acceptable pricing, our forecasts of future revenue, financial condition, and operating results could be materially adversely affected.

General economic conditions and deterioration in the global business environment could have a material adverse effect on our business, operating results, and financial condition.

Adverse economic conditions or our customers' perceptions of the economic environment may negatively affect customer demand for our products and services and result in delayed or decreased spending. Weak global economic conditions in the past have resulted in weak demand for our products in certain geographies and had an adverse impact on our results of operations. If weak economic conditions persist or worsen, our business could be harmed due to customers or potential customers reducing or delaying orders. In addition, the inability of customers to obtain credit, the insolvency of one or more customers, or the insolvency of key suppliers could result in sales or production delays. Any of these effects could impact our ability to effectively manage inventory levels and collect receivables, require additional restructuring actions, and decrease our revenue and profitability. Uncertainty about future economic conditions makes it difficult for us to forecast operating results and to make decisions about future investments. Any or all of these factors could adversely affect our financial condition and results of operations in the future.

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The intellectual property licensing component of our business strategy increases our business risk and fluctuation of our revenue.

Our business strategy includes licensing our intellectual property to companies that incorporate it into their respective technologies that address markets in which we do not directly participate or compete. We also license our intellectual property into markets where we do participate and compete. Our licensing and services revenue may be impacted by the introduction of new technologies by customers in place of the technologies based on our intellectual property, changes in the law that may weaken our ability to prevent the use of our patented technology by others, and changes of selling prices for products using licensed patents. We cannot assure that our licensing customers will continue to license our technology on commercially favorable terms or at all, or that these customers will introduce and sell products incorporating our technology, accurately report royalties owed to us, pay agreed upon royalties, honor agreed upon market restrictions, maintain the confidentiality of our proprietary information, or will not infringe upon or misappropriate our intellectual property. Our intellectual property licensing agreements are complex and depend upon many factors, including completion of milestones, allocation of values to delivered items and customer acceptances. Many of these require significant judgments. Additionally, this is a new end market for us, with which we do not yet have extensive experience.

We have also generated revenue from the sale of certain patents from our portfolio, generally for technology that we are no longer actively developing. While we plan to continue to monetize our patent portfolio through sales of non-core patents, we may not be able to realize adequate interest or prices for those patents. Accordingly, we cannot provide assurance that we will continue to generate revenue from these sales. In addition, although we seek to be strategic in our decisions to sell patents, we might incur reputational harm if a purchaser of our patents sues one of our customers for infringement of the purchased patent, and we might later decide to enter a space that requires the use of one or more of the patents we sold.

Our licensing and services revenue fluctuates, sometimes significantly, from period to period because it is heavily dependent on a few key transactions being completed in a given period, the timing of which is difficult to predict and may not match our expectations. Because of its high margin, the licensing and services revenue portion of our overall revenue can have a disproportionate impact on gross profit and profitability. Generating revenue from intellectual property licenses is a lengthy and complex process that may last beyond the period in which our efforts begin, and the accounting rules governing the recognition of revenue from intellectual property licensing transactions are increasingly complex and subject to interpretation. As a result, the amount of license revenue recognized in any period may differ significantly from our expectations.

A single large customer may be in a position to demand certain functionality, pricing or timing requirements that may detract from or interfere with our normal business activities. If this happens, delays in our normal development schedules could occur, causing our products to miss market windows, thereby reducing the total number of units sold of a particular product.

The products we develop are complex and require significant planning and resources. In the Mobile and Consumer end market, new products are typically introduced early in the year, often in association with key trade shows. In order to meet these deadlines, our customers must complete their product development by year-end, which usually means we must ship sample parts in early spring. If we cannot ship sample parts in early spring, customers may be forced to remove the feature provided by our product, use a competitor’s product, or use an alternate technology in order to meet their timelines. We plan our product development with these market windows in mind, but if we receive requests from a large customer to deploy resources to meet their requirements or work on a specific solution, our normal development path could be delayed, causing us to miss sample deadlines and therefore future revenues.

A number of factors, including our inventory strategy, can impact our gross margins.

A number of factors, including how products are manufactured to support the consumer market segment, yield, wafer pricing, cost of packaging raw materials, product mix, market acceptance of our new products, competitive pricing dynamics, geographic and/or end market mix, and pricing strategies, can cause our gross margins to fluctuate significantly either positively or negatively from period to period. In addition, forecasting our gross margins is difficult because a significant portion of our business is based on turns within the same quarter.

