



FORM 10-K

ADVANCED ENERGY INDUSTRIES INC – AEIS

Filed: March 28, 2006 (period: December 31, 2005)

Annual report which provides a comprehensive overview of the company for the past year

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended December 31, 2005.
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the transition period from _____ to _____.

Commission file number: 000-26966

ADVANCED ENERGY INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

84-0846841
(I.R.S. Employer Identification No.)

1625 Sharp Point Drive, Fort Collins, CO
(Address of principal executive offices)

80525
(Zip Code)

Registrant's telephone number, including area code: (970) 221-4670

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to section 12(g) of the Act:

Common Stock, \$0.001 par value

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No .

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The approximate aggregate market value of voting and non-voting common stock held by non-affiliates of the registrant was \$143.3 million as of June 30, 2005.

44,658,813

(Number of shares of Common Stock outstanding as of March 22, 2006)

DOCUMENTS INCORPORATED BY REFERENCE

Document

Incorporated By
Reference In Part No.

Portions of Advanced Energy Industries, Inc. definitive proxy statement for its 2006 Annual Meeting of Stockholders to be held on May 3, 2006

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NOTE ON FORWARD-LOOKING STATEMENTS:

This Form 10-K includes “forward-looking statements” within the meanings of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements contained or incorporated by reference in this Form 10-K, other than statements of historical fact, are “forward-looking statements.” For example, statements relating to our beliefs, expectations, plans and projections are forward-looking statements as are statements that specified actions, conditions or circumstances will continue or change. Forward-looking statements involve risks and uncertainties. In some cases, forward-looking statements can be identified by the inclusion of words such as “believe,” “expect,” “plan,” “anticipate,” “estimate” and similar words.

Some of the forward-looking statements in this Form 10-K are expectations or projections relating to:

- Our future revenues;
- Our future gross profit;
- Reducing our operating breakeven point;
- Incremental profit above our breakeven point;
- Market acceptance of our products;
- Customer inventory levels, requirements and order levels;
- Research and development expenses;
- Selling, general and administrative expenses;
- Sufficiency and availability of capital resources;
- Capital expenditures;
- Restructuring activities and expenses; and
- General global economic conditions.

Our actual results could differ materially from those projected or assumed in our forward-looking statements, because forward-looking statements by their nature are subject to risks and uncertainties. Factors that could contribute to these differences or prove our forward-looking statements, by hindsight, to be overly optimistic or unachievable include the factors described in “Item 1A-Risk Factors” with in Part I of this Form 10-K. Other factors might also contribute to the differences between our forward-looking statements and our actual results. We assume no obligation to update any forward-looking statement or the reasons why our actual results might differ.

ITEM 1. BUSINESS

Overview

We incorporated in Colorado in 1981 and reincorporated in Delaware in 1995. In 1995, we effected the initial public offering of our Common Stock. Unless the context otherwise requires, as used in this Form 10-K, references to “Advanced Energy” refer to Advanced Energy Industries, Inc., and references to “the Company”, “we”, “us” or “our” refer to Advanced Energy and its consolidated subsidiaries. Our executive offices are located at 1625 Sharp Point Drive, Fort Collins, Colorado 80525, and our telephone number is 970-221-4670. Our website address is www.advanced-energy.com. We make available, free of charge on our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to these reports as soon as reasonably practicable after filing such reports with, or furnishing them to, the Securities and Exchange Commission (the “SEC”). Such reports are also available at www.sec.gov.

We design, manufacture and support key components and subsystems primarily for industrial vacuum-based production systems. Our primary products are complex power conversion and control systems. Our products also control the flow of gases and liquids into process chambers for semiconductor and flat panel equipment and provide thermal control and sensing within the chamber. Our customers use our products in plasma-based thin-film processing equipment that is essential to the manufacture of products, including the following:

- Semiconductor devices for electronics applications;
- Flat panel displays for hand-held devices, computers and television screens;
- Compact discs, DVDs, magnetic hard drives and other digital storage media;
- Optical coatings for architectural glass, eyeglasses and solar panels; and
- Industrial laser and medical applications.

We also sell spare parts and repair services worldwide through our customer service and technical support organization.

We market and sell our products primarily to large, original equipment manufacturers (“OEMs”) of semiconductor, flat panel display, data storage and other industrial thin-film manufacturing equipment. Sales to customers in the semiconductor capital equipment industry comprised 63% of our sales in 2005, 63% in 2004 and 61% in 2003. We sell our products primarily through direct sales personnel to customers in the United States, Europe and Asia, and through distributors in regions both inside and outside the United States. International sales represented 50% of our sales in 2005, 48% in 2004 and 53% in 2003. Additionally, many of our products sold domestically are placed on systems shipped overseas by our customers.

Products

Our major products fall into four categories: Power Systems, Flow Management, Thermal Instrumentation and Source Technology. Our products are designed to enable new process technologies, improve productivity and lower the cost of ownership for our customers.

POWER SYSTEMS

Our power systems include direct current (“DC”), high power, low and mid frequency, and radio frequency (“RF”) power supplies, matching networks and RF instrumentation. Our power systems refine, modify and control the raw electrical power from a utility and convert it into power that is customized, predictable and repeatable. Our power systems are primarily used by semiconductor, flat panel display, data storage protective layering and architectural glass manufacturers in the following applications: physical vapor deposition; chemical vapor deposition; reactive sputtering; electroplating; plasma vacuum processes; oxide, poly and conductor etch; and carbon dioxide laser excitation.

FLOW MANAGEMENT

Our flow management products include thermal mass flow controllers (“MFCs”), pressure-based MFCs, liquid MFCs, liquid vapor delivery systems, pressure control systems and ultrasonic control systems. Our flow management products control or monitor the flow of high-purity liquids, liquid vapor, and gases encompassing a wide range of input pressures. Our flow management products are primarily used in semiconductor applications, flat panel manufacturing fiber optics, safe delivery system applications, chemical vapor deposition and silica industries.

THERMAL INSTRUMENTATION

Our thermal instrumentation products, primarily used in the semiconductor industry, provide thermal management and control solutions for applications where time-temperature cycles affect productivity and yield. They are used in physical vapor deposition, chemical vapor deposition, rapid thermal processing and other semiconductor applications requiring non-contact temperature measurement.

SOURCE TECHNOLOGY

Our source technology products include plasma and ion beam sources which are used in the direct deposition of thin films of diamond-like carbon, ion-assisted deposition, ion beam etching, optical coating, industrial coating, pre-cleaning and chamber clean. Our plasma-source platforms are complete systems, including a remote plasma source, a power supply and an active matching network.

Markets, Applications and Customers

MARKETS

Most of our sales have historically been to customers in the semiconductor capital equipment industry. Sales to customers in this industry represented 63% of our sales in 2005, 63% in 2004 and 61% in 2003. Our power, flow management, thermal instrumentation and source technology are also used in the flat panel display, data storage and advanced product applications markets. Following is a discussion of the major markets for our products.

SEMICONDUCTOR CAPITAL EQUIPMENT MANUFACTURING MARKET. We sell our products primarily to semiconductor capital equipment manufacturers for incorporation into equipment used to make integrated circuits, as well as to other equipment manufacturers discussed below. Our products are currently used in the major semiconductor processing steps, including:

- Chemical vapor deposition (“CVD”)
- Physical vapor deposition (“PVD”)
- Oxide etch
- Poly etch
- Conductor etch
- Wafer handling enhancement
- Chemical mechanical polishing
- Ion implantation
- Electro-chemical deposition

Our power systems provide the energy to drive the chemical reaction for thin-film processes such as deposition and etch. Our flow management products control the fluid or gas being delivered to ensure accuracy, repeatability and stability, our thermal instrumentation products measure the temperature of the process chamber and our source technology products optimize CVD clean, deposition and etch processes. The precise control over and energy delivered to plasma-based processes enables the production of integrated circuits with reduced feature sizes and increased speed and performance. We anticipate that the semiconductor capital equipment industry will continue to be a substantial part of our business for the foreseeable future.

FLAT PANEL DISPLAY MANUFACTURING EQUIPMENT MARKET. We sell our products to manufacturers of flat panel displays and flat panel projection devices, which have fabrication processes similar to those employed in manufacturing integrated circuits. Flat panel technology produces bright, sharp, large, color-rich images on flat screens for products ranging from hand-held devices to laptop and desktop computer monitors to plasma and liquid crystal display (“LCD”)–screen televisions. The transition to larger panel sizes and higher display resolution is driving the need for tighter process controls to reduce manufacturing costs and defects. There are three major types of flat panel displays: liquid crystal displays, field emitter displays, and gas plasma displays. There are two types of flat panel projection devices: liquid crystal projection and digital micro-mirror displays. We sell our products to all five of these flat panel markets.

DATA STORAGE MANUFACTURING EQUIPMENT MARKETS. We sell products to manufacturers of data storage equipment and data storage devices for use in producing a variety of products, including CDs and DVDs (read-only, one-time recordable and rewriteable); computer hard discs, including both media and thin-film heads; and magneto-optical storage media. These products use a PVD process to produce optical and magnetic thin-film layers as well as a protective-wear layer. In this market, the trend towards higher recording densities requires denser, thinner and more precise films. The use of equipment incorporating magnetic media to store analog and digital data expands with the growth of the laptop, desktop and workstation computer markets and the consumer electronics audio, video, gaming and entertainment markets.

ADVANCED PRODUCT APPLICATIONS MARKETS. We sell our products to OEMs and producers of end products in a variety of industrial markets. Thin-film optical coatings are used in the manufacture of many industrial products, including solar panels, architectural glass, eyeglasses, optical lenses, barcode readers and front surface mirrors. Thin films of diamond-like coatings and other materials are currently applied to products in plasma-based processes to strengthen and harden surfaces on such diverse products as tools, razor blades, automotive parts and hip joint replacements. Other thin-film processes that use our products enable a variety of industrial packaging applications such as decorative wrapping and food packaging. The advanced thin-film production processes allow precise control of various optical and physical properties, including color, transparency and electrical and thermal conductivity. The improved adhesion and high-film quality resulting from plasma-based processing make it the preferred method of applying the thin films. Many of these thin-film industrial applications require power levels substantially greater than those used in our other markets.



APPLICATIONS

We have sold our products for use in connection with the following processes and applications:

<u>Semiconductor</u>	<u>Data Storage</u>	<u>Flat Panel Display</u>	<u>Advanced Product Applications</u>
Chemical vapor deposition	CDs, DVDs, CD/DVD —	Active matrix LCDs	Advanced computer technology
Etch	ROMs	Digital micro-mirror	workstations and servers
(conductor and dielectric)	CDs/DVDs rewritable	Field emission displays	Automobile coatings
High-density plasma CVD	Hard disc carbon wear	Large flat panel displays	Chemical, physical and materials
Ion implantation	coatings	LCD projection	research
	Hard disc magnetic media		Circuit board etch-back and
			de-smear
Magnet field controls	Thin-film heads	Liquid crystal displays	Consumer product coatings
Mass flow management	Magneto-optic disks	Medical applications	Diamond-like coatings
Megasonic cleaning		Plasma displays	Food package coatings
Optical fiber thermometers			Large-area glass coatings
Photo-resist stripping			Optical coatings
Physical vapor deposition			Photovoltaics
Plasma-enhanced CVD			Superconductors
Chemical mechanical polishing			
Solid-state temperature controls			
Wafer handling			
Rapid thermal processing			
Electro-chemical deposition			

CUSTOMERS

Our products are sold worldwide to more than 100 OEMs and directly to more than 500 end users. Our ten largest customers accounted for 57% of our total sales in 2005, 60% in 2004 and 54% in 2003. We expect that sales of our products to these customers will continue to account for a large percentage of our sales in the foreseeable future.

Applied Materials, our largest customer, accounted for 23% of our sales in 2005, 28% in 2004 and 21% in 2003. Ulvac, Inc., our largest customer in the flat panel display industry, accounted for 11% of our sales in 2005, and less than 10% in 2004 and 2003. No other customer exceeded 10% of our sales during these yearly periods.

Backlog

Our backlog increased from \$33.9 million at December 31, 2004 to \$49.8 million at December 31, 2005. We schedule production of our systems based on order backlog and customer commitments. Backlog includes only orders scheduled to ship in the following quarter for which written authorizations have been accepted and revenue has not been recognized. Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not indicative of actual sales for any succeeding period. Delays in delivery schedules and/or a reduction of backlog during any particular period could have a material adverse effect on our business and results of operations.

Marketing, Sales and Service

We sell our products primarily through direct sales personnel to customers in the United States, Europe and Asia. Our sales personnel are located at our headquarters in Fort Collins, Colorado, and in sales offices in San Jose, California; Austin and Dallas, Texas; and Vancouver, Washington. To serve customers in Asia and Europe, we have offices in Shenzhen and Shanghai, China; Bicester, England; Filderstadt and Stolberg, Germany; Lumbin, France; Hachioji and Tokyo, Japan; Bundang, South Korea; and Hsinchu and Taipei Hsien, Taiwan. These offices have primary responsibility for sales in their respective markets. We also have distributors inside and outside the United States.

Sales outside the United States represented approximately 50% of our total sales in 2005, 48% in 2004 and 53% in 2003. International sales are subject to certain risks, including imposition of governmental controls, political and economic instability, trade restrictions, changes in tariffs and taxes, longer payment cycles typically associated with international sales and exposure to foreign currency fluctuations.

We believe that customer service and technical support are important competitive factors and are essential to building and maintaining close, long-term relationships with our customers. We maintain customer service offices at many of the locations listed above, as well as other sites chosen considering our customer locations.

Manufacturing

Our manufacturing locations are in Shenzhen, China; Fort Collins, Colorado; Hachioji, Japan; Stolberg, Germany; and Vancouver, Washington. In 2005, we completed the realignment of our worldwide manufacturing infrastructure, with Shenzhen, China being the central high-volume manufacturing site. The focus of our Fort Collins, Colorado and Hachioji, Japan locations is now on service and support, new product design and launch and advanced manufacturing.

We generally manufacture different products at each facility. Our manufacturing activities consist of the assembly and testing of components and subassemblies, which are then integrated into our final products. Once final testing of all electrical and electro-mechanical subassemblies is completed, the final product is subjected to a series of reliability-enhancing operations prior to shipment to our customers. We purchase a wide range of electronic, mechanical and electrical components, some of which are designed to our specifications. We are increasingly outsourcing more of our subassembly work.

Intellectual Property

We have a practice of seeking patents on inventions governing new products or technologies as part of our ongoing research, development and manufacturing activities. We currently hold 81 United States patents, 40 foreign-issued patents, and have nearly 100 patent applications pending in the United States, Europe and Asia. Generally, our efforts to obtain international patents have been concentrated in the industrialized countries of Europe and the Pacific Rim, because there are other manufacturers and developers of power conversion and control systems in those countries as well as customers for those systems.

Litigation may from time to time be necessary to enforce patents issued to us, to protect trade secrets or know-how owned by us, to defend us against claimed infringement of the rights of others or to determine the scope and validity of the proprietary rights of others. See "Item 1A Risk Factors – We are highly dependent on our intellectual property."

Competition

The markets we serve are highly competitive and characterized by ongoing technological development and changing customer requirements. Significant competitive factors in our markets include product performance, price, quality and reliability and level of customer service and support. We believe that we currently compete effectively with respect to these factors, although we cannot assure that we will be able to compete effectively in the future.

The markets in which we compete have seen an increase in global competition, especially from Asian and European-based equipment vendors. We have several foreign and domestic competitors for each of our product lines. Some of these competitors are larger and have greater resources than us. Our ability to continue to compete successfully in these markets depends on our ability to make timely introductions of system enhancements and new products. We expect our competitors will continue to improve the design and performance of their products and to introduce new products with competitive performance characteristics.

Operating Segment

We operate and manage our business of manufacturing, marketing and servicing components and subsystems for plasma-based manufacturing processes as one segment. All material operating units qualify for aggregation under Statement of Financial Accounting Standards ("SFAS") No. 131, "Disclosures About Segments of an Enterprise and Related Information," because all of our products and systems have similar economic characteristics, procurement, production and distribution processes. To report revenues from external customers for each product and service or each group of similar products and services would be impracticable. Since we operate in one segment, all financial segment information required by SFAS No. 131 is found in the accompanying consolidated financial statements. Please refer to Note 15 Foreign Operations and Major Customers, included in Part II, Item 8 of this Form 10-K for further discussion regarding our operations.

Research and Development

The market for our subsystems for vacuum process systems and related accessories is characterized by ongoing technological changes. We believe that continued and timely development of new highly differentiated products and enhancements to existing products to support OEM requirements is necessary for us to maintain a competitive position in the markets we serve. Accordingly, we devote a significant portion of our personnel and financial resources to research and development projects and seek to maintain close relationships with our customers and other industry leaders in order to remain responsive to their product requirements. Research and development expenses were \$39.7 million in 2005, \$49.0 million in 2004 and \$49.7 million in 2003, representing 12.2% of our total sales in 2005, 12.9% in 2004 and 19.6% in 2003.

Number of Employees

As of December 31, 2005, we had a total of 1,527 employees, 1,446 of whom were full-time employees. There is no union representation of our employees, and we have never experienced an involuntary work stoppage. We consider our employee relations to be good.

Effect of Environmental Laws

We are subject to federal, state and local environmental laws and regulations, as well as the environmental laws and regulations of the foreign federal and local jurisdictions in which we have manufacturing facilities. We believe we are in material compliance with all such laws and regulations.

EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers, their positions and their ages as of March 22, 2006, are as follows:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Hans Georg Betz	59	President and Chief Executive Officer
Charles S. Rhoades	45	Chief Operating Officer
Mark D. Hartman	32	Principal Financial & Accounting Officer
James G. Guilmart	51	Senior Vice President of Sales

Hans Georg Betz became our President and Chief Executive Officer in August 2005. Dr. Betz has been a member of our Board of Directors since July 2004 and retains his board position. From August 2001 to July 2005, Dr. Betz was chief executive officer of West STEAG Partners GmbH, a German-based venture capital company focused on the high-technology industry. From January 1996 to July 2001, he was chief executive officer of STEAG Electronic Systems AG and a managing director at Leybold AG. Dr. Betz currently serves as a director of Mattson Technology, Inc., a publicly held supplier of advanced process equipment used to manufacture semiconductors, and serves as a member of its audit and compensation committees. He also serves as a board member and compensation committee member of Steag HamaTech AG, a publicly held supplier of manufacturing equipment and process technology for the manufacture of optical media (CD/DVD) and for processing photomask and wafers for the semiconductor industry.

Charles S. Rhoades joined us in September 2002 as Senior Vice President and General Manager of Control Systems and Instrumentation; in November 2004 he was named Executive Vice President of Products and Operations. On December 19, 2005, Mr. Rhoades was appointed as Chief Operating Officer. From March 2000 to September 2002, Mr. Rhoades was Vice President, Corporate Development at Portera Systems. Prior to Portera Systems, he was Managing Director of Product Development at Lam Research.

Mark D. Hartman was designated as our Principal Financial Officer and Principal Accounting Officer, effective December 31, 2005, upon the departure of our former Chief Financial Officer. Mr. Hartman joined us in January 2002. He currently serves as the Director of Corporate Accounting and Assistant Corporate Controller, a position he has held since July 2002. Mr. Hartman served as our Assistant Corporate Controller from January 2002 to June 2002. Prior to joining Advanced Energy, Mr. Hartman was an independent financial management consultant and also had served in a progression of auditing and consulting positions at Arthur Andersen LLP. Mr. Hartman is a Certified Public Accountant.

James G. Guilmart joined us in September 1999 as Director of Applied Materials Account Team and was named Senior Vice President of Sales in October 2000. From October 1998 to August 1999, he was Senior Vice President, SAP Business Unit at Siemens Information and Communications Products, LLC. Prior to Siemens, he was Vice President, Business Implementation at Unisys Corporation.

ITEM 1A. RISK FACTORS

The semiconductor, semiconductor capital equipment and flat panel display industries are highly cyclical, which impacts our operating results.

Our business and operating results depend in significant part upon capital expenditures by manufacturers of semiconductors and flat panel displays, which in turn depend upon current and anticipated demand for their products. Historically, these industries have been highly cyclical, with recurring periods of over-supply that have had a negative impact on the demand for capital equipment used to manufacture their products.

During periods of declining demand, our customers typically reduce purchases of, and cancel orders for, our products and delay delivery of their own products. We may incur significant charges as we seek to align our cost structure with any such reduction in sales to these customers. In addition, we may not be able to respond adequately or quickly to the declining demand by reducing our costs. We may also be required to record significant reserves for excess and obsolete inventory as demand for our products changes. Our inability to reduce costs and the charges resulting from other actions taken in response to changes in demand for our products would adversely affect our business, financial condition and operating results.

Our quarterly and annual operating results fluctuate significantly and are difficult to predict.

Our operating results may be adversely affected by a variety of factors, many of which are beyond our control and difficult to predict. These factors include:

- Fluctuations in demand in the semiconductor, semiconductor capital equipment and flat panel display industries and other industries in which our customers operate;
- The timing and nature of orders placed by our customers;
- Seasonal variations in capital spending by our customers;
- Changes in our customers' inventory management practices;
- Customer cancellation or postponement of previously placed orders;
- Pricing competition from our competitors;
- Customer requests for us to reduce prices, enhance features, improve reliability, shorten delivery times and extend payment terms;
- Component shortages or allocations or other factors that result in delays in manufacturing and sales or result in changes to our inventory levels or cause us to substantially increase our spending on inventory;
- The introduction of new products by us or our competitors;
- Changes in macroeconomic conditions;
- Litigation, especially regarding intellectual property; and
- Currency exchange rate fluctuations. Currently, a 10% adverse change in exchange rates would have approximately a 4% to 5% adverse impact on reported revenues and expenses.

We have recently transferred the production of substantially all of our product lines to our manufacturing facility in Shenzhen, China, and may experience unforeseen difficulties and challenges with these new operations.

We have invested significant human and financial resources to establish our manufacturing facility in Shenzhen, China. These investments were made with the goal of reducing our labor costs by increasing our workforce in China and correspondingly decreasing our workforce in the United States. Because our operating history in Shenzhen is limited, we cannot predict with certainty the impact that this new facility will have on our operating results. We may incur unforeseen costs with respect to this facility and the related workforce.

We might not realize all of the intended benefits of transitioning our supply base to Asian suppliers.

We are continuing our transition to purchasing a substantial portion of components for our products from Asian suppliers to lower our materials costs and shipping expenses. These components might require us to incur higher than anticipated testing or repairing costs, which would have an adverse effect on our operating results. Customers, including major customers who have strict and extensive requirements, might not accept our products if they contain these lower-priced components. A delay or refusal by our customers to accept such products might require us to continue to purchase higher-priced components from our existing suppliers or might cause us to lose sales to these customers, which would have an adverse effect on our operating results.

Raw material, part, component and subassembly shortages, exacerbated by our dependence on sole and limited source suppliers, could affect our ability to manufacture products and systems and could delay our shipments.

Our business depends on our ability to manufacture products that meet the rapidly changing demands of our customers. Our ability to manufacture our products timely depends in part on the timely delivery of raw materials, parts, components and subassemblies from suppliers. We rely on sole and limited source suppliers for some of our raw materials, parts, components and subassemblies that are critical to the manufacturing of our products. This reliance involves several potential risks, including the following:

- Inability to obtain an adequate supply of required parts, components or subassemblies;
- Supply shortages if a sole source provider ceases operations;
- Having to fund the operating losses of a sole source provider;
- Reduced control over pricing and timing of delivery of raw materials, parts, components or subassemblies;
- Need to qualify alternative suppliers which could be time consuming and lead to delays in delivery of products to our customers, as well as increased costs; and
- Inability of our suppliers to develop technologically advanced products to support our growth and development of new products.

If we are unable to successfully qualify additional suppliers and manage relationships with our existing and future suppliers or if our suppliers cannot meet our performance or quality specifications, or timing requirements, we may experience shortages of raw materials, parts, components or subassemblies, increased material costs and shipping delays for our products, which would adversely affect our business, financial condition and operating results and relationships with our current and prospective customers.

A significant portion of our sales is concentrated among a few customers.

Our ten largest customers accounted for 57% of our total sales in 2005, 60% in 2004 and 54% in 2003. Applied Materials, our largest customer, accounted for 23% of our sales in 2005, 28% in 2004 and 21% in 2003. Ulvac, Inc., our largest customer in the flat panel display industry, accounted for 11% of our sales in 2005, and less than 10% in 2004 and 2003. No other customer exceeded 10% of our sales during these yearly periods. The loss of any of our significant customers or a material reduction in any of their purchase orders could significantly harm our business, financial condition and results of operations.

Our customers continuously exert pressure on us to reduce our prices and extend payment terms. Given the nature of our customer base and the highly competitive markets in which we compete, we may be required to reduce our prices or extend payment terms to remain competitive. We may not be able to reduce our expenses in an amount sufficient to offset potential margin declines.

We generally have no written long-term contracts with our customers requiring them to purchase any specified quantities from us.

As is typical in our industry, our sales are primarily made on a purchase order basis, and we generally have no written long-term purchase commitments from our customers. As a result, we are limited in our ability to predict the level of future sales or commitments from our current customers, which may diminish our ability to effectively allocate labor, materials and equipment in the manufacturing process. In addition, we may accumulate inventory in anticipation of sales that do not materialize resulting in excess and obsolete inventory write-offs.

If we are unable to adjust our business strategy successfully for some of our product lines to reflect the increasing price sensitivity on the part of our customers, our business and financial condition could be harmed.

Our business strategy for many of our product lines has been focused on product performance and technology innovation to provide enhanced efficiencies and productivity. As a result of recent economic conditions and changes in various markets that we serve, our customers have experienced significant cost pressures and, as a result, we have observed increased price sensitivity on the part of our customers. If competition for any of our product lines should come to focus solely on price rather than on product performance and technology innovation, we will need to adjust our business strategy and product offerings accordingly and, if we are unable to do so, our business, financial condition and operating results could be materially and adversely affected.

The markets in which we operate are highly competitive.

We face substantial competition, primarily from established companies, some of which have greater financial, marketing and technical resources than we do. We expect our competitors will continue to develop new products in direct competition with ours, improve the design and performance of their products and introduce new products with enhanced performance characteristics.

To remain competitive, we must improve and expand our products and product offerings. In addition, we may need to maintain a high level of investment in research and development and expand our sales and marketing efforts, particularly outside of the United States. We might not be able to make the technological advances and investments necessary to remain competitive. Our inability to improve and expand our products and product offerings would have an adverse affect on our sales and results of operations.

Our competitive position could be weakened if we are unable to convince end users to specify that our products be used in the equipment sold by our customers.

Our competitive success often depends upon factors outside of our control. For example, in some cases, particularly with respect to mass flow controller products, semiconductor device and flat panel display manufacturers may direct equipment manufacturers to use a specified supplier's product in their equipment at a particular facility. Accordingly, for such products, our success will depend in part on our ability to have end users specify that our products be used at their facilities. In addition, we may encounter difficulties in changing established relationships of competitors that already have a large installed base of products within such facilities. If device manufacturers do not specify the use of our products, our sales may be reduced which would negatively affect our business, financial condition and operating results.

We must achieve design wins to retain our existing customers and to obtain new customers, although design wins achieved do not necessarily result in substantial sales.

The constantly changing nature of semiconductor fabrication and flat panel display technology causes equipment manufacturers to continually design new systems. We must work with these manufacturers early in their design cycles to modify our equipment or design new equipment to meet the requirements of their new systems. Manufacturers typically choose one or two vendors to provide the components for use with the early system shipments. Selection as one of these vendors is called a design win. It is critical that we achieve these design wins in order to retain existing customers and to obtain new customers.

We believe that equipment manufacturers often select their suppliers based on factors such as long-term relationships. Accordingly, we may have difficulty achieving design wins from equipment manufacturers who are not currently our customers. In addition, we must compete for design wins for new systems and products of our existing customers, including those with whom we have had long-term relationships. If we are not successful in achieving design wins, our business, financial condition and operating results will be adversely impacted.

Once a manufacturer chooses a component for use in a particular product, it is likely to retain that component for the life of that product. Our sales and growth could experience material and prolonged adverse effects if we fail to achieve design wins. However, design wins do not always result in substantial sales, as sales of our products are dependent upon our customers' sales of their products.

Our ability to borrow under our revolving line of credit may be restricted if we do not maintain compliance with certain financial covenants. Restrictions in our ability to borrow under our revolving line of credit could limit our flexibility in reacting to periods of increasing demand and amplify our vulnerability to general adverse economic and industry conditions.

Although we currently have no outstanding borrowings under our \$40 million revolving line of credit, we may in the future need to borrow under this line of credit. Advances under the line of credit would bear interest at the prime rate (7.5% at March 22, 2006) minus 1% and would be due and payable in July 2006. Our borrowings under the line of credit agreement are limited based upon letters of credit outstanding under this agreement and the lenders borrowing base calculation, which considers among other factors, our accounts receivable and inventory balances. As a condition of borrowing and maintaining an outstanding balance under the line of credit, we are subject to covenants that provide certain restrictions related to working capital, net worth, acquisitions and payment and declaration of dividends. We were in compliance with all such covenants at December 31, 2005.

Our ability to comply with these covenants may be affected by changes in our business condition or results of our operations, or other events beyond our control or difficult to predict. The breach of any of these covenants would result in a default under the line of credit. There can be no assurance that a breach of any of the covenants will not occur in the future, nor can there be any assurance that our lender will waive any such breach. A breach of any of the covenants would permit our lender to restrict our borrowings and accelerate the maturity of any outstanding balances under the line of credit agreement and to take ownership of the assets securing them, which could adversely affect our business, financial condition and results of operations.

We might not be able to compete successfully in international markets or meet the service and support needs of our international customers.

Our sales to customers outside the United States were approximately 50% in 2005, 48% in 2004 and 53% in 2003. Our success in competing in international markets is subject to our ability to manage various risks and difficulties, including, but not limited to:

- Our ability to effectively manage our employees at remote locations who are operating in different business environments from the United States;
- Our ability to develop relationships with suppliers and other local businesses;
- Compliance with product safety requirements and standards that are different from those of the United States;
- Variations in enforcement of intellectual property and contract rights in different jurisdictions;

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- Trade restrictions, political instability, disruptions in financial markets and deterioration of economic conditions;
- The ability to provide sufficient levels of technical support in different locations;
- Collecting past due accounts receivable from foreign customers; and
- Changes in tariffs, taxes and foreign currency exchange rates.

Our ability to implement our business strategies, maintain market share and compete successfully in international markets will be compromised if we are unable to manage these and other international risks successfully.

Unfavorable currency exchange rate fluctuations may lead to lower operating margins, or may cause us to raise prices which could result in reduced sales.

Currency exchange rate fluctuations could have an adverse effect on our sales and results of operations and we could experience losses with respect to our forward exchange contracts. Unfavorable currency fluctuations could require us to increase prices to foreign customers which could result in lower net sales by us to such customers. Alternatively, if we do not adjust the prices for our products in response to unfavorable currency fluctuations, our operating results could be adversely affected. In addition, most sales made by our foreign subsidiaries are denominated in the currency of the country in which these products are sold and the currency they receive in payment for such sales could be less valuable at the time of receipt as a result of exchange rate fluctuations. We enter into forward exchange contracts and local currency purchased options to reduce currency exposure arising from intercompany sales of inventory. However, we cannot be certain that our efforts will be adequate to protect us against significant currency fluctuations or that such efforts will not expose us to additional exchange rate risks which could adversely affect our operating results.

Changes in the value of the Chinese yuan could impact the cost of our operation in Shenzhen, China.

The Chinese government is continually pressured by its trading partners to allow its currency to float in a manner similar to other major currencies. The recent revaluation of the yuan has not had a material impact on our operations. Any further change may impact our ability to control the cost of our products in the world market. Specifically, the decision by the Chinese government to allow the yuan to begin to float against the United States dollar could significantly increase the labor and other costs incurred in the operation of our Shenzhen facility and the cost of raw materials, parts, components and subassemblies that we source in China, thereby negatively affecting our financial condition and operating results.

We are highly dependent on our intellectual property.

Our success depends significantly on our proprietary technology. We attempt to protect our intellectual property rights through patents and non-disclosure agreements; however, we might not be able to protect our technology, and competitors might be able to develop similar technology independently. In addition, the laws of some foreign countries might not afford our intellectual property the same protections as do the laws of the United States. Our intellectual property is not protected by patents in several countries in which we do business, and we have limited patent protection in other countries, including China. The cost of applying for patents in foreign countries and translating the applications into foreign languages requires us to select carefully the inventions for which we apply for patent protection and the countries in which we seek such protection. Generally, our efforts to obtain international patents have been concentrated in the European Union and certain industrialized countries in Asia, including, Korea, Japan and Taiwan. If we are unable to protect our intellectual property successfully, our business, financial condition and operating results could be adversely affected.

Intellectual property rights are difficult to enforce in China.

Commercial law in China is relatively undeveloped compared to the commercial law in the United States. Limited protection of intellectual property is available under Chinese law. Consequently, manufacturing our products in China may subject us to an increased risk that unauthorized parties may attempt to copy our products or otherwise obtain or use our intellectual property. We cannot give assurance that we will be able to protect our intellectual property rights effectively or have adequate legal recourse in the event that we encounter infringements of our intellectual property in China.

We have been, and in the future may again be, involved in patent litigation. Patent litigation is costly and could result in further restrictions on our ability to sell certain products or an inability to prevent others from using technology we have developed.

Litigation may be necessary to enforce patents issued to us, to protect our trade secrets or know-how, to defend ourselves against claimed infringement of the rights of others or to determine the scope and validity of our proprietary rights or the proprietary rights of others. This type of litigation often requires substantial management time and attention, as well as financial and other resources.

Future patent litigation might:

- Cause us to incur substantial costs in the form of legal fees, fines and royalty payments;
- Result in restrictions on our ability to sell certain products;
- Result in an inability to prevent others from using technology we have developed; and
- Require us to redesign products or seek alternative technologies.

Any of these events could have a significant adverse effect on our business, financial condition and results of operations.

We are subject to numerous governmental regulations.

We are subject to federal, state, local and foreign regulations, including environmental regulations and regulations relating to the design and operation of our products and control systems. We might incur significant costs as we seek to ensure that our products meet safety and emissions standards, many of which vary across the states and countries in which our products are used. In the past, we have invested significant resources to redesign our products to comply with these directives. Compliance with future regulations, directives and standards could require us to modify or redesign some products, make capital expenditures or incur substantial costs. If we do not comply with current or future regulations, directives and standards:

- We could be subject to fines;
- Our production or shipments could be suspended; or
- We could be prohibited from offering particular products in specified markets.

