

INDEPENDENT AUDITOR'S REPORT

The Board of Directors and Stockholders of Advanced Energy Industries, Inc.:

We have audited the accompanying consolidated balance sheet of Advanced Energy Industries, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2002 and the related consolidated statements of operations, stockholders' equity and cash flows for the year then ended. In connection with our audit of the 2002 consolidated financial statements, we also have audited the 2002 financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audit. The financial statements of Advanced Energy Industries, Inc. and subsidiaries as of December 31, 2001 and for each of the two years in the period ended December 31, 2001 were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements, before the revision described in Note 1 to the financial statements, in their report dated February 28, 2002.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2002 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Advanced Energy Industries, Inc. and subsidiaries as of December 31, 2002, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related 2002 financial statement schedule, when considered in relation to the basic 2002 consolidated financial statements taken as a whole presents fairly, in all material respects, the information set forth therein.

As discussed in Notes 1 and 2 to the consolidated financial statements, Advanced Energy Industries, Inc. and subsidiaries adopted the provisions of Statements of Financial Accounting Standards No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets," effective January 1, 2002.

As discussed above, the consolidated balance sheet of Advanced Energy Industries, Inc. and subsidiaries as of December 31, 2001, and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 2001 and 2000, were audited by other auditors who have ceased operations. As described in Note 1, the consolidated financial statement as of December 31, 2001 and for each of the fiscal years ended December 31, 2001 and 2000 have been revised to include the transitional disclosures required by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," which was adopted by the Company as of January 1, 2002. In our opinion, the disclosures for 2001 and 2000 in Note 1 are appropriate. However, we were not engaged to audit, review, or apply any procedures to the 2001 and 2000 financial statements of the Company other than with respect to such disclosures and, accordingly, we do not express an opinion or any other form of assurance on the 2001 and 2000 consolidated financial statements taken as a whole.

KPMG LLP

Denver, Colorado,
February 11, 2003

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To Advanced Energy Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Advanced Energy Industries, Inc. (a Delaware corporation) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These consolidated financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Advanced Energy Industries, Inc. and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in the index to consolidated financial statements is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSEN LLP

Denver, Colorado,
February 28, 2002.

The report of Arthur Andersen LLP (Andersen) is a copy of a report previously issued by Andersen on February 28, 2002. The report has not been reissued by Andersen nor has Andersen consented to its inclusion in this Annual Report on Form 10-K. The Andersen report refers to consolidated balance sheet as of December 31, 2000, and the consolidated statements of operations, stockholders' equity and cash flows for the year ended December 31, 1999 which are no longer included in the accompanying financial statements.

CONSOLIDATED BALANCE SHEETS

	December 31,	
(In thousands)	2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 70,188	\$ 81,955
Marketable securities – available-for-sale	102,159	190,023
Accounts receivable –		
Trade (less allowances for doubtful accounts of approximately \$3,056 and \$1,049 at December 31, 2002 and 2001, respectively)	40,797	26,871
Other	3,088	3,941
Income tax receivable	14,720	15,862
Inventories	57,306	44,413
Other current assets	6,828	4,178
Deferred income tax assets, net	17,510	11,200
Total current assets	312,596	378,443
Property and equipment , at cost, net of accumulated depreciation of \$43,109 and \$31,946 at December 31, 2002 and 2001, respectively	41,178	31,095
Other assets:		
Deposits and other	5,181	6,482
Goodwill and intangibles, net of accumulated amortization of \$11,212 and \$5,789 at December 31, 2002 and 2001, respectively	86,601	23,072
Demonstration and customer service equipment, net of accumulated amortization of \$7,698 and \$4,507 at December 31, 2002 and 2001, respectively	6,086	5,367
Deferred debt issuance costs, net	4,091	5,736
	101,959	40,657
Total assets	\$455,733	\$450,195

The accompanying notes to consolidated financial statements are an integral part of these consolidated balance sheets.

	December 31,	
(In thousands, except per share data)	2002	2001
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	\$ 16,055	\$ 10,231
Accrued payroll and employee benefits	9,348	6,978
Accrued warranty expense	9,402	4,471
Accrued restructuring charges	5,989	1,427
Other accrued expenses	4,573	1,387
Acquisition related escrow	1,675	—
Customer deposits	77	515
Capital lease obligations, current portion	691	6
Notes payable, current portion	14,506	1,124
Accrued interest payable on convertible subordinated notes	2,338	2,696
Total current liabilities	64,654	28,835
Long-term liabilities:		
Capital leases, net of current portion	669	—
Senior borrowings	9,996	—
Deferred income tax liabilities, net	8,663	415
Convertible subordinated notes payable	187,718	206,600
Other long-term liabilities	694	—
	207,740	207,015
Total liabilities	272,394	235,850
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding	—	—
Common stock, \$0.001 par value, 70,000 and 55,000 shares authorized; 32,140 and 31,848 shares issued and outstanding at December 31, 2002 and 2001, respectively	32	32
Additional paid-in capital	138,429	131,698
Retained earnings	44,193	85,592
Deferred compensation	(542)	(1,094)
Unrealized holding (losses) gains on available-for-sale securities	(33)	1,257
Cumulative translation adjustments	1,260	(3,140)
Total stockholders' equity	183,339	214,345
Total liabilities and stockholders' equity	\$455,733	\$450,195

The accompanying notes to consolidated financial statements are an integral part of these consolidated balance sheets.

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
(In thousands, except per share amounts)	2002	2001	2000
Sales	\$238,898	\$193,600	\$359,782
Cost of sales	170,138	136,168	183,329
Gross profit	68,760	57,432	176,453
Operating expenses:			
Research and development	48,995	45,151	36,996
Sales and marketing	34,940	23,784	24,101
General and administrative	30,533	21,522	24,573
Litigation damages and expenses (recovery)	5,313	(1,500)	—
Restructuring charges	9,060	3,070	1,000
Impairment of goodwill and other intangible assets	1,904	5,446	—
Impairment of investments and advances	—	6,846	—
Merger costs	—	—	4,583
Total operating expenses	130,745	104,319	91,253
(Loss) income from operations	(61,985)	(46,887)	85,200
Other income (expense):			
Interest income	3,314	6,581	10,727
Interest expense	(12,460)	(7,399)	(7,698)
Foreign currency gain (loss)	5,280	(235)	(196)
Other (expense) income, net	(2,064)	(1,025)	4,652
	(5,930)	(2,078)	7,485
Net (loss) income before income taxes, minority interest and extraordinary item	(67,915)	(48,965)	92,685
(Benefit) provision for income taxes	(23,877)	(17,441)	32,241
Minority interest in net (loss) income	—	(145)	20
Net (loss) income before extraordinary item	(44,038)	(31,379)	60,424
Extraordinary item (less applicable income taxes of \$1,584 and \$4,566)	2,639	—	7,610
Net (loss) income	\$ (41,399)	\$ (31,379)	\$ 68,034
Net (loss) earnings per share before extraordinary item:			
Basic	\$ (1.38)	\$ (0.99)	\$ 1.93
Diluted	\$ (1.38)	\$ (0.99)	\$ 1.86
Earnings per share from extraordinary item:			
Basic	\$ 0.09	\$ —	\$ 0.24
Diluted	\$ 0.09	\$ —	\$ 0.24
Net (loss) earnings per share:			
Basic	\$ (1.29)	\$ (0.99)	\$ 2.17
Diluted	\$ (1.29)	\$ (0.99)	\$ 2.10
Basic weighted-average common shares outstanding	32,026	31,712	31,336
Diluted weighted-average common shares outstanding	32,026	31,712	32,425

The accompanying notes to consolidated financial statements are an integral part of these consolidated statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the years ended December 31, 2002, 2001, and 2000							
(In thousands)	Common Stock		Additional	Retained	Deferred	Accumulated	Total
	Shares	Amount	Paid-in Capital	Earnings	Compensation	Other Comprehensive (Loss) Income	Stockholders' Equity
BALANCES, December 31, 1999	30,981	\$31	\$108,997	\$ 48,937	\$ (86)	\$ (890)	\$156,989
Exercise of stock options for cash	488	1	4,393	—	—	—	4,394
Issuance of common stock for services provided and merger costs	55	—	2,430	—	—	—	2,430
Sale of common stock through employee stock purchase plan	13	—	520	—	—	—	520
Tax benefit related to shares acquired by employees under stock compensation plans	—	—	6,595	—	—	—	6,595
Deferred compensation on stock options issued	—	—	1,995	—	(1,995)	—	—
Amortization of deferred compensation	—	—	—	—	461	—	461
Comprehensive income:							
Equity adjustment from foreign currency translation	—	—	—	—	—	(1,990)	—
Unrealized holding gains	—	—	—	—	—	1,365	—
Net income	—	—	—	68,034	—	—	—
Total comprehensive income	—	—	—	—	—	—	67,409
BALANCES, December 31, 2000	31,537	32	124,930	116,971	(1,620)	(1,515)	238,798
Exercise of stock options for cash	273	—	3,342	—	—	—	3,342
Sale of common stock through employee stock purchase plan	38	—	628	—	—	—	628
Tax benefit related to shares acquired by employees under stock compensation plans	—	—	1,588	—	—	—	1,588
Fair value of stock options assumed in EMCO acquisition	—	—	1,126	—	—	—	1,126
Deferred compensation on stock options issued	—	—	84	—	(84)	—	—
Amortization of deferred compensation	—	—	—	—	610	—	610
Comprehensive income:							
Equity adjustment from foreign currency translation	—	—	—	—	—	(260)	—
Unrealized holding losses	—	—	—	—	—	(108)	—
Net loss	—	—	—	(31,379)	—	—	—
Total comprehensive loss	—	—	—	—	—	—	(31,747)
BALANCES, December 31, 2001	31,848	32	131,698	85,592	(1,094)	(1,883)	214,345
Exercise of stock options for cash	118	—	1,389	—	—	—	1,389
Issuance of common stock for acquisition of minority interest of LITMAS	120	—	4,219	—	—	—	4,219
Sale of common stock through employee stock purchase plan	54	—	689	—	—	—	689
Tax benefit related to shares acquired by employees under stock compensation plans	—	—	468	—	—	—	468
Amortization of deferred compensation	—	—	—	—	518	—	518
Adjustment for forfeited options	—	—	(34)	—	34	—	—
Comprehensive income:							
Equity adjustment from foreign currency translation	—	—	—	—	—	4,400	—
Unrealized holding losses	—	—	—	—	—	(2,641)	—
Less: reclassification adjustment for amounts included in net loss	—	—	—	—	—	1,351	—
Net loss	—	—	—	(41,399)	—	—	—
Total comprehensive loss	—	—	—	—	—	—	(38,289)
BALANCES, December 31, 2002	32,140	\$32	\$138,429	\$44,193	\$ (542)	\$ 1,227	\$183,339

The accompanying notes to consolidated financial statements are an integral part of these consolidated statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31,		
	2002	2001	2000
Cash flows from operating activities:			
Net (loss) income	\$ (41,399)	\$ (31,379)	\$ 68,034
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities -			
Depreciation of property and equipment	13,411	9,973	7,564
Amortization of intangibles and demonstration and customer service equipment	8,059	5,930	2,942
Amortization of deferred debt issuance costs	1,301	775	616
Amortization of deferred compensation	518	610	461
Minority interest	—	(145)	17
Stock issued for services rendered and merger costs	—	—	2,430
Benefit for deferred income taxes	(6,888)	(3,579)	(3,730)
Provision for excess and obsolete inventory	5,803	6,412	654
Impairment of goodwill and other intangible assets	1,904	5,446	—
Impairment of investment	—	6,846	—
Impairment of property and equipment	1,618	—	—
Impairment of marketable security	1,544	—	—
Provision for doubtful accounts	1,870	282	145
Unrealized loss on foreign currency forward contracts	388	—	—
Loss (gain) on disposal of property and equipment	359	13	(54)
Gain on sale of investment	—	—	(4,841)
Gain on retirement of convertible subordinated notes	(4,223)	—	(12,176)
Unrealized gain on intercompany foreign currency loan	(4,879)	—	—
Changes in operating assets and liabilities, net of assets and liabilities acquired—			
Accounts receivable-trade	(5,067)	44,972	(28,225)
Other receivables	1,386	(128)	(1,994)
Inventories	3,021	(5,484)	(17,510)
Other current assets	(2,232)	(1,752)	(705)
Deposits and other	(901)	(180)	(502)
Demonstration and customer service equipment	(2,859)	(2,754)	(1,282)
Trade accounts payable	2,366	(5,528)	2,073
Accrued payroll and employee benefits	(292)	(5,099)	4,117
Accrued warranty expense	4,896	496	2,528
Accrued restructuring charges	4,562	952	475
Customer deposits and other accrued expenses	(179)	3,134	(970)
Income taxes payable/receivable, net	608	(21,949)	14,631
Net cash (used in) provided by operating activities	(15,305)	7,864	34,698
Cash flows from investing activities:			
Purchase of marketable securities	(2,499)	(64,925)	(19,471)
Sale of marketable securities	90,439	33,312	48,100
Proceeds from sale of investment	—	—	4,464
Proceeds from sale of equipment	350	—	150
Purchase of property and equipment	(10,714)	(12,435)	(14,062)
Purchase of investments and advances	(2,781)	(7,186)	(3,453)
Acquisition of Aera Japan Limited, net of cash acquired	(35,689)	—	—
Acquisition of Dressler HF Technik GmbH, net of cash acquired	(14,395)	—	—
Acquisition of interest in LITMAS, net of cash acquired	(400)	—	(250)
Acquisition of Engineering Measurements Company, net of cash acquired	—	(29,932)	—
Net cash provided by (used in) by investing activities	24,311	(81,166)	15,478