Our customers typically test and evaluate our products prior to deciding to design our product into their own products, and then require additional time to begin volume production of those products. This lengthy sales cycle may cause us to experience significant delays and to incur additional inventory costs until we generate revenue from our products. It is possible that we may never generate any revenue from products after incurring significant expenditures.

While our sales cycles are typically long, our average product life cycles tend to be short as a result of the rapidly changing technology environment in which we operate. In addition, our inventory levels may be higher than historical norms, from time to time, due to inventory build decisions aimed at meeting expected demand from a single large customer, reducing direct material cost or enabling responsiveness to expected demand. In the event the expected demand does not materialize, or if our short sales cycle does not generate sufficient revenue, we may be subject to incremental excess and obsolescence costs. In addition, future product cost reductions could impact our inventory valuation, which could adversely affect our operating results.

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We and our connectivity customers depend on the availability of certain functions and capabilities within mobile and personal computing operating systems over which we may have no control. New releases of these operating systems may render certain of our products inoperable or may require significant engineering effort to create new device driver software.

Certain portions of our business operate within a market that is dominated by a few key OEMs. These OEMs could play a role in driving the growth of our business or could prevent our growth through deliberate or non-deliberate action. We do not have a presence in the Windows eco-system or in all iOS or Android devices. Our success and ability to grow depend upon our ability to continue to be successful within the iOS and Android eco-systems or gain significant traction within the Windows eco-system. Failure to maintain and grow our presence in these key eco-systems could adversely affect unit volumes.

Further, many of our products depend on the availability of certain functionality in the device operating system, typically Android, Linux, Windows, or iOS. Certain operating system primitives are needed to support video output. We have no control over these operating systems or the companies that produce them, and it is unlikely that we could influence any internal decision these companies make that may have a negative impact on our integrated circuits and their function. Updates to these operating systems that, for example, change the way video is output or remove the ability to output video could materially affect sales of MHL and HDMI integrated circuits.

Products targeted to personal computing or mobile, laptop, or notebook designs often require device driver software to operate. This software is difficult to produce and may require certifications before being released. Failure to produce this software could have a negative impact on our relation with operating system providers and may damage our reputation with end consumers as a quality supplier of products.

We may experience difficulties in transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries, and increased expenses.

To remain competitive, we expect to continue to transition our semiconductor products to increasingly smaller geometries. This requires us to change the manufacturing processes for our products and to redesign some products as well as standard cells and other integrated circuit designs we may use in multiple products. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. The transition to lower nanometer geometry process technologies will result in significantly higher mask and prototyping costs, as well as additional expenditures for engineering design tools.

We depend on our relationships with our foundry partners to transition to smaller geometry processes successfully. We make no assurance that our foundry partners will be able to effectively manage the transition in a timely manner, or at all. If we or any of our foundry partners experience significant delays in this transition or fail to efficiently implement this transition, we could experience reduced manufacturing yields, delays in product deliveries, and increased expenses, all of which could adversely affect our relationships with our customers and our financial condition and operating results.

Shortages in, or increased costs of, wafers and materials could adversely impact our gross margins and lead to reduced revenues.

Worldwide manufacturing capacity for silicon wafers is relatively inelastic. If the demand for silicon wafers or assembly material materially exceeds market supply, our supply of silicon wafers or assembly material could quickly become limited. A shortage in manufacturing capacity could hinder our ability to meet product demand and therefore reduce our revenue. In addition, silicon wafers constitute a material portion of our product cost. If we are unable to

purchase wafers at favorable prices, our gross margins will be adversely affected.

We depend on independent contractors for most of our assembly and test services, and disruption of their services, or an increased in cost of these services, could negatively impact our financial condition and results of operations.

We depend on subcontractors to assemble, test, and ship our products with acceptable quality and yield levels. Our operations and operating results may be adversely affected if we experience problems with our subcontractors that impact the delivery of product to our customers. Those problems may include: prolonged inability to obtain wafers or packaging materials with competitive performance and cost attributes; inability to achieve adequate yields or timely delivery; disruption or defects in assembly, test, or shipping services; or delays in stabilizing manufacturing processes or ramping up volume for new products. Economic conditions may adversely impact the financial health and viability of our subcontractors and result in their inability to meet their commitments to us resulting in product shortages, quality assurance problems, reduced revenue, and/or increased costs which could negatively impact our financial condition and results of operations.