Any inability to comply with current or future regulations, directives and standards could adversely affect our business, financial condition or operating results.

The market price of our common stock has fluctuated and may continue to fluctuate for reasons over which we have no control.

The stock market has from time to time experienced, and is likely to continue to experience, extreme price and volume fluctuations. Prices of securities of technology companies have been especially volatile and have often fluctuated for reasons that are unrelated to their operating performance. In the past, companies that have experienced volatility in the market price of their stock have been the objects of securities class action litigation. If we were the object of securities class action litigation, it could result in substantial costs and a diversion of our management's attention and resources.

Future sales of our common stock by our Chairman of the Board may negatively affect the market price of our common stock.

Douglas S. Schatz, our Chairman of the Board, beneficially owns approximately 21% of our outstanding common stock as of March 22, 2006. The sale of a substantial amount of the shares owned by him could negatively affect the market price of our common stock. Mr. Schatz has entered into a written trading plan pursuant to Rule 10b5-1 under the Securities Exchange Act of 1934, which provides for the sale of up to 720,000 shares of common stock if certain price targets and other conditions are met.

Our Chairman of the Board owns a significant percentage of our outstanding common stock, which could enable him to control our business and affairs.

Douglas S. Schatz, our Chairman of the Board, beneficially owns approximately 21% of our outstanding common stock as of March 22, 2006. This stockholding gives Mr. Schatz significant voting power and influence. Depending on the number of shares that abstain or otherwise are not voted on a particular matter, Mr. Schatz may be able to elect all of the members of our board of directors and to control our business affairs for the foreseeable future in a manner with which our other stockholders may not agree.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Information concerning our principal properties at December 31, 2005 is set forth below.

<u>Location</u>	<u>Type</u>	<u>Principal Use</u>	<u>Sq. Footage</u>	<u>Ownership</u>
San Jose, CA	Office	Distribution	20,000	Leased
Fort Collins, CO	Office, plant	Headquarters, Research and development, Manufacturing, Distribution	236,000	Leased
Austin, TX	Office	Distribution	8,000	Leased
Dallas, TX	Office	Distribution	2,000	Leased
Vancouver, WA	Office, plant	Research and development, Manufacturing, Distribution	20,000	Leased
Shanghai, China	Office	Distribution	8,000	Leased
Shenzhen, China	Office, plant	Manufacturing, Distribution	100,000	Leased
Bicester, England	Office	Distribution	1,000	Leased
Lumbin, France	Office	Distribution	1,000	Leased
Filderstadt, Germany	Office	Distribution	9,000	Leased
Stolberg, Germany	Office, plant	Research and development, Manufacturing, Distribution	17,000	Leased
Hachioji, Japan	Office, plant	Research and development, Manufacturing, Distribution	46,000	Owned(1)
Bundang, South Korea	Office	Distribution	14,000	Owned(2)
Hsinchu, Taiwan	Office	Distribution	9,000	Leased
Taipei Hsien, Taiwan	Office	Distribution	13,000	Leased

- (1) The Company owns this facility which serves as collateral for senior borrowings of approximately \$2.1 million as of December 31, 2005, maturing serially through May 2007.
- (2) The Company owns this facility which serves as collateral for a mortgage note payable of approximately \$1.6 million outstanding as of December 31, 2005, due July 2007.

During 2006, we expect to reduce the square footage of our Fort Collins, Colorado facilities by approximately 13%. We consider all of the above facilities suitable and adequate to meet our production and office space needs for the foreseeable future.

In 2005, we closed the following facilities:

<u>Location</u>	<u>Type</u>	<u>Principal Use</u>	<u>Sq. Footage</u>	<u>Ownership</u>
Dresden, Germany	Office	Distribution	2,000	Leased
Tokyo, Japan	Office	Distribution	4,000	Leased

ITEM 3. LEGAL PROCEEDINGS

On October 3, 2005, we executed a settlement agreement with MKS Instruments, Inc. (“MKS”) resolving all pending claims involving the Xstream™ With Active Matching Network™ products (“Xstream products”). Pursuant to the settlement agreement, we paid \$3.0 million in cash to MKS and stipulated to a final judgment of infringement and an injunction prohibiting us from making, using, selling, offering to sell, or importing into the United States, or any country in which a counterpart patent exists, our Xstream products and all other toroidal plasma generator products, except as permitted under the settlement agreement. Sales of these products have accounted for less than 5% of our total sales each year since introduction of the products. Pursuant to the settlement agreement, we also agreed to not refile our claims related to MKS’s Astron reactive gas source products.

On June 8, 2005, the Korean Customs Service (“KCS”) issued a Pre-Taxation Notification concerning back duties and value added taxes allegedly owed on goods imported by the Company’s Korean subsidiary, Advanced Energy Industries Korea, Inc., during the five year period ended June 8, 2005. On June 27, 2005, we protested the notifications on the grounds that the assessment was unwarranted and based on a misapplication of international tariff rules. On September 9, 2005, the KCS rejected our protest. Beginning on September 19, 2005, the KCS issued a series of taxation notices for duties and penalties owed of approximately \$2.2 million. In order to appeal the assessment to the Korean National Tax Tribunal, an independent review board of the Korean Ministry of Finance and Economy, we paid the taxation notices. We filed our appeals of the assessments in December 2005, and the KCS filed a response in opposition to our appeal. We anticipate that the Korean National Tax Tribunal will schedule a hearing for adjudication of the matter in the second quarter of 2006. We do not anticipate that the amount of any ultimate loss in respect of this matter will have a material adverse effect on our financial position or consolidated results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on the Nasdaq National Market under the symbol “AEIS.” At March 22, 2006, the number of common stockholders of record was 726, and the closing sale price on that day was \$13.81 per share.

The table below shows the range of high and low closing sale prices for the common stock as quoted (without retail markup or markdown and without commissions) on the Nasdaq National Market; quotations do not necessarily represent actual transactions:

	2005		2004	
	High	Low	High	Low
First Quarter	\$ 9.96	\$ 6.88	\$ 28.19	\$ 19.13
Second Quarter	\$ 11.10	\$ 7.86	\$ 23.07	\$ 12.83
Third Quarter	\$ 12.61	\$ 7.76	\$ 15.32	\$ 8.78
Fourth Quarter	\$ 13.85	\$ 10.01	\$ 10.97	\$ 7.92

We have not declared or paid any cash dividends on our capital stock since we terminated our election to be treated as an S–corporation for tax purposes, effective January 1, 1994. We currently intend to retain all future earnings to finance our business and do not anticipate paying cash or other dividends on our common stock in the foreseeable future. Furthermore, our revolving credit facility prohibits the declaration or payment of any cash dividends on our common stock.

ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated statement of operations data and the related consolidated balance sheet data were derived from the audited consolidated financial statements. The information below is not necessarily indicative of results of future operations and should be read in conjunction with Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of Part II of this Form 10–K in order to more fully understand the factors that may affect the comparability of the information presented below.

(In thousands, except per share data)	Years Ended December 31,				
	2005	2004	2003	2002	2001 (a)
Statement of Operations Data:					
Sales	\$325,482	\$380,537	\$253,536	\$233,730	\$193,600
Gross profit	117,081	114,626	84,319	66,192	57,432
Total operating expenses	101,107	118,093	108,746	128,891	104,319
Income (loss) from operations	15,974	(3,467)	(24,427)	(62,699)	(46,887)
Income (loss) from continuing operations	3,622	(14,670)	(45,536)	(42,113)	(31,379)
Net income (loss)	12,817	(12,747)	(44,241)	(41,399)	(31,379)
Income (loss) from continuing operations per share — diluted	\$ 0.10	\$ (0.45)	\$ (1.41)	\$ (1.31)	\$ (0.99)
Net income (loss) per share — diluted	\$ 0.34	\$ (0.39)	\$ (1.37)	\$ (1.29)	\$ (0.99)
Diluted weighted–average common shares outstanding	37,434	32,649	32,271	32,026	31,712

(a) The results of discontinued operations are included within the 2001 continuing operations balances, due to the Company not separately recording and analyzing these results prior to 2002 in sufficient detail to reclassify to discontinued operations.

	Years Ended December 31,				
	2005	2004	2003	2002	2001
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	\$ 59,685	\$107,982	\$134,892	\$172,347	\$271,978
Working capital	143,633	206,915	205,835	247,942	349,608
Total assets	310,117	394,407	414,731	455,733	450,195
Total debt	4,190	196,123	202,468	213,580	207,730
Stockholders’ equity	257,430	144,978	151,834	183,339	214,345

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains, in addition to historical information, forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are other than historical information are forward-looking statements. For example, statements relating to our beliefs, expectations, plans and projections are forward-looking statements, as are statements that certain actions, conditions or circumstances will continue or change. Forward-looking statements involve risks and uncertainties. Consequently, our actual results may differ materially from the results discussed in the forward-looking statements. Factors that could cause or contribute to such differences or prove any forward-looking statements, by hindsight to be overly optimistic or unachievable, include, but are not limited to, the following:

- Changes or slowdowns in general economic conditions or conditions in the semiconductor, semiconductor capital equipment and flat panel display industries and other industries in which our customers operate;
- Timing and nature of orders placed by our customers, including their product acceptance criteria;
- Future warranty costs in excess of anticipated levels;
- Periodic charges for excess and obsolete inventory;
- Pricing competition from our competitors;
- Lower average selling prices than anticipated;
- Costs incurred and judgments resulting from patent or other litigation;
- Component shortages or allocations or other factors that change our levels of inventory or substantially increase our spending on inventory;
- The introduction of new products by us or our competitors;
- Changes in our customers' inventory management practices;
- Customer cancellations of previously placed orders and shipment delays; and
- Changes in foreign currency exchange rates.

For a discussion of these and other factors that may impact our realization of our forward-looking statements, see "Item 1A – Risk Factors" within Part I of this Form 10-K.

Executive Summary

Our sales in 2005 were \$325.5 million, a 14% decrease from sales in 2004 of \$380.5 million. The decrease in our sales principally reflects a downturn in spending in the semiconductor, semiconductor capital equipment, and flat panel display industries.

In 2005, we completed the transition of our high-volume manufacturing to our Shenzhen, China facility for all product platforms originally identified for transfer to Shenzhen. We also continued our transition to lower-cost Asian suppliers. The elimination of the duplicative costs incurred throughout the transition, the benefit of reduced manufacturing costs in China, and the reduced costs experienced through increased purchasing from Asian suppliers have positively contributed to our results of operations in 2005 compared to 2004 and 2003. Our gross margin increased to 36.0% in 2005 from 30.1% in 2004 and 33.3% in 2003. Our gross margin in 2004 was negatively impacted by significant charges for excess and obsolete inventory totaling \$11.3 million.

We also completed the sale of 11.5 million shares of common stock through an underwritten public offering and realized approximately \$105.5 million in net proceeds, which we used towards the full redemption of our convertible subordinated notes with a total principal balance of \$187.7 million. As a result, we eliminated substantially all of our long-term debt and interest expense.

Our net income from continuing operations for 2005 was \$3.6 million, compared to a net loss in 2004 of \$14.7 million, and a net loss of \$45.5 million in 2003. The improvement in 2005 from 2004 and 2003 was principally due to the elimination of the duplicative operating and logistics costs associated with our operational restructuring, focus on material cost reductions, the significantly reduced excess and obsolete inventory charges attributable to improved product life-cycle management, and the refocusing of our research and development activities. The improvement from 2004 to 2005 occurred despite the 14% decrease in our sales.

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In 2005, we made a strategic decision to focus our management attention and spending on our core operations. As a result, we sold our EMCO and IKOR product lines, as these lines were not considered critical to our core operations. Our income from discontinued operations was \$9.2 million in 2005, comprised of a \$7.9 million gain on the sale of discontinued operations and \$1.3 million related to the operating results of discontinued operations. Income from discontinued operations was \$1.9 million in 2004 and \$1.3 million in 2003, representing the operating results of operations reclassified from continuing operations.

Results of Operations

The following table summarizes certain data as a percentage of sales extracted from our consolidated statements of operations:

	Years Ended December 31,		
	2005	2004	2003
Sales	100.0%	100.0%	100.0%
Cost of sales	64.0	69.9	66.7
Gross profit	36.0	30.1	33.3
Operating expenses:			
Research and development	12.2	12.9	19.6
Selling, general and administrative	17.1	16.3	21.1
Litigation settlement	0.9	—	—
Restructuring charges	0.8	1.0	1.7
Impairment of intangible assets	—	0.9	0.5
Total operating expenses	31.1	31.0	42.9
Income (loss) from operations	4.9	(0.9)	(9.6)
Other expense, net	(2.3)	(1.9)	(3.7)
Income (loss) from continuing operations before income taxes	2.6	(2.8)	(13.3)
Provision for income taxes	(1.5)	(1.0)	(4.7)
Income (loss) from continuing operations	1.1	(3.9)	(18.0)
Income from discontinued operations, net of tax	2.8	0.5	0.5
Net income (loss)	3.9%	(3.3)%	(17.4)%

SALES

The following tables summarize annual net sales, and percentages of net sales, by customer type for each of the three years in the period ended December 31, 2005:

	Years Ended December 31,		
	2005	2004	2003
	(In thousands)		
Semiconductor capital equipment	\$205,322	\$238,728	\$155,153
Flat panel display	43,174	56,304	28,953
Data storage	19,616	29,229	26,397
Advanced product applications	57,370	56,276	43,033
	<u>\$325,482</u>	<u>\$380,537</u>	<u>\$253,536</u>
	Years Ended December 31,		
	2005	2004	2003
Semiconductor capital equipment	63%	63%	61%
Flat panel display	13	15	12
Data storage	6	7	10
Advanced product applications	18	15	17
	<u>100%</u>	<u>100%</u>	<u>100%</u>

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The following tables summarize annual net sales, and percentages of net sales, by geographic region for each of the three years in the period ended December 31, 2005. The following amounts do not contemplate where our customers may subsequently transfer our products.

	Years Ended December 31,		
	2005	2004	2003
	(In thousands)		
United States	\$163,657	\$198,263	\$117,635
Europe	34,228	58,852	47,915
Asia	126,480	122,533	86,873
Rest of world	1,117	889	1,113
	<u>\$325,482</u>	<u>\$380,537</u>	<u>\$253,536</u>

	Years Ended December 31,		
	2005	2004	2003
United States	50%	52%	47%
Europe	11	16	19
Asia	39	32	34
Rest of world	—	—	—
	<u>100%</u>	<u>100%</u>	<u>100%</u>

Total sales were \$325.5 million in 2005, \$380.5 million in 2004 and \$253.5 million in 2003, representing a decrease of 14% from 2004 to 2005 and a 50% increase from 2003 to 2004. The growth from 2003 to 2004 was due primarily to a recovery from downturns in the semiconductor and semiconductor capital equipment industries, and continued growth of the flat panel display industry. The decrease from 2004 to 2005 principally reflects a decline in demand in the semiconductor capital equipment, flat panel display and data storage industries, partially offset by an increase in demand in the advanced product applications, particularly applications dependent upon industrial coatings. We expect that these industries will recover slightly in the near term, but have no clear visibility for all of 2006.

The semiconductor capital equipment industry is highly cyclical and is impacted by changes in the macroeconomic environment, changes in semiconductor supply and demand and rapid technological advances in both semiconductor devices and wafer fabrication processes. Our sales to the semiconductor capital equipment industry, which have consistently represented approximately 60% of our total sales, increased by approximately 54% from 2003 to 2004, and then declined by approximately 14% from 2004 to 2005, due largely to fluctuating demand. Our sales to our largest semiconductor capital equipment customers represented the majority of the fluctuating sales volume.

Applied Materials is our largest customer and accounted for 23% of our sales in 2005, 28% in 2004 and 21% in 2003. Our ten largest customers accounted for 57% of our total sales in 2005, 60% in 2004 and 54% in 2003.

Our sales to the flat panel display industry increased \$27.4 million, or 94% from 2003 to 2004, and then decreased \$13.1 million, or 23%, from 2004 to 2005. Our sales to the data storage industry increased \$2.8 million, or 11% from 2003 to 2004, and then decreased \$9.6 million, or 33%, from 2004 to 2005. The increases in sales from 2003 to 2004 followed by the decreases from 2004 to 2005 in these industries are primarily attributed to fluctuating demand. Ulvac, Inc., our largest customer in the flat panel display industry, accounted for 11% of our sales in 2005, and less than 10% in 2004 and 2003.

Sales for advanced product applications have been steadily increasing, which we attribute primarily to the general expansion of applications dependent upon industrial coatings. Our advanced product application sales increased \$13.2 million, or 31% from 2003 to 2004, and increased \$1.1 million, or 2%, from 2004 to 2005.

Looking forward to 2006, there is no assurance that our revenue will remain consistent with, or increase from, the levels experienced during 2005. Changes in the macroeconomic environment, semiconductor supply and demand, and other changes that are beyond our control introduce significant uncertainty into our forecasts.

GROSS MARGIN

Our gross margin was 36.0% in 2005, 30.1% in 2004 and 33.3% in 2003. The improvement in our gross margin is attributed to the completion of our high-volume manufacturing transition to China, lowering of our worldwide logistics costs, product portfolio management, supplier transitions and design-led cost reductions, offset by the impact of the lower sales base.

