LSI LOGIC CORP
Form 10-Q
May 14, 2004

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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 April 4, 2004

OR

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

For the transition period from _______ to ________

Commission File Number: 0-11674

LSI LOGIC CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**94-2712976**
(State of Incorporation)	**(I.R.S. Employer Identification Number)**

1621 Barber Lane
Milpitas, California 95035
(Address of principal executive offices)
(Zip code)

(408) 433-8000
(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) YES [X] NO [ ]

As of May 7, 2004, there were 382,109,210 shares of the registrant s Common Stock, $.01 par value, outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

LSI LOGIC CORPORATION

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	March 31, 2004	December 31, 2003
	(In thousands, except per-share amounts)	
Assets		
Cash and cash equivalents	$ 273,414	$ 269,682
Short-term investments	584,045	544,007
Accounts receivable, less allowances of $5,500 and $7,415	247,344	231,184
Inventories	205,652	198,517
Deferred tax assets	7,646	8,116
Prepaid expenses and other current assets	122,206	138,531
Total current assets	1,440,307	1,390,037
Property and equipment, net	464,520	481,489
Intangibles, net	165,219	161,236
Goodwill	968,747	968,483
Deferred tax assets	7,434	7,484
Non-current assets and deposits	297,468	318,176
Investment in equity securities	36,064	35,455
Other assets	83,836	85,541
Total assets	$ 3,463,595	$ 3,447,901
Liabilities and Stockholders Equity		
Accounts payable	$ 88,643	$ 102,632
Accrued salaries, wages and benefits	73,596	75,968
Other accrued liabilities	176,677	153,857
Income taxes payable	56,870	58,417
Current portion of long-term obligations	380	377
Total current liabilities	396,166	391,251

Long-term debt and capital lease obligations	861,813	865,606
Other non-current liabilities	138,378	141,096
Total long-term obligations and other liabilities	1,000,191	1,006,702
Commitments and contingencies (Note 13)		
Minority interest in subsidiary	6,755	7,498
Stockholders equity:		
Preferred shares; $.01 par value; 2,000 shares authorized; none outstanding		
Common stock; $.01 par value; 1,300,000 shares authorized; 382,033 and 381,491 shares outstanding	3,820	3,815
Additional paid-in capital	2,955,844	2,950,051
Deferred stock compensation	(25,263)	(24,839)
Accumulated deficit	(911,705)	(920,790)
Accumulated other comprehensive income	37,787	34,213
Total stockholders equity	2,060,483	2,042,450
Total liabilities and stockholders equity	$ 3,463,595	$ 3,447,901

The accompanying notes are an integral part of these Consolidated Financial Statements.

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LSI LOGIC CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three Months Ended March 31,	
	2004	**2003**
	(In thousands, except per share amounts)	
Revenues	$ 452,357	$ 372,785
Cost of revenues	250,925	248,068
Gross profit	201,432	124,717
Research and development	108,941	115,127
Selling, general and administrative	61,158	57,629
Restructuring of operations and other items, net	(598)	35,666
Amortization of non-cash deferred stock compensation (*)	1,826	10,543
Amortization of intangibles	18,274	20,125
Income/(loss) from operations	11,831	(114,373)
Interest expense	(5,912)	(8,831)
Interest income and other, net	9,166	6,779
Income/(loss) before income taxes	15,085	(116,425)
Provision for income taxes	6,000	6,000
Net income/(loss)	$ 9,085	$ (122,425)
Net income/(loss) per share:		
Basic	$ 0.02	$ (0.33)
Diluted	$ 0.02	$ (0.33)
Shares used in computing per share amounts:		
Basic	381,639	374,628
Diluted	389,882	374,628

(*) Amortization of non-cash deferred stock compensation, if not shown separately, would have been included in cost of revenues, research and development, and selling, general and administrative expenses, as shown below:

	Three months ended March 31,	
	2004	**2003**
	(In thousands)	
Cost of revenues	$ 50	$ 182
Research and development	1,181	8,150
Selling, general and administrative	595	2,211
Total	$1,826	$10,543

The accompanying notes are an integral part of these Consolidated Financial Statements.