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In the past, we have experienced delays in obtaining assembled and tested products and in securing assembly and test capacity commitments from our suppliers. We currently anticipate that our assembly and test capacity commitments are adequate; however, these existing commitments may not be sufficient for us to satisfy customer demand in future periods. We negotiate assembly and test prices and capacity commitments from our contractors on a periodic basis. If any of our assembly or test contractors reduce their capacity commitment or increase their prices, and we cannot find alternative sources, our operating results could be adversely affected.

The semiconductor industry routinely experiences cyclical market patterns and a significant industry downturn could adversely affect our operating results.

Our revenue and gross margin can fluctuate significantly due to downturns in the semiconductor industry. These downturns can be severe and prolonged and can result in price erosion and weak demand for our products. Weak demand for our products resulting from general economic conditions affecting the end markets we serve or the semiconductor industry specifically and reduced spending by our customers can result, and in the past has resulted, in excess and obsolete inventories and corresponding inventory write-downs. The dynamics of the markets in which we operate make prediction of and timely reaction to such events difficult. Due to these and other factors, our past results are not reliable predictors of our future results.

Our expense levels are based, in part, on our expectations of future sales. Many of our expenses, particularly those relating to facilities, capital equipment, and other overhead, are relatively fixed. We might be unable to reduce spending quickly enough to compensate for reductions in sales. Accordingly, shortfalls in sales could adversely affect our operating results.

Our participation in HDMI and MHL has included our acting as agent for these consortia for which we have been receiving adopter fees. We will no longer be acting as agent for the HDMI standard and there is no guarantee that we will continue to act as agent for the MHL standard. Starting in 2017, we will lose HDMI adopter fees and we could in the future lose MHL adopter fees.

Through our wholly owned subsidiary, HDMI Licensing, LLC, we have acted as agent of the HDMI consortium and are responsible for promoting and administering the specification. We received all of the adopter fees paid by adopters of the HDMI specification in connection with our role as agent. In September 2016, we agreed to restructure our role as agent with the members of the HDMI consortium. The agreement paved the way for the appointment of a new agent which we anticipate will likely occur by the first quarter of fiscal 2017. As a result of this appointment, we will no longer serve as agent for the consortium and we will be entitled to a reduced share of adopter fees paid by parties adopting the HDMI standard.

In addition, we have been informed by another member of the HDMI consortium that it asserts a claim for payment to the other HDMI consortium founders of their respective shares of any HDMI adopter fees not used by us in the marketing and other activities in furtherance of the HDMI standard. The consortium member has previously indicated its belief that the HDMI founders enjoy a right to these funds but has never pursued such claim. If a determination was made that there were excess adopter fees or if it was determined that we were obligated to share such fees with other consortium members, it could negatively impact our financial position. At this stage of the proceedings, we do not have an estimate of the likelihood or the amount of any financial consequences to us.

We share HDMI royalties with the other HDMI founders based on an allocation formula, which is reviewed every three years. The current royalty sharing formula covers the period from January 1, 2014 through December 31, 2016. Our portion of the royalty allocation has declined for the last several years. In 2015, we received between 24% and 25% of the royalty allocation, and for 2016, we expect to receive approximately 20% of the royalty allocation. The royalty allocation for 2017 and future years is not yet known, but if the level continues to decline, our financial

performance could be adversely affected.

Through our wholly owned subsidiary, MHL, LLC, we act as agent of the MHL specification and are responsible for promoting and administering the specification. As agent, we are entitled to receive license fees paid by adopters of the MHL specification sufficient to reimburse us for the costs we incur to promote and administer the specification. Given the limited number of MHL adopters to date, we do not believe the license fees paid by such adopters will be sufficient to reimburse us for these costs and we make no assurance that the license fees paid by MHL adopters will ever be sufficient to reimburse us the costs we incur as agent of the specification.

We currently intend to promote and continue to be involved and actively participate in other standard setting initiatives. For example, through Silicon Image’s acquisition of SiBEAM, Inc. in May 2011, it achieved SiBEAM’s prior position as founder and chair of the WirelessHD Consortium. We may decide to license additional elements of our intellectual property to others for use in implementing, developing, promoting, or adopting standards in our target markets, in certain circumstances at little or no cost. This may make it easier for others to compete with us in such markets. In addition, even if we receive license fees or royalties in connection with the licensing of our intellectual property, we make no assurance that such license fees or royalties will compensate us adequately.

