

## Report of Independent Registered Public Accounting Firm

Board of Directors and  
Shareholders of Advanced Energy Industries, Inc.

We have audited the accompanying consolidated balance sheet of Advanced Energy Industries, Inc. and subsidiaries (the Company) as of December 31, 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (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 audit provides a reasonable basis for our opinion.

In our opinion, the consolidated 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, 2004, 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule II listed in the index of financial statements is presented for purposes of additional analysis and is not a required part of the basic financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

We were also engaged to audit, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Advanced Energy Industries, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management was unable to complete their assessment of internal control over financial reporting as of December 31, 2004 in a timely manner, and due to that scope limitation we were unable to perform the procedures required to enable us to express, and we did not express, an opinion on management's assessment or on the effectiveness of the Company's internal control over financial reporting in our report dated March 30, 2005.

/s/ GRANT THORNTON LLP

Denver, Colorado  
March 30, 2005

## Report of Independent Registered Public Accounting Firm

Board of Directors and  
Shareholders of Advanced Energy Industries, Inc.

We were engaged to audit management's assessment, included in the accompanying Management's Reports on Internal Control Over Financial Reporting (included in Item 9A of this Form 10-K), that Advanced Energy Industries, Inc. (the Company) maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The Company's management has identified two material weaknesses, the first relates to the lack of segregation of duties within the Company's enterprise resource planning (ERP) system, as certain employees have ERP system access to record transactions outside of their assigned job responsibilities. The Company's ERP system is integrated throughout the organization including material foreign locations, with the exception of the Japan subsidiaries. The ERP system interacts with most of the Company's major processes including manufacturing, payables, receivables and inventory controls. This material weakness could result in a material misstatement of annual and interim financial statements that would not be prevented or detected, in the normal course of operations. The second material weakness relates to two significant deficiencies in the Company's Japan operations, that when considered in the aggregate, represents a material weakness. The first significant deficiency relates to both of the Japan facilities having their own unique information system, as well as a lack of segregation of duties, with certain employees having access in these systems to record transactions outside of their assigned job responsibilities. The second significant deficiency in Japan was caused in the fourth quarter of 2004 by the departure of key management personnel in Japan, creating a lack of proper segregation of duties and oversight at the local level. The Japan material weakness could result in a material misstatement of the operating results of the Japanese subsidiaries which are included in the annual and interim financial statements that would not be prevented or detected, in the normal course of operations. These material weaknesses were considered in determining the nature, timing and extent of audit tests applied in our audit of the 2004 consolidated financial statements. The material weaknesses identified did not affect our opinion on the Company's consolidated financial statements.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Since management was unable to complete its assessment timely and we were unable to apply other procedures to satisfy ourselves as to the effectiveness of the Company's internal control over financial reporting, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion either on management's assessment or on the effectiveness of the Company's internal control over financial reporting.

We have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Advanced Energy Industries, Inc. as of December 31, 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for the year then ended and our report dated March 30, 2005 expressed an unqualified opinion on those financial statements.

*/s/ GRANT THORNTON LLP*

Denver, Colorado  
March 30, 2005

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
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, 2003 and the related consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows for each of the years in the two-year period then ended. In connection with our audits of these consolidated financial statements, we also have audited the related financial statement schedules as listed in the accompanying index. These consolidated financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 consolidated 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, 2003, and the results of their operations and their cash flows for each of the years in the two-year period then ended, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

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.

Advanced Energy Industries, Inc. and subsidiaries adopted the provisions of Statement of Financial Accounting Standards No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*, effective January 1, 2003.

/s/ KPMG LLP

Denver, Colorado  
February 20, 2004

**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**  
**(In thousands)**

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents.....	\$ 38,404	\$ 41,522
Marketable securities .....	69,578	93,370
Accounts receivable --		
Trade (less allowances for doubtful accounts of approximately		
\$1,049 and \$1,303 at December 31, 2004 and 2003, respectively) .....	66,610	57,156
Other.....	5,443	4,771
Income tax receivable .....	404	151
Inventories, net.....	73,224	65,703
Other current assets .....	<u>5,736</u>	<u>5,486</u>
Total current assets.....	259,399	268,159
PROPERTY AND EQUIPMENT, at cost, net of accumulated depreciation of \$59,464 and \$50,848 at December 31, 2004 and 2003, respectively .....	44,746	44,725
<b>OTHER ASSETS:</b>		
Deposits and other.....	6,468	5,951
Goodwill.....	68,276	69,510
Other intangible assets, net of accumulated amortization of \$9,624 and \$11,197 at December 31, 2004 and 2003, respectively .....	12,032	19,433
Demonstration and customer service equipment, net of accumulated amortization of \$6,880 and \$5,688 at December 31, 2004 and 2003, respectively .....	2,968	3,934
Deferred debt issuance costs, net .....	<u>2,086</u>	<u>3,019</u>
Total assets.....	<u>\$395,975</u>	<u>\$414,731</u>

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

**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands, except per share data)**

	<b>December 31,</b>	
	<b>2004</b>	<b>2003</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Trade accounts payable .....	\$ 17,683	\$ 23,066
Taxes payable .....	2,974	445
Accrued payroll and employee benefits .....	7,788	7,953
Accrued warranty expense .....	6,791	6,612
Accrued restructuring charges .....	4,414	3,175
Other accrued expenses .....	5,986	7,079
Customer deposits and deferred revenue .....	662	2,952
Capital lease obligations, current portion .....	294	554
Senior borrowings, current portion .....	3,432	8,028
Accrued interest payable on convertible subordinated notes .....	2,460	2,460
<b>Total current liabilities .....</b>	<b><u>52,484</u></b>	<b><u>62,324</u></b>
<b>LONG-TERM LIABILITIES:</b>		
Capital leases, net of current portion .....	421	263
Senior borrowings, net of current portion .....	4,258	5,905
Deferred income tax liabilities, net .....	3,709	4,672
Convertible subordinated notes payable .....	187,718	187,718
Other long-term liabilities .....	2,407	2,015
<b>Total long-term liabilities .....</b>	<b><u>198,513</u></b>	<b><u>200,573</u></b>
<b>Total liabilities .....</b>	<b><u>250,997</u></b>	<b><u>262,897</u></b>
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding .....	--	--
Common stock, \$0.001 par value, 70,000 shares authorized; 32,760 and 32,573 shares issued and outstanding at December 31, 2004 and 2003, respectively .....	33	33
Additional paid-in capital .....	144,500	142,667
Accumulated deficit .....	(12,795)	(48)
Deferred compensation .....	--	(60)
Unrealized holding gains on available-for-sale securities, net .....	1,051	1,491
Cumulative translation adjustments, net .....	12,189	7,751
<b>Total stockholders' equity .....</b>	<b><u>144,978</u></b>	<b><u>151,834</u></b>
<b>Total liabilities and stockholders' equity .....</b>	<b><u>\$395,975</u></b>	<b><u>\$414,731</u></b>

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

**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share amounts)**

	<u>Years Ended December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
SALES .....	\$395,305	\$262,402	\$238,898
COST OF SALES .....	<u>275,626</u>	<u>174,455</u>	<u>170,138</u>
GROSS PROFIT .....	<u>119,679</u>	<u>87,947</u>	<u>68,760</u>
OPERATING EXPENSES:			
Research and development .....	51,541	51,647	48,995
Selling, general and administrative .....	62,444	53,951	66,586
Litigation damages .....	--	--	4,200
Restructuring charges .....	3,912	4,306	9,060
Impairment of intangible assets .....	<u>3,326</u>	<u>1,175</u>	<u>1,904</u>
Total operating expenses .....	<u>121,223</u>	<u>111,079</u>	<u>130,745</u>
LOSS FROM OPERATIONS .....	<u>(1,544)</u>	<u>(23,132)</u>	<u>(61,985)</u>
OTHER INCOME (EXPENSE):			
Interest income .....	1,737	1,721	3,314
Interest expense .....	(11,049)	(11,254)	(12,460)
Foreign currency gain .....	1,023	869	5,280
Gain on retirement of convertible subordinated notes .....	--	--	4,223
Other income (expense), net .....	<u>1,033</u>	<u>(644)</u>	<u>(2,064)</u>
Net loss before income taxes .....	<u>(7,256)</u>	<u>(9,308)</u>	<u>(1,707)</u>
(PROVISION) BENEFIT FOR INCOME TAXES .....	(8,800)	(32,440)	(63,692)
NET LOSS .....	<u>(3,947)</u>	<u>(11,801)</u>	<u>22,293</u>
	<u>\$(12,747)</u>	<u>\$(44,241)</u>	<u>\$(41,399)</u>
BASIC AND DILUTED NET LOSS PER SHARE .....	<u>\$(0.39)</u>	<u>\$(1.37)</u>	<u>\$(1.29)</u>
BASIC AND DILUTED WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING .....	<u>32,649</u>	<u>32,271</u>	<u>32,026</u>