(In thousands)	Years Ended December 31,		
	2002	2001	2000
Cash flows from financing activities:			
Proceeds from notes payable	—	837	1,491
Repayment of notes payable and capital lease obligations	(10,190)	(1,973)	(3,123)
Proceeds from convertible debt, net	—	121,250	—
Repurchase of convertible debt, net	(14,522)	—	(40,795)
Sale of common stock through employee stock purchase plan	689	628	520
Proceeds from exercise of stock options and warrants	1,389	3,342	4,394
Net cash (used in) provided by financing activities	(22,634)	124,084	(37,513)
Effect of currency translation on cash	1,861	(543)	(1,990)
(Decrease) increase in cash and cash equivalents	(11,767)	50,239	10,673
Cash and cash equivalents, beginning of year	81,955	31,716	21,043
Cash and cash equivalents, end of year	\$ 70,188	\$ 81,955	\$ 31,716
Supplemental disclosure of non-cash investing and financing activities:			
Tax benefit related to shares acquired by employees under stock option plans	\$ 468	\$ 1,588	\$ 6,595
Deferred compensation on stock options issued	\$ —	\$ 84	\$ 1,995
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$ 11,517	\$ 4,457	\$ 7,385
Cash (received) paid for income taxes, net	\$ (16,086)	\$ 9,572	\$ 25,791

The accompanying notes to consolidated financial statements are an integral part of these consolidated statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 COMPANY OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Advanced Energy Industries, Inc. (the “Company”), a Delaware corporation, is primarily engaged in the development and production of components and subsystems critical to plasma-based manufacturing processes, which are used by manufacturers of semiconductors and in industrial thin-film manufacturing processes. The Company owns 100% of each of the following subsidiaries: Advanced Energy Japan K.K. (“AE-Japan”), Advanced Energy Industries GmbH (“AE-Germany”), Advanced Energy Industries U.K. Limited (“AE-UK”), Advanced Energy Industries Korea, Inc. (“AE-Korea”), Advanced Energy Taiwan, Ltd. (“AE-Taiwan”), Advanced Energy Industries (ShenZhen) Co., Ltd. and Advanced Energy Industries (Shanghai) Co., Ltd., collectively (“AE-China”) and Sekidenko, Inc. (“Sekidenko”).

On January 18, 2002, the Company acquired 100% of Aera Japan, Ltd. (“Aera”), a privately held Japanese corporation. Aera supplies digital, pressure-based and liquid mass flow controllers, ultrasonic liquid flow meters and liquid vapor delivery systems to the semiconductor capital equipment industry.

On March 28, 2002, the Company acquired 100% of Dressler HF Technik GmbH (“Dressler”), a privately held Germany-based provider of power supplies and matching networks.

Prior to 2002, the Company also owned 100% of the following subsidiaries: Noah Holdings, Inc. (“Noah”), Advanced Energy Voorhees, Inc. (“AEV”), Tower Electronics, Inc. (“Tower”) and Engineering Measurements Company (“EMCO”), as well as 59.5% of LITMAS. As discussed in Note 2, Noah was merged into the Company on April 6, 2000, Sekidenko was merged into the Company on August 18, 2000, EMCO was merged into the Company on January 2, 2001, Aera was merged into a subsidiary of the Company on January 18, 2002, and Dressler was merged into a subsidiary of the Company on March 28, 2002. The Company completed its acquisition of the 40.5% of LITMAS that it did not previously own on April 2, 2002.

During 2002, AEV, Tower, Noah, EMCO and LITMAS were combined with and into the Company, and Aera was combined with and into AE-Japan. Through AE-Japan, the Company owns 100% of each of the following subsidiaries: Aera Corporation, Aera U.K. Ltd., Aera GmbH and Aera Korea Ltd.

The acquisitions of Noah and Sekidenko were accounted for as poolings of interest under Accounting Principles Board Opinion No. 16. Accordingly, all prior period consolidated financial statements have been restated to include Noah and Sekidenko as though they had always been part of the Company. The acquisitions of LITMAS, Aera, Dressler

and EMCO were accounted for under the purchase method of accounting, and the results of operations of LITMAS, Aera, Dressler and EMCO are included since their respective acquisition dates. These acquisitions are discussed in more detail in Note 2.

The Company is subject to many risks, some of which are similar to other companies in its industry. These risks include significant fluctuations of quarterly operating results, the volatility of the semiconductor and semiconductor capital equipment industries, customer concentration within the markets the Company serves, manufacturing and facilities risks, recent and potential future acquisitions, management of growth, supply constraints and dependencies, dependence on design wins, barriers to obtaining new customers, the high level of customized designs, rapid technological changes, competition, international operating risks, intellectual property rights, governmental regulations, dependence on key personnel and the volatility of the market price of the Company’s common stock. A significant change in any of these or other risk factors could have a material impact on the Company’s business.

BASIS OF PRESENTATION— The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements are stated in U.S. dollars and are prepared in accordance with accounting principles generally accepted in the United States of America.

CASH AND CASH EQUIVALENTS— For purposes of reporting cash flows, the Company considers all amounts on deposit with financial institutions and highly liquid investments with an original maturity of 90 days or less to be cash and cash equivalents.

MARKETABLE SECURITIES— The Company has investments in marketable equity securities and municipal bonds, which have original maturities of 90 days or more. In accordance with Statement of Financial Accounting Standards (“SFAS”) No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” the investments are classified as available-for-sale securities and reported at fair value with unrealized gains and losses included in other comprehensive income. Due to the short-term, highly liquid nature of the marketable securities held by the Company, the cost, including accrued interest of such investments, is typically the same as their fair value.

The Company also has investments in marketable equity securities which have been included with deposits and other in the accompanying consolidated balance sheets. In accor-

dance with SFAS No. 115, these investments are classified as available-for-sale securities and reported at fair value with unrealized holding gains and losses included in other comprehensive income. During the fourth quarter of 2002, the fair value of these securities continued a substantial decline such that management determined the decline was other than temporary. As a result the Company recorded an impairment of approximately \$1.5 million, which is included in other expense in the accompanying consolidated statements of operations. As of February 11, 2003, the value of this investment has declined an additional \$675,000. If the fair value of this investment does not return to its December 31, 2002 carrying value by the end of the first quarter of 2003, the Company will record an additional impairment in the first quarter of 2003.

INVENTORIES — Inventories include costs of materials, direct labor and manufacturing overhead. Inventories are valued at the lower of market or cost, computed on a first-in, first-out basis and are presented net of reserves for obsolete and excess inventory. Inventory is written down or written off when it becomes obsolete, generally because of engineering changes to a product or discontinuance of a product line, or when it is deemed excess. These determinations involve the exercise of significant judgment by management, and as demonstrated in recent periods, demand for the Company's products is volatile and changes in expectations regarding the level of future sales can result in substantial charges against earnings for obsolete and excess inventory.

PROPERTY AND EQUIPMENT — Property and equipment is stated at cost or estimated fair value upon acquisition. Additions, improvements, and major renewals are capitalized. Maintenance, repairs, and minor renewals are expensed as incurred.

Depreciation is provided using the straight-line method over three to ten years for machinery, equipment, furniture and fixtures, with computers and communication equipment depreciated over a three-year life. Amortization of leasehold improvements and leased equipment is provided using the straight-line method over the life of the lease term or the estimated useful life of the assets, whichever period is shorter.

DEMONSTRATION AND CUSTOMER SERVICE EQUIPMENT — Demonstration and customer service equipment are manufactured products that are utilized for sales demonstration and evaluation purposes. The Company also utilizes this equipment in its customer service function as replacement and loaner equipment to existing customers.

The Company depreciates this equipment based on its estimated useful life. Depreciation is computed based on a three-year life.

GOODWILL AND INTANGIBLES — The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002. SFAS No. 142 established new standards for accounting for goodwill and other intangibles acquired in business combinations. Goodwill continues to be recognized as an asset, but is no longer amortized as previously required by Accounting Principles Board ("APB") Opinion No. 17, "Intangible Assets." Certain other intangible assets with indefinite lives, if present, may also not be amortized. Instead, goodwill and other intangible assets are subject to periodic (at least annual) tests for impairment. The impairment testing is performed in two steps: (i) the Company assesses goodwill for a potential impairment loss by comparing the fair value of a reporting unit with its carrying value, and (ii) if an impairment is indicated by a reporting unit whose fair value is less than its carrying amount, the Company measures the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill.

In accordance with SFAS No. 142, the Company ceased amortizing goodwill on January 1, 2002, and reassessed its goodwill and other intangible assets. The Company determined that the classifications it made and the useful lives it assigned were appropriate for the goodwill and amortizable intangibles it held as of December 31, 2001.

In the fourth quarter of 2002, the Company completed its evaluation of the goodwill and intangible assets recorded as a result of the acquisitions of Aera, which it acquired on January 18, 2002, Dressler, which it acquired on March 28, 2002, and the acquisition of the minority interest of LIT-MAS, which it acquired on April 2, 2002. In the fourth quarter of 2002, the Company also performed its annual goodwill impairment test, and concluded that because the estimated fair value of the Company's reporting units exceeded their carrying amounts, no impairment of goodwill was indicated. Intangible assets are separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the asset can be sold, rented, transferred, licensed, or exchanged, regardless of the Company's intent to do so. Amortization expense and net (loss) income for the Company for the year of initial application and prior two years follow:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Years Ended December 31,		
	2002	2001	2000
Goodwill amortization, net of taxes	\$ —	\$ (3,900)	\$ (1,355)
Impairment of goodwill	—	(5,446)	—
Net (loss) income before extraordinary item	(44,038)	(31,379)	60,424
Extraordinary item, net of tax	2,639	—	7,610
Net (loss) income	\$ (41,399)	\$ (31,379)	\$ 68,034

The following table presents adjusted net (loss) income and earnings per share data restated to include the retroactive impact of the adoption of SFAS No. 142:

(In thousands)	Years Ended December 31,		
	2002	2001	2000
Net (loss) income before extraordinary items	\$ (44,038)	\$ (31,379)	\$ 60,424
Add back: Impact of goodwill amortization, net of taxes	—	3,900	1,355
Adjusted net (loss) income before extraordinary items	(44,038)	(27,479)	61,779
Extraordinary items, net of tax	2,639	—	7,610
Adjusted net (loss) income	\$ (41,399)	\$ (27,479)	\$ 69,389
Net (loss) income per share before extraordinary items:			
Basic	\$ (1.38)	\$ (0.99)	\$ 1.93
Diluted	\$ (1.38)	\$ (0.99)	\$ 1.86
Add back: Impact of goodwill amortization, net of taxes:			
Basic	\$ —	\$ 0.12	\$ 0.04
Diluted	\$ —	\$ 0.12	\$ 0.04
Adjusted net (loss) income per share before extraordinary items:			
Basic	\$ (1.38)	\$ (0.87)	\$ 1.97
Diluted	\$ (1.38)	\$ (0.87)	\$ 1.90
Earnings per share from extraordinary items:			
Basic	\$ 0.09	\$ —	\$ 0.24
Diluted	\$ 0.09	\$ —	\$ 0.24
Adjusted net (loss) income per share:			
Basic	\$ (1.29)	\$ (0.87)	\$ 2.21
Diluted	\$ (1.29)	\$ (0.87)	\$ 2.14

GOODWILL AND INTANGIBLES consisted of the following as of December 31, 2001:

(In thousands, except weighted-average useful life)	Gross Carrying Amount	Accumulated Amortization	Effect of Changes in Exchange Rates	Net Carrying Amount	Weighted-average Useful Life
Amortizable intangibles:					
Technology-based	\$ 2,404	\$ (299)	\$ —	\$ 2,105	7
Contract-based	3,860	(2,164)	—	1,696	6
Total amortizable intangibles	6,264	(2,463)	—	3,801	6
Goodwill	22,597	(3,326)	—	19,271	
Total goodwill and intangibles	\$ 28,861	\$ (5,789)	\$ —	\$23,072	

GOODWILL AND INTANGIBLES consisted of the following as of December 31, 2002:

(In thousands, except weighted-average useful life)	Gross Carrying Amount	Accumulated Amortization	Effect of Changes in Exchange Rates	Net Carrying Amount	Weighted-average Useful Life
Amortizable intangibles:					
Technology-based	\$ 9,378	\$ (3,715)	\$ 937	\$ 6,600	6
Contract-based	9,210	(3,634)	936	6,512	4
Other	8,500	(537)	1,298	9,261	17
Total amortizable intangibles	27,088	(7,886)	3,171	22,373	10
Goodwill	61,955	(3,326)	5,599	64,228	
Total goodwill and intangibles	\$ 89,043	\$(11,212)	\$8,770	\$86,601	

Aggregate amortization expense related to goodwill and other intangibles for the years ended December 31, 2002, 2001 and 2000, was \$5.5 million, \$4.9 million and \$2.2 million, respectively. Estimated amortization expense related to acquired intangibles for each of the five years 2003 through 2007 is as follows:

(In thousands)	
2003	\$4,179
2004	4,179
2005	4,179
2006	2,327
2007	1,103

CONCENTRATIONS OF CREDIT RISK— Financial instruments, which potentially subject the Company to credit risk include cash and trade accounts receivable. The Company maintains cash and cash equivalents, investments, and certain other financial instruments with various major financial institutions. The Company performs periodic evaluations of the relative credit standing of these financial institutions and limits the amount of credit exposure with any one institution. The Company's customers generally are concentrated in the semiconductor capital equipment industry. As a result the Company is generally exposed to credit risk associated with this industry. Sales by the Company's

foreign subsidiaries are primarily denominated in currencies other than the U.S. dollar. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information.

WARRANTY POLICY — The Company offers warranty coverage for its products for periods ranging from 12 to 36 months after shipment, with the majority of its products ranging from 18 to 24 months. The Company estimates the anticipated costs of repairing products under warranty based on the historical cost of the repairs and expected failure rates. The assumptions used to estimate warranty accruals are reevaluated periodically in light of actual experience and, when appropriate, the accruals are adjusted. The Company's determination of the appropriate level of warranty accrual is subjective and based on estimates. The industries in which the Company operates are subject to rapid technological change and as a result, the Company periodically introduces newer, more complex products, which tend to result in increased warranty costs. Estimated warranty costs are recorded at the time of sale of the related product, and are considered a cost of sales.

FOREIGN CURRENCY TRANSLATION — The functional currency of the Company's foreign subsidiaries is their local currency. Assets and liabilities of international sub-

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

subsidiaries are translated to U.S. dollars at yearend exchange rates, and income statement activity and cash flows are translated at average exchange rates during the year. Resulting translation adjustments are recorded as a separate component of equity.

Transactions denominated in currencies other than the local currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in foreign currency transaction gains and losses which are reflected in income as unrealized (based on period-end translation) or realized (upon settlement of the transactions). Unrealized transaction gains and losses applicable to permanent investments by the Company in its foreign subsidiaries are included as cumulative translation adjustments, and unrealized translation gains or losses applicable to non-permanent intercompany receivables from or payables to the Company and its foreign subsidiaries are included in income.

During the year ended December 31, 2002, the Company recorded a net foreign currency gain of approximately \$5.3 million, the majority of which was related to an intercompany loan of Japanese yen, which was settled subsequent to December 31, 2002, that Advanced Energy U.S. made to its subsidiary AE-Japan (which has a functional currency of yen) for the purpose of effecting the acquisition of Aera. The loan was transacted in the first quarter of 2002, for approximately 5.7 billion yen (approximately \$44 million based upon an exchange rate of approximately 130:1). During the year, the U.S. dollar weakened significantly against the yen to approximately 119:1, resulting in a gain of \$4.9 million. In July and September 2002, the Company entered into foreign currency forward contracts with its primary bank to substantially mitigate the effects of potential future currency fluctuations between the dollar and the yen until the associated intercompany obligations were settled (see Derivative Instruments below).

The Company recognized losses on foreign currency transactions of approximately \$235,000 and \$196,000 for the years ended December 31, 2001 and 2000, respectively.

REVENUE RECOGNITION — The Company recognizes revenue upon shipment of its products and spare parts, at which time title passes to the customer, as its shipping terms are FOB shipping point, the price is fixed and collectibility is reasonably assured. The Company does not generate revenue from the installation of its products.

In certain instances the Company requires its customers to pay for a portion or all of their purchases prior to the Company building or shipping these products. Cash payments received prior to shipment are recorded as customer deposits in the accompanying balance sheets, then recog-

nized as revenue upon shipment of the products. The Company does not offer price protections to its customers or allow returns, unless covered by the Company's normal policy for repair of defective products.

The Company has an arrangement with one of its major customers, a semiconductor capital equipment manufacturer, in which completed products are shipped to the customer and held by them in their warehouse. The customer draws products from this inventory as needed, at which time title passes to the customer and the Company recognizes revenue. The customer is subject to the Company's normal warranty policy for repair of defective products.

In certain instances the Company delivers products to customers for evaluation purposes. In these arrangements, the customer retains the products for specified periods of time without commitment to purchase. On or before the expiration of the evaluation period, the customer either rejects the product, and returns it to the Company, or accepts the product. Upon acceptance, title passes to the customer, the Company invoices the customer for the product, and revenue is recognized. Pending acceptance by the customer, such products are reported on the Company's balance sheet at an estimated value based on the lower of cost or market, and are included in the amount for demonstration and customer service equipment, net of accumulated depreciation.

INCOME TAXES — The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 requires deferred tax assets and liabilities to be recognized for temporary differences between the tax basis and financial reporting basis of assets and liabilities, computed at current tax rates, as well as for the expected tax benefit of net operating loss and tax credit carryforwards. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized.

RESTRUCTURING COSTS — Restructuring charges include the costs associated with actions taken by the Company in response to the continuing downturn in the semiconductor capital equipment industry and in response to changes in the Company's strategy. These charges consist of costs that are incremental to the Company's ongoing operations, and are incurred to exit an activity or cancel an existing contractual obligation, including closure of facilities and employee termination related charges. Other related costs, consisting primarily of employee relocation, are expensed as incurred.

The Company recorded restructuring charges totaling \$9.1 million in 2002, primarily associated with changes in operations designed to reduce redundancies and better align the

Company's Aera mass flow controller business within its operating framework. The Company's restructuring plans and associated costs consisted of \$6.0 million to close and consolidate certain manufacturing facilities, and \$3.1 million for related headcount reductions of approximately 223 employees.

The employee termination costs of \$3.1 million included severance benefits. All terminations and termination benefits were communicated to the affected employees prior to the accrual of the related charges. The affected employees were all part of the Company's U.S. operations and included full-time permanent and temporary employees, and consisted primarily of manufacturing and administrative personnel.

Included is the closure of the Company's AEV manufacturing facilities, due to the transfer of the manufacturing of these products to Fort Collins, Colorado, and the closure of a manufacturing facility in Fort Collins, expected to be completed by the third quarter of 2003; the closure of EMCO's manufacturing facilities (see Long-Lived Assets below) due to the transfer of the manufacturing of these products to Fort Collins, Colorado and Shenzhen, China, expected to be completed by the third quarter of 2003; and the closure of LIT-MAS expected to be completed by the first quarter of 2003. During the fourth quarter of 2002, the Company closed its San Jose, California sales and service location; and the Company's Austin, Texas manufacturing facility for the Aera-brand mass flow controller products, due to the transfer of the manufacturing of these products to Hachioji, Japan, to be co-located with Aera Japan Limited. These costs consist primarily of payments required under operating lease contracts and costs for writing down related leasehold improvements.

At December 31, 2002, outstanding liabilities related to the 2002 restructuring charges were approximately \$6.0 million, and were reported on the consolidated balance sheet.

In response to the downturn in the semiconductor capital equipment industry and the global economy, the Company recorded approximately \$3.1 million of restructuring charges in 2001. The Company's restructuring plans and associated costs consisted of \$2.1 million to terminate 330 employees and \$946,000 to close three facilities. These costs were recorded in the accompanying consolidated statements of operations as restructuring charges as a component of operating expenses.

The employee termination costs of \$2.1 million included severance benefits. All terminations and termination benefits were communicated to the affected employees prior to December 31, 2001, and the Company paid the severance benefits in full in 2002. The affected employees were all part of the Company's U.S. operations and included full-time permanent and temporary employees, and consisted primarily of manufacturing and administrative personnel.

The facility related costs of \$946,000 resulted from the phase out of the Company's Austin, Texas manufacturing facility to begin outsourcing the assembly of certain DC power products; the transition of its Voorhees, New Jersey facility from a manufacturing site to a design center; and the closure of Noah's manufacturing and office facilities in San Jose, California, due to the transfer of Noah's manufacturing to Vancouver, Washington, to be co-located with Sekidenko. These costs accrued reflect payments required under operating lease contracts and costs for writing down related leasehold improvements of facilities.

At December 31, 2001, outstanding liabilities related to the 2001 restructuring charges were approximately \$1.3 million, and were reported on the consolidated balance sheet.

The Company also recorded a \$1.0 million restructuring charge in 2000 related to the termination of employees associated with Tower in Fridley, Minnesota, and charges related to closing that facility, resulting from the relocation of Tower's operations to the Company's facility in Voorhees, New Jersey. This restructuring was completed in the fourth quarter of 2000.

The following table summarizes the components of the restructuring charges, the payments and non-cash charges, and the remaining accrual as of December 31, 2002:

(In thousands)	Employee Severance & Termination Costs	Facility Closure Costs	Total Restructuring Charges
2000 restructuring charges	\$ 681	\$ 319	\$1,000
Payments in 2000	(380)	(145)	(525)
Accrual balance December 31, 2000	301	174	475
Second quarter 2001 restructuring charge	614	—	614
Fourth quarter 2001 restructuring charge	1,510	946	2,456
Total restructuring charges 2001	2,124	946	3,070
Payments in 2001	(1,460)	(658)	(2,118)
Accrual balance December 31, 2001	965	462	1,427
Third quarter 2002 restructuring charge	1,033	2,187	3,220
Fourth quarter 2002 restructuring charge	2,021	3,819	5,840
Total restructuring charges 2002	3,054	6,006	9,060
Payments in 2002	(2,412)	(2,086)	(4,498)
Accrual balance December 31, 2002	\$ 1,607	\$ 4,382	\$ 5,989

In June 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 146, "Accounting for Exit or Disposal Activities." This statement addresses significant

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issues regarding the recognition, measurement and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance set forth in EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." SFAS No. 146 will be effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The Company is currently evaluating the effects of this pronouncement, but believes that this new pronouncement will likely delay the recognition of restructuring-related charges from when such charges would have been recorded under previous accounting standards.

STOCK-BASED COMPENSATION— At December 31, 2002, the Company had five stock-based compensation plans, which are more fully described in Note 16. The Company accounts for employee stock-based compensation using the intrinsic value method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations. With the exception of certain options granted in 1999 by a shareholder of Sekidenko, prior to its acquisition by the Company (which was accounted for as a pooling of interests), all options granted under these plans have an exercise price equal to the market value of the underlying common stock on the date of grant, therefore no stock-based compensation cost is reflected in net (loss) income.

Had compensation cost for the Company's plans been determined consistent with SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure, an Amendment of FASB Statement No. 123," the Company's net (loss) income would have been (increased) reduced to the following adjusted amounts:

(In thousands, except per share data)	2002	2001	2000
Net (loss) income:			
As reported	\$(41,399)	\$(31,379)	\$68,034
Adjustment for stock-based compensation determined under fair value based method for all awards, net of related tax effects	(9,470)	(6,646)	(4,783)
As adjusted	\$(50,869)	\$(38,025)	\$63,251
Basic (loss) earnings per share:			
As reported	\$ (1.29)	\$ (0.99)	\$ 2.17
As adjusted	(1.59)	(1.20)	2.02
Diluted (loss) earnings per share:			
As reported	\$ (1.29)	\$ (0.99)	\$ 2.10
As adjusted	(1.59)	(1.20)	1.95

Cumulative compensation cost recognized in adjusted net income or loss with respect to options that are forfeited prior to vesting is adjusted as a reduction of adjusted compensation expense in the period of forfeiture.