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We rely on independent software and hardware developers and disruption of their services could negatively affect our operations and financial results.

We rely on independent software and hardware developers for the design, development, supply, and support of intellectual property cores; design and development software; and certain elements of evaluation boards. As a result, failure or significant delay to complete software or deliver hardware in accordance with our plans, specifications, and agreements could disrupt the release of or introduction of new or existing products, which could be detrimental to the capability of our new or existing products to win designs. Any of these delays or inability to complete the design or development could have an adverse effect on our business, financial condition, or operating results.

Our failure to control unauthorized access to our IT systems may cause problems with key business partners or liability.

We may be subject to unauthorized access to our IT systems through a security breach or cyber-attack. In the ordinary course of our business, we maintain sensitive data on our networks, including our intellectual property and proprietary or confidential business information relating to our business and that of our customers and business partners. The secure maintenance of this information is critical to our business and reputation. We believe that companies have been increasingly subject to a wide variety of security incidents, cyber-attacks, and other attempts to gain unauthorized access. Cyber-attacks have become more prevalent and much harder to detect and defend against. Our network and storage applications may be subject to unauthorized access by hackers or breached due to operator error, malfeasance, or other system disruptions. It is often difficult to anticipate or immediately detect such incidents and to assess the damage caused by them. In the past, third parties have attempted to penetrate and/or infect our network and systems with malicious software in an effort to gain access to our network and systems.

These data breaches and any unauthorized access or disclosure of our information or intellectual property could compromise our intellectual property and expose sensitive business information. Cyber-attacks could also cause us to incur significant remediation costs, result in product development delays, disrupt key business operations, and divert attention of management and key information technology resources. Our reputation, brand, and business could be significantly harmed, and we could be subject to third party claims in the event of such a security breach.

Foreign sales, accounting for the majority of our revenue, are subject to various risks associated with selling in international markets, which could have a material adverse effect on our operations, financial condition, and results of operations.

We derive the majority of our revenue from sales outside of the United States. Accordingly, if we experience a decline in foreign sales, our operating results could be adversely affected. Our foreign sales are subject to numerous risks, including:

- changes in local economic conditions;
- currency exchange rate volatility;
- governmental stimulus packages, controls, and trade restrictions;
- governmental policies that promote development and consumption of domestic products;
- export license requirements, foreign trade compliance matters, and restrictions on the use of technology;
- political instability, war, terrorism, or pandemic disease;
- changes in tax rates, tariffs, or freight rates;
- reduced protection for intellectual property rights;
- longer receivable collection periods;
- natural or man-made disasters in the countries where we sell our products;
- interruptions in transportation;

- interruptions in the global communication infrastructure; and
- labor regulations.

Any of these factors could adversely affect our financial condition and results of operations in the future.

We have significant international operations exposing us to various economic, regulatory, political, and business risks, which could have a material adverse effect on our operations, financial condition, and results of operations.

We have significant international operations, including foreign sales offices to support our international customers and distributors, and operational and research and development sites in China, India, the Philippines, and other Asian locations. In addition, we purchase our wafers from foreign foundries; have our commercial products assembled, packaged, and tested by subcontractors located outside of the United States; and rely on an international service provider for inventory management, order fulfillment, and direct sales logistics.

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These and other integral business activities outside of the United States are subject to the risks and uncertainties associated with conducting business in foreign economic and regulatory environments including trade barriers; economic sanctions; environmental regulations; import and export regulations; duties and tariffs and other trade restrictions; changes in trade policies; anti-corruption laws; domestic and foreign governmental regulations; potential vulnerability of and reduced protection for intellectual property; disruptions or delays in production or shipments; and instability or fluctuations in currency exchange rates, any of which could have a material adverse effect on our business, financial condition, and operating results. In addition, with the acquisition of Silicon Image, we have increased the operational challenges of conducting our business in and across multiple geographic regions around the world, especially in the face of different business practices, social norms, and legal standards.

Moreover, our financial condition and results of operations could be affected in the event of political instability, including as a result of the United Kingdom referendum on June 23, 2016, in which voters approved an exit from the European Union (commonly referred to as "Brexit"), terrorist activity, U.S. or other military actions, or economic crises in countries where our main wafer suppliers, end customers, contract manufacturers, and logistics providers are located.