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

**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND  
COMPREHENSIVE LOSS  
(In thousands)**

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Retained Earnings (Accumulated Deficit)</u>	<u>Deferred Compensation</u>	<u>Accumulated Other Comprehensive (Loss) Income</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>					
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 loss:							
Equity adjustment from foreign currency translation, net of tax .....	--	--	--	--	--	4,400	
Unrealized holding losses, net of tax .....	--	--	--	--	--	(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
Exercise of stock options for cash .....	360	1	3,499	--	--	--	3,500
Sale of common stock through employee stock purchase plan .....	73	--	739	--	--	--	739
Amortization of deferred compensation .....	--	--	--	--	482	--	482
Comprehensive loss:							
Equity adjustment from foreign currency translation, net of tax .....	--	--	--	--	--	6,491	
Unrealized holding gains, net of tax .....	--	--	--	--	--	1,524	
Net loss .....	--	--	--	(44,241)	--	--	
Total comprehensive loss .....	--	--	--	--	--	--	(36,226)
BALANCES, December 31, 2003 .....	32,573	\$ 33	\$142,667	\$(48)	\$(60)	\$ 9,242	\$151,834
Exercise of stock options for cash .....	122	--	1,224	--	--	--	1,224
Sale of common stock through employee stock purchase plan .....	65	--	609	--	--	--	609
Amortization of deferred compensation .....	--	--	--	--	60	--	60
Comprehensive loss:							
Equity adjustment from foreign currency translation, net of tax .....	--	--	--	--	--	4,438	
Unrealized holding losses, net of tax .....	--	--	--	--	--	(146)	
Reclassification adjustment for amounts included in net loss related to sales of securities .....	--	--	--	--	--	(294)	
Net loss .....	--	--	--	(12,747)	--	--	
Total comprehensive loss .....	--	--	--	--	--	--	(8,749)
BALANCES, December 31, 2004 .....	<u>32,760</u>	<u>\$ 33</u>	<u>\$144,500</u>	<u>\$(12,795)</u>	<u>\$ --</u>	<u>\$13,240</u>	<u>\$144,978</u>

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

**ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

	<u>Years Ended December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net loss .....	\$(12,747)	\$(44,241)	\$(41,399)
Adjustments to reconcile net loss to net cash used in operating activities -			
Depreciation and amortization .....	21,119	21,829	23,289
Demonstration and evaluation equipment write-off .....	3,752	--	--
Provision (benefit) for deferred income taxes .....	444	6,429	(6,888)
Provision for excess and obsolete inventory .....	11,262	3,016	5,803
Asset impairment charges .....	3,326	1,350	5,066
Provision for (recovery of) doubtful accounts .....	198	(429)	1,870
Unrealized (gain) loss on foreign currency forward contracts .....	(107)	160	388
Gain on retirement of convertible subordinated notes .....	--	--	(4,223)
Net (gain) loss on disposal of assets .....	(864)	2,846	359
Unrealized gain on intercompany foreign currency loan .....	--	--	(4,879)
Changes in operating assets and liabilities, net of assets and liabilities acquired -			
Accounts receivable-trade .....	(8,925)	(14,556)	(5,067)
Inventories .....	(19,783)	(11,339)	3,021
Other current assets .....	(675)	(62)	(846)
Accounts payable – trade .....	(5,849)	5,873	2,366
Other current liabilities and accrued expenses .....	(2,329)	(2,379)	8,293
Income taxes payable/receivable, net .....	2,507	16,530	608
Non-current assets .....	(3,099)	666	(3,760)
Non-current liabilities .....	392	1,321	694
Net cash used in operating activities .....	<u>(11,378)</u>	<u>(12,986)</u>	<u>(15,305)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of marketable securities .....	(1,208)	(1,308)	(2,499)
Proceeds from sale of marketable securities .....	25,000	10,106	90,439
Proceeds from sale of assets .....	2,556	5,196	350
Purchase of property and equipment .....	(14,019)	(20,509)	(10,714)
Purchase of investments and advances .....	--	(400)	(2,781)
Acquisition of Aera Japan Limited, net of cash acquired .....	--	--	(35,689)
Acquisition of Dressler HF Technik GmbH, net of cash acquired .....	--	(1,675)	(14,395)
Acquisition of interest in Litmas, net of cash acquired .....	--	--	(400)
Net cash provided by (used in) investing activities .....	<u>12,329</u>	<u>(8,590)</u>	<u>24,311</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from senior borrowings .....	1,585	--	--
Repayment of senior borrowings and capital lease obligations .....	(8,609)	(12,847)	(10,190)
Repurchase of convertible subordinated debt, net .....	--	--	(14,522)
Sale of common stock through employee stock purchase plan .....	609	739	689
Proceeds from exercise of stock options .....	1,224	3,500	1,389
Net cash used in financing activities .....	<u>(5,191)</u>	<u>(8,608)</u>	<u>(22,634)</u>
EFFECT OF CURRENCY TRANSLATION ON CASH .....	<u>1,122</u>	<u>1,518</u>	<u>1,861</u>
DECREASE IN CASH AND CASH EQUIVALENTS .....	(3,118)	(28,666)	(11,767)
CASH AND CASH EQUIVALENTS, beginning of year .....	41,522	70,188	81,955
CASH AND CASH EQUIVALENTS, end of year .....	<u>\$ 38,404</u>	<u>\$ 41,522</u>	<u>\$ 70,188</u>
<b>SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>			
Tax benefit related to shares acquired by employees under stock option plans .....	\$ --	\$ --	\$ 468
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Cash paid for interest .....	\$ 9,949	\$ 10,521	\$ 11,517
Cash paid (received) for income taxes, net .....	\$ 1,227	\$ (9,642)	\$ (16,086)
Assets sold for note receivable .....	\$ 1,842	\$ 1,538	\$ --

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

## ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (1) COMPANY OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Advanced Energy Industries, Inc., 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.

*BASIS OF PRESENTATION* -- The consolidated financial statements include the accounts of Advanced Energy Industries, Inc. and its' wholly-owned subsidiaries (collectively, the "Company") since their dates of acquisition (see Note 2). 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.

*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 Statement of Financial Accounting Standard ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information," the Company's chief operating decision maker has been identified as the Chief Executive Officer, who 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 consolidated financial statements and notes thereto.

*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 revenue 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 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 December 2004, the Financial Accounting Standards Board ("FASB") reissued SFAS No. 123, "Accounting for Stock-Based Compensation" as SFAS No. 123(R), "Share Based Compensation." This statement replaces SFAS No. 123, amends SFAS No. 95, "Statement of Cash Flows", and supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) requires companies to apply a fair-value based measurement method in accounting for share-based payment transactions with employees and to record compensation expense for all stock awards granted, and to awards modified, repurchased or cancelled after the required effective date. Compensation expense for outstanding awards for which the requisite service had not been rendered as of the effective date will be recognized over the remaining

service period using the compensation cost calculated for pro forma disclosure purposes under SFAS No. 123, adjusted for expected forfeitures. Additionally, SFAS No. 123(R) will require entities to record compensation expense for employee stock purchase plans that may not have previously been considered compensatory under the existing rules. SFAS No. 123(R) will be effective for quarterly periods beginning after June 15, 2005, which is the Company's third quarter of 2005. The Company will adopt the provisions of SFAS No. 123(R) using a modified prospective application. This statement may have a significant impact on the Company's results of operations as the Company will be required to record compensation expense in the consolidated statement of operations rather than disclose the impact on the Company's results of operations within its notes to the consolidated financial statements (see Note 18).

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs", an amendment of Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing." SFAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges. In addition, it requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 will be effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and will be applied on a prospective basis by the Company for the fiscal year beginning January 1, 2006. The Company is currently evaluating the impact that adoption of SFAS No. 151 will have on its financial position and results of operations.

*REVENUE RECOGNITION* -- The Company's standard shipping term is freight on board ("FOB") shipping point, for which revenue is recognized upon shipment of its products, at which time title passes to the customer, the price is fixed and collectability is reasonably assured. For certain customers, the Company has FOB destination terms, for which revenue is recognized upon receipt of the products by the customer, at which time title passes to the customer, the price is fixed and collectability is reasonably assured. Generally, the Company does not have obligations to its customers after its products are shipped under FOB shipping point terms or after its products are received by the customer under FOB destination terms, other than pursuant to warranty obligations. In limited instances, the Company provides installation of its products. In accordance with Emerging Issues Task Force ("EITF") Issue 00-21 "Accounting for Revenue Arrangements With Multiple Deliverables", the Company allocates revenue based on the fair value of the delivered item, generally the product, and the undelivered item, installation, based on their respective fair values. Revenue related to the undelivered item is deferred until the services have been completed. In certain limited instances, some of the Company's customers have negotiated product acceptance provisions relative to specific orders. Under these circumstances, the Company defers revenue recognition until the related acceptance provisions have been satisfied. Revenue deferrals are reported as customer deposits and deferred revenue in the consolidated balance sheets.

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 and deferred revenue in the consolidated balance sheets, and then recognized as revenue upon shipment of the products. The Company does not offer price protections to its customers or allow returns, unless covered by its normal policy for repair of defective products.

*SHIPPING AND HANDLING COSTS* – Amounts billed to customers for shipping and handling are recorded in sales in the consolidated statements of operations. Shipping and handling costs incurred by the Company for the delivery of products to customers are included in cost of sales in the consolidated statements of operations.

*EXCESS AND OBSOLETE INVENTORY*-- Inventory is written down or written off when it becomes obsolete, generally due to engineering changes to a product or discontinuance of a product line, or when it is deemed excess. Judgment by management is necessary in estimating the net realizable value of inventory based primarily upon forecasts of product demand. Charges for excess and obsolete inventory are recorded, as necessary, within cost of sales in the consolidated statements of operations. For the years ended December 31, 2004, 2003 and 2002, the Company recorded charges for excess and obsolete inventory of \$11.3 million, \$3.0 million and \$5.8 million, respectively.

**WARRANTY POLICY** -- The Company offers warranty coverage for its products for periods typically ranging from 12 to 24 months after shipment. 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 recorded within cost of sales in the consolidated statements of operations. The Company recorded warranty charges of \$10.5 million, \$8.1 million and \$13.2 million for the years ended December 31, 2004, 2003 and 2002, respectively. The following summarizes the activity in the Company's warranty reserves during 2004 and 2003:

	<u>2004</u>	<u>2003</u>
	(In thousands)	
Balance at beginning of period	\$ 6,612	\$ 9,402
Additions charged to expense	10,466	8,105
Deductions	<u>(10,287)</u>	<u>(10,895)</u>
Balance at end of period	<u>\$ 6,791</u>	<u>\$ 6,612</u>

**SELLING, GENERAL AND ADMINISTRATIVE** -- Selling, general and administrative expenses in the accompanying consolidated statements of operations are expensed as incurred, including legal and advertising costs.