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LSI LOGIC CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Three Months Ended March 31,	
	2004	**2003**
	(In thousands)	
Operating activities:		
Net income/(loss)	$ 9,085	$(122,425)
Adjustments:		
Depreciation and amortization	46,116	87,058
Amortization of non-cash deferred stock compensation	1,826	10,543
Non-cash restructuring and other items	2,229	29,754
Gain on sale and exchange of equity securities, loss on write-down	(3,000)	7,006
Gain on sale of property and equipment	(3,101)	(1,703)
Changes in deferred tax assets and liabilities	520	(410)
Changes in assets and liabilities, net of assets acquired and liabilities assumed in acquisitions:		
Accounts receivable	(15,368)	24,160
Inventories	(6,190)	(11,866)
Prepaid expenses and other assets	12,529	(336)
Accounts payable	(12,761)	(1,106)
Accrued and other liabilities	(21,778)	1,205
Net cash provided by operating activities	10,107	21,880
Investing activities:		
Purchase of debt securities available-for-sale	(229,440)	(857,231)
Maturities and sales of debt securities available-for-sale	189,040	885,609
Purchase of equity securities	(2,250)	
Purchase of property and equipment	(11,557)	(15,610)
Proceeds from sale of property and equipment	4,014	4,533
Proceeds from the sale-leaseback of equipment		160,000
Increase in non-current assets and deposits	(23)	(389,393)
Decrease in non-current assets and deposits	27,753	238,983
Acquisitions of companies, net of cash acquired	(4,777)	
Increase in a payable to acquire a company	17,592	
Net cash (used in)/provided by investing activities	(9,648)	26,891

Financing activities:		
Repayment of debt obligations	(122)	(88)
Purchase of minority interest in subsidiary	(1,059)	
Issuance of common stock	3,548	242
Net cash provided by financing activities	2,367	154
Effect of exchange rate changes on cash and cash equivalents	906	756
Increase in cash and cash equivalents	3,732	49,681
Cash and cash equivalents at beginning of period	269,682	448,847
Cash and cash equivalents at end of period	$ 273,414	$ 498,528

The accompanying notes are an integral part of these Consolidated Financial Statements.

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LSI LOGIC CORPORATION

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

In the opinion of LSI Logic Corporation (the Company or LSI), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments and restructuring and other items, net as discussed in Note 5 to the Unaudited Consolidated Financial Statements, hereafter referred to as the Notes), necessary to present fairly the financial information included herein. While the Company believes that the disclosures are adequate to make the information not misleading, it is suggested that these financial statements be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

For financial reporting purposes, the Company reports on a 13 or 14-week quarter with a year ending December 31. The current quarter ended April 4, 2004. For presentation purposes, the consolidated financial statements refer to the calendar quarters for convenience. The results of operations for the quarter ended April 4, 2004, are not necessarily indicative of the results to be expected for the full year. The current quarter ended April 4, 2004 was a 14-week quarter while the same quarter of the previous year was a 13-week quarter.

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

Certain items previously reported in specific financial statement captions have been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (EITF) issued EITF Issue No. 03-06, Participating Securities and the Two-class Method Under FASB Statement No. 128, Earnings Per Share. EITF Issue No. 03-06 addresses a number of questions regarding the computation of earnings per share (EPS) by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. The issue also provides further guidance in applying the two-class method of calculating EPS. It clarifies what constitutes a participating security and how to apply the two-class method of computing EPS once it is determined that a security is participating, including how to allocate undistributed earnings to such a security. This pronouncement is effective for fiscal periods beginning after March 31, 2004. The Company does not believe that the adoption of this standard will have a material impact on its computation of EPS.

In March 2004, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 03-01, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. EITF No. 03-01 provides guidance on recording other-than-temporary impairments of cost method investments and requires additional disclosures for those investments. The recognition and measurement guidance in EITF No. 03-01 should be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. The disclosure requirements are effective for fiscal years ending after June 15, 2004 and are required only for annual periods. The Company does not believe that the adoption of this standard will have a material impact on its consolidated balance sheet or statement of operations.