Our global organizational structure and operations expose us to unanticipated tax consequences.

Our legal organizational structure could result in unanticipated unfavorable tax or other consequences which could have an adverse effect on our financial condition and results of operations. We have a global tax structure to more effectively align our corporate structure with our business operations including responsibility for sales and purchasing activities. We created new and realigned existing legal entities; completed intercompany sales of rights to intellectual property, inventory, and fixed assets across different tax jurisdictions; and implemented cost-sharing and intellectual property licensing and royalty agreements between our legal entities. We currently operate legal entities in countries where we conduct supply-chain management, design, and sales operations around the world. In some countries, we maintain multiple entities for tax or other purposes. In addition, we are currently conducting further restructuring activities following our acquisition of Silicon Image as we integrate Silicon Image and its subsidiaries, which include numerous foreign entities, into our existing global tax and corporate structures. These integration activities, changes in tax laws, regulations, future jurisdictional profitability of the Company and its subsidiaries, and related regulatory interpretations in the countries in which we operate may impact the taxes we pay or tax provision we record, which could adversely affect our results of operations.

We are subject to taxation in the United States, Singapore, and other countries. Future effective tax rates could be affected by changes in the composition of earnings in countries with differing tax rates, changes in the valuation of deferred tax assets and liabilities, or changes in tax laws. We compute our effective tax rate using actual jurisdictional profits and losses. Changes in the jurisdictional mix of profits and losses may cause fluctuations in the effective tax rate. Adverse changes in tax rates, our tax assets, and tax liabilities could negatively affect our results in the future.

We make no assurance as to what taxes we pay or the ability to estimate our future effective tax rate because of, among other things, uncertainty regarding the tax policies of the jurisdictions where we operate. The U.S. government and the Organization for Economic Cooperation and Development have proposed tax policy changes with respect to the taxation of global operations of multinational companies. As a result, our actual effective tax rate or taxes paid may vary materially from our expectations. Changes in tax laws, regulations, and related interpretations in the countries in which we operate may have an adverse effect on our business, financial condition, or operating results.

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

In general, we warrant our products for varying lengths of time against non-conformance to our specifications and certain other defects. Because our products, including hardware, software, and intellectual property cores, are highly

complex and increasingly incorporate advanced technology, our quality assurance programs may not detect all defects, whether manufacturing defects in individual products or systematic defects that could affect numerous shipments. Inability to detect a defect could result in a diversion of our engineering resources from product development efforts, increased engineering expenses to remediate the defect, and increased costs due to customer accommodation or inventory impairment charges. On occasion we have also repaired or replaced certain components, made software fixes, or refunded the purchase price or license fee paid by our customers due to product or software defects. If there are significant product defects, the costs to remediate such defects, net of reimbursed amounts from our vendors, if any, or to resolve warranty claims may adversely affect our revenue, gross margins, and net income.

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The nature of our business makes our revenue and gross margin subject to fluctuation and difficult to predict which could have an adverse impact on our business and our ability to provide forward-looking revenue and gross margin guidance.

In addition to the challenging market conditions we may face, we have limited visibility into the demand for our products, particularly new products, because demand for our products depends upon our products being designed into our end customers' products and those products achieving market acceptance. Due to the complexity of our customers' designs, the design to volume production process for many of our customers requires a substantial amount of time, frequently longer than a year. In addition, we are dependent upon "turns," orders received and turned for shipment in the same quarter. These factors make it difficult for us to forecast future sales and project quarterly revenues. The difficulty in forecasting future sales weakens our ability to project our inventory requirements, which could result, and in the past has resulted, in inventory write-downs or failure to meet customer product demands in a timely manner. The difficulty in forecasting revenues as well as the relative customer and product mix of those revenues inhibits our ability to provide forward-looking revenue and gross margin guidance.

In addition, effective with the announcement of the proposed merger contemplated by the Merger Agreement with Parent and Merger Sub, providing for the merger of Merger Sub with and into the Company, with the Company surviving the Merger as a wholly owned subsidiary of Parent, the Company has discontinued the provision of forward-looking revenue and gross margin guidance.

Reductions in the average selling prices of our products could have a negative impact on our gross margins.