**STOCK-BASED COMPENSATION** -- At December 31, 2004, the Company had three active stock-based compensation plans, which are more fully described in Note 18. 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. APB Opinion No. 25 requires the use of the intrinsic value method, which measures compensation cost as the excess, if any, of the quoted market price of the stock at the measurement date over the amount an employee must pay to acquire the stock. With the exception of certain options granted in 1999 and 2000 by a shareholder of Sekidenko, Inc., 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 the Company's net loss. Had compensation cost for the Company's plans been determined consistent with the fair value-based method prescribed by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net loss would have increased to the following adjusted amounts:

(in thousands, except per share data)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net loss:			
As reported	\$ (12,747)	\$ (44,241)	\$ (41,399)
Adjustment for stock-based compensation determined under fair value-based method for all awards, net of related tax effects in 2002 (a), (b)	(12,133)	(12,410)	(9,794)
Less: Compensation expense recognized in net loss, net of related tax effects in 2002 (a), (c)	60	482	324
As adjusted	<u>\$ (24,820)</u>	<u>\$(56,169)</u>	<u>\$(50,869)</u>
Basic and diluted loss per share:			
As reported	\$ (0.39)	\$ (1.37)	\$ (1.29)
As adjusted	\$ (0.76)	\$ (1.74)	\$ (1.59)

(a) Compensation expense in 2004 and 2003 is presented prior to income tax effects due to the Company recording valuation allowances against certain deferred tax assets in 2003 (see Note 12).

(b) Cumulative compensation cost recognized with respect to options that are forfeited prior to vesting is reflected as a reduction of compensation expense in the period of forfeiture. Compensation expense related to awards granted under the Company's employee stock purchase plan is estimated until the period in which settlement occurs, as the number of shares of common stock awarded and the purchase price are not known until settlement.

(c) Prior to its acquisition by the Company, a shareholder of Sekidenko, Inc. granted employees options under a preexisting arrangement to purchase shares of his common stock already outstanding at exercise prices below fair value. Under this agreement, 29,700 and 34,250 of such options were granted in 1999 and 2000, respectively. These options result in the Company recognizing approximately \$2.1 million as compensation expense over the four-year vesting period of the options. The options fully vested during the first quarter of 2004.

For SFAS No. 123 purposes, the fair value of each option grant and purchase right granted under the ESPP are estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2004	2003	2002
<b>OPTIONS:</b>			
Risk-free interest rates	3.05%	2.96%	3.89%
Expected dividend yield rates	0.0%	0.0%	0.0%
Expected lives	3.0 years	2.9 years	2.9 years
Expected volatility	75.23%	85.64%	88.05%
<b>ESPP:</b>			
Risk-free interest rates	1.70%	1.34%	1.91%
Expected dividend yield rates	0.0%	0.0%	0.0%
Expected lives	0.5 years	0.5 years	0.5 years
Expected volatility	65.31%	83.82%	76.62%

Based on the Black-Scholes option pricing model, the weighted-average estimated fair value of employee stock option grants was \$8.49, \$7.88 and \$12.54 for the years ended December 31, 2004, 2003 and 2002, respectively. The weighted-average estimated fair value of purchase rights granted under the ESPP was \$3.45, \$4.99 and \$8.92 for the years ended December 31, 2004, 2003 and 2002, respectively.

The total fair value of options granted was computed to be approximately \$10.9 million, \$14.3 million and \$24.4 million for the years ended December 31, 2004, 2003 and 2002, respectively. These amounts are amortized ratably over the vesting period of the options for the purpose of calculating the pro forma disclosure above.

The Company will adopt the provisions of SFAS No. 123(R) as of the Company's third quarter of fiscal year 2005, as further discussed the heading "New Accounting Pronouncements" above. The adoption of this statement may have a significant impact on the Company's results of operations as the Company will be required to record compensation expense in the consolidated statement of operations rather than disclose the impact on the Company's results of operations within its notes to the consolidated financial statements.

*COMMITMENTS AND CONTINGENCIES* -- We are involved in disputes and legal actions arising in the normal course of our business. While we currently believe that the amount of any ultimate potential loss would not be material to our 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 our financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in our inability to ship products or components found to have violated third-party patent rights. We accrue loss contingencies in connection with our commitments and contingencies, including litigation, when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

*CASH AND CASH EQUIVALENTS* -- The Company considers all amounts on deposit with financial institutions and highly liquid investments (valued at cost, which approximates fair value) with an original maturity of 90 days or less to be cash and cash equivalents.

*CONCENTRATIONS OF CREDIT RISK* -- Financial instruments, which potentially subject the Company to credit risk, include cash and cash equivalents, marketable securities and trade accounts receivable. The Company maintains cash and cash equivalents, marketable securities 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.

*MARKETABLE SECURITIES* -- The Company's investment in marketable securities, includes commercial paper, municipal bonds and notes and institutional money markets. These investments are classified as available for sale securities, and are recorded at fair value with changes in fair market value recorded as unrealized holding gains or losses in other comprehensive loss, net of tax. Due to the short-term, highly liquid nature of the marketable securities held by the Company, the cost, including accrued interest on such investments, approximates fair value.

The Company also has investments in marketable equity securities which have been included in deposits and other in the accompanying consolidated balance sheets, due to the Company's expressed intent and demonstrated ability to hold for greater than one year. These investments are classified as available-for-sale securities and are reported at fair value with unrealized holding gains and losses included in other comprehensive loss, net of tax.

*INVENTORIES, NET* -- 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 excess and obsolete inventory.

*PROPERTY AND EQUIPMENT* -- Property and equipment is stated at cost or estimated fair value upon acquisition. Depreciation is computed using the straight-line method over thirty-five to forty years for buildings; three to ten years for machinery, equipment, furniture and fixtures and vehicles; and three years for computers and communication equipment. Amortization of leasehold improvements and leased equipment is calculated using the straight-line method over the lease term or the estimated useful life of the assets, whichever period is shorter. Additions, improvements, and major renewals are capitalized, while maintenance, repairs, and minor renewals are expensed as incurred. When depreciable assets are retired, or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any related gains or losses are included in the consolidated statement of operations. Property and other long-lived assets are reviewed for impairment whenever events or circumstances indicate that their carrying amount may not be recoverable.

*GOODWILL AND OTHER INTANGIBLE ASSETS* -- Goodwill represents the excess of the cost over the fair market value of net tangible and identifiable intangible assets of acquired businesses.

Goodwill and certain other intangible assets with indefinite lives are not amortized. Instead, goodwill and other indefinite-lived intangible assets are subject to periodic (at least annual) tests for impairment. For the periods presented, the Company does not have any indefinite-lived intangible assets, other than goodwill. Impairment testing is performed in two steps: (i) the Company assesses goodwill for potential impairment by comparing the fair value of its reporting unit with its carrying value, and (ii) if potential impairment is indicated because the reporting unit's 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.

Finite-lived intangible assets continue to be amortized using the straight-line method over their estimated useful lives and are reviewed for impairment whenever events or circumstances indicate that their carrying amount may not be recoverable.

*DEMONSTRATION AND CUSTOMER SERVICE EQUIPMENT* -- Demonstration equipment is manufactured product that is utilized for sales demonstration and evaluation purposes. Customer service equipment is manufactured product that is utilized as replacement and loaner equipment to existing customers.

Historically, the Company has amortized demonstration and customer service equipment over its estimated useful life of two years. During the fourth quarter of 2004, as a result of the continuing process of obtaining and analyzing historical data and the Company's plan for use of the current and future demonstration equipment, the Company made a change in the estimated useful life of the demonstration equipment from two years to zero years. As a result of this change in estimate, the net book value of demonstration equipment of approximately \$3.2 million, net of tax, or \$0.10 per share, was written off.

The Company's current policy is to record selling, general and administrative expense for the demonstration equipment as it is placed into service at our customers' or potential customers' location. Customer service equipment will continue to be amortized over its estimated useful life of two years.

*FOREIGN CURRENCY TRANSLATION* -- The functional currency of the Company's foreign subsidiaries is their local currency, with the exception of the Company's manufacturing facility in Shenzhen, China where the U.S. dollar is the functional currency. Assets and liabilities of international subsidiaries are translated to U.S. dollars at period-end exchange rates, and statement of operations activity and cash flows are translated at average exchange rates during the period. Resulting translation adjustments are recorded as a separate component of stockholders' 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.

*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 designed and manufactured plasma gas abatement systems and high-density plasma sources. The purchase price consisted of \$1.0 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 assets as goodwill. The results of operations of Litmas have been consolidated in the Company's financial statements from the date the controlling interest of 56.5% was acquired. In October 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%. In April 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 the remaining minority interest in Litmas resulted in approximately \$5.0 million of additional goodwill.

*DRESSLER* -- On March 28, 2002, the Company acquired Dressler HF Technik GmbH ("Dressler"), a privately owned Stolberg, Germany-based provider of power supplies and matching networks, for a purchase price of approximately \$15.0 million in cash and a \$1.7 million escrow. The escrow fund was retained by the Company until January 2003, at which time the related escrow liability was settled. The purchase price was also subject to a \$3.0 million earn-out provision if Dressler achieved certain key business objectives by March 30, 2003. These business objectives were not met prior to the expiration date.