The decline in gross margin from 2003 to 2004 was primarily due to: lower average selling prices than anticipated; increasing manufacturing costs at the Shenzhen facility as production of more product lines was transferred and customers began accepting products from such facility, without equivalent decreases in manufacturing and facilities costs at our Fort Collins facility (impact of approximately 200 – 300 basis points); high demand during 2004 for product lines with relatively low margins; and excess and obsolete inventory charges during the fourth quarter of 2004 resulting from changes in our product life-cycle management program,

discontinuance of certain products in select markets, the product mix shift from 200mm wafers to 300mm wafers and the expected continued slowdown in the semiconductor industry in the near term.

Our gross margin in 2005 was positively impacted by 1.7 percentage points, due to our discontinuance of the allocation of human resource and finance department costs to cost of sales. As part of our significant operational restructuring, we have reviewed all aspects of our management reporting and determined that the continued allocation of such costs was no longer appropriate. In 2005, these costs are recorded in selling, general and administrative expenses. Human resource and finance department costs included in our gross margin represented 1.6 percentage points in 2004 and 1.9 percentage points in 2003.

Our gross margins during these years have been adversely affected principally by the following factors:

- The lower sales bases in 2005 and 2003 caused in large part by downturns in the semiconductor equipment industry, resulting in lower absorption of our fixed costs;
- During our transition of high-volume manufacturing to Shenzhen, from 2003 to mid-2005, we had been required to operate manufacturing facilities in both Shenzhen and Fort Collins to produce the same products, which required duplicate management, procurement and engineering teams, as well as facilities costs;
- Increased shipping and related costs for products manufactured in our Shenzhen facility during our manufacturing transition;
- Lower average selling prices;
- High demand for two product groups with margins lower than our corporate average;
- Charges for excess and obsolete inventory were approximately \$1.7 million in 2005, \$11.3 million in 2004 and \$3.0 million in 2003. The 2004 charge was primarily due to changes in our product life-cycle management program, discontinuance of certain products in select markets, the product mix shift from 200mm wafers to 300mm wafers and the expected continued slowdown in the semiconductor industry in the near term. The 2003 charge was primarily due to a reduced sales outlook and a management decision to discontinue certain product offerings. Due to the highly customized nature of our inventory, minimal quantities of reserved inventory are subsequently sold, and therefore subsequent sales of this inventory have not had a material impact on our gross margin. The reserved inventory is typically disposed of when it is determined that no possible future use could arise; and
- Warranty costs of approximately \$11.2 million in 2005, \$10.5 million in 2004 and \$8.1 million in 2003.

Factors that could cause our gross margins to be negatively impacted in 2006 and beyond include, but are not limited to the following:

- Decrease in average selling prices;
- Unanticipated costs related to our recent transition to China manufacturing and continuing move to lower-cost Asian suppliers;
- Cost reduction programs initiated by semiconductor manufacturers and semiconductor capital equipment manufacturers that negatively impact our average selling price;
- Warranty costs in excess of historical rates and our expectations;
- Freight costs in excess of historical rates and our expectations;
- Increased levels of excess and obsolete inventory, either due to market conditions, the introduction of new products by our competitors, or our decision to discontinue certain product lines;
- Impact of our adoption of the stock-based compensation expensing provisions of SFAS 123(R); and
- Changes in foreign currency exchange rates that might affect our costs.

RESEARCH AND DEVELOPMENT

The market for our subsystems for vacuum process systems and related accessories is characterized by ongoing technological changes. We believe that continued and timely development of new highly differentiated products and enhancements to existing products to support OEM requirements is necessary for us to maintain a competitive position in the markets we serve. Accordingly, we devote a significant portion of our personnel and financial resources to research and development projects and seek to maintain close relationships with our customers and other industry leaders in order to remain responsive to their product requirements. We believe that the continued investment in research and development and ongoing development of new products are essential to the expansion of our markets, and expect to continue to make significant investments in research and development activities. Since our inception, all of our research and development costs have been expensed as incurred.

Our research and development expenses were \$39.7 million in 2005, \$49.0 million in 2004 and \$49.7 million in 2003. As a percentage of sales, research and development expenses have decreased to 12.2% in 2005, from 12.9% in 2004 and 19.6% in 2003. The decrease from 2003 to 2004 was due primarily to the higher sales base in 2004. The decrease from 2004 to 2005 is primarily due to less engineering support needed in connection with the transition of high-volume product manufacturing to China, prioritization of our research and development projects and increased scrutiny of our costs.

SELLING, GENERAL AND ADMINISTRATIVE

Our selling expenses support domestic and international sales and marketing activities that include personnel, trade shows, advertising, and other selling and marketing activities. Our general and administrative expenses support our worldwide corporate, legal, patent, tax, financial, corporate governance, administrative, information systems and human resource functions in addition to our general management.

Selling, general and administrative (“SG&A”) expenses were \$55.7 million in 2005, \$61.9 million in 2004 and \$53.6 million in 2003. As a percentage of sales, SG&A expenses decreased from 21.1% in 2003 to 16.3% in 2004 and then increased to 17.1% in 2005. The percentage decrease from 2003 to 2004 was due to the increasing sales base and our cost reduction measures, including the closures of certain locations, partially offset by an increase in selling expense in 2004 of \$3.8 million due to a change in an accounting estimate related to our demonstration equipment (described below). In dollar terms, SG&A expenses decreased from 2004 to 2005 due primarily to the benefit of our cost reduction measures and decreased commissions, partially offset by the increased allocation of certain costs from cost of sales to SG&A expenses discussed above. As a percentage of sales, the increase from 2004 to 2005 is primarily attributed to the 14% decreased sales base.

Prior to the fourth quarter of 2004, our demonstration equipment program was structured to enable our customers or potential customers to evaluate equipment in order to facilitate sales. Under this program, we amortized our demonstration equipment based on its originally estimated useful life of two years. During the fourth quarter of 2004, we evaluated this program and determined that it was not achieving the desired results, primarily in terms of the ultimate sale of the demonstration equipment. As a result, we shifted our focus from selling the demonstration equipment to utilizing the equipment for achieving design wins with our major customers and significant potential customers, with the demonstration equipment used solely as a sales and marketing tool and with no subsequent efforts to sell the equipment. Based upon these changes, specifically our decision not to expend resources to realize sales value from the demonstration equipment currently in the field, we wrote-off the net book value of the demonstration equipment. Subsequently, our practice has been to expense our demonstration equipment to SG&A in the period in which it is given to our customer or potential customer. This change has not had a continuing material impact on our operating results.

Patent litigation expenses from 2003 through 2005 have comprised a portion of our SG&A expenses. In addition to the litigation settlement paid to MKS Instruments, Inc. (“MKS”) as described below, we have recorded legal fees and expenses related to litigation with MKS and others of approximately 2% to 8% of our total SG&A expenses for each of the three years in the period ended December 31, 2005.

LITIGATION SETTLEMENT

On October 3, 2005, we executed a settlement agreement with MKS, resolving all pending claims worldwide relating to our Xstream™ With Active Matching Network™ reactive gas generator products. Pursuant to the settlement agreement, we paid MKS \$3.0 million in cash. We also stipulated to a final judgment of infringement and an injunction prohibiting us from making, using, selling, offering to sell, or importing into the United States, or any country in which a counterpart patent exists, our Xstream products and all other toroidal plasma generator products, except as permitted under the settlement agreement. Sales of these products have accounted for less than 5% of our total sales each year since introduction of the products.

RESTRUCTURING CHARGES

At the end of 2002, we announced major changes in our operations planned to occur through 2003. These included establishing the manufacturing location in China; consolidating worldwide sales forces; a move to lower-cost Asian suppliers; and the intention to close or sell certain facilities. Associated with these changes, we have recorded restructuring charges of \$2.7 million in 2005, \$3.9 million in 2004 and \$4.3 million in 2003.

The 2003 charges consisted of the recognition of expense for involuntary employee termination benefits for 109 employees in our United States operations; voluntary employee termination benefits, primarily in our Japanese operations for 36 employees; and asset impairments incurred as a result of closing our Longmont, CO manufacturing facilities.

Our restructuring charges throughout 2004 and 2005 were incurred primarily in conjunction with our transition of our high-volume manufacturing to Shenzhen, China, which was substantially complete as of September 30, 2005. In 2004, we recorded \$3.9 million of restructuring charges, primarily attributable to employee severance and termination costs for 262 employees in the Fort Collins facility. Related to this operations restructuring, and the transition of certain product lines from certain of our locations in Europe and Japan, we recorded restructuring charges in 2005 of \$2.7 million, consisting primarily of \$1.9 million for employee severance and termination costs and \$746,000 for impairments of facilities-related assets in the United States and Japan, as a result of consolidation of certain of our facilities. The employee severance and termination costs were associated with 216 employees in the United States, 11 employees in Europe and three employees in Japan. With the exception of one employee in the United States, all of these employee severance and termination costs have been paid as of December 31, 2005. We expect to pay the remaining accrual for employee severance and termination costs of approximately \$130,000 by the end of the first quarter of 2006. The remaining facility closing liability is expected to be paid over the remaining lease term expiring at the end of 2006 and is reflected net of expected sublease income of \$51,000. Additional charges and cash requirements may be required in the future if the expected sublease income is not realized.

We originally estimated that upon completion of the transfer of high-volume manufacturing to China, we would expect to save approximately \$10.0 million to \$12.0 million annually in labor and related costs when compared to what the costs would have been prior to the transition at similar production volumes. The expected savings were anticipated to be approximately \$7.0 million in costs of sales, approximately \$2.0 million in SG&A and approximately \$2.0 million in research and development. We continue to believe that our annual savings as a result of our high-volume manufacturing transition to China will approximate these amounts, which we began to realize in the second half of 2005.

GOODWILL AND OTHER INTANGIBLE ASSET IMPAIRMENTS

We perform our annual impairment test for goodwill in the fourth quarter. However, whenever events or circumstances indicate that the carrying value of our goodwill or other intangible assets may not be recoverable, we perform tests for impairment of these assets and record impairment charges, as necessary. Such events or circumstances include downturns or anticipated downturns in the industries in which we serve, changes in customer technology requirements, and other changes in circumstances affecting the underlying value of the recorded asset. We did not record any impairment charges of our amortizable intangible assets in 2005. We recorded amortizable intangible asset impairment charges totaling \$3.3 million in 2004 and \$1.2 million in 2003.

During the fourth quarter of 2004, in conjunction with our financial forecasting for future periods, it was evident that projected cash flows from certain customers of the Dressler product line were substantially below amounts previously projected. The projected cash flows were considered in determining the fair value of certain contract-based and other amortizable intangible assets recorded at acquisition and also in subsequent periods to assess such assets for potential impairment. Due to the decline in projected cash flows, we 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. We 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 we 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 our restructuring plan, employees who were the subject of certain contract-based amortizable intangibles left the Company or their responsibilities were significantly altered. As a result, we 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. We 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 we 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, we determined that one of our mass flow controller products would not conform to changing customer technology requirements, and as such would no longer be accepted by our customers. As a result, we performed an assessment of the carrying value of the related intangible asset. We 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 we 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.

OTHER INCOME (EXPENSE)

Other income (expense) consists primarily of interest income and expense, foreign exchange gains and losses and other miscellaneous gains, losses, income and expense items.

Interest income was approximately \$2.9 million in 2005 and \$1.7 million in 2004 and 2003. The increase in interest income from the 2003 and 2004 periods was due to our higher level of cash, cash equivalents and marketable securities for most of the year prior to our redemption of the convertible subordinated notes, increasing interest rates, and our investing the \$105.5 million in net proceeds from our public offering of 11.5 million shares prior to our use of those proceeds to redeem our convertible subordinated notes. Portions of the proceeds were held by us, up to 45 days. We expect interest income in future periods to decrease due to our lower combined cash, cash equivalent and marketable securities balances resulting from the use of cash to redeem our convertible subordinated notes.

Interest expense consisted principally of interest on our convertible subordinated notes, on borrowings under capital lease facilities and senior debt, and amortization of our deferred debt issuance costs. Interest expense was approximately \$8.2 million in 2005, \$11.0 million in 2004 and \$11.3 million in 2003. Interest expense decreased slightly from 2003 to 2004 due to the repayment of approximately \$8.6 million of senior borrowings and capital leases during 2004, offset in part by a new borrowing of approximately \$1.6 million. Interest expense decreased \$2.9 million from 2004 to 2005 due primarily to the redemption of our 5.25% convertible subordinated notes with a total principal balance of \$66.2 million and our 5.0% convertible subordinated notes with a total principal balance of \$121.5 million in September 2005. Due to the redemption of all our convertible subordinated notes by the end of the third quarter of 2005, quarterly interest expense and amortized debt issuance costs of approximately \$2.7 million has been eliminated.

Our foreign subsidiaries' sales are primarily denominated in currencies other than the United States dollar. We recorded net foreign currency gains of \$243,000 in 2005, \$1.0 million in 2004 and \$869,000 in 2003.

Debt extinguishment expense of \$3.2 million resulted from the redemption of our convertible subordinated notes with a total principal balance of \$187.7 million. The expense of \$3.2 million is comprised of \$2.1 million for redemption premium and \$1.1 million for the write-off of deferred debt issuance costs.

Net other income (expense) consists principally of miscellaneous gains and losses, including gains and losses on the sale of investments and impairments of investments. We recorded net other income of \$763,000 in 2005 and \$1.0 million in 2004. We recorded net other expense of \$644,000 in 2003.

PROVISION FOR INCOME TAXES

We account 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 the expected tax rates for the periods in which the assets or liabilities will be realized, as well as for the expected tax benefit of net operating loss and tax credit carryforwards. Since 2003, we have recorded valuation allowances against certain of our United States and foreign net deferred tax assets in jurisdictions where we have incurred significant losses. Given such experience, management could not conclude that it was more likely than not that these net deferred tax assets will be realized. While there may be indications that our operating results may improve in future periods, our management, in accordance with SFAS No. 109, in evaluating the recoverability of these net deferred tax assets, is required to place greater weight on our historical results as compared to projections regarding future taxable income. If we generate future taxable income, or should we 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 such period.

We assess the recoverability of our net deferred tax assets on a quarterly basis. If we determine that it is more likely than not that we will realize a portion or all of our net deferred tax assets, some portion or all of the valuation allowance will be reversed with a corresponding reduction in income tax expense in such period. From 2003 through 2005, we have only reversed portions of such valuation allowances for which we have realized the underlying asset.

The income tax provision of \$4.9 million for 2005 represented an effective tax rate on income from continuing operations of 57%. On the loss from continuing operations, the income tax provision of \$3.9 million for 2004 represented an effective tax rate of negative 37% and the income tax provision of \$11.8 million for 2003 represented an effective tax rate of negative 35%. The fluctuation in our effective tax rate from period to period is due to the fluctuations in our taxable income by jurisdiction. Despite the consolidated loss from continuing operations earned in 2004 and 2003, taxable income earned in certain foreign jurisdictions resulted in a consolidated provision for income taxes. The income from our discontinued operations was earned in the United States. No provision for income taxes is attributed to these discontinued operations, due to the valuation allowances against certain deferred tax assets in the United States, including those generated by net operating losses.

When recording acquisitions, we have 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. 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, 2005, no valuation allowances established in purchase accounting were reversed with a corresponding reduction in goodwill.

Approximately \$2.6 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.

DISCONTINUED OPERATIONS

Income from discontinued operations was \$9.2 million in 2005, \$1.9 million in 2004 and \$1.3 million in 2003. In 2005, we sold the assets of our EMCO product line and our IKOR product line, as they were not critical to our core operations. We recognized a gain on the sale of the EMCO product line of \$2.9 million and a gain on the sale of the IKOR product line of \$5.0 million. Because the EMCO product line has not represented a significant portion of our operations, with revenues representing 2.7% of annual consolidated sales in 2003, 1.6% in 2004 and 1.8% through its sale on June 24, 2005, and represents an insignificant portion of our operating results for all periods presented, we have not reclassified the results of operations of the EMCO product line to income from discontinued operations. The results of operations of the IKOR product line have been reclassified to income from discontinued operations, which results include income of \$1.3 million in 2005, \$1.9 million in 2004 and \$1.3 million in 2003. No provision for income taxes is attributed to these operations due to the valuation allowances against certain deferred tax assets in the United States, as the income from our discontinued operations was earned in the United States.

Quarterly Results of Operations

The following tables present unaudited quarterly results in dollars and as a percentage of sales for each of the eight quarters in the period ended December 31, 2005. We believe that all necessary adjustments have been included in the amounts stated below to present fairly such quarterly information. Due to the volatility of the industries in which our customers operate the operating results for any quarter are not necessarily indicative of results for any subsequent period.