The average selling prices of our products generally decline as the products mature or may decline as we compete for market share or customer acceptance in competitive markets. We seek to offset the decrease in selling prices through yield improvement, manufacturing cost reductions, and increased unit sales. We also seek to continue to develop higher value products or product features that increase, or slow the decline of, the average selling price of our products. However, we cannot guarantee that our ongoing efforts will be successful or that they will keep pace with the decline in selling prices of our products, which could ultimately lead to a decline in revenues and have a negative effect on our gross margins.

If we are unable to adequately protect our intellectual property rights, our financial results and our ability to compete effectively may suffer.

Our success depends in part on our proprietary technology and we rely upon patent, copyright, trade secret, mask work, and trademark laws to protect our intellectual property. We intend to continue to protect our proprietary technology, however, we may be unsuccessful in asserting our intellectual property rights or such rights may be invalidated, violated, circumvented, or challenged. From time to time, third parties, including our competitors, have asserted against us patent, copyright, and other intellectual property rights to technologies that are important to us. Third parties may attempt to misappropriate our intellectual property through electronic or other means or assert infringement claims against us in the future. Such assertions by third parties may result in costly litigation, indemnity claims, or other legal actions, and we may not prevail in such matters or be able to license any valid and infringed patents from third parties on commercially reasonable terms. This could result in the loss of our ability to import and sell our products or require us to pay costly royalties to third parties in connection with sales of our products. Any infringement claim, indemnification claim, or impairment or loss of use of our intellectual property could materially adversely affect our financial condition and results of operations.

A material change in the agreements governing encryption keys we use could place additional restrictions on us, or our distributors or contract manufacturers, which could restrict product shipment or significantly increase the cost to track products throughout the distribution chain.

Many of the components in our products contain encryption keys used in connection with High Definition Content Protection (HDCP). The regulation and distribution of these encryption keys are controlled through license agreements with Digital Content Protection (DCP), a wholly owned subsidiary of Intel Corporation. These license agreements have been modified by DCP from time to time, and such changes could impact us, our distributors, and our customers. An important element of both HDMI and MHL is the ability to implement link protection for high definition (HD), and more recently, 4K UltraHD, content. We implement various aspects of the HDCP link protection within certain parts we sell. We also, for the benefit of our customers, include the necessary HDCP encryption keys in parts we ship to customers. These encryption keys are provided to us from DCP. We have a specific process for tracking and handling these encryption keys. If DCP changes any of the tracking or handling requirements associated with HDCP encryption keys, we may be required to change our manufacturing and distribution processes, which could adversely affect our manufacturing and distribution costs associated with these products. If we cannot satisfy new requirements for the handling and tracking of encryption keys, we may have to cease shipping or manufacturing certain products.

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Our participation in consortia for the development and promotion of industry standards in certain of our target markets, including the HDMI, MHL, and WirelessHD standards, requires us to license some of our intellectual property for free or under specified terms and conditions, which makes it easier for others to compete with us in such markets.

An element of our business strategy includes participating in consortia to establish industry standards in certain of our target markets; promoting and enhancing specifications; and developing and marketing products based on those specifications and future enhancements. We intend to continue participating in consortia that develop and promote the HDMI, MHL, and WirelessHD specifications. In connection with our participation in these consortia, we make certain commitments regarding our intellectual property, in each case with the effect of making certain of our intellectual property available to others, including our competitors, desiring to implement the specification in question. For example, we must license specific elements of our intellectual property to others for use in implementing the HDMI specification, including enhancements, as long as we remain part of the consortium. Also, we must agree not to assert certain necessary patent claims against other members of the MHL consortium, even if those members may have infringed upon those patents in implementing the MHL specification.

Accordingly, certain companies that implement these specifications in their products may use specific elements of our intellectual property to compete with us. Although in the case of the HDMI and MHL consortia, there are annual fees and royalties associated with the adopters' use of the technology, we make no assurance that our shares of such annual fees and royalties will adequately compensate us for having to license or refrain from asserting our intellectual property. In September 2016, we agreed to restructure our role as agent with the members of the HDMI consortium. The agreement paved the way for the appointment of a new agent which we anticipate will likely occur by the first quarter of fiscal 2017. As a result of this appointment, we will no longer serve as agent for the consortium and we will be entitled to a reduced share of adopter fees paid by parties adopting the HDMI standard.

Our business depends, in part, on the continued adoption and widespread implementation of the HDMI and MHL specifications and the new implementation and adoption of the WirelessHD specifications.