The Company believes that Dressler expands the Company's product offerings to customers in the semiconductor, data storage, and flat panel equipment markets due to its strong power product portfolio that includes a wide range of power levels and radio frequencies. In addition, with inroads already made into the laser and medical markets, Dressler is used to explore new market opportunities for the Company. Dressler also strengthens 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 acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations" ("SFAS No. 141"), 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
Property and equipment	260
Goodwill	9,405
Other intangible assets	7,750
Other assets	19
Accounts payable	(314)
Accrued payroll	(39)
Other accrued expenses	(474)
Deferred tax liability	(2,945)
Income taxes payable	(725)
	<u>\$16,750</u>

The excess purchase price over the estimated fair value of tangible net assets acquired was allocated to goodwill and other intangible assets (see Notes 1 and 8). The Company recognized approximately \$2.3 million, \$2.5 million and \$769,000 of amortization expense related to these amortizable intangibles acquired from Dressler for the years ended December 31, 2004, 2003 and 2002, respectively.

Prior to the combination, there were transactions between the Company and Dressler in the first three months of 2002, during which time 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 acquired Aera Japan Limited ("Aera"), 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 paid by AE-Japan was 5.7 billion Japanese yen (approximately \$44.0 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 \$34.0 million of Aera's debt. 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 acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141 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
Property and equipment	13,388
Goodwill	24,869
Other intangible assets	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	<u>(19,598)</u>
	<u>\$43,965</u>

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 other intangible assets (see Notes 1 and 8). The Company recognized approximately \$1.5 million, \$1.4 million and \$3.0 million of amortization expense related to the amortizable intangibles acquired from Aera for the years ended December 31, 2004, 2003 and 2002, respectively.

The pro forma results for the Company, Aera and Dressler for the year ended December 31, 2002, assuming the acquisitions of Aera and Dressler occurred on January 1, 2002, are not presented as the difference between the pro forma results and actual results are not material.

### **(3) RESTRUCTURING COSTS**

Restructuring charges include the costs associated with actions taken by the Company primarily in response to downturns in the semiconductor capital equipment industry. These charges consist of costs that are incurred to exit an activity or cancel an existing contractual obligation, including the closure of facilities and employee termination related charges.

Effective January 1, 2003, the Company adopted SFAS No. 146, "Accounting for Exit or Disposal Activities", which nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity." SFAS No. 146 requires costs associated with exit or disposal activities to be recognized when they are incurred, whereas under EITF Issue No. 94-3, a liability was recognized at the date of an entity's commitment to an exit plan. As related to employee termination benefits, the provisions of SFAS No. 146 offer guidance on "one-time termination benefits", and exclude from the scope "on-going benefit arrangements", therefore, the Company follows the guidance within SFAS No. 146 for voluntary severances and other one-time termination benefits.

The accounting for the standard severance benefits that the Company pays for involuntarily severed employees, considered an on-going benefit arrangement, is excluded from the scope of SFAS No. 146. For these benefits, the Company follows the guidance under SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits." Severance costs accounted for under SFAS No. 88 are accrued and recorded as restructuring expense when such amount is probable that employees will be entitled to benefits and the amount can be reasonably estimated.

The following table summarizes the components of the restructuring charges, the payments and non-cash charges, and the remaining accrual as of December 31, 2004, 2003 and 2002:

	<b>Employee Severance and Termination Costs</b>	<b>Facility Closure Costs</b>	<b>Total Restructuring Charges</b>
	<b>(In thousands)</b>		
Accrual balance December 31, 2001 .....	<u>\$ 965</u>	<u>\$ 462</u>	<u>\$ 1,427</u>
Third quarter 2002 restructuring charge.....	1,033	2,187	3,220
Fourth quarter 2002 restructuring charge.....	<u>2,021</u>	<u>3,819</u>	<u>5,840</u>
Total restructuring charges 2002 .....	3,054	6,006	9,060
Payments and other settlements in 2002.....	<u>(2,412)</u>	<u>(2,086)</u>	<u>(4,498)</u>
Accrual balance December 31, 2002 .....	<u>1,607</u>	<u>4,382</u>	<u>5,989</u>
First quarter 2003 restructuring charge.....	1,509	--	1,509
Second quarter 2003 restructuring charge.....	670	98	768
Third quarter 2003 restructuring charge.....	704	307	1,011
Fourth quarter 2003 restructuring charge .....	<u>994</u>	<u>24</u>	<u>1,018</u>
Total restructuring charges 2003 .....	3,877	429	4,306
Payments and other settlements in 2003.....	<u>(4,924)</u>	<u>(2,196)</u>	<u>(7,120)</u>
Accrual balance December 31, 2003 .....	<u>560</u>	<u>2,615</u>	<u>3,175</u>
First quarter 2004 restructuring charge.....	220	--	220
Second quarter 2004 restructuring charge.....	187	--	187
Third quarter 2004 restructuring charge.....	57	31	88
Third quarter 2004 restructuring reversal.....	<u>(127)</u>	<u>(126)</u>	<u>(253)</u>
Fourth quarter 2004 restructuring charge.....	<u>3,639</u>	<u>31</u>	<u>3,670</u>
Total net restructuring charges 2004.....	3,976	(64)	3,912
Payments and other settlements in 2004.....	<u>(1,243)</u>	<u>(1,430)</u>	<u>(2,673)</u>
Accrual balance December 31, 2004 .....	<u>\$ 3,293</u>	<u>\$ 1,121</u>	<u>\$ 4,414</u>

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 manufacturing and administrative employees in the Company's U.S. operations.

Included in the 2002 expense are charges for the closure of a portion of the Company's Voorhees, New Jersey manufacturing facilities, due to the transfer of the manufacturing of these products to Fort Collins, Colorado; the closure of a manufacturing facility in Fort Collins; the closure of a manufacturing facilities in Longmont, Colorado, due to the transfer of the manufacturing of these products to Fort Collins, Colorado and ultimately to Shenzhen, China; and the closure of Litmas. 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 consisted primarily of payments required under operating lease contracts and costs for writing down related leasehold improvements.

At the end of 2002, the Company announced major changes in its operations to occur through the end of 2003. These included establishing a new manufacturing facility in China, consolidating worldwide sales forces, a move to high-quality, low-cost suppliers local to our Shenzhen, China facility ("Tier 1 Asian suppliers"), and the intention to close or sell certain facilities.

Associated with the above plan, the Company recognized charges during 2003 as follows:

- In the first quarter of 2003, the Company recorded charges totaling approximately \$1.5 million primarily associated with manufacturing and administrative personnel headcount reductions in the Company's Japanese operations. In accordance with Japanese labor regulations the Company offered voluntary termination benefits to all of its Japanese employees. The voluntary termination benefits were accepted by 36 employees, with termination dates in the second quarter of 2003.
- In the second quarter of 2003, the Company recognized charges totaling \$768,000 that consisted primarily of the involuntary termination of 55 manufacturing and administrative personnel in the Company's U.S. operations.
- In the third quarter of 2003, the Company recognized charges of approximately \$1.0 million that consisted of \$704,000 of expense for involuntary employee termination benefits for 20 employees and \$307,000 related to asset impairments incurred as a result of exiting its Longmont, Colorado manufacturing facilities.
- In the fourth quarter of 2003, the Company recognized approximately \$1.0 million that consisted primarily of the recognition of expense for involuntary employee termination benefits associated with the involuntary employee termination benefits of 34 manufacturing and administrative personnel in the Company's U.S. operations.

In the first, second and third quarters of 2004, the Company recorded restructuring charges of \$220,000, \$187,000 and \$88,000, respectively, which primarily consisted of the recognition of expense for involuntary employee termination benefits associated with headcount reductions of approximately 34, 12 and 4 employees, respectively, in the Company's U.S. operations. All affected employees were terminated prior to the respective quarter ends. Additionally, in the third quarter, the Company reversed \$253,000 of previously recorded charges due to variances from the original estimates used to establish the Company's reserve, consequently, the Company's restructuring accrual balance for employee severance and termination costs was \$0 at September 30, 2004.

In the fourth quarter of 2004, the Company recorded restructuring charges of \$3.7 million. The \$3.7 million charge primarily consisted of employee termination and related costs associated with the involuntary severance of 212 employees, including 60 agency employees, at the Company's Fort Collins facility. All of such charges relate to separation costs anticipated to be paid to the terminated employees, in cash, by the end of the second quarter of 2005. The need to reduce headcount in Fort Collins resulted primarily from the transfer of a substantial portion of the Company's manufacturing operations to Shenzhen, China.

#### **(4) MARKETABLE SECURITIES**

Marketable securities consisted of the following:

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
	(In thousands)	
Commercial paper .....	\$43,459	\$40,792
Municipal bonds and notes.....	20,332	46,762
Institutional money markets .....	<u>5,787</u>	<u>5,816</u>
Total marketable securities .....	<u>\$69,578</u>	<u>\$93,370</u>

These marketable securities are considered available-for-sale and 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.

At December 31, 2004 and 2003, the Company also had \$3.6 million and \$4.8 million, respectively, of investments in marketable equity securities which are included in deposits and other in the accompanying consolidated balance sheets, due to the Company's expressed intent and demonstrated ability to hold for

greater than one year. These investments are classified as available-for-sale securities and are reported at fair value with unrealized holding gains and losses included in other comprehensive loss, net of tax.

During the fourth quarter of 2002, the fair value of one of these securities continued a substantial decline, and the Company determined the decline was other than temporary. As a result, the Company recorded an impairment charge of approximately \$1.5 million. In the first quarter of 2003, this security continued to decline in value, and the Company recorded an additional impairment charge of \$175,000. Since the first quarter of 2003, the value of this security has appreciated which has been reflected as a component of other comprehensive loss, net of tax.