For SFAS No. 123 purposes, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2002	2001	2000
Risk-free interest rates	3.89%	4.51%	6.06%
Expected dividend yield rates	0.0%	0.0%	0.0%
Expected lives	7 years	7 years	7 years
Expected volatility	88.05%	87.94%	103.69%

For the years ended December 31, 2002, 2001 and 2000, \$518,000, \$526,000 and \$461,000, respectively, of stock-based compensation expense was included in the determination of net (loss) income as reported related to Sekidenko option grants made prior to the Company's acquisition of Sekidenko (see Note 16).

EARNINGS PER SHARE— Basic Earnings Per Share ("EPS") is computed by dividing (loss) income available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the numerator is increased to exclude certain charges which would not have been incurred, and the denominator is increased to include the number of additional common shares that would have been outstanding (using the if-converted and treasury stock methods), if securities containing potentially dilutive common shares (convertible notes payable, options and warrants) had been converted to such common shares, and if such assumed conversion is dilutive. For the year ended December 31, 2000, certain stock options outstanding and conversion of the convertible subordinated notes payable were not included in this calculation because to do so would be anti-dilutive. The anti-dilutive stock options would have increased the weighted-average number of diluted shares by 239,000, and the anti-dilutive convertible subordinated notes, if converted, would have increased the number of diluted shares by 2,546,000 in 2000. Due to the Company's net loss for the years ended December 31, 2002 and 2001, basic and diluted EPS are the same, as the assumed conversion of all potentially dilutive securities would be anti-dilutive. Potential shares of common stock issuable under options and warrants for common stock at December 31, 2002 and 2001 were approximately 3,587,000 and 2,200,000, respectively. Potential shares of common stock issuable upon conversion of the Company's convertible subordinated notes payable was 5,411,000 and 5,838,000, respectively.

The following is a reconciliation of the numerators and denominators used in the calculation of basic and diluted EPS for the years ended December 31, 2002, 2001 and 2000:

(In thousands except per share data)	2002			2001			2000		
	Net Loss Before Extra- ordinary Item	Shares	Per Share Amount	Net Loss Before Extra- ordinary Item	Shares	Per Share Amount	Net Loss Before Extra- ordinary Item	Shares	Per Share Amount
Basic EPS:									
Net (loss) income before extraordinary item attributable to common stock and share amounts	\$ (44,038)	32,026	\$ (1.38)	\$ (31,379)	31,712	\$ (0.99)	\$ 60,424	31,336	\$ 1.93
Dilutive securities:									
Stock options	—	—	—	—	—	—	—	1,089	—
Convertible subordinated debt	—	—	—	—	—	—	—	—	—
Diluted EPS:									
Net (loss) income before extraordinary item attributable to common stock and assumed share amounts	\$ (44,038)	32,026	\$ (1.38)	\$ (31,379)	31,712	\$ (0.99)	\$ 60,424	32,425	\$ 1.86

COMPREHENSIVE (LOSS) INCOME—

Comprehensive (loss) income for the Company consists of net (loss) income, foreign currency translation adjustments and net unrealized holding (losses) gains on available-for-sale marketable investment securities and is presented in the Consolidated Statement of Stockholders' Equity.

SEGMENT REPORTING— The Company operates in one segment for the manufacture, marketing and servicing of key subsystems, primarily to the semiconductor capital equipment industry. In accordance with SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," the Company's chief operating decision maker has been identified as the Office of the Chief Executive Officer, which reviews operating results to make decisions about allocating resources and assessing performance for the entire company. SFAS No. 131, which is based on a management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report annually entity-wide disclosures about products and services, major customers, and the countries in which the entity holds material assets and reports revenue. All material operating units qualify for aggregation under SFAS No. 131 due to their similar customer base and similarities in: economic characteristics; nature of products and services; and procurement, manufacturing and distribution processes. To report revenues from external customers for each product and service or group of similar products and services would not be practicable. Since the Company operates in one segment, all financial information required by SFAS No. 131 can be found in the accompanying consolidated financial statements.

LONG-LIVED ASSETS— In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 121 did not address the accounting for a segment of a business accounted for as a discontinued operation, which resulted in two accounting models for long-lived assets to be disposed of. SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of by sale, and requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The Company adopted SFAS No. 144 on January 1, 2002. In the fourth quarter of 2002, in conjunction with the restructuring of its operations discussed above, the Company determined that its EMCO facilities would be relocated to Fort Collins, Colorado. As a result the Company performed an analysis of the fair value of EMCO's long-lived assets. This analysis included an appraisal of EMCO's land and building, which indicated an impairment of approximately \$560,000, which has been reflected as restructuring charges in the accompanying statement of operations.

During 2001, the Company reviewed certain amounts recorded as goodwill for impairment under the SFAS No. 121 model. Due to declines in the related businesses and changes in the Company's strategy, it was determined that the related expected future cash flows no longer supported the recorded amounts of goodwill, and the Company recorded an impairment in the amount of approximately

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\$5.4 million. Approximately \$3.6 million of this was related to impairment of goodwill associated with Tower and approximately \$1.8 million was related to impairment of goodwill associated with the Company's Fourth State Technology ("FST") product line.

GAINS AND LOSSES FROM EXTINGUISHMENT OF DEBT— In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This statement rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt," which required all gains and losses from extinguishments of debt to be aggregated and, if material, classified as an extraordinary item, net of income taxes. As a result, the criteria in Accounting Principles Board Opinion No. 30 will now be used to classify those gains and losses. Any gain or loss on the extinguishments of debt that was classified as an extraordinary item in prior periods presented that does not meet the criteria in APB 30 for classification as an extraordinary item shall be reclassified. The provisions of SFAS No. 145 are effective for fiscal years beginning after May 15, 2002, with early application encouraged. The Company will adopt the provisions of SFAS No. 145 in the Company's fiscal year ended December 31, 2003. The adoption of this Statement will require the Company to reclassify its pretax extraordinary gain of \$4,223,000 (see Note 8) recorded for the year ended December 31, 2002 to income from continuing operations in future financial statements.

DERIVATIVE INSTRUMENTS — In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Company adopted SFAS No. 133, as amended on January 1, 2001. SFAS No. 133 establishes accounting and reporting standards for derivative instruments and for hedging activity by requiring all derivatives to be recorded on the balance sheet as either an asset or liability and measured at their fair value. Changes in the derivative's fair value will be recognized currently in earnings unless specific hedging accounting criteria are met. SFAS No. 133 also establishes uniform hedge accounting criteria for all derivatives. The Company did not seek specific hedge accounting treatment for its foreign currency forward contracts that existed on the date of adoption (see below). The adoption of SFAS No. 133 did not have a material impact on the Company's financial condition or results of operations.

The Company, including its subsidiaries, enters into foreign currency forward contracts with counterparties to mitigate foreign currency exposure from foreign currency denominated trade purchases and intercompany receivables and

payables. These derivative instruments are not held for trading or speculative purposes. To the extent that changes occur in currency exchange rates, the Company is exposed to market risk on its open derivative instruments. This market risk exposure is generally offset by the gain or loss recognized upon the translation of its intercompany payables and receivables. Foreign currency forward contracts are entered into with major commercial U.S. and Japanese banks that have high credit ratings, and the Company does not expect the counterparties to fail to meet their obligations under outstanding contracts. Foreign currency gains and losses under these arrangements are not deferred. The Company generally enters into foreign currency forward contracts with maturities ranging from four to eight months, with contracts outstanding at December 31, 2002 maturing through May 2003.

In July 2002, one of the Company's U.S. entities entered into a foreign currency forward contract maturing January 6, 2003, to sell approximately 5.7 billion Japanese yen to mitigate the currency exposure on its yen denominated intercompany receivable from AE-Japan. At December 31, 2002, the Company held this foreign currency forward contract with (dollar equivalent) notional amounts of \$48.4 million and market settlement amounts of approximately \$48.3 million for an unrealized gain position of approximately \$0.1 million that has been included in foreign currency gain (loss) and other current assets in the accompanying consolidated financial statements.

In September 2002, the Company's Aera Japan subsidiary entered into two foreign currency forward contracts maturing January 6, 2003, to sell U.S. dollars to mitigate the currency exposure from its dollar denominated intercompany receivable from its U.S. subsidiary Aera Corporation. At December 31, 2002, Aera held foreign currency forward contracts with notional amounts of \$15.0 million and market settlement amounts of approximately \$15.3 million for an unrealized loss position of approximately \$0.3 million that has been included in foreign currency gain (loss) and other current liabilities in the accompanying consolidated financial statements.

The Company's subsidiary AE-Japan enters into foreign currency forward contracts to buy U.S. dollars to mitigate currency exposure from its payable position arising from trade purchases and intercompany transactions with its parent. At December 31, 2002, AE-Japan held foreign currency forward contracts with notional amounts of \$6.5 million and market settlement amounts of \$6.7 million for an unrealized loss position of approximately \$0.2 million that has been included in foreign currency (loss) gain in the accompanying consolidated statements of operations.

ESTIMATES AND ASSUMPTIONS— The preparation of the Company’s consolidated financial statements in conformity with accounting principles generally accepted in the United States requires the Company’s management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are used when establishing allowances for doubtful accounts, determining useful lives for depreciation and amortization, assessing the need for impairment charges, establishing restructuring accruals and warranty reserves, allocating purchase price among the fair values of assets acquired and liabilities assumed, accounting for income taxes, and assessing excess and obsolete inventory and various others items. The Company evaluates these estimates and judgments on an ongoing basis and bases its estimates on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances. The results of these estimates form the basis for making judgments about the carrying values of assets and liabilities as well as identifying and assessing the accounting treatment with respect to commitments and contingencies. Actual results may differ from these estimates under different assumptions or conditions.

NEW ACCOUNTING PRONOUNCEMENTS— In January 2003, the FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities” (“FIN No. 46”). This interpretation clarifies existing accounting principles related to the preparation of consolidated financial statements when the equity investors in an entity do not have the characteristics of a controlling financial interest or when the equity at risk is not sufficient for the entity to finance its activities without additional subordinated financial support from others parties. FIN No. 46 requires a company to evaluate all existing arrangements to identify situations where a company has a “variable interest” (commonly evidenced by a guarantee arrangement or other commitment to provide financial support) in a “variable interest entity” (commonly a thinly capitalized entity) and further determine when such variable interests require a company to consolidate the variable interest entities’ financial statements with its own. The Company is required to perform this assessment by September 30, 2003 and consolidate any variable interest entities for which it will absorb a majority of the entities’ expected losses or receive a majority of the expected residual gains. Management has not yet performed this assessment and is currently evaluating the impact on its financial statements of adopting this Standard.

In November 2002, the FASB issued FASB Interpretation No. 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others” (“FIN No. 45”). This interpretation requires a liability to be recognized at the time a company issues a guarantee for the fair value of the obligations assumed under certain guarantee agreements. Additional disclosures about guarantee agreements are also required in the interim and annual financial statements, including a roll forward of the company’s product warranty liabilities. The disclosure provisions of FIN No. 45 are effective for the Company as of December 31, 2002. The provisions for initial recognition and measurement of guarantee agreements are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002. The Company is in the process of assessing the impact of the recognition provisions of FIN No. 45 on its consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, “Accounting for Stock-Based Compensation, Transition and Disclosure” (“SFAS No. 148”). SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. SFAS No. 148 also requires that disclosures of the pro forma effect of using the fair value method of accounting for stock-based employee compensation be displayed more prominently and in a tabular format. Additionally, SFAS No. 148 requires disclosure of the pro forma effect in interim financial statements. The transition and disclosure requirements of SFAS No. 148 are effective for the Company’s fiscal year ended December 31, 2002. The adoption of SFAS No. 148 did not have a material effect on the consolidated financial statements.

RECLASSIFICATIONS— Certain prior period amounts have been reclassified to conform to the current period presentation.

2 ACQUISITIONS

LITMAS — During 1998, the Company acquired a 29% ownership interest in LITMAS, a privately held, North Carolina-based early-stage company that designs and manufactures plasma gas abatement systems and high-density plasma sources. The purchase price consisted of \$1 million in cash. On October 1, 1999, the Company acquired an additional 27.5% interest in LITMAS for an additional \$560,000. The purchase price consisted of \$385,000 in the Company’s common stock and \$175,000 in cash. The acquisition was accounted for using the purchase method of accounting and resulted in \$523,000 allocated to intangible

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assets as goodwill. The results of operations of LITMAS are included within the accompanying consolidated financial statements from the date the controlling interest of 56.5% was acquired. On October 1, 2000, the Company acquired an additional 3.0% interest in LITMAS for an additional \$250,000, bringing the Company's ownership interest in LITMAS to 59.5%. On April 2, 2002, the Company completed its acquisition of the 40.5% of LITMAS that it did not previously own, by issuing approximately 120,000 shares of the Company's common stock valued at approximately \$4.2 million, and approximately \$400,000 of cash. The acquisition of all the minority interest in LITMAS resulted in approximately \$5 million of additional goodwill.