	Quarters Ended							
	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005	Sept. 30, 2005	Dec. 31, 2005
Sales	\$100,163	\$105,321	\$90,242	\$ 84,811	\$82,176	\$84,163	\$78,756	\$80,387
Gross profit	36,762	35,923	28,666	13,275	27,322	30,646	28,922	30,191
Income (loss) from operations	8,835	8,318	1,683	(22,303)	2,533	5,026	2,177	6,238
Income (loss) from continuing operations	5,949	4,034	(1,308)	(23,345)	(83)	2,877	(4,203)	5,031
Income from discontinued operations	975	436	172	340	817	3,072	312	4,994
Net income (loss)	\$ 6,924	\$ 4,470	\$ (1,136)	\$ (23,005)	\$ 734	\$ 5,949	\$ (3,891)	\$10,025
Diluted earnings (loss) per share	\$ 0.21	\$ 0.13	\$ (0.03)	\$ (0.70)	\$ 0.02	\$ 0.18	\$ (0.10)	\$ 0.22

	Quarters Ended							
	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005	Sept. 30, 2005	Dec. 31, 2005
Percentage of Sales:								
Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross profit	36.7%	34.1%	31.8%	15.7%	33.2%	36.4%	36.7%	37.6%
Income (loss) from operations	8.8%	7.9%	1.9%	(26.3)%	3.1%	6.0%	2.8%	7.8%
Income (loss) from continuing operations	5.9%	3.8%	(1.4)%	(27.5)%	(0.1)%	3.4%	(5.3)%	6.3%
Income from discontinued operations	1.0%	0.4%	0.2%	0.4%	1.0%	3.7%	0.4%	6.2%
Net income (loss)	6.9%	4.2%	(1.3)%	(27.1)%	0.9%	7.1%	(4.9)%	12.5%

We had a net 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 within Part II, Item 8), \$3.7 million to restructuring for employee severance and termination costs primarily attributable to the Fort Collins facility (see Note 3 within Part II, Item 8), \$3.3 million to impairment of intangible assets (see Note 8 within Part II, Item 8). These items contributed significantly to our fourth quarter 2004 results. We increased our 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 near term demand, the declining trend in our sales from the second quarter of 2004 to the fourth quarter of 2004, and the expected continued slowdown in the semiconductor industry in the near term.

Our loss from continuing operations in the third quarter of 2005 included pretax charges of \$3.2 million for debt extinguishment expenses (see Note 10 within Part II, Item 8) and \$3.0 million for a litigation settlement (see Note 14 within Part II, Item 8).

Due to the cyclical nature of the semiconductor capital equipment industry as well as the other industries in which our customers operate, and the sudden changes resulting in severe downturns and upturns, we have experienced and expect to continue to experience significant fluctuations in our quarterly operating results. Our levels of operating expenditures are based, in part, on expectations of future revenues that such expenses support. If revenue levels in a particular quarter do not meet expectations, operating results may be adversely affected.

Liquidity and Capital Resources

At December 31, 2005, our principal sources of liquidity consisted of cash, cash equivalents and marketable securities of \$59.7 million, and a credit facility consisting of a \$40.0 million revolving line of credit, none of which was outstanding at December 31, 2005. Borrowings under the revolving line of credit agreement are limited based upon letters of credit outstanding under this agreement and the lenders borrowing base calculation, which considers among other factors, our accounts receivable and inventory balances. Advances under the revolving line of credit would bear interest at the prime rate (7.5% at March 22, 2006) minus 1%. Any advances under this revolving line of credit will be due and payable in July 2006. We are subject to covenants on our line of credit that provide certain restrictions related to working capital, net worth, acquisitions and payment and declaration of dividends. We were in compliance with all such covenants at December 31, 2005.

We have historically financed our operations and capital requirements through a combination of cash provided by operations, the issuance of long-term debt and common stock, bank loans, capital lease obligations and operating leases. During 2005, our cash, cash equivalents and marketable securities decreased \$48.3 million from \$108.0 million at December 31, 2004 to \$59.7 million at December 31, 2005, primarily due to the redemption of our convertible subordinated notes for \$189.8 million, offset by the \$105.5 million of net proceeds from our public offering of 11.5 million shares of common stock and \$36.1 million of net cash provided by operating activities.

Operating activities provided cash of \$36.1 million in 2005, which is the first annual period since 2001 in which cash was generated from operating activities. Operating activities used cash of \$11.4 million in 2004 and \$13.0 million in 2003. The generation of cash in 2005 is attributed to our improved operating results, namely our manufacturing and operating expense reductions and sell-through of inventory, despite the lower sales volume.

Investing activities provided cash of \$67.0 million in 2005, which primarily consisted of the net sale of marketable securities of \$64.5 million used to redeem a portion of the convertible subordinated notes. Cash provided by investing activities in 2005 also reflects \$8.9 million received on the sale of our IKOR product line and \$3.9 million on the sale of our EMCO product line, offset in part by \$10.8 million used for the purchase of property and equipment. Investing activities provided cash of \$12.3 million in 2004, which primarily consisted of \$23.8 million from proceeds on the net sale of marketable securities, offset by \$14.0 million for the purchase of property and equipment. Investing activities used cash of \$8.6 million in 2003, primarily attributed to \$20.5 million of property and equipment purchases offset by \$8.8 million of proceeds on the net sale of marketable securities.

With the significant capital expenditures related to our investment in our manufacturing operations as well as our information technology infrastructure, we expect to reduce our capital expenditures in 2006 to approximately \$6.0 million. Our planned level of capital expenditures is subject to frequent revisions as our business experiences sudden changes. In addition, changes in foreign currency exchange rates may significantly impact our capital expenditures in a particular period.

Investing cash flows experience significant fluctuations from year to year as we buy and sell marketable securities, which we convert to cash to fund strategic investments and our current operations, and as we transfer cash into marketable securities when we attain levels of cash that are greater than needed for current operations.

Financing activities used cash of \$86.0 million in 2005, primarily due to the redemption of our convertible subordinated notes offset in part by our public offering of common stock. During the third quarter of 2005, we raised \$105.5 million in net proceeds from a public offering of 11.5 million shares of common stock. With these proceeds we fully redeemed the 5.25% convertible subordinated notes due November 15, 2006. This redemption consisted of a \$66.2 million principal payment, \$883,000 for redemption premium, and \$1.1 million for interest through the redemption dates. After the redemption of the 5.25% convertible subordinate notes, proceeds of approximately \$37.3 million remained. These proceeds together with approximately \$88.9 million of cash, cash equivalents and marketable securities were used to redeem the 5.0% convertible subordinated notes due September 1, 2006. This redemption consisted of a \$121.5 million principal payment, \$1.2 million for redemption premium, and \$3.5 million for interest through the redemption dates. As a result, we expect to save approximately \$2.4 million of cash interest expense quarterly. Financing activities used cash of \$5.2 million in 2004 and \$8.6 million in 2003, which primarily consisted of payments on our senior borrowings and capital lease obligations, partially offset by proceeds from the exercise of employee stock options and sale of common stock through our employee stock purchase plan and in 2004 proceeds of a senior borrowing used to purchase a building in South Korea.

We expect our financing activities to continue to fluctuate in the future. Our payments under capital lease obligations and senior borrowings may also increase in the future if we enter into additional capital lease obligations or change the level of our bank financing. Our estimated payments under senior borrowings during 2006 will be approximately \$1.8 million. A significant portion of these obligations are held in countries other than the United States; therefore, future foreign currency fluctuations, especially between the United States dollar and the Japanese yen, could cause significant fluctuations in our estimated 2006 payment obligations.

CONTRACTUAL OBLIGATIONS

The following table sets forth our future payments due under significant off-balance sheet arrangements and long-term debt obligations as of December 31, 2006.

Contractual Obligations	Payments Due by Period (In thousands)						Total
	2006	2007	2008	2009	2010	Thereafter	
Senior borrowings	\$ 1,815	\$ 1,909	\$ —	\$ —	\$ —	\$ —	\$ 3,724
Operating lease obligations	5,966	4,579	3,564	2,826	2,199	7,250	26,384
Inventory purchase obligations	2,500	—	—	—	—	—	2,500
Total obligations	<u>\$10,281</u>	<u>\$ 6,488</u>	<u>\$ 3,564</u>	<u>\$ 2,826</u>	<u>\$ 2,199</u>	<u>\$ 7,250</u>	<u>\$32,608</u>

Please refer to Note 9 Senior Borrowings, Note 14 Commitments And Contingencies and Note 16 Related Party Transactions included in Part II, Item 8 of this Form 10-K for further discussion regarding our significant off-balance sheet arrangements, long-term debt and capital lease obligations.

Our inventory purchase obligations consist of minimum purchase commitments we entered into to ensure we have an adequate supply of critical components to meet the demand of our customers. We believe that these inventory purchases will be consumed in our on-going operations within one year of purchase.

We believe that our working capital, together with cash anticipated to be generated by operations and borrowing capability under our revolving line of credit, will be sufficient to satisfy our anticipated liquidity requirements for the next twelve months.

Critical Accounting Policies and Estimates

The above discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing our consolidated financial statements, we must make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions. We have evaluated the accounting policies used in the preparation of the consolidated financial statements and related notes under Part II, Item 8 of this Form 10-K and believe that our accounting policies are reasonable and appropriate. We believe that the following critical accounting policies, among others, are most critical as they relate to our more significant judgments and estimates used in the preparation of our consolidated financial statements.

REVENUE RECOGNITION — Our standard shipping term is freight on board (“FOB”) shipping point, for which revenue is recognized upon shipment of 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. Revenues from contracts that contain customer acceptance provisions are deferred until customer acceptance occurs. Generally, we do not have obligations to our customers after our products are shipped under FOB shipping point terms, after our products are received by customers under FOB destination terms, and after our products are accepted by customers under contractual acceptance provisions, other than pursuant to warranty obligations. In limited instances, we provide installation of our products. In accordance with Emerging Issues Task Force (“EITF”) Issue 00-21 “Accounting for Revenue Arrangements With Multiple Deliverables”, we allocate 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. Revenue deferrals are reported as customer deposits and deferred revenue in the condensed consolidated balance sheets.

In certain instances, we require our customers to pay for a portion or all of their purchases prior to our 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 as appropriate based upon the shipping terms of the products. We do not offer price protections to our customers or allow returns, unless covered by our normal policy for repair of defective products.

WARRANTY POLICY — We offer warranty coverage for our products for periods typically ranging from 12 to 24 months after shipment. We estimate the anticipated costs of repairing products under warranty based on the historical or expected cost of the repairs and expected failure rates. The assumptions used to estimate warranty accruals are reevaluated quarterly, at a minimum, in light of actual experience and, when appropriate, the accruals are adjusted. Our determination of the appropriate level of warranty accrual is

based on estimates. 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.

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 statement of operations.

STOCK-BASED COMPENSATION — At December 31, 2005, we had three active stock-based compensation plans, which are more fully described in Note 18 within Part II, Item 8. We account for employee stock-based compensation using the intrinsic value method prescribed by Accounting Principles Board (“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. 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 compensation cost related to such options is reflected in the consolidated statement of operations. In 2005, we began issuing restricted stock units, compensation cost for which is recorded in the consolidated statement of operations. We make disclosures of pro forma net income and earnings per share as if the fair-value-based method of accounting had been applied to all stock-based compensation as required by SFAS No. 123, “Accounting for Stock-Based Compensation” and as amended by SFAS No. 148, “Accounting for Stock-Based Compensation – Transition and Disclosure” (see Note 18 within Part II, Item 8).

We will adopt the provisions of SFAS No. 123(R), “Share Based Compensation”, as of January 1, 2006, as further discussed under the heading “New Accounting Pronouncements” under Note 1 within Part II, Item 8. The adoption of this statement will have a material impact on our results of operations as we will be required to record compensation expense in the consolidated statement of operations rather than disclose the impact on our results of operations within the 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 (see Item 3 within Part I and Note 14 within Part II, Item 8). While we currently believe that the amount of any ultimate 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 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.

INCOME TAXES — We account 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 the tax rates expected in the period that the assets or liabilities are realized, as well as for the expected tax benefit of net operating loss and tax credit carryforwards. We assess the recoverability of our net deferred tax assets on a quarterly basis. Our assessment includes a number of factors, including historical results and income projections for each jurisdiction. If we determine that it is more likely than not that we will realize a portion or all of our net deferred tax assets, some portion or all of the valuation allowance will be reversed with a corresponding reduction in income tax expense in such period.

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, we did not have any indefinite-lived intangible assets, other than goodwill. Impairment testing is performed in two steps: (i) we assess goodwill for potential impairment by comparing the fair value of our reporting unit with the carrying value, and (ii) if potential impairment is indicated because the reporting unit’s fair value is less than its carrying amount, we measure 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.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and long-term debt obligations. We generally place our investments with high-credit quality issuers and by policy are averse to principal loss and seek to protect and preserve our invested funds by limiting default risk, market risk and reinvestment risk. As of December 31, 2005, our investments in marketable securities consisted primarily of commercial paper, municipal bonds and notes and institutional money markets. These securities are highly liquid. Earnings on our marketable securities are typically invested into similar securities. Interest

rate risk on our investment portfolio has decreased since 2002 with the decrease in our marketable securities balance, which is primarily attributable to the use of these funds in operations and for the redemption of our convertible subordinated notes. We believe that a 10% decrease in average interest rates on these instruments would not have a material effect on our financial condition and results of operations.

The interest rates on the borrowings of our foreign subsidiaries are variable and as of December 31, 2005 ranged from 1.5% to 5.5%. Due to the relatively low amount of our variable rate obligations, we believe a 10% increase in average interest rates on these instruments would not have a material effect on our financial condition or results of operations.

Foreign Currency Exchange Rate Risk

We transact business in various foreign countries. Our primary foreign currency cash flows are generated in countries in Asia and Europe. It is highly uncertain how currency exchange rates will fluctuate in the future. We have entered into various foreign currency forward exchange contracts to mitigate against currency fluctuations in the Japanese yen, Taiwanese dollar, South Korean won and Chinese yuan. The notional amount of our foreign currency contracts at December 31, 2005 was \$8.9 million. The potential fair value loss for a hypothetical 10% adverse change in foreign currency exchange rates at December 31, 2005, would be approximately \$898,000, which would be essentially offset by corresponding gains related to the underlying assets. At December 31, 2005 we held foreign currency forward exchange contracts, maturing through January 2006, primarily to purchase United States dollars and sell various foreign currencies. The following table summarizes our outstanding contracts as of December 31, 2005:

	<u>Notional Amounts</u>	<u>Market Settlement Amounts</u> (In thousands)	<u>Unrealized (Loss)/Gain</u>
Japanese yen contracts	\$ 4,200	\$ 4,108	\$ 92
Taiwanese dollar contract	2,700	2,712	(12)
South Korean won contract	1,200	1,189	11
Chinese yuan contract	<u>800</u>	<u>800</u>	<u>—</u>
Balance at December 31, 2005	<u>\$ 8,900</u>	<u>\$ 8,809</u>	<u>\$ 91</u>

We also have long-term non-United States dollar-denominated debt of \$1.9 million as of December 31, 2005 and \$4.3 million as of December 31, 2004. A weakening of the United States dollar by 10% against the applicable Asian currencies would have resulted in unrealized translation losses of approximately \$212,000 as of December 31, 2005 and \$473,000 as of December 31, 2004. We will continue to evaluate various methods to minimize the effects of currency fluctuations when we translate the financial statements of our foreign subsidiaries into United States dollars.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Advanced Energy Industries, Inc. (a Delaware corporation) and subsidiaries (together the “Company”) as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders’ equity and comprehensive income, and cash flows for each of the two years in the period ended December 31, 2005. 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 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, 2005 and 2004, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule II 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 audits 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 also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Advanced Energy Industries, Inc. and subsidiaries’s internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 20, 2006 expressed an unqualified opinion on management’s assessment of the effectiveness of the Company’s internal control over financial reporting and an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/S/ GRANT THORNTON LLP

Denver, Colorado
March 20, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting appearing under Item 9A, that Advanced Energy Industries, Inc. (a Delaware Corporation) and subsidiaries (together the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Advanced Energy Industries, Inc.'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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting 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 effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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.

In our opinion, management's assessment that Advanced Energy Industries, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Advanced Energy Industries, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Advanced Energy Industries, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and comprehensive income, and cash flows for each of the two years in the period ended December 31, 2005 and our report dated March 20, 2006 expressed an unqualified opinion on those financial statements.

/S/ GRANT THORNTON LLP

Denver, Colorado
March 20, 2006

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows of Advanced Energy Industries, Inc. (a Delaware Corporation) and subsidiaries for the year ended December 31, 2003. In connection with our audit of these consolidated financial statements, we also have audited the related financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audit.