#### (5) ACCOUNTS RECEIVABLE – TRADE

Trade accounts receivable consisted of the following:

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
	(In thousands)	
Domestic.....	\$16,612	\$17,100
Foreign.....	51,047	41,359
Allowance for doubtful accounts.....	(1,049)	(1,303)
Total accounts receivable - trade.....	<u>\$66,610</u>	<u>\$57,156</u>

#### (6) INVENTORIES, NET

Net inventories consisted of the following:

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
	(In thousands)	
Parts and raw materials.....	\$54,069	\$47,120
Work in process.....	4,491	4,385
Finished goods.....	14,664	14,198
Total inventories, net.....	<u>\$73,224</u>	<u>\$65,703</u>

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 recognition of revenue.

#### (7) PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
	(In thousands)	
Land.....	\$ 5,127	\$ 5,663
Buildings.....	5,738	4,293
Machinery and equipment.....	40,196	36,039
Computers and communication equipment.....	28,954	24,324
Furniture and fixtures.....	6,221	6,268
Vehicles.....	290	1,368
Leasehold improvements.....	17,684	17,618
	104,210	95,573
Less – accumulated depreciation.....	(59,464)	(50,848)
Total property and equipment.....	<u>\$ 44,746</u>	<u>\$ 44,725</u>

Aggregate depreciation expense related to property and equipment for the years ended December 31, 2004, 2003 and 2002, was \$13.7 million, \$12.7 million and \$13.4 million, respectively.

In the fourth quarter of 2002, in conjunction with the restructuring of its operations, the Company determined that certain facilities would be closed. The Company performed an analysis of the fair value of certain long-lived assets, including land and buildings acquired in conjunction with the Company's acquisition of Engineering Measurements Company in January 2001. As a result, the Company recorded impairments of property and equipment of \$1.6 million, which has been reflected as restructuring charges in the consolidated statement of operations.

## (8) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets consisted of the following as of December 31, 2004:

	Gross Carrying Amount	Effect of Changes in Exchange Rates	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life in Years
(In thousands, except weighted-average useful life)					
Amortizable intangibles:					
Technology-based .....	\$ 7,304	\$ 1,741	\$ (5,290)	\$ 3,755	6
Contract-based .....	1,200	222	(1,386)	36	4
Trademarks and other .....	8,500	2,689	(2,948)	8,241	17
Total amortizable intangibles.....	<u>17,004</u>	<u>4,652</u>	<u>(9,624)</u>	<u>12,032</u>	11
Goodwill.....	55,104	13,172	--	68,276	
Total goodwill and other intangible assets	<u>\$ 72,108</u>	<u>\$ 17,824</u>	<u>\$ (9,624)</u>	<u>\$ 80,308</u>	

Goodwill and other intangible assets consisted of the following as of December 31, 2003:

	Gross Carrying Amount	Effect of Changes in Exchange Rates	Accumulated Amortization	Net Carrying Amount	Weighted-Average Useful Life in Years
(In thousands, except weighted-average useful life)					
Amortizable intangibles:					
Technology-based .....	\$ 7,304	\$ 1,544	\$ (3,906)	\$ 4,942	6
Contract-based .....	9,210	1,709	(5,882)	5,037	4
Trademarks and other .....	8,500	2,363	(1,409)	9,454	17
Total amortizable intangibles.....	<u>25,014</u>	<u>5,616</u>	<u>(11,197)</u>	<u>19,433</u>	11
Goodwill.....	58,629	10,881	--	69,510	
Total goodwill and other intangible assets	<u>\$ 83,643</u>	<u>\$ 16,497</u>	<u>\$ (11,197)</u>	<u>\$ 88,943</u>	

The Company's goodwill and other intangible assets have primarily resulted from purchases of Japanese and German companies, and accordingly, carrying amounts for these assets are impacted by changes in foreign currency exchange rates.

Aggregate amortization expense related to amortizable intangibles for the years ended December 31, 2004, 2003 and 2002, was \$3.9 million, \$4.6 million and \$5.5 million, respectively. Estimated amortization expense related to the Company's acquired intangibles fluctuates with changes in foreign currency exchange rates between the U.S. dollar and the Japanese yen and the euro. Estimated amortization expense related to amortizable intangibles for each of the five years 2005 through 2009 is as follows (in thousands):

	Estimated Amortization Expense (in thousands)
2005 .....	\$2,173
2006 .....	2,016
2007 .....	1,009
2008 .....	876
2009 .....	474

In the fourth quarter of 2004, the Company performed its annual goodwill impairment test, and concluded that no impairment of goodwill existed at the measurement date, as the estimated fair value of the Company's reporting unit exceeded its carrying amount. For the year ended December 31, 2004, goodwill was reduced by approximately \$3.3 million due to the reversals of deferred tax asset valuation allowances established in purchase accounting (see Note 12).

During the fourth quarter of 2004, in conjunction with the Company's financial forecasting for future periods, it was evident that projected cash flows from certain customers of Dressler were substantially below amounts projected at the time of acquisition, which were considered in determining the fair value of certain contract-based and other amortizable intangible assets recorded at acquisition. As a result, the Company performed assessments of the carrying values of the related amortizable intangible assets. These

assessments consisted of estimating the intangible asset's fair value and comparing the estimated fair value to the carrying value of the asset. The Company estimated the intangible asset's fair value through the use of projected cash flows based upon projected revenue streams over the life of the asset, discounted at rates consistent with the risk of the related cash flows. Based on this analysis the Company determined that the fair values of certain intangible assets were below the respective carrying values, and recorded impairment charges of approximately \$2.9 million, which has been reported as an impairment of intangible assets in the accompanying consolidated statement of operations.

Also during the fourth quarter of 2004, in conjunction with the Company's restructuring plan, employees who were the subject of certain contract-based amortizable intangibles were severed from the Company or their responsibilities were altered. As a result, the Company performed assessments of the carrying values of the related amortizable intangible assets. These assessments consisted of estimating the intangible asset's fair value and comparing the estimated fair value to the carrying value of the asset. The Company estimated the intangible asset's fair value through the use of a lost profits method of determining the fair value, arriving at projected cash flows which were then discounted at rates consistent with the risk of the related cash flows. Based on this analysis the Company determined that the fair values of certain intangible assets were below the respective carrying values, and recorded impairment charges of approximately \$397,000, which has been reported as an impairment of intangible assets in the accompanying consolidated statement of operations.

During the third quarter of 2003, the Company determined that one of its mass flow controller products would not conform to changing customer technology requirements, and as such would no longer be accepted by the Company's customers. As a result, the Company performed an assessment of the carrying value of the related intangible asset. This assessment consisted of estimating the intangible asset's fair value and comparing the estimated fair value to the carrying value of the asset. The Company estimated the intangible asset's fair value by applying a hypothetical royalty rate to the projected revenue stream and using a cash flow model discounted at rates consistent with the risk of the related cash flows. Based on this analysis the Company determined that the fair value of the intangible asset was minimal and recorded an impairment charge of approximately \$1.2 million, which has also been reported as an impairment of intangible assets in the accompanying consolidated statement of operations.

In the fourth quarter of 2002, the Company's sales to the semiconductor capital equipment industry declined substantially from the third quarter of 2002. As a result 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 that the Company's investment was impaired by approximately \$1.9 million, which has been reflected as impairment of intangible assets in the accompanying consolidated statement of operations.

## (9) SENIOR BORROWINGS

Senior borrowings consisted of the following:

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
	(In thousands)	
Revolving line of credit of \$25 million, expiring May 2005, interest at bank's prime rate minus 1%, (4.00% at December 31, 2004) .....	\$ --	\$ --
Senior borrowings (assumed in the acquisition of Aera), maturing serially through April 2010, interest from 1.5% to 3.1% at December 31, 2004 .....	5,953	13,933
Mortgage note payable, maturing July 2007, interest at 3.0% at December 31, 2004 ...	1,737	--
Less – current portion .....	<u>(3,432)</u>	<u>(8,028)</u>
Senior borrowings, net of current portion	<u>\$ 4,258</u>	<u>\$ 5,905</u>

The Company is subject to covenants on its line of credit that provide certain restrictions related to working capital, leverage, net worth, acquisitions, and payment and declaration of dividends. The Company was in compliance with these covenants at December 31, 2004. The senior borrowings assumed in the acquisition of Aera and the mortgage note payable are collateralized by the Company's buildings in Japan and Korea, respectively.

Scheduled maturities of the Company's outstanding borrowings and convertible subordinated notes payable (see Note 10) are as follows at December 31, 2004:

	<u>Bank Loans</u>	<u>Convertible Subordinated Notes</u> (In thousands)	<u>Total</u>
2005.....	\$ 3,432	\$ --	\$ 3,432
2006.....	2,185	187,718	189,903
2007.....	<u>2,073</u>	<u>-</u>	<u>2,073</u>
Total.....	<u>\$ 7,690</u>	<u>\$ 187,718</u>	<u>\$ 195,408</u>

#### **(10) CONVERTIBLE SUBORDINATED NOTES PAYABLE**

In August 2001, the Company issued \$125.0 million of 5.00% convertible subordinated notes. These notes mature September 1, 2006, with interest payable on March 1<sup>st</sup> and September 1<sup>st</sup> 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 \$29.83 per share. The conversion rate is subject to adjustment in certain circumstances. The Company may 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. 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 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, 2004, approximately \$2.0 million of interest expense related to these notes was accrued as a current liability.

In November 1999, the Company issued \$135.0 million of 5.25% convertible subordinated notes. These notes mature November 15, 2006, with interest payable on May 15<sup>th</sup> and November 15<sup>th</sup> 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 a conversion rate of 20.1898 shares per each \$1,000 principal amount of notes, equivalent to a conversion price of \$49.53 per share. The conversion rate is subject to adjustment in certain circumstances. The Company may redeem the notes on or after November 19, 2002 at a redemption price of 103% of 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, 2004, approximately \$435,000 of interest expense related to these notes was accrued as a current liability.

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.