DRESSLER— On March 28, 2002, the Company completed its acquisition of Dressler HF Technik GmbH, a privately owned Stolberg, Germany-based provider of power supplies and matching networks, for a purchase price of approximately \$15 million in cash and a \$1.7 million escrow. The escrow funds were retained by the Company until January 6, 2003, at which time the related escrow liability was settled. The Company may pay an additional \$3 million if Dressler achieves certain key business objectives by March 30, 2003. Upon the close of this acquisition, the Company recorded its preliminary estimate of the fair value of the assets acquired and liabilities assumed. In the second quarter of 2002, the Company recognized approximately \$1.4 million of goodwill associated with Dressler, offset by a long-term deferred income tax liability. In the third quarter of 2002, based upon additional information regarding the assets at the time of purchase, the Company allocated an additional \$280,000 of its initial purchase price to accounts receivable and inventory, offset by a reduction of goodwill. In the fourth quarter of 2002, the Company finalized its purchase price allocation, which resulted in an increase in the long-term deferred tax liability and goodwill recorded in the second quarter of approximately \$1,557,000.

The Company believes that Dressler will expand the Company's product offerings to customers in the semiconductor, data storage, and flat panel equipment markets due to its power product portfolio that includes a wide range of power levels and RF frequencies. In addition, with inroads already made into the laser and medical markets, Dressler will be used to explore new market opportunities for the Company. Dressler will also strengthen the Company's presence in the European marketplace. Dressler has well established relationships with many European customers, who look to Dressler for innovative technical capability, quality products, and highly responsive customer service. The Company also expects to achieve synergies in product technology, production efficiency, logistics and worldwide service.

The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations," and the operating results of Dressler are reflected in the accompanying consolidated financial statements prospectively from the date of acquisition. The tangible assets acquired and liabilities assumed were recorded at estimated fair values as determined by the Company's management. Goodwill and other intangible assets were recorded at estimated fair values based upon independent appraisals. The purchase price was allocated to the net assets of Dressler as summarized below:

(In thousands)	
Cash and cash equivalents	\$ 680
Accounts receivable	1,939
Inventories	1,111
Other current assets	83
Fixed assets	260
Goodwill	9,405
Intangibles	7,750
Other assets	19
Accounts payable	(314)
Accrued payroll	(39)
Other accrued expenses	(2,149)
Deferred tax liability	(2,945)
Income taxes payable	(725)
	\$15,075

The excess purchase price over the estimated fair value of tangible net assets acquired was allocated to goodwill and intangibles (see Note 1). In the fourth quarter of 2002, the Company reviewed these assets for impairment under the provisions of SFAS No. 142. Based on this evaluation, an impairment was not indicated. The Company will continue to review these assets in the future for impairment. The Company recognized approximately \$769,000 of amortization expense related to these amortizable intangibles acquired from Dressler through December 31, 2002.

Prior to the combination, there were transactions between the Company and Dressler in 2001 and the first three months of 2002. In 2001, the Company purchased approximately \$2 million of inventory from Dressler, and Dressler purchased approximately \$200,000 of inventory from the Company. In the first three months of 2002, the Company purchased approximately \$500,000 of inventory from Dressler. These purchases were made in the normal course of the Company's business.

AERA— On January 18, 2002, the Company completed its acquisition of Aera Japan Limited, a privately held Japanese corporation. The Company effected the acquisition through its wholly owned subsidiary, AE-Japan, which purchased all of the outstanding stock of Aera. The aggregate purchase

price AE-Japan paid was 5.73 billion Japanese yen (approximately \$44 million, based upon an exchange rate of 130:1), which the Company funded from its available cash. In connection with the acquisition, AE-Japan assumed approximately \$34 million of Aera's debt. In the second quarter of 2002, the Company recognized approximately \$8.5 million of additional goodwill associated with Aera, offset by a long-term deferred income tax liability. In the fourth quarter of 2002, the Company finalized its purchase price allocation, which resulted in a reduction of the deferred tax liability and goodwill recorded in the second quarter of 2002 by approximately \$3.8 million. Aera, which is headquartered in Hachioji, Japan, has manufacturing facilities there and manufacturing, sales and service offices in Austin, Texas (see Note 1); Kirchheim, Germany; and Bundang, South Korea; and sales and service offices in Dresden, Germany and Edinburgh, Scotland. Aera supplies the semiconductor capital equipment industry with product lines that include digital mass flow controllers, pressure-based mass flow controllers, liquid mass flow controllers, ultrasonic liquid flow meters and liquid vapor delivery systems. The company believes that Aera provides it with a key leadership position in the gas delivery market. In addition, Aera's products expand the Company's offerings of critical subsystem solutions that enable the plasma-based manufacturing process used in the manufacture of semiconductors.

The acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations," and the operating results of Aera are reflected in the accompanying consolidated financial statements prospectively from the date of acquisition. The tangible assets acquired and liabilities assumed were recorded at estimated fair values as determined by the Company's management. Goodwill and other intangible assets were recorded at estimated fair values based upon independent appraisals.

The purchase price was allocated to the net assets of Aera as summarized below:

(In thousands)	
Cash and cash equivalents	\$ 8,276
Marketable securities	115
Accounts receivable	8,405
Inventories	19,243
Other current assets	530
Fixed assets	13,388
Goodwill	24,869
Other intangibles	12,500
Other assets	427
Accounts payable	(2,329)
Accrued payroll	(2,924)
Other liabilities	(2,164)
Deferred tax liability	(4,765)
Current portion of long-term debt	(12,008)
Long-term debt	(19,598)
	\$43,965

There were no transactions between the Company and Aera prior to the combination. The excess purchase price over the estimated fair value of tangible net assets acquired was allocated to goodwill and intangibles (see Note 1). In the fourth quarter of 2002, the Company reviewed these assets for impairment under the provisions of SFAS No. 142. Based on this evaluation, an impairment was not indicated. The Company recognized approximately \$3.0 million of amortization expense related to the amortizable intangibles acquired from Aera from January 18, 2002, the date of acquisition, through December 31, 2002.

Had these acquisitions of Aera and Dressler occurred on January 1, 2001, the pro forma, unaudited, combined results of operations for the Company, Aera and Dressler for the year ended December 31, 2001 would have generated revenue of approximately \$267.8 million, net loss of approximately \$50.1 million and basic and diluted loss per share of \$1.58. However, pro forma results are not necessarily indicative of future results.

EMCO— On January 2, 2001, Engineering Measurements Company ("EMCO"), a publicly held, Longmont, Colorado-based manufacturer of electronic and electromechanical precision instruments for measuring and controlling the flow of liquids, steam and gases, was merged with a wholly owned subsidiary of the Company. The Company paid the EMCO shareholders cash in an aggregate amount of approximately \$30 million. In connection with the acquisition, the Company issued stock options to purchase approximately 71,000 shares of its common stock for the assumption of outstanding, fully vested options for EMCO common stock. The fair value of the options granted was estimated by the Company (using the Black-Scholes option pricing model) to be approximately \$1.1 million.

The acquisition was accounted for using the purchase method of accounting, and the operating results of EMCO are reflected in the accompanying consolidated financial statements prospectively from the date of acquisition. The assets acquired and liabilities assumed were recorded based upon independent appraisals of the fair values of the acquired property, plant and equipment, identified intangible assets and goodwill.

The purchase price was allocated to the net assets of EMCO as summarized below:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	
Cash and cash equivalents	\$ 459
Marketable securities	674
Accounts receivable	1,167
Inventories	1,678
Deferred income tax assets, current	584
Other current assets	88
Fixed assets	4,596
Goodwill	20,878
Other intangibles	3,400
Accounts payable	(355)
Accrued payroll	(405)
Other accrued expenses	(391)
Deferred tax liability	(856)
	\$ 31,517

There were no transactions between the Company and EMCO prior to the combination. The excess purchase price over the estimated fair value of tangible net assets acquired was allocated to goodwill and intangibles, which was amortized in 2001 over an average of a seven-year life. In accordance with SFAS Nos. 141 and 142, the Company ceased amortization of goodwill on January 1, 2002, and will continue to review these assets in the future for impairment. The amount of annual goodwill amortization, which will no longer be recorded, is approximately \$3.3 million.

SEKIDENKO, INC.— On August 18, 2000, Sekidenko, Inc. (“Sekidenko”), a privately held, Vancouver, Washington-based supplier of optical fiber thermometers to the semiconductor capital equipment industry, was merged with a wholly owned subsidiary of the Company in a business combination accounted for as a pooling of interests. The Company issued 2.1 million shares of its common stock to the former shareholders of Sekidenko. In connection with the merger, the Company recorded in the third quarter of 2000 a charge to operating expenses of \$2.3 million for direct merger-related costs.

NOAH HOLDINGS, INC.— On April 6, 2000, Noah Holdings, Inc. (“Noah”), a privately held, California-based manufacturer of solid state temperature control systems used to control process temperatures during semiconductor manufacturing, was merged with a wholly owned subsidiary of the Company in a business combination accounted for as a pooling of interests. The Company issued approximately 687,000 shares of its common stock in connection with the acquisition. In addition, outstanding Noah stock options were converted into options to purchase approximately 40,000 shares of the Company’s common stock. In connection with the merger, the Company recorded in the second quarter of 2000 a charge to operating expenses of \$2.3 million for direct merger-related costs.

The Sekidenko and Noah mergers have been accounted for as poolings of interest under Accounting Principles Board Opinion No. 16. Accordingly, all prior period consolidated financial statements presented have been restated to include the combined balance sheet, statements of operations and cash flows of Noah and Sekidenko as though each had always been part of the Company. There were no transactions between the Company, Noah and Sekidenko prior to the combinations. Certain reclassifications were made to conform the Noah and Sekidenko financial statements to the Company’s presentation.

The results of operations for the separate companies and combined amounts presented in the consolidated financial statements follow:

(In thousands)	Year Ended December 31, 2000
Sales:	
Pre-Noah and Sekidenko mergers (prior to April 6, 2000)	
Advanced Energy	\$ 67,171
Noah	3,080
Sekidenko	4,777
Advanced Energy and Noah combined before Sekidenko merger	123,190
Sekidenko before Sekidenko merger (April 6 to August 18, 2000)	7,034
Post-Sekidenko merger (August 18 to December 31, 2000)	154,530
Consolidated	\$359,782
Net income:	
Pre-Noah and Sekidenko mergers (prior to April 6, 2000)	
Advanced Energy	\$ 9,996
Noah	43
Sekidenko	1,199
Advanced Energy and Noah combined before Sekidenko merger	20,809
Sekidenko before Sekidenko merger (April 6 to August 18, 2000)	1,367
Noah merger costs	(2,333)
Post-Sekidenko merger (August 18 to December 31, 2000)	39,203
Sekidenko merger costs	(2,250)
Consolidated	\$ 68,034

3 MARKETABLE SECURITIES

MARKETABLE SECURITIES consisted of the following:

(In thousands)	December 31,	
	2002	2001
Commercial paper	\$ 65,250	\$172,506
Municipal bonds and notes	34,100	12,622
Institutional money markets	2,809	4,895
	\$102,159	\$190,023

These marketable securities are stated at period end market value. The commercial paper consists of high credit quality, short-term money market common and preferreds, with maturities or reset dates of 120 days or less.

4 ACCOUNTS RECEIVABLE—TRADE

ACCOUNTS RECEIVABLE – TRADE consisted of the following:

(In thousands)	December 31,	
	2002	2001
Domestic	\$16,475	\$13,463
Foreign	27,378	14,457
Allowance for doubtful accounts	(3,056)	(1,049)
Total accounts receivable	\$40,797	\$26,871

5 INVENTORIES

INVENTORIES consisted of the following:

(In thousands)	December 31,	
	2002	2001
Parts and raw materials	\$40,147	\$31,273
Work in process	4,435	2,521
Finished goods	12,724	10,619
Total inventories	\$57,306	\$44,413

Inventories include costs of materials, direct labor and manufacturing overhead. Inventories are valued at the lower of market or cost, computed on a first-in, first-out basis. Inventory is expensed as cost of sales upon shipment of product.