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 results of operations and cash flows of Advanced Energy Industries, Inc. and subsidiaries for the year ended December 31, 2003 in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, 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 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, except as to the matters related to the
year ended December 31, 2003 disclosed in note 2
to the consolidated financial statements,
as to which the date is March 22, 2006

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands)

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 52,874	\$ 38,404
Marketable securities	6,811	69,578
Accounts receivable —		
Trade (less allowances for doubtful accounts of approximately \$645 and \$1,049 at December 31, 2005 and 2004, respectively)	64,900	66,610
Other	4,092	5,443
Income tax receivable	—	404
Inventories	56,199	73,224
Other current assets	<u>6,773</u>	<u>4,168</u>
Total current assets	191,649	257,831
PROPERTY AND EQUIPMENT, at cost, net of accumulated depreciation of \$70,666 and \$59,464 at December 31, 2005 and 2004, respectively	39,294	44,746
OTHER ASSETS:		
Deposits and other	3,808	6,468
Goodwill	61,316	68,276
Other intangible assets, net of accumulated amortization of \$9,940 and \$9,624 at December 31, 2005 and 2004, respectively	8,527	12,032
Customer service equipment, net of accumulated amortization of \$8,436 and \$6,880 at December 31, 2005 and 2004, respectively	2,407	2,968
Deferred debt issuance costs, net	—	2,086
Deferred income tax assets, net	<u>3,116</u>	<u>—</u>
Total assets	<u>\$ 310,117</u>	<u>\$ 394,407</u>

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

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade accounts payable	\$ 22,028	\$ 17,683
Taxes payable	5,538	2,974
Accrued payroll and employee benefits	8,313	7,788
Accrued warranty expense	6,313	6,791
Accrued restructuring charges	616	4,414
Other accrued expenses	2,226	4,418
Customer deposits and deferred revenue	971	662
Capital lease obligations, current portion	196	294
Senior borrowings, current portion	1,815	3,432
Accrued interest payable on convertible subordinated notes	—	2,460
Total current liabilities	<u>48,016</u>	<u>50,916</u>
LONG-TERM LIABILITIES:		
Capital leases, net of current portion	270	421
Senior borrowings, net of current portion	1,909	4,258
Deferred income tax liabilities, net	—	3,709
Convertible subordinated notes payable	—	187,718
Other long-term liabilities	2,492	2,407
Total long-term liabilities	<u>4,671</u>	<u>198,513</u>
Total liabilities	<u>52,687</u>	<u>249,429</u>
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none issued and outstanding	—	—
Common stock, \$0.001 par value, 70,000 shares authorized; 44,500 and 32,760 shares issued and outstanding at December 31, 2005 and 2004, respectively	45	33
Additional paid-in capital	253,675	144,500
Retained earnings (accumulated deficit)	22	(12,795)
Deferred compensation	(1,290)	—
Unrealized holding gains on available-for-sale securities, net	1,328	1,051
Cumulative translation adjustments, net	3,650	12,189
Total stockholders' equity	<u>257,430</u>	<u>144,978</u>
Total liabilities and stockholders' equity	<u>\$ 310,117</u>	<u>\$ 394,407</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 OPERATIONS
(In thousands, except per share amounts)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
SALES	\$ 325,482	\$ 380,537	\$ 253,536
COST OF SALES	<u>208,401</u>	<u>265,911</u>	<u>169,217</u>
GROSS PROFIT	117,081	114,626	84,319
OPERATING EXPENSES:			
Research and development	39,720	49,004	49,711
Selling, general and administrative	55,681	61,851	53,554
Litigation settlement	3,000	—	—
Restructuring charges	2,706	3,912	4,306
Impairment of intangible assets	<u>—</u>	<u>3,326</u>	<u>1,175</u>
Total operating expenses	<u>101,107</u>	<u>118,093</u>	<u>108,746</u>
INCOME (LOSS) FROM OPERATIONS	15,974	(3,467)	(24,427)
OTHER INCOME (EXPENSE):			
Interest income	2,866	1,737	1,721
Interest expense	(8,171)	(11,049)	(11,254)
Foreign currency gain	243	1,023	869
Debt extinguishment expense	(3,180)	—	—
Other income (expense), net	<u>763</u>	<u>1,033</u>	<u>(644)</u>
Total other expense, net	<u>(7,479)</u>	<u>(7,256)</u>	<u>(9,308)</u>
Income (loss) from continuing operations before income taxes	8,495	(10,723)	(33,735)
PROVISION FOR INCOME TAXES	<u>(4,873)</u>	<u>(3,947)</u>	<u>(11,801)</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS	\$ 3,622	\$ (14,670)	\$ (45,536)
Gain on sale of discontinued operations	7,855	—	—
Results of discontinued operations	1,340	1,923	1,295
Provision for income taxes	<u>—</u>	<u>—</u>	<u>—</u>
INCOME FROM DISCONTINUED OPERATIONS	<u>\$ 9,195</u>	<u>\$ 1,923</u>	<u>\$ 1,295</u>
NET INCOME (LOSS)	<u><u>\$ 12,817</u></u>	<u><u>\$ (12,747)</u></u>	<u><u>\$ (44,241)</u></u>
BASIC EARNINGS (LOSS) PER SHARE			
Income from continuing operations	\$ 0.10	\$ (0.45)	\$ (1.41)
Income from discontinued operations	\$ 0.25	\$ 0.06	\$ 0.04
NET INCOME (LOSS) PER SHARE	\$ 0.35	\$ (0.39)	\$ (1.37)
DILUTED EARNINGS (LOSS) PER SHARE			
Income from continuing operations	\$ 0.10	\$ (0.45)	\$ (1.41)
Income from discontinued operations	\$ 0.25	\$ 0.06	\$ 0.04
NET INCOME (LOSS) PER SHARE	\$ 0.34	\$ (0.39)	\$ (1.37)
BASIC WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING	37,084	32,649	32,271
DILUTED WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING	37,434	32,649	32,271

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 INCOME
(In thousands)

	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Deferred Compensation	Accumulated Other Comprehensive (Loss) Income	Total Stockholders' Equity
	Shares	Amount					
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	32,760	\$ 33	\$144,500	\$ (12,795)	\$ —	\$ 13,240	\$ 144,978
Exercise of stock options for cash	195	—	1,659	—	—	—	1,659
Sale of common stock through public offering	11,500	12	105,533	—	—	—	105,545
Sale of common stock through employee stock purchase plan	45	—	348	—	—	—	348
Stock-based compensation and amortization, net	—	—	1,635	—	(1,290)	—	345
Comprehensive income:							
Equity adjustment from foreign currency translation, net of tax	—	—	—	—	—	(8,539)	
Unrealized holding gains, net of tax	—	—	—	—	—	1,159	
Less: reclassification adjustment for amounts included in net income	—	—	—	—	—	(882)	
Net income	—	—	—	12,817	—	—	
Total comprehensive income	—	—	—	—	—	—	4,555
BALANCES, December 31, 2005	<u>44,500</u>	<u>\$ 45</u>	<u>\$253,675</u>	<u>\$ 22</u>	<u>\$ (1,290)</u>	<u>\$ 4,978</u>	<u>\$ 257,430</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)

	Years Ended December 31,		
	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ 12,817	\$(12,747)	\$(44,241)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities –			
Depreciation and amortization	18,377	21,059	21,347
Stock-based compensation expense	345	60	482
Demonstration and evaluation equipment write-off	—	3,752	—
Benefit (provision) for deferred income taxes	(1,130)	444	6,429
Provision for excess and obsolete inventory	1,689	11,262	3,016
Asset impairment charges	—	3,326	1,350
Provision for (recovery of) doubtful accounts	126	198	(429)
Unrealized (gain) loss on foreign currency forward contracts	(91)	(107)	160
Net (gain) loss on disposal of assets	(7,944)	(864)	2,846
Debt extinguishment expense	3,180	—	—
Changes in operating assets and liabilities —			
Accounts receivable-trade	(1,743)	(8,925)	(14,556)
Inventories	11,737	(19,783)	(11,339)
Other current assets	(1,311)	(675)	(62)
Accounts payable – trade	6,000	(5,849)	5,873
Other current liabilities and accrued expenses	(7,260)	(2,329)	(2,379)
Income taxes payable/receivable, net	3,307	2,507	16,530
Non-current assets	(2,133)	(3,099)	666
Non-current liabilities	85	392	1,321
Net cash provided by (used in) operating activities	36,051	(11,378)	(12,986)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of marketable securities	(87,175)	(1,208)	(1,308)
Proceeds from sale of marketable securities	151,697	25,000	10,106
Proceeds from sale of assets	13,335	2,556	5,196
Purchase of property and equipment	(10,825)	(14,019)	(20,509)
Purchase of investments and advances	—	—	(400)
Acquisition of Dressler HF Technik GmbH, net of cash acquired	—	—	(1,675)
Net cash provided by (used in) investing activities	67,032	12,329	(8,590)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from senior borrowings	—	1,585	—
Repayment of senior borrowings and capital lease obligations	(3,708)	(8,609)	(12,847)
Payments on convertible subordinated notes	(189,816)	—	—
Sale of common stock through public offering, net of expenses	105,545	—	—
Sale of common stock through employee stock purchase plan	348	609	739
Proceeds from exercise of stock options	1,659	1,224	3,500
Net cash used in financing activities	(85,972)	(5,191)	(8,608)
EFFECT OF CURRENCY TRANSLATION ON CASH	(2,641)	1,122	1,518
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,470	(3,118)	(28,666)
CASH AND CASH EQUIVALENTS, beginning of year	38,404	41,522	70,188
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 52,874</u>	<u>\$ 38,404</u>	<u>\$ 41,522</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid for interest	\$ 9,292	\$ 9,949	\$ 10,521
Cash paid (received) for income taxes, net	\$ 3,035	\$ 1,227	\$ (9,642)
Assets sold for note receivable	\$ —	\$ 1,842	\$ 1,538

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”). All significant intercompany accounts and transactions have been eliminated in consolidation. The consolidated financial statements are stated in United States 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 other 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 Statement of Financial Accounting Standard (“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 share-based 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. It will also require the benefits associated with tax deductions in excess of recognized compensation cost to be reported as a financing cash flow rather than as an operating cash flow as currently required. The Company will adopt SFAS No. 123(R) as of January 1, 2006. Upon adoption, the Company will use the modified prospective method and therefore will not restate prior period results. This statement will have a material 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 within its notes to the consolidated financial statements, but will not have a significant impact on the Company’s overall cash flow or financial position. Before adjustment for expected forfeitures, unrecognized stock-based compensation expense related to unvested options outstanding as of December 31, 2005 was approximately \$3.5 million and will be recorded over the remaining vesting period. The Company will continue to use the Black-Scholes option pricing model to estimate the fair value of share-based awards upon adoption in 2006.

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

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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 adoption of SFAS No. 151 is not expected to have a material affect on the Company's financial position and results of operations.

On June 9, 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 replaces APB Opinion No. 20, "Accounting Changes", and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements", and changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS No. 154 must be adopted for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date SFAS No. 154 is issued. The adoption of SFAS No. 154 is not expected to have a material affect on the Company's 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. Revenues from contracts that contain customer acceptance provisions are deferred until customer acceptance occurs. Generally, the Company does not have obligations to its customers after its products are shipped under FOB shipping point terms, after its products are received by customers under FOB destination terms, and after the products are accepted by customers under contractual acceptance provisions, 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 condensed consolidated balance sheets, and then recognized as revenue as appropriate based upon the shipping terms 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. The Company recorded charges for excess and obsolete inventory of \$1.7 million in 2005, \$11.3 million in 2004 and \$3.0 million in 2003.

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. 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 \$11.2 million in 2005, \$10.5 million in 2004 and \$8.1 million in 2003.

Included within the warranty charges is amortization of customer service equipment, which is manufactured product that is utilized as replacement and loaner equipment to existing customers, of \$2.1 million in 2005, \$2.0 million in 2004 and \$2.2 million in 2003.

The following summarizes the activity in the Company's warranty reserves during 2005 and 2004:

	<u>2005</u>	<u>2004</u>
	(In thousands)	
Balance at beginning of period	\$ 6,791	\$ 6,612
Additions charged to expense	9,116	8,457
Deductions	<u>(9,594)</u>	<u>(8,278)</u>
Balance at end of period	<u>\$ 6,313</u>	<u>\$ 6,791</u>

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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, 2005, 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 compensation cost related to such options is reflected in the consolidated statement of operations. In 2005, the Company began issuing restricted stock units, compensation cost for which is recorded in the consolidated statement of operations. 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 income would have changed to the following adjusted amounts:

(in thousands, except per share data)	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net income (loss):			
As reported	\$ 12,817	\$(12,747)	\$(44,241)
Adjustment for stock-based compensation determined under fair value-based method for all awards (a), (b), (d)	(13,551)	(12,133)	(12,410)
Less: Compensation expense recognized in net income (loss) (a), (c)	<u>345</u>	<u>60</u>	<u>482</u>
As adjusted	<u>\$ (389)</u>	<u>\$(24,820)</u>	<u>\$(56,169)</u>
Basic earnings (loss) per share:			
As reported	\$ 0.35	\$ (0.39)	\$ (1.37)
As adjusted	\$ (0.01)	\$ (0.76)	\$ (1.74)
Diluted earnings (loss) per share:			
As reported	\$ 0.34	\$ (0.39)	\$ (1.37)
As adjusted	\$ (0.01)	\$ (0.76)	\$ (1.74)

- (a) Compensation expense in all periods presented is shown prior to income tax effects due to the Company recording valuation allowances against certain deferred tax assets in 2003 (see Note 12).
- (b) 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 (“ESPP”) 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) Compensation expense in 2005 represents the expense associated with the Company’s grants to employees of restricted stock units. Compensation expense in 2004 and 2003, represents expense associated with employee option grants made by a shareholder of Sekidenko, Inc. (prior to its acquisition by the Company) to employees under a preexisting arrangement to purchase shares of his common stock already outstanding at exercise prices below fair value. The options fully vested during the first quarter of 2004.
- (d) Adjustment includes expense of approximately \$6.9 million, resulting from the acceleration of vesting of options outstanding as of October 18, 2005 that have an exercise price of \$15.00 per share or higher. Options to purchase approximately 624,000 shares of common stock that would otherwise have vested over the subsequent 30 months became fully vested.

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:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
OPTIONS:			
Risk-free interest rates	3.7%	3.1%	3.0%
Expected dividend yield rates	0.0%	0.0%	0.0%
Expected lives	3.8 years	3.0 years	2.9 years
Expected volatility	74.1%	75.2%	85.6%
ESPP:			
Risk-free interest rates	2.9%	1.7%	1.3%
Expected dividend yield rates	0.0%	0.0%	0.0%
Expected lives	0.5 years	0.5 years	0.5 years
Expected volatility	59.6%	65.3%	83.8%



Based on the Black–Scholes option pricing model, the weighted–average estimated fair value of employee stock option grants was \$4.76 in 2005, \$8.49 in 2004 and \$7.88 in 2003. The weighted–average estimated fair value of purchase rights granted under the ESPP was \$3.08 in 2005, \$3.45 in 2004 and \$4.99 in 2003.

The total fair value of options granted was computed to be approximately \$2.1 million in 2005, \$10.9 million in 2004 and \$14.3 million in 2003. 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 January 1, 2006, as further discussed under the heading “New Accounting Pronouncements” above. The adoption of this statement will have a material 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 within its notes to the consolidated financial statements.

On October 18, 2005, the Board of Directors of the Company approved the acceleration of the vesting of certain stock options. Vesting was accelerated for those options outstanding as of October 18, 2005 that have exercise prices of \$15.00 per share or higher. The closing price of the Company’s common stock on October 18, 2005 was \$10.69 per share. As a result, options to purchase approximately 624,000 shares of common stock that would otherwise have vested over the subsequent 30 months became fully vested. As of October 18, 2005, options to purchase 3.8 million shares of the Company’s common stock were outstanding. Unvested options totaling 852,000 that have an exercise price less than \$15.00 per share that were outstanding as of October 18, 2005 will continue to vest on their normal schedule. The Board of Directors determined to accelerate the vesting of these options principally to reduce future compensation expense that would otherwise be required to be recorded in the statement of operations in periods following the Company’s adoption of SFAS No. 123(R).

COMMITMENTS AND CONTINGENCIES — The Company is involved in disputes and legal actions arising in the normal course of our business. While we currently believe that the amount of any ultimate 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 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. The Company accrues loss contingencies in connection with its 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 United States 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 — 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 computer 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.

CUSTOMER SERVICE EQUIPMENT — Customer service equipment is manufactured product that is utilized as replacement and loaner equipment to existing customers, which is amortized to cost of sales over its estimated useful life of two years.

Demonstration equipment was manufactured product that is utilized for sales demonstration and evaluation purposes. Historically, the Company had amortized demonstration 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 \$3.7 million was written off. The Company's current policy is to record selling, general and administrative expense for the demonstration equipment as it is given to our customer or potential customer.

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 United States dollar is the functional currency. Assets and liabilities of international subsidiaries are translated to United States 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) DISPOSITIONS AND DISCONTINUED OPERATIONS

On June 24, 2005, the Company sold the assets of its EMCO product line to an unrelated third party for net cash proceeds of \$3.7 million, as this product line was not critical to the Company's core operations. The sale included assets with a book value of approximately \$663,000, comprised of \$515,000 of accounts receivable, \$71,000 of inventory, \$42,000 of fixed assets, and \$35,000 of prepaid expenses, and liabilities of approximately \$94,000. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", goodwill of \$471,000 was allocated to the sale based upon its estimated fair value relative to the portion of the reporting unit that will be retained. The Company recognized a gain on the sale of \$2.6 million, which is recorded in discontinued operations in the statement of operations. In the fourth quarter of 2005, a purchase price adjustment of \$237,000 was made in favor of the Company, and recorded as additional gain on the sale. The EMCO product line did not represent a significant portion of the Company's operations, with revenues representing 2.7% of annual consolidated sales in 2003, 1.6% in 2004 and 1.8% through its sale on June 24, 2005. Due to the insignificant impact of the EMCO product line on the Company's results of operations, such results are included in income from operations in the accompanying consolidated statements of operations.