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 a pre-tax gain of \$4.2 million. At December 31, 2004 and 2003, approximately \$66.2 million and \$121.5 million principal amounts of the 5.25% and 5.00% notes, respectively, remained outstanding.

## **(11) EARNINGS PER SHARE**

Basic earnings per share (“EPS”) is computed by dividing income (loss) 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 and stock options) had been converted to such common shares, and if such assumed conversion is dilutive. For the years ended December 31, 2004, 2003 and 2002, certain stock options outstanding and the conversion of the Company’s convertible subordinated notes payable were not included in this calculation because to do so would be anti-dilutive. Due to the Company’s net loss for years ended December 31, 2004, 2003 and 2002, 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 for common stock at December 31, 2004, 2003 and 2002 were approximately 4.7 million, 4.0 million and 3.6 million, respectively. Potential shares of common stock issuable upon conversion of the Company’s convertible subordinated notes payable were 5.4 million at December 31, 2004, 2003 and 2002.

## **(12) 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. During 2004 and 2003, the Company recorded valuation allowances against certain of its United States and foreign net deferred tax assets in jurisdictions where the Company has incurred significant losses in recent years. Given such experience, the Company’s management could not conclude that it was more likely than not that these net deferred tax assets would be realized. While there were indications that the markets in which the Company operates may have improved in future periods, the Company’s management, in accordance with SFAS No. 109, in evaluating the recoverability of these net deferred tax assets, was required to place greater weight on the Company’s historical results as compared to projections regarding future taxable income. If the Company generates future taxable income, or should the Company be able to conclude that sufficient taxable income is reasonably assured based on profitable operations, in the appropriate tax jurisdictions, against which these tax attributes may be applied, some portion or all of the valuation allowance will be reversed and a corresponding reduction in income tax expense will be reported in future periods. Approximately \$2.3 million of the valuation allowance relates to the benefit from stock-based compensation. Any reversal of valuation allowance from this item will be reflected as a component of stockholders’ equity.

When recording acquisitions, the Company has recorded valuation allowances due to the uncertainty related to the realization of certain deferred tax assets existing at the acquisition dates. The amount of deferred tax assets considered realizable is subject to adjustment in future periods if estimates of future taxable income are changed. Any reversals of valuation allowances recorded in purchase accounting will be reflected as a reduction of goodwill in the period of reversal. For the year ended December 31, 2004, valuation allowances established in purchase accounting were reversed with a corresponding reduction in goodwill of approximately \$3.3 million.

The income tax provision of \$3.9 million in 2004 represents an effective tax rate of negative 45% and the income tax provision of \$11.8 million in 2003 represents an effective tax rate of negative 36%, due to taxable income earned in certain foreign jurisdictions. The income tax benefit of \$22.3 million for 2002 represents an effective tax rate of 35%. The provision (benefit) for income taxes for the years ended December 31, 2004, 2003 and 2002 was, as follows:

	December 31,		
	2004	2003	2002
	(In thousands)		
Federal.....	\$ -	\$ 8,437	\$(18,575)
State and local.....	-	784	(2,178)
Foreign taxes.....	<u>3,947</u>	<u>2,580</u>	<u>(1,540)</u>
	<u>\$ 3,947</u>	<u>\$11,801</u>	<u>\$(22,293)</u>
Current.....	\$ 3,503	\$ 5,372	\$(15,405)
Deferred.....	<u>444</u>	<u>6,429</u>	<u>(6,888)</u>
	<u>\$ 3,947</u>	<u>\$11,801</u>	<u>\$(22,293)</u>

The following reconciles the Company's effective tax rate to the federal statutory rate for the years ended December 31, 2004, 2003 and 2002:

	December 31,		
	2004	2003	2002
	(In thousands)		
Income tax benefit per federal statutory rate.....	\$ (3,080)	\$(11,354)	\$(22,293)
State income taxes, net of federal deduction.....	(810)	(1,328)	(1,414)
Extraterritorial income exclusion.....	(350)	(350)	(262)
Nondeductible intangible and goodwill amortization.....	98	98	183
Other permanent items, net.....	(514)	(456)	760
Effect of foreign taxes.....	(415)	(333)	(272)
Change in valuation allowance.....	7,884	29,130	1,255
Tax credits and other items.....	<u>1,134</u>	<u>(3,606)</u>	<u>(250)</u>
	<u>\$ 3,947</u>	<u>\$11,801</u>	<u>\$(22,293)</u>

The sources of the Company's deferred income tax assets and liabilities are summarized as follows:

	December 31,	
	2004	2003
	(In thousands)	
Current:		
Employee bonuses and commissions.....	\$ 31	\$ 314
Warranty reserve.....	2,493	2,463
Bad debt reserve.....	201	533
Vacation accrual.....	833	806
Restructuring accrual.....	1,545	1,222
Excess and obsolete inventory.....	3,156	4,093
Other.....	2,604	988
Valuation allowance.....	<u>(10,863)</u>	<u>(10,419)</u>
Net current.....	--	--
Long-term:		
Net operating loss and tax credit carryforward.....	42,284	38,246
Accumulated other comprehensive income.....	(7,099)	(5,464)
Depreciation and amortization.....	(2,454)	(7,898)
Other, net.....	2,963	3,340
Valuation allowance.....	<u>(39,403)</u>	<u>(32,896)</u>
Net long-term.....	<u>\$ (3,709)</u>	<u>\$ (4,672)</u>

The following reconciles the change in the net deferred income tax liability from December 31, 2003 to December 31, 2004, to the deferred income tax provision:

	2004
	(In thousands)
Net change in deferred income tax liability from the preceding table.....	\$ (963)
Net change in deferred tax liability associated with foreign currency fluctuation.....	(246)
Net change in deferred tax liability associated with purchase accounting – reduction in Goodwill.....	3,288
Increase in deferred tax liability associated with other comprehensive income.....	<u>(1,635)</u>
Deferred income tax provision for the period.....	<u>\$ 444</u>

As of December 31, 2004, the Company had a gross federal net operating loss, alternative minimum tax credit and research and development credit carryforwards of approximately \$85 million, \$2 million and \$4 million, respectively, which may be available to offset future federal income tax liabilities. The federal net operating loss and research and development credit carryforwards expire at various dates through December 31, 2024, the alternative minimum tax credit carryforward has no expiration date. In addition, as of December 31, 2004, the Company had a gross foreign net operating loss carryforward of \$4 million, which may be available to offset future foreign income tax liabilities and expire at various dates through December 31, 2008.

The domestic versus foreign component of the Company's net loss before income taxes for the years ended December 31, 2004, 2003 and 2002, was as follows:

	<u>December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
	(In thousands)		
Domestic .....	\$(20,725)	\$(35,137)	\$(60,070)
Foreign .....	<u>11,925</u>	<u>2,697</u>	<u>(3,622)</u>
	<u>\$ (8,800)</u>	<u>\$(32,440)</u>	<u>\$(63,692)</u>

### **(13) RETIREMENT PLANS**

The Company has a 401(k) profit sharing plan which covers 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. In 2002, the Company's contribution for participants in its 401(k) plan was 10% matching on contributions by employees up to 6% of the employee's compensation. In 2003, the Company increased its matching contributions to 25% matching on contributions by employees up to 6% of the employee's compensation; such contribution level was maintained for 2004. The Company's total contributions to the plan were approximately \$698,000, \$635,000 and \$272,000 for the years ended December 31, 2004, 2003 and 2002, respectively. Vesting in the profit sharing contribution account is based on years of service, with most participants fully vested after four years of credited service.

### **(14) COMMITMENTS AND CONTINGENCIES**

The Company has committed to purchase approximately \$5.0 million of parts, components and subassemblies in 2005 and \$2.5 million in 2006. This inventory purchase obligation represents a minimum purchase commitment to ensure the Company has an adequate supply of critical components to meet the demand of its customers. The Company believes these inventory purchases will be consumed in its on-going operations during the respective years of purchase commitment.

The Company has also committed to advance up to \$850,000 to a privately held company in exchange for an exclusive intellectual property license. The amount and timing of this advance is dependent upon the privately held company achieving certain development milestones. As of December 31, 2004, approximately \$50,000 has been advanced under this agreement, which was recorded within research and development expense in the consolidated statement of operations.

### *DISPUTES AND LEGAL ACTIONS*

The Company is involved in disputes and legal actions arising in the normal course of its business. Currently and historically, the Company's most significant legal actions have involved the application of patent law to complex technologies and intellectual property. The determination of whether such technologies infringe upon the Company's or others' patents is highly subjective. This high level of subjectivity introduces substantial additional risk with regard to the outcome of the Company's disputes and legal actions related to intellectual property. While the Company currently believes that the amount of any ultimate potential loss for currently-known matters 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 will occur and the amount of the loss can be reasonably estimated.

In April 2003, the Company filed a claim in the United States District Court for the District of Colorado seeking a declaratory ruling that its new plasma source products Xstream™ With Active Matching Network™ ("Xstream products") are not in violation of U.S. Patents held by MKS Instruments, Inc. ("MKS"). This case was transferred by the Colorado court to the United States District Court for the District of Delaware for consolidation with a patent infringement suit filed in that court by MKS in May 2003, alleging that the Company's Xstream products infringe five patents held by MKS. On July 23, 2004, a jury returned a verdict of infringement of three MKS patents, which did not stipulate damages. The court has not enjoined the Company from selling the Xstream products. The Company has filed four separate motions to have the verdict set aside based upon defects in the trial. The court has not scheduled any further activity in the case, including trial of the Company's patent invalidity and inequitable conduct defenses, while the post-trial motions are being reviewed. Potential liability, if any, resulting from the jury verdict is indeterminable at this time, and therefore no amount has been accrued by the Company in the accompanying consolidated financial statements.