In December 2003, the Financial Accounting Standards Board (FASB) released a revision to FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. A public entity shall apply the provisions of the FIN 46 revision no later than the end of the first reporting period that ends after March 15, 2004. However, a public entity shall apply FIN 46 to entities considered to be special-purpose entities no later than as of the end of the first reporting period that ends after December 15, 2003. The adoption of this standard did not have a material impact on the consolidated balance sheet or statement of operations.

NOTE 2 SEPARATION OF LSI LOGIC STORAGE SYSTEMS, INC.

On November 13, 2003, the Company announced its intention to separate its wholly-owned subsidiary, Engenio Information Technologies, Inc. (Engenio or Storage Systems segment), and create an independent storage systems company. Engenio was formerly referred to as LSI Logic Storage Systems, Inc. The Company has entered into agreements to implement this separation and to address various arrangements between Engenio and the Company. On February 19, 2004, Engenio filed a registration statement on Form S-1 (the Registration Statement) with the Securities and Exchange Commission (SEC). On March 31, 2004, Engenio filed Amendment No. 1 to the Registration Statement, and on May 10, 2004, Engenio filed Amendment No. 2 to the Registration Statement. The separation of Engenio from the Company, including the transfer of related assets, liabilities and intellectual property rights, was substantially completed in December 2003. At that time, the Company and Engenio entered into a Master Separation

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Agreement, General Assignment and Assumption Agreement, Intellectual Property Agreement, Employee Matters Agreement and an Indemnification and Insurance Matters Agreement as more fully described in the Company s Annual Report on Form 10-K. In March 2004, the Company and Engenio entered into the following additional agreements that further specify the terms of the separation.

Tax Sharing Agreement. The Tax Sharing Agreement sets forth the principal arrangements between the Company and Engenio regarding the filing of tax returns, the payment of taxes and the conduct of tax audits or disputes. The Tax Sharing Agreement provides that Engenio s stand-alone tax liability equals its taxable income multiplied by the highest corporate tax rate in effect for the year, modified by taking into account its losses and loss carryovers from prior years and, to the extent actually used, its credits. Engenio is obligated to pay the Company the amount of its stand-alone tax liability to the extent Engenio is included in any consolidated, combined or unitary tax return with the Company.

Under the Tax Sharing Agreement, the Company is required to prepare and file all consolidated, combined or unitary tax returns of the Company and Engenio through the date that Engenio ceases to be a member of the Company s consolidated or combined group, including the final consolidated federal income tax return. The Company has the right to review and consent to the federal and state income tax returns filed for the first tax year after Engenio ceases to be a member of the Company s consolidated group, which may not be withheld unreasonably. In addition, the Company has sole and complete authority to control and resolve all tax audits and other disputes relating to any consolidated, combined or unitary returns filed by the Company. However, the Company may not enter into any dispute settlement that would materially increase Engenio s liability under the Tax Sharing Agreement without Engenio s consent, which cannot be withheld unreasonably.

Transition Services Agreement. The Transition Services Agreement governs the provisions by the Company to Engenio of services such as finance, accounting and treasury, human resources, sales support, legal matters and information technology.

Real Estate Matters Agreement. The Real Estate Matters Agreement describes the manner in which the Company will transfer to or share with Engenio various properties leased and owned by the Company. The agreement provides that all reasonable costs required to effect the transfers, including landlord consent fees and landlord attorneys fees, will be paid by the Company.

Investor Rights Agreement. The Investor Rights Agreement provides for specified registration and other rights relating to the Company s ownership of Engenio s shares of Class B common stock.

The Company currently plans to receive the net proceeds of the offering from Engenio in the form of a dividend and settlement of payables owed to the Company. The Company may sell shares of Engenio s common stock in the public market or in private transactions, which may or may not include the sale of a controlling interest in Engenio.

The Company currently intends to distribute to its stockholders, by the summer of 2005, all remaining shares of Engenio s common stock held by the Company at such time. We will determine the timing, structure and all terms of the distribution, taking into account factors such as market conditions. Completion of the distribution would also be contingent upon the receipt of a favorable tax ruling from the Internal Revenue Service and/or a favorable opinion from the Company s tax advisor as to the tax-free nature of the distribution for U.S. federal income tax purposes. The Company is not obligated to undertake the distribution, and the distribution may or may not occur by the contemplated time or at all.