6 PROPERTY AND EQUIPMENT

PROPERTY AND EQUIPMENT consisted of the following:

(In thousands)	December 31,	
	2002	2001
Land	\$ 5,946	\$ 1,127
Building	7,123	1,737
Machinery and equipment	35,432	29,410
Computers and communication equipment	18,872	15,619
Furniture and fixtures	5,666	4,694
Vehicles	159	222
Leasehold improvements	11,089	10,232
	84,287	63,041
Less – accumulated depreciation	(43,109)	(31,946)
Total property and equipment	\$ 41,178	\$31,095

7 NOTES PAYABLE

NOTES PAYABLE consisted of the following:

(In thousands)	December 31,	
	2002	2001
Revolving line of credit of \$25,000,000, expiring May 2003, interest at bank's prime rate minus 1%, (3.25% at December 31, 2002). Borrowing base consists of the sum of 80% of eligible accounts receivable plus the lesser of 20% of eligible inventory or \$5,000,000. Loan covenants provide certain financial restrictions related to working capital, leverage, net worth, payment and declaration of dividends and profitability.	\$ —	\$ 760
Note payable, royalties, with interest at 7%, with monthly payments ranging from \$5,000 to \$15,000, including interest, due July 2002. The note is unsecured.	—	244
Note payable, other	—	120
Bank loans (assumed in the acquisition of Aera), maturing serially through May 2007, interest at 1.28% to 3.1% at December 31, 2002	24,502	—
	24,502	1,124
Less – current portion	(14,506)	(1,124)
	\$ 9,996	\$ —

Scheduled maturities of the Company's bank loans and convertible subordinated notes payable (see Note 8) are as follows at December 31, 2002:

(In thousands)	Convertible		Total
	Bank Loans	Subordinated Notes	
2003	\$ 14,506	\$ —	\$ 14,506
2004	4,916	—	4,916
2005	2,892	—	2,892
2006	1,896	187,718	189,614
2007	292	—	292
Total	\$ 24,502	\$ 187,718	\$ 212,220

The Company is subject to covenants on its line of credit that provide certain restrictions related to working capital, leverage, net worth, and payment and declaration of dividends. The Company was in compliance with these covenants at December 31, 2002. As of December 31, 2002, the Company had letters of credit outstanding related to the foreign currency forward contracts discussed in Note 1, of approximately \$6.4 million, for total available credit at that time of approximately \$18.6 million. These foreign currency contracts matured subsequent to December 31, 2002, and the letters of credit were cancelled.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

8 CONVERTIBLE SUBORDINATED NOTES PAYABLE

In August 2001, the Company issued \$125 million of 5.00% convertible subordinated notes. These notes mature September 1, 2006, with interest payable on March 1st and September 1st of each year beginning March 1, 2002. Net proceeds to the Company were \$121.25 million, after deducting \$3.75 million of offering costs, which have been capitalized and are being amortized as additional interest expense over a period of five years. Holders of the notes may convert the notes at any time before maturity into shares of the Company's common stock at a conversion rate of 33.5289 shares per each \$1,000 principal amount of notes, equivalent to a conversion price of approximately \$29.83 per share. The conversion rate is subject to adjustment in certain circumstances. The Company may redeem the notes, in whole or in part, at any time before September 4, 2004, at specified redemption prices plus accrued and unpaid interest, if any, to the date of redemption if the closing price of the Company's common stock exceeds 150% of the conversion price then in effect for at least 20 trading days within a period of 30 consecutive trading days ending on the trading day before the date of mailing of the provisional redemption notice. Upon any provisional redemption, the Company will make an additional payment in cash with respect to the notes called for redemption in an amount equal to \$150.56 per \$1,000 principal amount of notes, less the amount of any interest paid on the note. The Company may also make this additional payment in shares of its common stock, and any such payment will be valued at 95% of the average of the closing prices of the Company's common stock for the five consecutive trading days ending on the day prior to the redemption date. The Company will be obligated to make an additional payment on all notes called for provisional redemption. The Company may also redeem the notes from September 4, 2004 through August 31, 2005 at 102% times the principal amount, from September 1, 2005 through August 31, 2006 at 101% times the principal amount, and thereafter at 100% of the principal amount. The notes are subordinated to the Company's present and potential future senior debt, and are effectively subordinated in right of payment to all indebtedness and other liabilities of the Company's subsidiaries. At December 31, 2002, approximately \$2.1 million of interest expense related to these notes was accrued as a current liability.

In November 1999, the Company issued \$135 million of 5.25% convertible subordinated notes. These notes mature November 15, 2006, with interest payable on May 15th and November 15th each year beginning May 15, 2000. Net proceeds to the Company were approximately \$130.5 million, after deducting \$4.5 million of offering costs, which have

been capitalized and are being amortized as additional interest expense over a period of seven years. Holders of the notes may convert the notes at any time into shares of the Company's common stock, at \$49.53 per share. The Company may redeem the notes on or after November 19, 2002 at a redemption price of 103.00% times the principal amount, and may redeem at successively lesser amounts thereafter until November 15, 2006, at which time the Company may redeem at a redemption price equal to the principal amount. At December 31, 2002, approximately \$200,000 of interest expense related to these notes was accrued as a current liability.

In October and November 2002, the Company repurchased approximately \$15.4 million and \$3.5 million principal amounts of its 5.25% and 5.00% convertible subordinated notes, respectively. These purchases were made in the open market, for a cost of approximately \$14.5 million, resulting in an after-tax extraordinary gain of \$2.6 million. At December 31, 2002, approximately \$66.2 million and \$121.5 million principal amounts of the 5.25% and 5.00% notes remained outstanding.

In October and November 2000, the Company repurchased an aggregate of approximately \$53.4 million principal amount of its 5.25% convertible subordinated notes in the open market, for a cost of approximately \$40.8 million. These purchases resulted in an after-tax extraordinary gain of \$7.6 million. At December 31, 2001, approximately \$81.6 million principal amount of the 5.25% notes remained outstanding.

The Company may continue to purchase additional notes in the open market from time to time, if market conditions and the Company's financial position are deemed favorable for such purposes.

9 INCOME TAXES

The income tax benefit of \$22.3 million for 2002 represents an effective rate of 35%, which included a \$1.6 million provision for an extraordinary item. The income tax benefit of \$17.4 million for 2001 represented an effective rate of 36%. The income tax provision of \$36.8 million in 2000, which included a \$4.6 million provision for an extraordinary item, represented an effective rate of 35%.

The (benefit) provision for income taxes for the years ended December 31, 2002, 2001, and 2000 were as follows:

(In thousands)	December 31,		
	2002	2001	2000
Federal	\$ (18,575)	\$ (17,468)	\$ 28,869
State and local	(2,178)	(469)	3,592
Foreign taxes	(1,540)	496	4,346
	\$ (22,293)	\$ (17,441)	\$ 36,807
Current	\$ (15,405)	\$ (13,462)	\$ 40,537
Deferred	(6,888)	(3,979)	(3,730)
	\$ (22,293)	\$ (17,441)	\$ 36,807

The following reconciles the Company's effective tax rate to the federal statutory rate for the years ended December 31, 2002, 2001 and 2000:

(In thousands)	December 31,		
	2002	2001	2000
Income tax (benefit) expense per federal statutory rate	\$ (22,293)	\$ (17,138)	\$ 36,703
State income taxes, net of federal deduction	(1,414)	(1,259)	2,232
Foreign sales corporation	(262)	(688)	(2,516)
Nondeductible merger costs	—	—	1,604
Nondeductible intangible and goodwill amortization	183	2,818	618
Other permanent items, net	760	(1,716)	(2,262)
Effect of foreign taxes	(272)	2	578
Change in valuation allowance	1,255	790	—
Tax credits	(250)	(250)	(150)
	\$ (22,293)	\$ (17,441)	\$ 36,807

The Company's deferred income tax assets are summarized as follows:

(In thousands)	December 31,	
	2002	2001
Employee bonuses and commissions	\$ 401	\$ 386
Net operating loss carryforward	6,670	790
Warranty reserve	3,291	1,565
Bad debt reserve	1,131	378
Vacation accrual	1,077	948
Restructuring accrual	2,096	499
Obsolete and excess inventory	8,168	2,140
Investments	—	2,476
Depreciation and amortization	(6,777)	(415)
Other	5,320	2,808
Valuation allowance	(12,530)	(790)
	\$ 8,847	\$ 10,785

The following reconciles the change in the net deferred income tax asset from December 31, 2001 to December 31, 2002, to the deferred income tax benefit:

(In thousands)	2002
Net change in deferred income tax asset from the preceding table	\$ 1,938
Net deferred tax liabilities associated with acquisitions	(8,070)
Deferred taxes associated with other comprehensive income	(756)
Deferred income tax benefit for the period	\$ (6,888)

Realization of the Company's net deferred tax asset is dependent upon the Company generating sufficient taxable income in the appropriate tax jurisdictions in future years to obtain benefit from the reversal of net deductible temporary differences and from tax credit carryforwards. When recording acquisitions, the Company has recorded valuation allowances due to the uncertainty related to the realization of certain deferred tax assets existing at December 31, 2002. The amount of deferred tax assets considered realizable is subject to adjustment in future periods if estimates of future taxable income are changed. The Company believes that it is more likely than not that the Company will realize the benefits of the deferred tax asset, net of valuation allowance, as of December 31, 2002. Reversals of valuation allowances recorded in purchase accounting will be reflected as a reduction of goodwill in the period of reversal.

The domestic versus foreign component of the Company's net (loss) income before income taxes for the years ended December 31, 2002, 2001 and 2000, was as follows:

(In thousands)	December 31,		
	2002	2001	2000
Domestic	\$ (60,070)	\$ (50,377)	\$ 94,094
Foreign	(3,622)	1,412	10,767
	\$ (63,692)	\$ (48,965)	\$ 104,861

At December 31, 2002 the Company had income taxes receivable of approximately \$14.7 million, which is expected to be converted to cash during 2003.

10 OTHER INCOME AND EXPENSE ITEMS

OTHER OPERATING EXPENSES - SYMPHONY— Beginning in April 2000, the Company made periodic advances to and investments in Symphony Systems, Inc., a privately held, early-stage developer of equipment productivity management software. In addition to the approximately \$8 million from the Company as investments, advances and license payments, Symphony received investments of \$7 million from other parties. In 2000, the Company

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

obtained an exclusive license, for which the Company paid \$1.5 million, to use Symphony's products in the semiconductor industry. In connection with certain of the Company's advances in 2001, it obtained a security interest in all of Symphony's intellectual and proprietary property.

Beginning in the third quarter of 2001, and continuing through the end of the year, Symphony's financial situation began to deteriorate significantly, and the Company determined that due to Symphony's need for immediate liquidity, its declining business prospects (including the indefinite postponement of a significant order for its products from a major semiconductor capital equipment manufacturer) and other factors, the value of the Company's investment in and advances to Symphony had substantially declined. Given the precarious financial condition of Symphony, the Company valued its investments in and advances to Symphony at December 31, 2001, at approximately \$1 million, which reflects its assessment of the value of the Symphony technology license, which has continuing value to the Company. The amount of the impairment related to Symphony was \$6.8 million, all of which was recorded in 2001 as an operating expense.

Symphony effectively ceased operations in February 2002, the Company hired Symphony's key employees, and acquired Symphony's remaining assets in a foreclosure and liquidation sale of such assets on April 2, 2002. At no time prior to the foreclosure and liquidation sale did the Company's percentage ownership in the voting stock of Symphony exceed 1.7%, and the Company did not have the ability to exercise significant influence over Symphony. The assets acquired were recorded at estimated fair values as determined by the Company's management, based on information currently available. The purchase price and excess purchase price over the estimated fair value of tangible assets acquired of approximately \$2.5 million was allocated to amortizable intangibles, with a weighted-average estimated useful life of approximately 5 years.

In the fourth quarter of 2002, the semiconductor industry declined substantially from its levels in the second and third quarters of 2002. As a result the Company determined there would be a significant delay by the industry in adopting advanced connectivity technology, and the Company, determined that due to industry conditions as well as the Company's future strategic priorities, these intangible assets were likely impaired. The Company evaluated the carrying amount of assets acquired from Symphony by comparing its estimated future cash flows to its carrying value. This analysis indicated the Company's investment was impaired by approximately \$1.9 million, which has been reflected as an operating expense in the accompanying statement of operations for 2002.

GAIN ON SALE OF INVESTMENT— In the third quarter of 2000, the Company exercised warrants of a sup-

plier in a cashless transaction and received 458,000 shares of the supplier's common stock, which is publicly traded. The Company had received the warrants in a series of transactions with the supplier since 1995. Concurrent with the exercise, the Company sold 320,000 shares of the supplier's common stock and recognized a gain of approximately \$4.8 million. The remaining 138,000 shares are valued at approximately \$0.4 million and are included in deposits and other assets.