Silicon Image has depended on its participation in standard setting organizations, such as the HDMI and MHL consortiums, and the widespread adoption and success of those standards. From time to time, competing standards have been established which negatively affect the success of existing standards or jeopardize the creation of new standards.

Our future success depends, in part, upon the continued adoption and widespread implementation of the HDMI, MHL, and WirelessHD specifications. A significant portion of Silicon Image's total revenue was derived from the sale of HDMI and MHL-enabled products and the licensing of our HDMI and MHL technology. Silicon Image's leadership in the market for HDMI and MHL-enabled products and intellectual property has been based on the ability to introduce first-to-market semiconductor and intellectual property solutions to customers and to continue to innovate within the standard. Our inability to continue to drive innovation in the HDMI and MHL specifications could have an adverse effect on our business going forward.

MHL has not been widely adopted and Silicon Image had a reduction in mobile design wins at one of our largest customers as a result of not including MHL. If other manufacturers who have included MHL in their designs decide that MHL is no longer necessary or cost-effective as a product feature, they too could choose to omit the MHL functionality (and our product) from their designs. Such decisions would adversely affect our revenues. Similarly, if our largest customer decides to remove MHL from other products, our revenue would be adversely affected.

We now have 60GHz wireless technology that we hope will be made widely available and adopted by the marketplace through the efforts of the WirelessHD consortium and incorporated into certain of our future products. As with our

HDMI and MHL products and intellectual property, our success with this technology will depend on our ability to introduce first-to-market WirelessHD-enabled semiconductor and intellectual property solutions to our customers and to continue to innovate within the WirelessHD standard. WiGig is an example of a competing 60GHz standard that has been created as an alternative high-bandwidth wireless connectivity solution for the personal computing industry. While the WiGig standard has not been in the market as long as the WirelessHD standard, it does represent a viable alternative to WirelessHD for 60GHz connectivity. If WiGig should gain broader adoption before WirelessHD is adopted, it could negatively impact the adoption of WirelessHD.

As successor-in-interest to Silicon Image, we have granted Intel Corporation certain rights with respect to our intellectual property, which could allow Intel to develop products that compete with ours or otherwise reduce the value of our intellectual property.

Silicon Image entered into a patent cross-license agreement with Intel in which each of them granted the other a license to use the patents filed by the grantor prior to a specified date, except for use related to identified types of products. We believe that the scope of this license to Intel excludes our current products and anticipated future products. Intel could, however, exercise its rights under this agreement to use certain of our patents received in the acquisition of Silicon Image to develop and market other products that compete with ours, without payment to us. Additionally, Intel’s rights to these patents could reduce the value of the patents to any third-party who otherwise might be interested in acquiring rights to use these patents in such products. Finally, Intel could endorse competing products, including a competing digital interface, or develop its own proprietary digital interface. Any of these actions could substantially harm our business and results of operations.

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Litigation and unfavorable results of legal proceedings could adversely affect our financial condition and operating results.

From time to time we are subject to various legal proceedings and claims that arise out of the ordinary conduct of our business. Certain claims are not yet resolved, including those that are discussed under Note 15 contained in the Notes to Consolidated Financial Statements, and additional claims may arise in the future. Results of legal proceedings cannot be predicted with certainty. Regardless of merit, litigation may be both time-consuming and disruptive to our operations and cause significant expense and diversion of management attention and we may enter into material settlements to avoid these risks. Should we fail to prevail in certain matters, we may be faced with significant monetary damages or injunctive relief against us that could materially and adversely affect our financial condition and operating results and certain portions of our business.

We depend upon a third party to provide inventory management, order fulfillment, and direct sales logistics and disruption of these services could adversely impact our business and results of operations.

We rely on a third party vendor to provide cost-effective and efficient supply chain services. Among other activities, these outsourced services relate to direct sales logistics, including order fulfillment, inventory management and warehousing, and distribution of inventory to third party distributors. If our third party supply chain provider were to discontinue services for us or its operations are disrupted as a result of a fire, earthquake, act of terrorism, political unrest, governmental uncertainty, war, disease, or other natural disaster or catastrophic event, or any other reason, our ability to fulfill direct sales orders and distribute inventory timely, cost effectively, or at all, would be hindered, which could adversely affect our business.

We rely on information technology systems, and failure of these systems to function properly may cause business disruptions.