NOTE 3 BUSINESS COMBINATIONS

Acquisition of Velio Communications. On April 2, 2004, the Company acquired Velio Communications, Inc. (Velio). The acquisition will expand product offerings for high-speed interconnect and switch fabric application specific standard products (ASSPs) in the global communications market within the Semiconductor segment. The acquisition was accounted for as a purchase of a business.

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The Company paid approximately $19.8 million in cash ($2.2 million was paid in the first quarter, and the remainder was paid early in the second quarter of 2004). The Company will also issue approximately 100,000 restricted common shares to certain Velio employees hired as part of the transaction. Resulting deferred stock compensation will be amortized over a vesting period of two years using the straight-line method. The total purchase price was allocated to the estimated fair value of net assets acquired based on management estimates as follows:

	(In thousands)
Fair value of tangible net assets acquired	$ 1,783
Current technology	8,689
Customer base	8,689
Non-compete agreements	444
Existing purchase orders	200
Total purchase price excluding deferred stock compensation	19,805
Deferred stock compensation	1,000
Total purchase price	$20,805

Useful life of intangible assets. The amounts allocated to current technology, customer base, non-compete agreements and existing purchase orders are being amortized over their estimated useful lives of 9 months to 5.5 years using the straight-line method.

Pro forma statements of earnings information have not been presented because the effect of these acquisitions was not material either individually or on an aggregate basis.

NOTE 4 STOCK-BASED COMPENSATION

The following table provides pro forma disclosures as if the Company had recorded compensation costs based on the estimated grant date fair value, as defined by SFAS No. 123, for awards granted under its stock option and stock purchase plans. The estimated weighted-average grant date fair value, as defined by SFAS No. 123, was calculated using the Black-Scholes model. The Black-Scholes model was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company s stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated grant date fair value.

	Three months ended March 31,	
	2004	2003
	(In thousands, except per	

		share amounts)
Net income/(loss), as reported	$ 9,085	$ (122,425)
Add: Amortization of non-cash deferred stock compensation expense determined under the intrinsic value method as reported in net loss, net of related tax effects *	1,274	3,901
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(37,841)	(55,806)
Pro forma net loss **	$ (27,482)	$ (174,330)
Income/(loss) per share:		
Basic-as reported	$ 0.02	$ (0.33)
Basic-pro forma	$ (0.07)	$ (0.47)
Diluted-as reported	$ 0.02	$ (0.33)
Diluted-pro forma	$ (0.07)	$ (0.47)

* This amount excludes amortization of non-cash deferred stock compensation on restricted stock awards.

** The amount for the three months ended March 31, 2003 has been adjusted to reflect higher calculated fair values for the Employee Stock Purchase Plan, which resulted in a 2% increase in the pro forma net loss in the first quarter of 2003.

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NOTE 5 RESTRUCTURING AND OTHER ITEMS

The Company recorded a net gain of $0.6 million in restructuring of operations and other items during the first quarter of 2004, primarily in the Semiconductor segment. The Company recorded charges of $35.7 million for restructuring of operations and other items during the first quarter of 2003. For a complete discussion of the 2003 restructuring actions, please refer to the Company s Annual Report on Form 10-K.

Restructuring and impairment of long-lived assets:

First quarter of 2004:

The Company recorded a gain of $3.3 million on the sale of fixed assets that had previously been held for sale and an expense of $1.1 million for the abandonment of fixed assets that had previously been held for sale. In addition, an expense of $1.1 million was recorded for the write-down of fixed assets due to impairment.

An expense of $0.3 million was recorded to reflect the change in time value of accruals for facility lease termination costs, net of adjustments for changes in sublease assumptions for certain previously accrued facility lease termination costs. An expense of $0.2 million was recorded primarily for severance and termination benefits for four employees involved in research and development.

The fair values of impaired equipment, facilities and intangible assets were estimated by management. Given that current market conditions for the sale of older fabrication facilities and related equipment may fluctuate, there can be no assurance that the Company will realize the current net carrying value of the assets held for sale. The Company reassesses the realizability of the carrying value of these assets at the end of each quarter until the assets are sold or otherwise disposed of and additional adjustments may be necessary. Assets held for sale of $28 million and $30 million were included as a component of prepaid expenses and other current assets as of March 31, 2004 and December 31, 2003, respectively. Assets classified as held for sale are not depreciated.