On June 2, 2004, MKS filed a petition in the District Court in Munich, Germany, alleging infringement by the Company's Xstream products of a counterpart German patent owned by MKS. On August 4, 2004, this court dismissed MKS's petition and assessed costs of the proceeding against MKS. MKS refiled an infringement petition in the District Court of Mannheim. At a hearing held on February 18, 2005, the Mannheim court indicated that a decision on the infringement allegation would be rendered on April 8, 2005. A petition for invalidity of MKS's patent brought by the Company is still pending before the German Federal Patent Court.

On July 12, 2004, the Company filed a complaint in the United States District Court for the District of Delaware against MKS alleging that MKS's Astron reactive gas source products infringe Advanced Energy's U.S. Patent No. 6,046,546. A stipulation of voluntary dismissal of the action was filed by the parties on March 9, 2005, which leaves the Company free to refile its claims upon conclusion of MKS's lawsuit against the Company's Xstream products.

On September 17, 2001, Sierra Applied Sciences, Inc. ("Sierra") filed for declaratory judgment asking the U.S. District Court for the District of Colorado to rule that its products did not infringe the Company's U.S. patent no. 5,718,813 and that the patent was invalid. On March 24, 2003, the Court granted the Company's motion to dismiss the case for lack of subject matter jurisdiction. The Court of Appeals for the Federal Circuit affirmed the dismissal on April 13, 2004 as to all of Sierra's current activities, but remanded for findings related to past sales of older products. The case was settled and dismissed on September 2, 2004 under terms of a settlement agreement that provided for no monetary consideration to be paid by either party.

In May 2002, the Company recognized approximately \$4.2 million of litigation damages pertaining to a judgment entered by a jury against the Company and in favor of 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 not material in any of the periods presented.

## CAPITAL LEASES

The Company finances a portion of its property and equipment under capital lease obligations at interest rates averaging approximately 3%. The future minimum lease payments under capital lease obligations as of December 31, 2004 are as follows:

	(In thousands)
2005 .....	\$ 303
2006 .....	225
2007 .....	112
2008 .....	57
2009 .....	<u>40</u>
Total minimum lease payments .....	737
Less -- amount representing interest .....	(22)
Less -- current portion .....	<u>(294)</u>
	<u>\$ 421</u>

## OPERATING LEASES

The Company has various operating leases for automobiles, equipment, and office and production facilities (see Note 16). Lease expense under operating leases was approximately \$6.2 million, \$6.3 million, and \$6.5 million for the years ended December 31, 2004, 2003 and 2002, respectively.

The future minimum rental payments required under non-cancelable operating leases as of December 31, 2004 are as follows:

	(In thousands)
2005 .....	\$ 6,062
2006 .....	5,492
2007 .....	4,443
2008 .....	3,761
2009 .....	2,957
Thereafter .....	<u>9,432</u>
	<u>\$32,147</u>

## (15) FOREIGN OPERATIONS AND MAJOR CUSTOMERS

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

	Years Ended December 31,		
	2004	2003	2002
	(In thousands)		
Sales (1):			
Originating in U.S. and sold to domestic customers .....	\$207,279	\$124,128	\$141,637
Originating in U.S. and sold to foreign customers .....	42,407	35,509	24,607
Originating in Europe and sold to domestic customers .....	115	57	2,108
Originating in Europe and sold to foreign customers .....	36,151	24,492	18,672
Originating in Asia Pacific and sold to domestic customers .....	608	--	--
Originating in Asia Pacific and sold to foreign customers .....	<u>108,745</u>	<u>78,216</u>	<u>51,874</u>
	<u>\$395,305</u>	<u>\$262,402</u>	<u>\$238,898</u>
Loss from operations:			
United States .....	\$(13,603)	\$(27,639)	\$(57,305)
Europe .....	(1,540)	559	(725)
Asia .....	13,508	4,811	1,865
Intercompany eliminations .....	<u>91</u>	<u>(863)</u>	<u>(5,820)</u>
	<u>\$ (1,544)</u>	<u>\$ (23,132)</u>	<u>\$ (61,985)</u>
Identifiable assets:			
United States .....	\$411,324	\$424,661	
Europe .....	43,011	48,150	
Asia .....	280,351	210,585	
Intercompany eliminations .....	<u>(338,711)</u>	<u>(268,665)</u>	
	<u>\$395,975</u>	<u>\$414,731</u>	

(1) These sales amounts do not contemplate where our customers may subsequently transfer our products.

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, 2004, 2003 and 2002:

	<u>December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Applied Materials, Inc. ....	<u>27%</u>	<u>20%</u>	<u>27%</u>

There were no other customers that represented greater than 10% of the Company's total sales for the years ended December 31, 2004, 2003 and 2002.

Trade accounts receivable from Applied Materials, Inc. were approximately \$7.8 million as of December 31, 2004, which represented approximately 12% of the Company's total trade accounts receivable. At December 31, 2004, trade accounts receivable from ULVAC, Inc. were approximately \$17.4 million, representing approximately 26% of the Company's total trade accounts receivable. No other customers had a trade accounts receivable balance in excess of 10% of the total trade accounts receivable at December 31, 2004.

#### **(16) RELATED PARTY TRANSACTIONS**

The Company leases its executive offices and manufacturing facilities in Fort Collins, Colorado from two limited liability partnerships, in which the Company's Chief Executive Officer holds an interest. The leases relating to these spaces expire in 2009, 2011 and 2016, and contain monthly payments of approximately \$87,000, \$69,000 and \$85,000, respectively.

For each of the years ended December 31, 2004 and 2003 approximately \$2.8 million was paid attributable to these leases. For the year ended December 31, 2002, approximately \$2.7 million was paid attributable to these leases. Rent and related amounts are expensed as incurred.

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 a parcel of land in Colorado. Such amounts are expensed as incurred. Approximately \$132,000 was paid attributable to this agreement for the year ended December 31, 2004, and \$156,000 for each of the years ended December 31, 2003 and 2002.

The Company leased, for business purposes, a condominium owned by a partnership of certain stockholders, including the Company's Chief Executive Officer. The Company paid the partnership \$10,000, \$60,000 and \$67,000 in 2004, 2003 and 2002, respectively. In February 2004, this lease agreement was terminated.

The Company charters aircraft from time to time from a company owned by the Company's Chief Executive Officer. Aggregate payments for the use of such aircraft were \$16,000, \$6,000 and \$103,000 in 2004, 2003 and 2002, respectively.

#### **(17) CONCENTRATIONS OF CREDIT RISK**

*FORWARD CONTRACTS* -- 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 trade purchases and intercompany receivables and payables. Foreign currency forward contracts are entered into with major commercial United States, Japanese and German 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 one to eight months, with contracts outstanding at December 31, 2004 maturing through January 2005. The Company did not seek specific hedge accounting treatment for its foreign currency forward contracts.

At December 31, 2004, the Company held the following foreign currency forward contracts to buy U.S. dollars and sell various foreign currencies:

	<u>Notional Amounts</u>	<u>Market Settlement Amounts</u> (In thousands)	<u>Unrealized (Loss)/Gain</u>
Japanese yen contracts .....	\$ 8,200	\$ 8,263	\$ 63
Taiwanese dollar contracts .....	4,000	4,031	31
South Korean won contract .....	1,300	1,315	15
Chinese yuan contract .....	400	398	(2)
Balance at December 31, 2004 .....	<u>\$13,900</u>	<u>\$14,007</u>	<u>\$ 107</u>

*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, and municipal bonds and notes. 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.

## **(18) STOCK PLANS**

As of December 31, 2004, the Company had three active stock-based compensation plans; the 2003 Stock Option Plan (the "2003 Plan"), the 2003 Non-Employee Directors' Stock Option Plan (the "2003 Directors' Plan") and the Employee Stock Purchase Plan ("ESPP").

*2003 STOCK OPTION PLAN* -- The 2003 Plan is a broad-based plan for employees, executive officers, and consultants in which directors of the Company are not allowed to participate. The Board of Directors currently administers this plan, and makes all decisions concerning which employees, executive officers 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 2003 Plan, adopted in 2003, provides for the issuance of up to 3,250,000 shares of common stock. Shares may be issued under the 2003 Plan on exercise of incentive stock options or non-qualified stock options granted under the 2003 Plan or as restricted stock awards. Stock appreciation rights may also be granted under the 2003 Plan, and the shares represented by the stock appreciation rights will be deducted from shares issuable under the 2003 Plan. The exercise price of incentive stock options and non-qualified stock options may not be less than the market value of the Company's common stock on the date of grant. The Company has the discretion to determine the vesting period of options granted under the 2003 Plan, however option grants will generally vest over four years, contingent upon the optionee continuing to be an employee, executive officer or consultant of the Company. The options are exercisable for ten years from the date of grant. The 2003 Plan will expire in February 2013, unless the administrator of the plan terminates it earlier. As of December 31, 2004, approximately 1.3 million shares of common stock were available for grant under this plan.

On January 31, 2005, the Company amended the 2003 Plan to provide additional terms for the restricted stock units. The restricted stock units generally vest as to 10% on the first anniversary of the grant date, an additional 20% on the second anniversary of the grant date, an additional 30% on the third anniversary of the grant date and the remaining 40% on the fourth anniversary of the grant date. Additional terms are set forth in the individual grant agreements between the Company and the award recipient.

*2003 NON-EMPLOYEE DIRECTORS' STOCK OPTION PLAN* -- The 2003 Directors' Plan, adopted in 2003, provides for the issuance of up to 150,000 shares of common stock upon the exercise of non-qualified stock options granted under the 2003 Directors' Plan. The exercise price of options granted under the 2003 Directors' Plan may not be less than the market value of the Company's common stock on the date of grant. Non-employee directors are automatically granted an option to purchase 15,000 shares on the first date elected or appointed as a member of the Company's board, and 5,000 shares on any date re-elected as a member of the board. Options granted on the date first elected or appointed as a member of the Company's board immediately vest as to one-third of the shares subject to the grant, then another one-third on each of the first two anniversaries of the date granted, provided the optionee continues to be a director. Options granted upon re-election are immediately exercisable. As of December 31, 2004, 40,000 shares of common stock were available for grant under this plan.