11 RETIREMENT PLANS

The Company has 401(k) Profit Sharing Plans which cover most full-time employees age eighteen or older. Participants may defer up to the maximum amount allowed as determined by law. Participants are immediately vested in their contributions.

The Company may make discretionary contributions based on corporate financial results for the fiscal year. Effective January 1, 1998, the Company increased its matching contribution for participants in the 401(k) Plans up to a 50% matching on contributions by employees up to 6% of the employee's compensation. In 2002, as part of its cost cutting measures, the Company reduced its contributions to 10% matching on contributions by employees up to 6% of the employee's compensation. The Company's total contributions to the plans were approximately \$272,000, \$1,433,000 and \$1,291,000 for the years ended December 31, 2002, 2001 and 2000, respectively. Effective January 1, 2003, the Company increased its matching contribution to 25% matching of the employees contributions up to 6% of the employee's compensation. Vesting in the profit sharing contribution account is based on years of service, with most participants fully vested after four years of credited service.

The Company's Money Purchase Pension Plan, which covered certain employees, received a letter of termination by the Internal Revenue Service, effective October 1, 2002.

12 COMMITMENTS AND CONTINGENCIES

GUARANTEES

The Company offers warranty coverage for its products for periods ranging from 12 to 36 months after shipment, with the majority of its products ranging from 18 to 24 months. The Company estimates the anticipated costs of repairing products under warranty based on the historical cost of the repairs and expected failure rates. The assumptions used to estimate warranty accruals are reevaluated periodically in light of actual experience and, when appropriate, the accruals are adjusted. The Company's determination of the appropriate level of warranty accrual is subjective and based on

estimates. Estimated warranty costs are recorded at the time of sale of the related product, and are considered a cost of sales. The following summarizes the activity in the Company's warranty reserves during 2002:

(In thousands)	Balance at Beginning of Period	Additions Charged to Expense	Deductions	Balance at End of Period
Reserve for warranty obligations	\$ 4,471	\$13,150	\$(8,219)	\$9,402

On March 28, 2002, the Company completed its acquisition of Dressler, for a purchase price of approximately \$15 million in cash and an escrow reserve of approximately \$1.7 million. The Company may also pay an additional \$3 million if Dressler achieves certain key business objectives by March 30, 2003. At December 31, 2002, the Company has not accrued a liability for the contingent purchase price. If the Company becomes obligated to make this cash payment, the Company would record an additional \$3 million of goodwill.

In October 2002, the Company entered into an agreement with a supplier to advance this supplier \$1.25 million in four installments through November 2003 in exchange for a promissory note due October 31, 2004. The advance bears interest at the prime rate and is secured by all of the supplier's developed intellectual property. At December 31, 2002, the Company had advanced \$450,000 to the supplier which has been recorded as a deposit and other asset. The Company will continue to evaluate the realizability of this asset in the future and may be required to record a charge against income from operations if the supplier's financial position deteriorates.

DISPUTES AND LEGAL ACTIONS

The Company is involved in disputes and legal actions arising in the normal course of its business. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular period. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights. The Company accrues loss contingencies in connection with its litigation when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

In May 2002, the Company recognized approximately \$5.3 million of litigation damages and related legal expenses pertaining to a judgment entered by a jury against the Company

and in favor of MKS Instruments, Inc. ("MKS") in a patent-infringement suit in which the Company was the defendant. The Company has entered into a settlement agreement with MKS allowing it to sell the infringing product subsequent to the date of the jury award. The settlement agreement is in effect until all patents subject to the litigation expire. Under the settlement agreement, royalties payable to MKS from sales of the related product were approximately \$530,000 for the year ended December 31, 2002, and are recorded as a component of cost of sales.

CAPITAL LEASES

The Company finances a portion of its property and equipment under capital lease obligations at interest rates of approximately 5%. The future minimum lease payments under capitalized lease obligations as of December 31, 2002 are as follows:

(In thousands)	
2003	\$ 729
2004	392
2005	215
2006	111
2007	11
Total minimum lease payments	1,458
Less — amount representing interest	(98)
Less — current portion	(691)
	\$ 669

OPERATING LEASES

The Company has various operating leases for automobiles, equipment, and office and production facilities (see Note 14). Lease expense under operating leases was approximately \$6,493,000, \$5,770,000 and \$5,155,000 for the years ended December 31, 2002, 2001 and 2000, respectively.

The future minimum rental payments required under non-cancelable operating leases as of December 31, 2002 are as follows:

(In thousands)	
2003	\$ 5,468
2004	4,464
2005	3,869
2006	3,507
2007	2,990
Thereafter	12,055
	\$32,353

13 INDUSTRY SEGMENT, FOREIGN OPERATIONS AND MAJOR CUSTOMER

SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," requires a public business enter-

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prise to report financial and descriptive information about its reportable operating segments. SFAS No. 131, which is based on a management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report annually entity-wide disclosures about products and services, major customers, and the countries in which the entity holds material assets and reports revenue. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance. Management operates and manages the Company's business for the manufacture, marketing and servicing of its products and related systems as one operating segment. All material operating units qualify for aggregation under SFAS No. 131 because all the Company's products and systems have similar economic characteristics, and procurement, production and distribution processes. To report revenues from external customers for each product and service or each group of similar products and services would be impracticable. Since the Company operates in one segment, all financial segment information required by SFAS No. 131 is found in the accompanying consolidated financial statements.

The Company has operations in the U.S., Europe and Asia Pacific. The following is a summary of the Company's operations by region:

(In thousands)	Years Ended December 31,		
	2002	2001	2000
Sales:			
Originating in U.S. and sold to domestic customers	\$141,637	\$124,746	\$260,596
Originating in U.S. and sold to foreign customers	24,607	19,687	35,504
Originating in Europe and sold to domestic customers	2,108	—	—
Originating in Europe to foreign customers	18,672	18,239	24,375
Originating in Asia Pacific to foreign customers	51,874	30,928	39,307
Transfers between geographic areas	40,567	40,774	48,963
Intercompany eliminations	(40,567)	(40,774)	(48,963)
	\$238,898	\$193,600	\$359,782
(Loss) income from operations:			
U.S.	\$(57,305)	\$(47,532)	\$73,508
Europe	(725)	1,517	3,805
Asia Pacific	1,865	1,157	7,878
Intercompany eliminations	(5,820)	(2,029)	9
	\$(61,985)	\$(46,887)	\$85,200
Identifiable assets:			
U.S.	\$498,906	\$529,465	
Europe	41,485	21,357	
Asia Pacific	137,295	23,633	
Intercompany eliminations	(221,953)	(124,260)	
	\$455,733	\$450,195	

Intercompany sales among the Company's geographic areas are recorded on the basis of intercompany prices established by the Company.

The Company has a major customer (sales in excess of 10% of total sales) that is a manufacturer of semiconductor capital equipment. Sales to this customer accounted for the following percentages of sales for the years ended December 31, 2002, 2001 and 2000:

	December 31,		
	2002	2001	2000
Applied Materials, Inc.	27%	24%	39%

The Company had trade accounts receivable from this customer of approximately \$6.7 million as of December 31, 2002, which was approximately 16.0% of the Company's total trade accounts receivable. The Company had no other trade accounts receivable from any customers in excess of 10% of its total trade accounts receivable as of December 31, 2002 and 2001.

14 RELATED PARTY TRANSACTIONS

The Company leases its executive offices and manufacturing facilities in Fort Collins, Colorado from two limited liability partnerships consisting of a director of the Company who is also an officer, a former director and other individuals unrelated to the Company. The leases relating to these spaces expire in 2009, 2011 and 2016, and contain monthly payments of approximately \$67,000, \$55,000 and \$64,000, respectively.

Approximately \$2,660,000, \$2,229,000 and \$1,637,000 was paid and charged to rent expense attributable to these leases for the years ended December 31, 2002, 2001 and 2000, respectively.

The Company also has an agreement whereby monthly payments of approximately \$12,000 are made to one of the above mentioned limited liability partnerships, which secures future leasing rights on an parcel of land in Colorado. Approximately \$156,000 was paid and charged to rent expense attributable to this agreement for the year ended December 31, 2002.

In 2000, the Company also paid an additional \$637,000 to one of the partnerships for leasehold improvements made in the normal course of the Company's operations, which are capitalized and reported as leasehold improvements on the balance sheet as part of property and equipment.

The Company leases, for business purposes, a condominium owned by a partnership of certain stockholders. The Company paid the partnership \$67,000, \$47,000 and \$36,000 in 2002, 2001 and 2000, respectively.

The Company charters aircraft from time to time from companies owned by a certain shareholder. Aggregate payments for the use of such aircraft were \$103,000, \$0 and \$57,000 in 2002, 2001 and 2000, respectively.

15 CONCENTRATIONS OF CREDIT RISK

FORWARD CONTRACTS— The Company, including its subsidiaries, enters into foreign currency forward contracts with counterparties to mitigate its exposure to foreign currency denominated trade purchases and intercompany receivables and payables. These derivative instruments are not held for trading or speculative purposes. To the extent that changes occur in currency exchange rates, the Company is exposed to market risk on its open derivative instruments. This market risk exposure is generally offset by the gain or loss recognized upon the translation of its intercompany payables and receivables. Foreign currency forward contracts are entered into with major commercial U.S. and Japanese banks that have high credit ratings, and the Company does not expect the counterparties to fail to meet their obligations under outstanding contracts. Foreign currency gains and losses under these arrangements are not deferred. The Company generally enters into foreign currency forward contracts with maturities ranging from four to eight months, with contracts outstanding at December 31, 2002 maturing through May 2003. At December 31, 2002, the Company held foreign currency forward exchange contracts to sell Japanese yen with notional amounts of \$48.4 million and market settlement amounts of \$48.3 million for an unrealized gain position of \$0.1 million; foreign currency forward exchange contracts to sell U.S. dollars with notional amounts of \$15.0 million and market settlement amounts of \$15.3 million for an unrealized loss position of approximately \$0.3 million; and foreign currency forward exchange contract to buy U.S. dollars with notional amounts of \$6.5 million and market settlement amounts of \$6.7 million for an unrealized loss position of approximately \$0.2 million. The net unrealized foreign currency loss of \$0.4 million has been included in foreign currency gain (loss) in the accompanying consolidated statement of operations.

OTHER CONCENTRATIONS OF CREDIT RISK— The Company uses financial instruments that potentially subject it to concentrations of credit risk. Such instruments include cash equivalents, short-term investments, accounts receivable, and foreign currency forward contracts. The Company invests its cash in cash deposits, money market funds, commercial paper, certificates of deposit and readily marketable debt securities. The Company places its investments with high credit quality financial institutions and limits

the credit exposure from any one financial institution or instrument. To date, the Company has not experienced significant losses on these investments. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral. Because the Company's receivables are primarily related to companies in the semiconductor capital equipment industry, the Company is exposed to credit risk generally related to this cyclical industry.

16 STOCK PLANS

1995 EMPLOYEE STOCK OPTION PLAN — During 1993, the Company adopted an Employee Stock Option Plan (the "Employee Option Plan") that has been amended and restated various times through December 2002. The Employee Option Plan allows issuance of incentive stock options, non-qualified options, and stock purchase rights. The exercise price of incentive stock options shall not be less than 100% of the stock's market value on the date of grant. The exercise price of non-qualified stock options shall not be less than 85% of the stock's market value on the date of grant. Options the Company (exclusive of acquired subsidiaries) issued under this plan in 2002, 2001 and 2000 were at 100% of market value with typical vesting over three to four years. Under the Employee Option Plan, the Company has the discretion to accelerate the vesting period. The options are exercisable for ten years from the date of grant. The Company has reserved 8,125,000 shares of common stock for the issuance of stock under the Employee Option Plan, which terminates in June 2003. At December 31, 2002, approximately 2,200,000 shares of common stock were available for grant under this plan.

During 1999, prior to its acquisition by the Company, a shareholder of Sekidenko granted employees options under a preexisting arrangement to purchase shares of his common stock already outstanding at exercise prices below fair market value. Under this agreement, 29,700 and 34,250 of such options were exercised in 1999 and 2000, respectively. These options result in the Company recognizing \$109,000 as compensation expense over the four-year vesting period related to the 1999 purchases, and \$1,995,000 as compensation expense over the four-year vesting period related to the 2000 purchases. Compensation expense of \$518,000, \$526,000 and \$461,000 was recognized in 2002, 2001 and 2000, respectively. These amounts are presented as a reduction of stockholders' equity, and the remaining amount of deferred compensation of \$542,000 is being amortized over the four-year vesting period of the related stock options. During 2002, options to purchase approximately 15,000 shares

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under this plan were forfeited as a result of terminations, and the related deferred compensation of \$34,000 was reversed.