On November 23, 2005, the Company entered into an agreement to sell the assets of its IKOR product line to an unrelated third party, as this product line was not considered to be critical to the Company's core operations. Net cash proceeds of \$8.9 million were received, with an additional \$1.0 million held in escrow to satisfy any potential indemnity claims. The sale included assets with a book value of approximately \$4.1 million, comprised of \$1.3 million of accounts receivable, \$1.3 million of inventory, \$492,000 of fixed assets, and \$44,000 of prepaid expenses, and liabilities of approximately \$207,000. Goodwill of \$1.0 million was allocated to the sale based upon its estimated fair value relative to the portion of the reporting unit that will be retained. The Company recognized a gain on

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the sale of \$5.0 million, which is recorded in discontinued operations in the consolidated statement of operations. The results of operations directly attributed to the IKOR product line that have been reclassified from continuing operations are as follows:

(in thousands)	2005	2004	2003
Sales	\$11,581	\$14,768	\$ 8,866
Cost of sales	6,505	9,715	5,238
Operating expenses	3,736	3,130	2,333

(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, 2005, 2004 and 2003:

	Employee Severance and Termination Costs	Facility Closure Costs	Impairment of Facility-related Assets	Total Restructuring Charges
	(In thousands)			
Accrual balance December 31, 2002	\$ 1,607	\$ 3,952	\$ 430	\$ 5,989
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	994	24	—	1,018
Total restructuring charges 2003	3,877	122	307	4,306
Payments in 2003	(4,924)	(1,459)	—	(6,383)
Write-off of facility-related assets in 2003	—	—	(737)	(737)
Accrual balance December 31, 2003	560	2,615	—	3,175
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	(127)	(126)	—	(253)
Fourth quarter 2004 restructuring charge	3,639	31	—	3,670
Total net restructuring charges 2004	3,976	(64)	—	3,912
Payments in 2004	(1,243)	(1,430)	—	(2,673)
Accrual balance December 31, 2004	3,293	1,121	—	4,414
First quarter 2005 restructuring charge	1,262	—	—	1,262
Second quarter 2005 restructuring charge	475	4	589	1,068
Third quarter 2005 restructuring charge	202	31	157	390
Third quarter 2005 restructuring reversal	(180)	—	—	(180)
Fourth quarter 2005 restructuring charge	135	31	—	166
Total net restructuring charges 2005	1,894	66	746	2,706
Payments and other settlements in 2005	(5,057)	(701)	(746)	(6,504)
Accrual balance December 31, 2005	\$ 130	\$ 486	\$ —	\$ 616

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 lower-cost 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 United States 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 United States 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 United States 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 due to some voluntary employee terminations prior to their agreed upon termination date (no longer meeting the requirements to receive a severance payment) and negotiated lease termination payments below original estimates. As a result of such reversal, 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.

Related to this operational restructuring, and the transition of certain product lines from certain of the Company's locations in Europe and Japan, the Company recorded restructuring charges for employee severance and termination costs of \$1.3 million in the first quarter of 2005, \$475,000 in the second quarter, \$202,000 in the third quarter and \$135,000 in the fourth quarter. These charges are associated with 216 employees in the United States, 11 employees in Europe and three employees in Japan. With the exception of one employee in the United States, all of these employee severance and termination costs have been paid as of December 31, 2005. Through the transition of the Company's manufacturing operations from the Fort Collins facility to Shenzhen, China, the Company recognized the need to retain 11 employees considered in the original reserve, and therefore in the third quarter of 2005 restructuring reserves of \$180,000 have been reversed. The Company expects to pay the remaining accrual for employee severance and termination costs of approximately \$130,000 by the end of the first quarter of 2006.

Impairments of facility-related assets were recorded in the second quarter of 2005 for \$589,000 in the United States and in the third quarter of 2005 for \$157,000 in Japan, as a result of consolidation of certain of the Company's facilities.

The remaining facility closure cost liability is expected to be paid over the remaining lease term expiring at the end of 2006 and is reflected net of expected sublease income of \$51,000.

(4) MARKETABLE SECURITIES

Marketable securities consisted of the following:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
	(In thousands)	
Commercial paper	\$ 4,639	\$43,459
Municipal bonds and notes	1,901	20,332
Institutional money markets	<u>271</u>	<u>5,787</u>
Total marketable securities	<u>\$ 6,811</u>	<u>\$69,578</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.

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The Company also had investments in marketable equity securities which are included in deposits and other in the accompanying consolidated balance sheets of \$2.9 million at December 31, 2005 and \$3.6 million at December 31, 2004. 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.

(5) ACCOUNTS RECEIVABLE – TRADE

Trade accounts receivable consisted of the following:

	December 31,	
	2005	2004
	(In thousands)	
Domestic	\$21,797	\$16,612
Foreign	43,748	51,047
Allowance for doubtful accounts	(645)	(1,049)
Total accounts receivable — trade	<u>\$64,900</u>	<u>\$66,610</u>

(6) INVENTORIES

Inventories consisted of the following:

	December 31,	
	2005	2004
	(In thousands)	
Parts and raw materials	\$42,090	\$54,069
Work in process	3,982	4,491
Finished goods	10,127	14,664
Total inventories	<u>\$56,199</u>	<u>\$73,224</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.

(7) PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 31,	
	2005	2004
	(In thousands)	
Land	\$ 4,513	\$ 5,127
Buildings	3,030	5,738
Machinery and equipment	41,033	40,196
Computer and communication equipment	33,123	28,954
Furniture and fixtures	5,223	6,221
Vehicles	646	290
Leasehold improvements	<u>22,392</u>	<u>17,684</u>
	109,960	104,210
Less – accumulated depreciation	<u>(70,666)</u>	<u>(59,464)</u>
Total property and equipment	<u>\$ 39,294</u>	<u>\$ 44,746</u>

Aggregate depreciation expense related to property and equipment was \$12.8 million in 2005, \$13.7 million in 2004 and \$12.7 million in 2003.

(8) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets consisted of the following as of December 31, 2005:

	Gross	Effect of		Net	Weighted- Average Useful Life in Years
	Carrying Amount	Exchange Rates	Accumulated Amortization	Carrying Amount	
Amortizable intangibles:					
Technology-based	\$ 7,000	\$ 1,354	\$ (6,322)	\$ 2,032	5
Trademarks and other	<u>8,500</u>	<u>1,613</u>	<u>(3,618)</u>	<u>6,495</u>	17
Total amortizable intangibles	15,500	2,967	(9,940)	8,527	12

Goodwill	<u>53,589</u>	<u>7,727</u>	<u>—</u>	<u>61,316</u>
Total goodwill and other intangible assets	<u>\$69,089</u>	<u>\$ 10,694</u>	<u>\$ (9,940)</u>	<u>\$69,843</u>

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

	Gross	Effect of		Net	Weighted–
	Carrying	Changes in		Carrying	Average
	Amount	Exchange	Accumulated	Amount	Useful
		Rates	Amortization		Life
		(In thousands, except weighted–average useful life)			in Years
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	<u>8,500</u>	<u>2,689</u>	<u>(2,948)</u>	<u>8,241</u>	17
Total amortizable intangibles	<u>17,004</u>	<u>4,652</u>	<u>(9,624)</u>	<u>12,032</u>	11
Goodwill	<u>55,104</u>	<u>13,172</u>	—	<u>68,276</u>	
Total goodwill and other intangible assets	<u>\$72,108</u>	<u>\$ 17,824</u>	<u>\$ (9,624)</u>	<u>\$80,308</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 was \$2.1 million in 2005, \$3.9 million in 2004 and \$4.6 million in 2003. Estimated amortization expense related to the Company’s acquired intangibles fluctuates with changes in foreign currency exchange rates between the United States dollar and the Japanese yen and the euro. Estimated amortization expense related to amortizable intangibles for each of the five years 2006 through 2010 is as follows (in thousands):

	Estimated Amortization Expense (in thousands)
2006	\$ 1,665
2007	960
2008	750
2009	477
2010	386

In the fourth quarter of 2005, 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.

During the fourth quarter of 2004, in conjunction with our financial forecasting for future periods, it was evident that projected cash flows from certain customers of the Dressler product line were substantially below amounts previously projected. The projected cash flows were considered in determining the fair value of certain contract–based and other amortizable intangible assets recorded at acquisition and also in subsequent periods to assess such assets for potential impairment. Due to the decline in projected cash flows, 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 left the Company or their responsibilities were significantly 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

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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.

(9) SENIOR BORROWINGS

Senior borrowings consisted of the following:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
(In thousands)		
Revolving line of credit of \$40 million, expiring July 2006, interest at bank's prime rate minus 1%, at December 31, 2005. Revolving line of credit of \$25 million at December 31, 2004.	\$ —	\$ —
Senior borrowings (assumed in the acquisition of Aera Japan Limited), maturing serially through May 2007, interest from 1.5% to 3.1% at December 31, 2005	2,084	5,953
Mortgage note payable, maturing July 2007, interest at 5.5% at December 31, 2005	1,640	1,737
Less – current portion	<u>(1,815)</u>	<u>(3,432)</u>
Senior borrowings, net of current portion	<u>\$ 1,909</u>	<u>\$ 4,258</u>

Borrowings under the revolving line of credit agreement are limited based upon letters of credit outstanding under this agreement and the lenders borrowing base calculation, which considers among other factors, our accounts receivable and inventory balances. 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, 2005.

The senior borrowings assumed in the acquisition of Aera Japan Limited are collateralized by the Company's building in Japan and the mortgage note payable is collateralized by the Company's building in Korea. Additionally, approximately \$600,000 is restricted in Korea associated with the mortgage note payable, which restrictions will be released upon payment of the mortgage note.

Scheduled maturities of the Company's outstanding borrowings are as follows at December 31, 2005:

	<u>Total</u>
2006	\$ 1,815
2007	<u>1,909</u>
Total	<u>\$ 3,724</u>

(10) CONVERTIBLE SUBORDINATED NOTES PAYABLE

Convertible subordinated notes payable consisted of the following (in thousands):

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
5.25% convertible subordinated notes due November 15, 2006	\$ —	\$ 66,218
5.00% convertible subordinated notes due September 1, 2006	—	<u>121,500</u>
Total convertible subordinated notes	<u>\$ —</u>	<u>\$187,718</u>

On August 17, 2005, the Company issued 10 million shares of common stock at a price of \$9.75 per share pursuant to an underwritten public offering. On August 22, 2005, the Company issued an additional 1.5 million shares of common stock at the same price, pursuant to the underwriters' exercise of their over-allotment option. Proceeds from this offering of 11.5 million shares of common stock were approximately \$105.5 million, net of the underwriters' discount and offering expenses of approximately \$6.6 million. The net proceeds were used to fully redeem the Company's 5.25% convertible subordinated notes due 2006, and toward the full redemption of the Company's 5.0% convertible subordinated notes due 2006. Debt extinguishment expense recorded in the consolidated statements of operations of \$3.2 million is comprised of \$2.1 million for redemption premium and \$1.1 million for the write-off of deferred debt issuance costs.

(11) EARNINGS PER SHARE

Basic earnings per share ("EPS") is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the numerator is increased to exclude certain charges which would not have been incurred, and the denominator is increased to include the number of additional common shares that would have been outstanding (using the if-converted and treasury stock methods), if securities containing potentially dilutive common shares (convertible notes payable, stock options and restricted

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stock units) had been converted to such common shares, and if such assumed conversion is dilutive. As of December 31, 2005, stock options and restricted stock units totaling approximately 3.6 million were outstanding, of which 3.3 million shares are not included in the computation of diluted earnings per share because the effect of including such options in the computation would be anti-dilutive. Due to the Company's net loss for the years ended December 31, 2004 and 2003, basic and diluted EPS are the same, as the assumed conversion of all potentially dilutive securities would be anti-dilutive. For the years ended December 31, 2005, 2004 and 2003, the affect of potential conversion of the Company's convertible subordinated notes payable was not included in this computation because to do so would be anti-dilutive.

The following is a reconciliation of the numerators and denominators used in the calculation of basic and diluted EPS for the years ended December 31, 2005, 2004 and 2003:

(In thousands, except per share data)	Years Ended December 31,		
	2005	2004	2003
Earnings (loss) per common share—basic			
Net income (loss)	\$12,817	\$(12,747)	\$(44,241)
Weighted average common shares outstanding	<u>37,084</u>	<u>32,649</u>	<u>32,271</u>
Earnings (loss) per common share—basic	<u>\$ 0.35</u>	<u>\$ (0.39)</u>	<u>\$ (1.37)</u>
Earnings (loss) per common share—assuming dilution			
Net income (loss)	\$12,817	\$(12,747)	\$(44,241)
Weighted average common shares outstanding	37,084	32,649	32,271
Effect of dilutive securities:			
Stock options and restricted stock units	350	—	—
Convertible subordinated debt	<u>—</u>	<u>—</u>	<u>—</u>
Potentially dilutive common shares	<u>350</u>	<u>—</u>	<u>—</u>
Adjusted weighted average common shares outstanding	<u>37,434</u>	<u>32,649</u>	<u>32,271</u>
Earnings (loss) per common share—assuming dilution	<u>\$ 0.34</u>	<u>\$ (0.39)</u>	<u>\$ (1.37)</u>

(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 the expected tax rates for the periods in which the assets or liabilities will be realized, as well as for the expected tax benefit of net operating loss and tax credit carryforwards. Since 2003, the Company has recorded valuation allowances against certain of its United States and foreign net deferred tax assets in jurisdictions where the Company has incurred significant losses. Given such experience, management could not conclude that it was more likely than not that these net deferred tax assets will be realized. While there may be indications that the Company's operating results may improve in future periods, the Company's management, in accordance with SFAS No. 109, in evaluating the recoverability of these net deferred tax assets, is 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 such period. Approximately \$2.6 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.

The Company assesses the recoverability of its net deferred tax assets on a quarterly basis. If the Company determines that it is more likely than not that it will realize a portion or all of its net deferred tax assets, some portion or all of the valuation allowance will be reversed with a corresponding reduction in income tax expense in such period. From 2003 through 2005, the Company has only reversed portions of such valuation allowances for which it has realized the underlying asset.

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. Approximately \$3.7 million of the valuation allowance relates to deferred tax assets obtained through acquisitions. 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, 2005, no valuation allowances established in purchase accounting were reversed with a corresponding reduction in goodwill.

The income tax provision of \$4.9 million in 2005 represents an effective tax rate on income from continuing operations of 57% and the income tax provision of \$3.9 million in 2004 represents an effective tax rate on income from continuing operations of negative 37%, due to taxable income earned in certain foreign jurisdictions. The income tax provision of \$11.8 million in 2003 represents an effective tax rate on income from continuing operations of negative 35%, due to taxable income earned in certain foreign jurisdictions. The Company's income from discontinued operations was earned in the United States. No provision for income taxes is attributed to these discontinued operations, due to the valuation allowances against certain deferred tax assets in the United States, including those

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The provision (benefit) for income taxes for the years ended December 31, 2005, 2004 and 2003 was, as follows:

	December 31,		
	2005	2004	2003
	(In thousands)		
Federal	\$ 700	\$ —	\$ 8,437
State and local	300	—	784
Foreign taxes	3,873	3,947	2,580
	<u>\$ 4,873</u>	<u>\$ 3,947</u>	<u>\$11,801</u>
Current	\$ 6,003	\$ 3,503	\$ 5,372
Deferred	(1,130)	444	6,429
	<u>\$ 4,873</u>	<u>\$ 3,947</u>	<u>\$11,801</u>

The following reconciles the Company's effective tax rate on income from continuing operations to the federal statutory rate for the years ended December 31, 2005, 2004 and 2003:

	December 31,		
	2005	2004	2003
	(In thousands)		
Income tax benefit per federal statutory rate	\$ 2,973	\$ (3,753)	\$ (11,807)
State income taxes, net of federal deduction	2	(810)	(1,328)
Effect of discontinued operations	3,219	673	453
Extraterritorial income exclusion	(1,050)	(350)	(350)
Nondeductible intangible and goodwill amortization	2	98	98
Other permanent items, net	(361)	(514)	(456)
Effect of foreign taxes	(2,135)	(415)	(333)
Change in valuation allowance	283	7,884	29,130
Tax credits and other items	1,940	1,134	(3,606)
	<u>\$ 4,873</u>	<u>\$ 3,947</u>	<u>\$ 11,801</u>

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

	December 31,	
	2005	2004
	(In thousands)	
Current:		
Employee bonuses and commissions	\$ 250	\$ 31
Warranty reserve	2,357	2,493
Bad debt reserve	242	201
Vacation accrual	866	833
Restructuring accrual	237	1,545
Excess and obsolete inventory	4,345	3,156
Other	1,540	2,604
Valuation allowance (a)	(9,837)	(10,863)
Net current	—	—
Long-term:		
Net operating loss and tax credit carryforward	44,637	42,284
Accumulated other comprehensive income	(1,947)	(7,099)
Depreciation and amortization	(575)	(2,454)
Other, net	2,013	2,963
Valuation allowance (a)	(41,012)	(39,403)
Net long-term	<u>\$ 3,116</u>	<u>\$ (3,709)</u>

(a) Valuation allowance represents a reserve against the recovery of certain deferred tax assets.

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The following reconciles the change in the net deferred income tax liability from December 31, 2004 to December 31, 2005, to the deferred income tax provision:

	<u>2005</u>
	<u>(In thousands)</u>
Net change in deferred income tax liability from the preceding table	\$ (6,825)
Net change in deferred tax liability associated with foreign currency fluctuation	544
Net change in deferred tax liability associated with purchase accounting — reduction in Goodwill	—
Increase in deferred tax liability associated with other comprehensive income	<u>5,151</u>
Deferred income tax provision for the period	<u>\$ (1,130)</u>

As of December 31, 2005, the Company had a gross federal net operating loss, alternative minimum tax credit and research and development credit carryforwards of approximately \$93 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, 2025, the alternative minimum tax credit carryforward has no expiration date. In addition, as of December 31, 2005, the Company had a gross foreign net operating loss carryforward of \$2.6 million, which may be available to offset future foreign income tax liabilities and expire at various dates through December 31, 2010.