We rely in part on various information technology ("IT") systems to manage our operations, including financial reporting, and we regularly make changes to improve them as necessary by periodically implementing new, or upgrading or enhancing existing, operational and IT systems, procedures, and controls. We are undergoing a significant integration and systems implementation as we integrate the operations and systems of Silicon Image into our operations and systems following the acquisition. Our current implementation has been delayed to 2017. Such a delay in the implementation of, or disruption in the transition to or integration of, new or enhanced systems, procedures, or controls, could harm our ability to record and report financial and management information on a timely and accurate basis, and could impact our internal control compliance efforts especially because Silicon Image is now in scope for SOX testing in 2016. In addition, we are presently upgrading our main enterprise resource planning system, which if not completed on time and as planned, could result in cost overruns or limit our ability to manufacture and ship products as planned. These systems are also subject to power and telecommunication outages or other general system failures. Failure of our IT systems or difficulties or delays in managing and integrating them could result in excessive cost or business disruption.

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

We carry insurance customary for companies in our industry, including, but not limited to, liability, property, and casualty; workers' compensation; and business interruption insurance. We also insure our employees for basic medical expenses. In addition, we have insurance contracts that provide director and officer liability coverage for our directors and officers. Other than the specific areas mentioned above, we are self-insured with respect to most other risks and exposures, and the insurance we carry in many cases is subject to a significant policy deductible or other limitation before coverage applies. Based on management's assessment and judgment, we have determined that it is more cost

effective to self-insure against certain risks than to incur the insurance premium costs. The risks and exposures for which we self-insure include, but are not limited to, certain natural disasters, certain product defects, political risk, certain theft, patent infringement, and employment practice matters. Should there be a catastrophic loss due to an uninsured event (such as an earthquake) or a loss due to adverse occurrences in any area in which we are self-insured, our financial condition or operating results could be adversely affected.

We compete with others to attract and retain key personnel, and any loss of, or inability to attract, such personnel could adversely affect our ability to compete effectively.

We depend on the efforts and abilities of certain key members of management and other technical personnel. Our future success depends, in part, upon our ability to retain such personnel and attract and retain other highly qualified personnel, particularly product engineers who can respond to market demands and required product innovation. Competition for such personnel is intense and we may not be successful in hiring or retaining new or existing qualified personnel. From time to time we have effected restructurings which have eliminated a number of positions. Even if such personnel are not directly affected by the restructuring effort, such terminations can have a negative impact on morale and our ability to attract and hire new qualified personnel in the future. If we lose existing qualified personnel or are unable to hire new qualified personnel, as needed, we could have difficulty competing in our highly-competitive and innovative environment.

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The conflict minerals provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act could result in additional costs and liabilities.

As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission established new disclosure and reporting requirements for those companies who use "conflict" minerals mined from the Democratic Republic of Congo and adjoining countries in their products, whether or not these products are manufactured by third parties. As these new requirements are fully implemented, they could affect the sourcing and availability of minerals used in the manufacture of our semiconductor products. There are also costs associated with complying with the disclosure requirements, including for due diligence in regard to the sources of any conflict minerals used in our products, in addition to the cost of any required remediation and other changes to products, processes, or sources of supply as a consequence of such verification activities. Although we filed the required conflict minerals reports in 2014, 2015, and 2016 it may be several years before we can fully assess the internal and external cost of compliance of the effect the rules will have on our business.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	Description
1.1	Agreement and Plan of Merger, dated as of November 3, 2016, by and among the Company, Parent and Merger Sub (Incorporated by reference to Exhibit 1.1 filed with the Company's Current Report on Form 8-K filed November 3, 2016).
3.1	The Company's Restated Certificate of Incorporation filed, as amended on June 4, 2009 (Incorporated by reference to Exhibit 3.1 filed with the Company's Current Report on Form 8-K filed June 4, 2009).
3.2	The Company's Bylaws, as amended and restated as of June 4, 2009 (Incorporated by reference to Exhibit 3.2 filed with the Company's Current Report on Form 8-K filed June 4, 2009).
3.3	Amendment to the Company's Bylaws, as amended and restated, as of November 2, 2016 (Incorporated by reference to Exhibit 3.1 filed with the Company's Current Report on Form 8-K filed November 3, 2016).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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 Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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SIGNATURES

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

LATTICE SEMICONDUCTOR CORPORATION
(Registrant)

/s/ Max Downing
MAX DOWNING
Interim Chief Financial Officer
(Duly Authorized Officer and Principal Financial and Accounting Officer)

Date: November 10, 2016