EMPLOYEE STOCK PURCHASE PLAN— In September 1995, stockholders approved an Employee Stock Purchase Plan (the “Stock Purchase Plan”) covering an aggregate of 200,000 shares of common stock. Employees are eligible to participate in the Stock Purchase Plan if employed by the Company for at least 20 hours per week during at least five months per calendar year. Participating employees may have up to 15% (subject to a 5% limitation set by the Company) of their earnings or a maximum of \$1,250 per six-month period withheld pursuant to the Stock Purchase Plan. Common stock purchased under the Stock Purchase Plan will be equal to 85% of the lower of the fair market value on the commencement date of each offering period or the relevant purchase date. During 2002, 2001 and 2000, employees purchased an aggregate of 54,196, 37,376 and 13,025 shares under the Stock Purchase Plan, respectively. At December 31, 2002, approximately 28,000 shares were available for issuance under this plan.

NON-EMPLOYEE DIRECTORS STOCK OPTION PLAN— In September 1995, the Company adopted the 1995 Non-Employee Directors Stock Option Plan (the “Directors Plan”) covering 50,000 shares of common stock. In May 2001, the plan was amended to increase the number of shares of common stock issuable under such plan to 200,000 shares of common stock. The Directors Plan provides for automatic grants of non-qualified stock options to directors of the Company who are not employees of the Company (“Outside Directors”). Pursuant to the Directors Plan, upon becoming a director of the Company, each Outside Director will be granted an option to purchase 7,500 shares of common stock. Such options will be immediately exercisable as to 2,500 shares of common stock, and will vest as to 2,500 shares of common stock on each of the second and third anniversaries of the grant date. On each anniversary of the date on which a person became an Outside Director, an option for an additional 2,500 shares is granted. Such additional options vest on the third anniversary of the date of grant. Options will expire ten years after the grant date, and the exercise price of the options will be equal to the fair market value of the common stock on the grant date. The Directors Plan terminates in September 2005. At December 31, 2002, approximately 78,000 shares of common stock were available for grant under this plan.

2001 EMPLOYEE STOCK OPTION PLAN— In 2001, the Company adopted the 2001 Stock Option Plan (the “2001 Option Plan”), which does not require approval by the Company’s stockholders. The 2001 Option Plan is a broad-based plan for employees and consultants in which executive officers and directors of the Company are not allowed to participate. The board of directors currently administers the plan, and makes all decisions concerning which employees and consultants are granted options, how many to grant to each optionee, when options are granted, how the plan should be properly interpreted, whether to amend or terminate the plan, and whether to delegate administration of the plan to a committee. The 2001 Option Plan allows issuance of only non-qualified options. The exercise price of the options shall not be less than 100% of the stock’s fair market value on the date of grant, and the options vest over four years. The options are exercisable for ten years from the date of grant. The Company has reserved up to 600,000 shares of common stock under the plan. The 2001 Option Plan will expire in January 2011, unless the administrator of the plan terminates it earlier. At December 31, 2002, approximately 54,000 shares of common stock were available for grant under this plan.

2002 EMPLOYEE STOCK OPTION PLAN— In 2002, the Company adopted the 2002 Stock Option Plan (the “2002 Option Plan”), which does not require approval by the Company’s stockholders. The 2002 Option Plan is a broad-based plan for employees and consultants in which executive officers and directors of the Company are not allowed to participate. The board of directors currently administers the plan, and makes all decisions concerning which employees and consultants are granted options, how many to grant to each optionee, when options are granted, how the plan should be properly interpreted, whether to amend or terminate the plan, and whether to delegate administration of the plan to a committee. The 2002 Option Plan allows issuance of only non-qualified options. The exercise price of the options shall not be less than 100% of the stock’s fair market value on the date of grant, and the options vest over four years. The options are exercisable for ten years from the date of grant. The Company has reserved up to 600,000 shares of common stock under the plan. The 2002 Option Plan will expire in January 2012, unless the administrator of the plan terminates it earlier. At December 31, 2002, approximately 43,000 shares of common stock were available for grant under this plan.

The following summarizes the activity relating to options for the years ended December 31, 2002, 2001 and 2000:

(In thousands, except share prices)	2002		2001		2000	
	Shares	Weighted-average Exercise Price	Shares	Weighted-average Exercise Price	Shares	Weighted-average Exercise Price
Stock options:						
Employee stock options-						
Options outstanding at beginning of period	2,108	\$25.07	1,719	\$23.39	1,850	\$13.90
Granted	1,920	21.73	845	25.64	461	45.45
Exercised	(118)	11.70	(273)	12.13	(488)	9.12
Terminated	(435)	29.02	(183)	31.22	(104)	19.26
Options outstanding at end of period	3,475	23.18	2,108	25.07	1,719	23.39
Options exercisable at end of period	1,239	23.25	938	20.45	689	14.09
Weighted-average fair value of options granted during the period						
	\$ 17.15		\$ 25.61		\$ 32.75	
Price range of outstanding options	\$0.67 - \$64.94		\$0.67 - \$64.94		\$0.67 - \$60.75	
Price range of options terminated	\$0.83 - \$60.75		\$7.50 - \$60.75		\$0.83 - \$43.69	
Non-employee directors stock options-						
Options outstanding at beginning of period	90	\$26.92	75	\$27.25	55	\$19.04
Granted	22	15.58	15	24.44	20	49.81
Exercised	—	—	—	—	—	—
Terminated	—	—	—	—	—	—
Options outstanding at end of period	112	22.64	90	26.92	75	27.25
Options exercisable at end of period	62	22.24	45	16.97	32	18.65
Weighted-average fair value of options granted during the period						
	\$ 12.25		\$ 24.85		\$ 30.83	
Price range of outstanding options	\$6.13 - \$64.94		\$6.13 - \$64.94		\$6.13 - \$64.94	
Price range of options terminated	\$ —		\$ —		\$ —	

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), defines a fair value based method of accounting for employee stock options or similar equity instruments. However, SFAS No. 123 allows the continued measurement of compensation cost for such plans using the intrinsic value based method prescribed by APB No. 25, provided that pro forma disclosures are made of net income or loss and net income or loss per share, assuming the fair value based method of SFAS No. 123 had been applied. The Company has elected to account for employee stock-based compensation plans under APB No. 25, under which com-

pensation expense, if any, is recognized based on the intrinsic value of stock options and other stock awards, generally measured at the date of grant (see Note 1).

The total fair value of options granted was computed to be approximately \$33,170,000, \$17,675,000 and \$15,719,000 for the years ended December 31, 2002, 2001 and 2000, respectively. These amounts are amortized ratably over the vesting period of the options.

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The following table summarizes information about the stock options outstanding at December 31, 2002:

Range of Exercise Prices	Number Outstanding	Options Outstanding		Options Exercisable	
		Weighted-average Remaining Contractual Life	Weighted-average Exercise Price	Number Exercisable	Weighted-average Exercise Price
\$ 0.67 to \$ 6.75	188,000	5.0 years	\$ 5.69	183,000	\$ 5.68
\$ 7.50 to \$ 7.70	453,000	9.3 years	\$ 7.69	57,000	\$ 7.62
\$ 8.25 to \$ 16.51	418,000	5.7 years	\$ 12.21	333,000	\$ 11.66
\$ 17.32 to \$ 17.57	23,000	7.1 years	\$ 17.38	18,000	\$ 17.32
\$ 17.85 to \$ 17.85	565,000	9.6 years	\$ 17.85	3,000	\$ 17.85
\$ 18.00 to \$ 24.90	542,000	8.9 years	\$ 22.56	59,000	\$ 18.58
\$ 26.13 to \$ 28.55	385,000	7.4 years	\$ 27.65	247,000	\$ 27.71
\$ 29.53 to \$ 36.94	282,000	8.1 years	\$ 33.06	160,000	\$ 33.97
\$ 38.55 to \$ 38.55	381,000	9.3 years	\$ 38.55	—	—
\$ 40.00 to \$ 64.94	350,000	7.1 years	\$ 46.60	241,000	\$ 46.08
	3,587,000	8.1 years	\$ 23.23	1,301,000	\$ 23.20

17 FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments include cash, trade receivables, trade payables, marketable securities, short-term and long-term debt, and foreign currency forward exchange contracts (see Note 1). The fair values of cash, trade receivables, trade payables and short-term debt approximate the carrying values due to the short-term nature of these instruments. Marketable securities are stated at fair value (see Note 3). At December 31, 2002 and 2001, the carrying value of long-term debt was \$212.2 million and \$207.7 million, respectively. The carrying value of the notes payable and senior borrowing approximates its fair value due to the variable interest rates associated with the borrowings. At December 31, 2002, the estimated fair value of the Company's 5.25% convertible subordinated notes that are due November 15, 2006, was approximately \$53.0 million, compared to a book value of \$66.2 million. The estimated fair value of the Company's 5.00% convertible subordinated notes that are due September 1, 2006, was approximately \$103.3 million, compared to a book value of \$121.5 million.

18 GOODWILL IMPAIRMENT

During the second quarter of 2001, the Company terminated the operations of Tower and FST, due to significant softening in the projected demand for these products. Revenue contributed by Tower and FST operations for 2001 and 2000 represented less than 5% of total revenue for each period. Because the expected future cash flows for these products

were insignificant after the second quarter of 2001, the Company recognized an impairment charge of \$3.6 million related to the termination of Tower and a charge of \$1.8 million related to the termination of FST. These amounts represented the carrying values of these assets on June 30, 2001, before the writedown. These charges are disclosed as impairment of goodwill and other intangible assets in the accompanying consolidated statements of operations.

19 SUBSEQUENT EVENTS

Subsequent to December 31, 2002, the Company agreed in principle to advance \$1.5 million to a privately held corporation which has developed the technology used in etching processes at normal atmospheric pressures. These advances will be made over the next two years, pending the attainment of certain business development milestones, by the private company.

20 QUARTERLY FINANCIAL DATA—UNAUDITED

The following table presents unaudited quarterly financial data for each of the eight quarters in the period ended December 31, 2002. The Company believes that all necessary adjustments have been included in the amounts stated below to present fairly such quarterly information. The operating results for any quarter are not necessarily indicative of results for any subsequent period.

	Quarters Ended							
	Mar. 31, 2001	June 30, 2001	Sept. 30, 2001	Dec. 31, 2001	Mar. 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002
(In thousands, except per share data)								
Sales	\$74,714	\$ 46,171	\$ 38,722	\$ 33,993	\$ 42,887	\$67,893	\$70,674	\$ 57,444
Gross profit	31,223	7,781	11,036	7,392	13,374	24,312	26,600	4,474
Income (loss) from operations	7,531	(20,927)	(11,663)	(21,828)	(11,423)	(9,330)	(5,788)	(35,444)
Net income (loss) before extraordinary item	5,094	(14,549)	(7,482)	(14,442)	(8,723)	(5,139)	(5,580)	(24,596)
Extraordinary item (net of income taxes)	—	—	—	—	—	—	—	2,639
Net income (loss)	\$ 5,094	\$(14,549)	\$(7,482)	\$(14,442)	\$ (8,723)	\$ (5,139)	\$(5,580)	\$(21,957)
Diluted earnings (loss) per share before extraordinary item	\$ 0.16	\$ (0.46)	\$ (0.24)	\$ (0.45)	\$ (0.27)	\$ (0.16)	\$ (0.17)	\$ (0.77)
Diluted earnings per share from extraordinary item	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 0.09
Diluted earnings (loss) per share	\$ 0.16	\$ (0.46)	\$ (0.24)	\$ (0.45)	\$ (0.27)	\$ (0.16)	\$ (0.17)	\$ (0.68)

The Company had a loss in the fourth quarter of 2002 of \$22.0 million. Pretax charges recorded to cost of sales for excess and obsolete inventory of \$4.6 million and warranty costs of \$6.9 million contributed significantly to the Company's fourth quarter results. The Company increased its reserve for excess and obsolete inventory in the fourth quarter of 2002, as a result of the Company's sales declining substantially from the third quarter of 2002 to the fourth

quarter of 2002, and the Company's fourth quarter strategic management decision to discontinue certain product offerings. The Company increased its warranty reserve to reflect higher than expected repair costs on certain products. The Company also recorded charges for uncollectible accounts receivable of \$1.6 million, restructuring of \$5.8 million and an impairment of marketable securities of \$1.6 million (see Note 1).