*EMPLOYEE STOCK PURCHASE PLAN* -- In September 1995, stockholders approved an ESPP covering an aggregate of 200,000 shares of common stock. On May 7, 2003, the Company's stockholders' approved an amendment to increase the number of common shares reserved for issuance under the plan from 200,000 shares to 400,000 shares. Employees are eligible to participate in the ESPP if employed by the Company for at least 20 hours per week during at least five months per calendar year. Participating employees may have the lesser of 5% their earnings or \$1,250 per six-month period withheld pursuant to the ESPP. The purchase price of common stock purchased under the ESPP is equal to 85% of the lower of the fair value on the commencement date of each offering period or the relevant purchase date. During 2004, 2003 and 2002, employees purchased an aggregate of approximately 65,000, 73,000 and 54,000 shares of common stock under the ESPP, respectively. At December 31, 2004, approximately 90,000 shares remained available for future issuance.

On April 14, 2004, by resolution of the Company's Board of Directors, the Company terminated its 2002 and 2001 Employee Stock Option Plans. Existing stock options outstanding under the 2002 and 2001 Employee Stock Option Plans remain outstanding according to their original terms. At December 31, 2004, options to purchase approximately 406,000 and 423,000 shares of common stock remained outstanding under the 2002 and 2001 Employee Stock Option Plans, respectively.

On May 7, 2003, the Company terminated the 1995 Employee Stock Option Plan and the Non-Employee Directors Stock Option Plan upon stockholder approval of the 2003 Plan and the 2003 Directors' Plan; however, existing stock options outstanding under these terminated plans remain outstanding according to their original terms. At December 31, 2004, options to purchase approximately 1.8 million and 67,000 shares of common stock remained outstanding under the 1995 Employee Stock Option Plan and the Non-Employee Directors Stock Option Plan, respectively.

The following summarizes the activity relating to stock options for the years ended December 31, 2004, 2003 and 2002:

	2004		2003		2002	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
(In thousands, except share prices)						
Stock options:						
Employee stock options --						
Options outstanding at beginning of period ..	3,920	\$ 19.95	3,475	\$ 23.18	2,108	\$ 25.07
Granted .....	1,196	16.99	1,790	14.66	1,920	21.73
Exercised .....	(117)	9.52	(352)	9.89	(118)	11.70
Terminated .....	(472)	19.09	(993)	25.28	(435)	29.02
Options outstanding at end of period .....	<u>4,527</u>	19.53	<u>3,920</u>	19.95	<u>3,475</u>	23.18
Options exercisable at end of period .....	<u>1,943</u>	22.70	<u>1,230</u>	25.50	<u>1,239</u>	23.25
Weighted-average fair value of options granted during the period .....	\$ 8.40		\$ 7.88		\$ 12.55	
Price range of outstanding options .....	<u>\$3.11 - \$60.75</u>		<u>\$0.67 - \$60.75</u>		<u>\$0.67 - \$60.75</u>	
Price range of options terminated .....	<u>\$0.83 - \$60.75</u>		<u>\$0.83 - \$60.75</u>		<u>\$0.83 - \$60.75</u>	
Non-employee directors stock options--						
Options outstanding at beginning of period ...	104	\$ 19.00	112	\$ 22.64	90	\$ 26.92
Granted .....	85	13.62	25	10.67	22	15.58
Exercised .....	(5)	10.67	(8)	6.75	--	--
Terminated .....	(12)	51.10	(25)	30.90	--	--
Options outstanding at end of period .....	<u>172</u>	15.81	<u>104</u>	19.00	<u>112</u>	22.64
Options exercisable at end of period .....	<u>122</u>	16.94	<u>80</u>	21.91	<u>62</u>	22.24
Weighted-average fair value of options granted during the period .....	\$ 9.67		\$ 7.84		\$ 11.33	
Price range of outstanding options .....	<u>\$6.13 - \$46.13</u>		<u>\$6.13 - \$60.75</u>		<u>\$6.13 - \$64.94</u>	
Price range of options terminated .....	<u>\$6.15 - \$64.94</u>		<u>\$6.13 - \$64.94</u>		<u>\$ --</u>	

The following table summarizes information about the stock options outstanding at December 31, 2004:

(In thousands, except share prices and lives)

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
\$ 3.11 to \$ 7.70	609	7.7 years	\$ 7.46	267	\$ 7.24
\$ 7.92 to \$10.37	682	8.0 years	9.58	197	8.96
\$10.67 to \$16.51	495	7.7 years	13.21	206	13.43
\$17.32 to \$19.24	876	7.9 years	18.56	414	18.34
\$20.81 to \$22.30	634	9.1 years	21.88	13	21.95
\$22.52 to \$24.90	574	8.1 years	23.50	252	24.09
\$26.13 to \$38.55	669	6.3 years	33.17	556	32.48
\$40.00 to \$46.13	117	5.0 years	43.79	117	43.79
\$56.13 to \$60.75	43	5.6 years	59.68	43	59.68
	<u>4,699</u>	7.7 years	\$19.39	<u>2,065</u>	\$22.36

## (19) 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 17). 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 Notes 1 and 4). At December 31, 2004 and 2003, the carrying value of long-term debt was \$195.4 million and \$201.7 million, respectively. The carrying value of senior borrowings approximates their fair value due to the variable interest rates associated with the borrowings. At December 31, 2004, the estimated fair value of the Company's 5.25% convertible subordinated notes that are due November 15, 2006 was approximately \$64.6 million, compared to a book value of \$66.2 million. At December 31, 2004, the estimated fair value of the Company's 5.00% convertible subordinated notes that are due September 1, 2006 was approximately \$115.1 million, compared to a book value of \$121.5 million.

## (20) SUPPLEMENTAL CASH FLOW DISCLOSURES

In the first quarter of 2004, the Company made a strategic decision to further focus its marketing and product support resources on its core competencies and reorient its operating infrastructure towards sustained profitability. As a result, the Company sold its Noah chiller business to an unrelated third party for \$797,000 in cash and a \$1.9 million note receivable due March 31, 2009. The note bears interest at 5.0%, payable annually on March 31. The sale included property and equipment with a book value of approximately \$300,000, inventory of approximately \$1.0 million, goodwill and intangible assets net of accumulated amortization of approximately \$900,000, demonstration and customer service equipment of approximately \$140,000, and estimated warranty obligations of approximately \$140,000. The Company recognized a gain on the sale of \$404,000, which has been recorded as other income and expense in the accompanying consolidated statement of operations. In the third quarter of 2004, the Company purchased equipment of approximately \$71,000 from the buyers of the Noah chiller assets in exchange for an equivalent reduction of the note receivable due March 31, 2009.

In the second quarter of 2003, as part of the Company's ongoing cost reduction measures, the Company committed to a plan to sell certain inventory and property and equipment assets to an unrelated third party at their respective net book values. These assets were primarily used in the manufacture of a component for the Company's direct current and radio frequency products and were sold on June 30, 2003. In conjunction with the sale, the Company received approximately \$1.6 million in cash and a short-term note receivable for approximately \$1.5 million in exchange for inventory with a carrying value of approximately \$2.1 million and property and equipment with a carrying value of approximately \$1.0 million.

## (21) QUARTERLY FINANCIAL DATA - UNAUDITED

The following table presents unaudited quarterly financial data for each of the eight quarters in the period ended December 31, 2004. 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, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004
	(In thousands, except per share data)							
Sales.....	\$ 56,158	\$ 62,946	\$ 68,567	\$ 74,731	\$104,487	\$108,869	\$ 93,550	\$ 88,399
Gross profit.....	17,950	20,273	23,093	26,631	38,414	36,962	29,740	14,563
(Loss) income from operations .....	(10,885)	(6,825)	(5,741)	319	9,810	8,754	1,855	(21,963)
Net (loss) income .....	<u>\$(8,590)</u>	<u>\$(5,774)</u>	<u>\$(27,438)</u>	<u>\$(2,439)</u>	<u>\$ 6,924</u>	<u>\$ 4,470</u>	<u>\$ (1,136)</u>	<u>\$(23,005)</u>
Diluted (loss) income per share .....	<u>\$ (0.27)</u>	<u>\$ (0.18)</u>	<u>\$ (0.85)</u>	<u>\$ (0.08)</u>	<u>\$ 0.21</u>	<u>\$ 0.13</u>	<u>\$ (0.03)</u>	<u>\$ (0.70)</u>

The Company had a loss in the fourth quarter of 2004 of \$23.0 million. Pretax charges in the fourth quarter included \$9.2 million to cost of sales for increased excess and obsolete inventory reserves, \$3.8 million to selling, general and administrative for the change in estimate of the useful life of the demonstration equipment (see Note 1), \$3.7 million to restructuring for employee severance and termination costs primarily attributable to the Fort Collins facility (see Note 3), \$3.3 million to impairment of intangible assets related to certain amortizable intangible assets acquired in conjunction with the Company's purchase of Dressler and Aera (see Note 8). These items contributed significantly to the Company's fourth quarter 2004 results. The Company increased its reserve for excess and obsolete inventory in the fourth quarter of 2004, as a result of the fourth quarter strategic management decision to discontinue certain product offerings, the outlook for future periods demand and the declining trend in the Company's sales from the second quarter of 2004 to the fourth quarter of 2004.

The Company had a loss of \$27.4 million in the third quarter of 2003. During this quarter the Company recorded a valuation allowance against certain of its U.S. and foreign net deferred tax assets in jurisdictions where significant losses had been recognized (see Note 12).