The following table sets forth the Company s restructuring reserves as of March 31, 2004, which are included in other accrued liabilities on the balance sheet:

	Balance at December 31, 2003	**Restructuring Expense Q1 2004**	**Utilized during Q1 2004**	**Balance at March 31, 2004**
		(In thousands)		
Write-down of excess assets (a)	$ 2,661	$(1,118)	$ 718	$ 2,261
Lease terminations and maintenance contracts (b)	21,021	252	(1,886)	19,387
Facility closure and other exit costs (c)	2,136	64	(782)	1,418
Payments to employees for severance (d)	874	204	(767)	311
Total	$26,692	$ (598)	$(2,717)	$23,377

(a)

The amounts utilized in 2004 reflect $2.2 million of non-cash write-downs of long-lived assets in the U.S. due to impairment and $0.4 million in cash payments to decommission and sell assets, offset by $3.3 million realized gain on the sale of fixed assets previously held for sale. The write-downs of long-lived assets were accounted for as a reduction of the assets and did not result in a liability. The $2.3 million balance as of March 31, 2004, relates to machinery and equipment decommissioning costs in the U.S. and estimates of selling costs for assets held for sale and is expected to be utilized during 2004.

(b) Amounts utilized represent cash payments. The balance remaining for primarily real estate lease terminations and maintenance contracts will be paid during the remaining terms of these contracts, which extend through 2011.

(c) Amounts utilized represent cash payments. The balance remaining for facility closure and other exit costs will be paid during 2004.

(d) Amounts utilized represent cash severance payments to fourteen employees during the three months ended March 31, 2004. The balance remaining for severance is expected to be paid by the end of the second quarter of 2004.

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NOTE 6 INVESTMENTS

	March 31, 2004	December 31, 2003
	(In thousands)	
Available-for-sale debt securities		
Asset and mortgage-backed securities	$352,202	$345,625
U.S. government and agency securities	157,289	104,173
Corporate and municipal debt securities	71,401	90,730
Auction rate preferred stock	3,153	3,150
Foreign debt securities		329
Total short-term investments	$584,045	$544,007
Long-term investment in equity securities	$ 36,064	$ 35,455

An unrealized gain on available-for-sale securities of $7 million, net of the related tax effect of $4 million, and $8 million, net of the related tax effect of $4 million, was included in accumulated other comprehensive income as of March 31, 2004 and December 31, 2003, respectively. Net realized gains on sales of available-for-sale debt securities were $1 million and $7 million for the three months ended March 31, 2004 and 2003, respectively.

For the quarter ended March 31, 2004, the Company realized a net pre-tax loss of $1 million related to losses from investments in non-marketable equity securities associated with certain investments in equity securities because management believed the decline in value was other than temporary. As of March 31, 2004, the carrying value of equity securities impaired during the first quarter of 2004 was $3 million. There were no impairments related to investments in marketable available-for-sale equity securities during the quarter ended March 31, 2004. The Company realized a $3 million pre-tax gain associated with marketable available-for-sale equity securities of a certain technology company that was acquired by another technology company during the quarter ended March 31, 2004.

For the quarter ended March 31, 2003, the Company realized a net pre-tax loss of $3 million and $4 million associated with the decline in value of long-term investments in marketable and non-marketable equity securities, respectively. The decline in value was considered by management to be other than temporary. As of March 31, 2004, the carrying value of the non-marketable and marketable equity securities impaired during the first quarter of 2003 was $1 million and $4 million, respectively.

NOTE 7- DERIVATIVE FINANCIAL INSTRUMENTS

Foreign currency risk

The Company has foreign subsidiaries that operate and sell the Company s products in various global markets. As a result, the Company is exposed to changes in foreign currency exchange rates and interest rates. The Company utilizes various hedge instruments, primarily forward contracts and currency option contracts, to manage its exposure associated with firm intercompany and third-party transactions and net asset and liability positions denominated in non-functional currencies.

The Company enters into forward contracts that are designated as foreign currency cash-flow hedges of forecasted payments in euros. Changes in the fair value of the forward contracts due to changes in time value are excluded from the assessment of effectiveness and are recognized in interest income and other, net. As of March 31, 2004 and December 31, 2003, the Company held forward contracts designated as foreign currency cash flow hedges of forecasted euro payment transactions that were set to expire over nine-month and twelve-month periods, respectively. For the three months ended March 31, 2004, the change in time value of these forward contracts was not significant. As of March 31, 2004, unrealized losses included in accumulated other comprehensive income, which will be reclassified to the income statement over the next nine months, were not significant. There were no unrealized gains or losses included in accumulated other comprehensive income as of December 31, 2003. The expense for the three months ended March 31, 2004 and the benefit for three months ended March 31, 2003 reclassified to the income statement was not significant. The Company did not record any gains or losses due to hedge ineffectiveness for the three months ended March 31, 2004 and 2003.

Forward exchange contracts and options are also used to hedge certain foreign currency-denominated assets or liabilities. These derivatives do not qualify for SFAS No. 133 hedge accounting treatment. Accordingly, changes in the fair value of these hedges are recorded immediately in earnings to offset the changes in fair value of the assets or liabilities being hedged. The related gains and losses included in interest income and other, net were not significant.

Interest rate risk

With the objective of protecting cash flows and earnings of the Company from the impact of fluctuations in interest rates, while minimizing the cost of capital, the Company may enter into or terminate interest rate swaps, such as the below mentioned transactions.

In the second quarter of 2003, the Company entered into an interest rate swap transaction to effectively convert the LIBOR-based floating rate interest payments on the equipment operating leases discussed in Note 13 of the Notes, with an initial notional amount of $395 million, to a fixed interest rate (the Lease Swap). The Lease Swap qualifies to be accounted for as a cash flow hedge of the forecasted interest payments attributable to the benchmark interest rate on the equipment operating leases through September 2006. The unrealized gains or losses included in accumulated other comprehensive income will be reclassified to cost of revenues on a quarterly basis as lease payments are made. An unrealized loss of approximately $1 million, net of tax of $1 million was included in accumulated other comprehensive income as of March 31, 2004 and December 31, 2003, respectively, and is expected to be reclassified to cost of revenues within the next 12 months. The loss due to ineffectiveness recorded in interest income and other, net during the three months ended March 31, 2004 was not significant. Under the terms of the Lease Swap, the Company must provide collateral to match any mark-to-market exposure on the swap. As of March 31, 2004 and December 31, 2003, collateral of approximately $8 million was included in other long-term assets.

NOTE 8- BALANCE SHEET DETAIL

	March 31, 2004	**December 31, 2003**
	(In thousands)	
Cash and cash equivalents:		
Cash in financial institutions	$ 86,402	$ 108,989
Cash equivalents	187,012	160,693
	$273,414	$ 269,682
Inventories:		
Raw materials	$ 22,139	$ 15,352
Work-in-process	123,714	116,340
Finished goods	59,799	66,825
	$205,652	$ 198,517

Intangible assets, net of accumulated amortization:		
Semiconductor segment	$144,452	$137,230
Storage Systems segment	20,767	24,006
	$165,219	$161,236
Goodwill:		
Semiconductor segment	$888,114	$887,992
Storage Systems segment	80,633	80,491
	$968,747	$968,483

The Company monitors the recoverability of goodwill recorded in connection with acquisitions annually, or sooner if events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment, if any, would be determined in

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accordance with SFAS No. 142, which uses a fair value model for determining the carrying value of goodwill. See the Company s Annual Report on Form 10-K for further discussion.

NOTE 9 DEBT

	Maturity	Interest Rate *	Conversion Price	March 31, 2004	December 31, 2003
				(In thousands)	
2003 Convertible Subordinated Notes	2010	4.00%	$13.4200	$350,000	$350,000
2001 Convertible Subordinated Notes	2006	4.00%	$26.3390	490,000	490,000
Deferred gain on terminated swap				21,748	25,416
Capital lease obligations				445	567
				862,193	865,983
Current portion of long-term debt and capital lease obligations				(380)	(377)
Long-term debt and capital lease obligations				$861,813	$865,606