The domestic versus foreign component of the Company's income from continuing operations before income taxes for the years ended December 31, 2005, 2004 and 2003, was as follows:

	<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
	<u>(In thousands)</u>		
Domestic	\$ (4,772)	\$ (22,648)	\$ (36,432)
Foreign	13,267	11,925	2,697
	<u>\$ 8,495</u>	<u>\$ (10,723)</u>	<u>\$ (33,735)</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. For the years ended December 31, 2003, 2004 and 2005, the Company's contribution for participants in its 401(k) plan was 25% matching on contributions by employees up to 6% of the employee's compensation. The Company's total contributions to the plan were approximately \$633,000 in 2005, \$698,000 in 2004 and \$635,000 in 2003. 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 \$2.5 million of parts, components and subassemblies 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 2006.

DISPUTES AND LEGAL ACTIONS

The Company is involved in disputes and legal actions arising in the normal course of its business. 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 can be highly subjective. This subjectivity introduces substantial additional risk with regard to the outcome of the Company's disputes and legal actions related to intellectual property. In the event of any adverse outcome, the ultimate loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular period. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights. The Company accrues loss contingencies in connection with its litigation when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

In April 2003, the Company filed a claim in the United States District Court for the District of Colorado seeking a declaratory ruling that its plasma source products Xstream™ With Active Matching Network™ ("Xstream products") were not in violation of patents held in the United States 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. On October 3, 2005, the Company executed a settlement agreement with MKS resolving all pending claims involving the Xstream products and all other toroidal plasma generator products. Pursuant to the settlement agreement, the Company paid \$3.0 million in cash to MKS. The Company also stipulated to a final judgment of infringement and an injunction prohibiting the Company from making, using, selling, offering to sell, or importing into the United States, or any country in which a counterpart patent exists, its Xstream products and all other toroidal plasma generator products, except as permitted under the settlement agreement. Sales of these products have accounted for less than 5% of the Company's total sales each year since introduction of the products.

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. On April 8, 2005, the Mannheim court issued a judgment against the Company for infringement of MKS's patent, which did not specify damages. The action was dismissed pursuant to the settlement agreement referenced above in connection with the Xstream products litigation in the United States. A petition for invalidity of MKS's patent brought by the Company was also dismissed.

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 United States Patent No. 6,046,546. The case was voluntarily dismissed on March 11, 2005 under an agreement that left the Company free to refile its claims upon conclusion of MKS's lawsuit against the Company's Xstream products. Pursuant to the settlement agreement referenced above in connection with the Xstream products litigation, the Company agreed to not refile its claims related to MKS's Astron reactive gas source products.

On June 8, 2005, the Korean Customs Service ("KCS") issued a Pre-Taxation Notification concerning back duties and value added taxes allegedly owed on goods imported by the Company's Korean subsidiary, Advanced Energy Industries Korea, Inc., during the five year period ended June 8, 2005. On June 27, 2005, the Company protested the notifications on the grounds that the assessment was unwarranted and based on a misapplication of international tariff rules. On September 9, 2005, the KCS rejected the protest brought by the Company. Beginning on September 19, 2005, the KCS issued a series of taxation notices for duties and penalties owed of approximately \$2.2 million. In order to appeal the assessment to the Korean National Tax Tribunal, an independent review board of the Korean Ministry of Finance and Economy, the Company paid the taxation notices. The Company filed its appeals of the assessments in December 2005, and the KCS has filed a response in opposition to its appeal. The Company anticipates that the Korean National Tax Tribunal will schedule a hearing for adjudication of the matter in the second quarter of 2006. Although the Company has paid the taxation notices in order to appeal the assessment, the Company does not believe such amounts represent a probable expense and therefore has not accrued such in the consolidated statement of operations. The Company believes that the amount of any ultimate loss will not have a material adverse effect on the Company's financial position or consolidated results of operations.

OPERATING & CAPITAL 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 \$5.9 million in 2005, \$6.2 million in 2004 and \$6.2 million in 2003.

The future minimum rental payments required under non-cancelable operating leases as of December 31, 2005 are as follows:

	(In thousands)
2006	\$ 5,966
2007	4,579
2008	3,564
2009	2,826
2010	2,199
Thereafter	<u>7,250</u>
	<u>\$ 26,384</u>

The Company finances a portion of its property and equipment under capital lease obligations at interest rates averaging approximately 3%. Pursuant to the capital lease agreements, future minimum lease payments totaling \$490,000 are due in varying monthly increments through 2011.

(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:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Sales (1):			
Originating in United States and sold to United States customers	\$163,657	\$197,540	\$117,578
Originating in United States and sold to foreign customers	19,134	37,378	33,193
Originating in Europe and sold to United States customers	—	115	57
Originating in Europe and sold to foreign customers	26,432	36,151	24,492
Originating in Asia Pacific and sold to United States customers	—	608	—
Originating in Asia Pacific and sold to foreign customers	<u>116,259</u>	<u>108,745</u>	<u>78,216</u>
	<u>\$325,482</u>	<u>\$380,537</u>	<u>\$253,536</u>
Income (loss) from operations:			
United States	\$ 709	\$ (15,526)	\$ (28,934)
Europe	1,868	(1,540)	559
Asia	12,285	13,508	4,811
Intercompany eliminations	<u>1,112</u>	<u>91</u>	<u>(863)</u>
	<u>\$ 15,974</u>	<u>\$ (3,467)</u>	<u>\$ (24,427)</u>
	<u>2005</u>	<u>2004</u>	
Long-lived assets:			
United States	\$19,813	\$25,266	
Europe	1,667	2,102	
Asia	<u>21,144</u>	<u>21,422</u>	
	<u>\$42,624</u>	<u>\$48,790</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 two major customers (sales in excess of 10% of total sales), one which is a manufacturer of semiconductor capital equipment, and the other which is a manufacturer of flat panel display capital equipment. Sales to these customers accounted for the following percentages of sales for the years ended December 31, 2005, 2004 and 2003:

	<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Applied Materials, Inc.	23%	28%	21%
Ulvac, Inc.	11%	*	*

* Sales to Ulvac, Inc. represented less than 10% during this period.

There were no other customers that represented greater than 10% of the Company's total sales for the years ended December 31, 2005, 2004 and 2003.

Trade accounts receivable from Applied Materials, Inc. were approximately \$10.2 million as of December 31, 2005, which represented approximately 16% of the Company's total trade accounts receivable. At December 31, 2005, trade accounts receivable from ULVAC, Inc. were approximately \$14.5 million, representing approximately 22% 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, 2005.

(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 Chairman of the Board of Directors holds an interest. The leases relating to these spaces expire in 2009, 2011 and 2016, and contain monthly payments of approximately \$89,000, \$71,000 and \$84,000, respectively.

For the year ended December 31, 2005, approximately \$2.9 million was paid attributable to these leases, and approximately \$2.8 million in each of the years ended December 31, 2004 and 2003. 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 \$144,000 was paid attributable to this agreement in the year ended December 31, 2005, \$132,000 in 2004 and \$156,000 in 2003.

The Company leased, for business purposes, a condominium owned by a partnership of certain stockholders, including the Company’s Chairman of the Board of Directors. The Company paid the partnership \$10,000 in 2004 and \$60,000 in 2003. In February 2004, this lease agreement was terminated.

Prior to 2005, the Company reimbursed expenses associated with its use of an aircraft owned by a company, which is owned by the Company’s Chairman of the Board of Directors. Aggregate payments for the use of such aircraft were \$16,000 in 2004 and \$6,000 in 2003.

(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 of one month, with contracts outstanding at December 31, 2005 maturing through January 2006. The Company did not seek specific hedge accounting treatment for its foreign currency forward contracts.

At December 31, 2005, the Company held the following foreign currency forward contracts to buy United States 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	\$ 4,200	\$ 4,108	\$ 92
Taiwanese dollar contract	2,700	2,712	(12)
South Korean won contract	1,200	1,189	11
Chinese yuan contract	<u>800</u>	<u>800</u>	<u>—</u>
Balance at December 31, 2005	<u>\$ 8,900</u>	<u>\$ 8,809</u>	<u>\$ 91</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, 2005, 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 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 administrator of the plan 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

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February 2013, unless the administrator of the plan terminates it earlier. As of December 31, 2005, approximately 1.6 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 provides for the issuance of up to 250,000 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. Prior to January 26, 2006, non-employee directors were 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 vested 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 continued to be a director. Options granted upon re-election were immediately exercisable. On January 26, 2006, the Company revised its non-employee director compensation structure, which revisions eliminated the granting of stock options. Non-employee directors are now granted 5,000 restricted stock units on the date first elected or appointed as a member of the Company's board, and 2,000 restricted stock units on any date re-elected as a member of the board. As of December 31, 2005, 120,000 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. The Company's stockholders' approved amendments to increase the number of common shares reserved for issuance under the plan from 200,000 shares to 400,000 shares in May 2003 and from 400,000 shares to 500,000 shares in May 2005. 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. Employees purchased shares of common stock under the ESPP of approximately 45,000 shares in 2005, 65,000 in 2004 and 73,000 in 2003. At December 31, 2005, approximately 145,000 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, 2005, options to purchase shares of common stock remained outstanding under the 2002 Employee Stock Option Plan of approximately 305,000 options and under the 2001 Employee Stock Option Plan of approximately 325,000 options.

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, 2005, options to purchase approximately 1.1 million shares of common stock remained outstanding under the 1995 Employee Stock Option Plan and options to purchase approximately 58,000 shares of common stock remained outstanding under the Non-Employee Directors Stock Option Plan.

The following summarizes the activity relating to stock options for the years ended December 31, 2005, 2004 and 2003:

(In thousands, except share prices)

	2005		2004		2003	
	Shares	Weighted-average Exercise Price	Shares	Weighted-average Exercise Price	Shares	Weighted-average Exercise Price
Stock options and RSUs:						
Employees —						
Options outstanding at beginning of period	4,527	\$ 19.53	3,920	\$ 19.95	3,475	\$ 23.18
Options granted	404	7.99	1,196	16.99	1,790	14.66
Options exercised	(195)	8.41	(117)	9.52	(352)	9.89
Options cancelled	(1,553)	18.55	(472)	19.09	(993)	25.28
Options outstanding at end of period	<u>3,183</u>	19.22	<u>4,527</u>	19.53	<u>3,920</u>	19.95
Options exercisable at end of period	2,540	21.81	1,943	22.70	1,230	25.50
Weighted-average fair value of options granted during the period	\$ 4.42		\$ 8.40		\$ 7.88	
Price range of outstanding options	\$ 3.88-\$60.75		\$ 3.11-\$60.75		\$ 0.67-\$60.75	

Price range of options
terminated

\$3.11-\$60.75

\$0.83-\$60.75

\$0.83-\$60.75

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	2005		2004		2003	
	Shares	Weighted-average Exercise Price	Shares	Weighted-average Exercise Price	Shares	Weighted-average Exercise Price
RSUs outstanding at beginning of period	0		0		0	
RSUs granted	280		0		0	
RSUs cancelled	(45)		0		0	
RSUs outstanding at end of period	<u>235</u>		<u>0</u>		<u>0</u>	
Non-employee directors						
Options outstanding at beginning of period	172	\$ 15.81	104	\$ 19.00	112	\$ 22.64
Granted	40	11.68	85	13.62	25	10.67
Exercised	0	—	(5)	10.67	(8)	6.75
Terminated	(29)	17.95	(12)	51.10	(25)	30.90
Options outstanding at end of period	<u>183</u>	14.58	<u>172</u>	15.81	<u>104</u>	19.00
Options exercisable at end of period	158	15.18	122	16.94	80	21.91
Weighted-average fair value of options granted during the period	\$ 8.13		\$ 9.67		\$ 7.84	
Price range of outstanding options	\$ 6.13–\$46.13		\$ 6.13–\$46.13		\$ 6.13–\$60.75	
Price range of options terminated	\$ 6.15–\$22.30		\$ 6.15–\$64.94		\$ 6.13–\$64.94	

The following table summarizes information about the stock options outstanding at December 31, 2005:

(In thousands, except share prices and lives)

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$3.88 to \$7.61	406	7.8 years	\$ 7.21	139	\$ 7.12
\$7.70 to \$9.12	384	6.3 years	8.42	291	8.41
\$9.13 to \$11.69	337	9.0 years	9.99	110	10.42
\$12.75 to \$17.85	505	6.5 years	15.35	424	15.80
\$18.00 to \$20.81	405	7.3 years	19.35	405	19.35
\$21.16 to \$22.52	557	7.9 years	22.37	557	22.37
\$23.67 to \$29.88	336	5.3 years	26.21	336	26.21
\$30.19 to \$43.69	384	5.4 years	37.61	384	37.61
\$44.97 to \$56.13	19	4.4 years	51.23	19	51.23
\$60.75 to \$60.75	<u>33</u>	4.5 years	60.75	<u>33</u>	60.75
	3,366	6.9 years	\$ 18.95	2,698	\$ 21.42

(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). The carrying value of senior borrowings approximates their fair value due to the variable interest rates associated with the borrowings.

(20) SUPPLEMENTAL CASH FLOW DISCLOSURES

As of December 31, 2005, approximately \$24.6 million of the Company's cash balance is held in banks outside of the United States.

Cash paid (received) for income taxes, net: In 2003, the Company received approximately \$14.1 million in income tax refunds in the United States due primarily to its 2002 net operating loss carry-back.

Assets sold for note receivable: 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 fourth quarter of 2005, the Company negotiated an early settlement of the note, and as a result recorded a loss of \$942,000, which was recorded as other income and expense, the same line item as the original gain on the sale.

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, 2005. 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. The amounts below have been restated to reclassify the results of discontinued operations.

	Quarters Ended							
	Mar. 31, 2004	June 30, 2004	Sept. 30, 2004	Dec. 31, 2004	Mar. 31, 2005	June 30, 2005	Sept. 30, 2005	Dec. 31, 2005
	(In thousands, except per share data)							
Sales	\$100,163	\$105,321	\$90,242	\$ 84,811	\$82,176	\$84,163	\$78,756	\$80,387
Gross profit	36,762	35,923	28,666	13,275	27,322	30,646	28,922	30,191
Income (loss) from operations	8,835	8,318	1,683	(22,303)	2,533	5,026	2,177	6,238
Income (loss) from continuing operations	5,949	4,034	(1,308)	(23,345)	(83)	2,877	(4,203)	5,031
Income from discontinued operations	975	436	172	340	817	3,072	312	4,994
Net income (loss)	\$ 6,924	\$ 4,470	\$ (1,136)	\$ (23,005)	\$ 734	\$ 5,949	\$ (3,891)	\$10,025
Diluted earnings (loss) per share	\$ 0.21	\$ 0.13	\$ (0.03)	\$ (0.70)	\$ 0.02	\$ 0.18	\$ (0.10)	\$ 0.22
Diluted weighted-average shares outstanding	33,593	33,187	32,674	32,698	32,878	33,094	38,366	44,902

The Company had a net 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 (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 net loss of \$3.9 million in the third quarter of 2005 included pretax charges of \$3.2 million for debt extinguishment expenses (see Note 10) and \$3.0 million for a litigation settlement (see Note 14). The net income of \$10.0 million in the fourth quarter of 2005 includes pretax gains on the sale of discontinued operations \$5.2 million.

ADVANCED ENERGY INDUSTRIES, INC. AND SUBSIDIARIES
SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Expense (Recoveries)</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Year ended December 31, 2003:				
Inventory obsolescence reserve	\$ 20,419	\$ 3,016	\$ 13,944	\$ 9,491
Allowance for doubtful accounts	<u>3,056</u>	<u>(429)</u>	<u>1,324</u>	<u>1,303</u>
	<u>\$ 23,475</u>	<u>\$ 2,587</u>	<u>\$ 15,268</u>	<u>\$ 10,794</u>
Year ended December 31, 2004:				
Inventory obsolescence reserve	\$ 9,491	\$ 11,262	\$ 6,102	\$ 14,651
Allowance for doubtful accounts	<u>1,303</u>	<u>198</u>	<u>452</u>	<u>1,049</u>
	<u>\$ 10,794</u>	<u>\$ 11,460</u>	<u>\$ 6,554</u>	<u>\$ 15,700</u>
Year ended December 31, 2005:				
Inventory obsolescence reserve	\$ 14,651	\$ 1,689	\$ 5,752	\$ 10,588
Allowance for doubtful accounts	<u>1,049</u>	<u>126</u>	<u>530</u>	<u>645</u>
	<u>\$ 15,700</u>	<u>\$ 1,815</u>	<u>\$ 6,282</u>	<u>\$ 11,233</u>

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, with the participation of management, including our Chief Executive Officer and Principal Financial Officer, of the effectiveness of the disclosure controls and procedures pursuant to the Exchange Act Rule 13a-15(b). Based upon this evaluation, the Chief Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2005.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Our internal controls over financial reporting are designed to provide reasonable assurance concerning the reliability of financial data used in the preparation of our financial statements. All internal control systems, no matter how well designed, have inherent limitations and may not prevent or detect misstatements. Controls considered to be operating effectively in one period may become inadequate in future periods because of changes in conditions or a deterioration in the degree of compliance with policies or procedures.

Management, including our Chief Executive Officer and Principal Financial Officer, assessed the effectiveness of our internal control over financial reporting as of December 31, 2005 using the criteria described in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As a result of the assessment, Management has concluded that our internal control over financial reporting was effective as of December 31, 2005.

Grant Thornton LLP, an independent registered public accounting firm, has issued an attestation report on both management's assessment and the effectiveness of the Company's internal control over financial reporting, which is included in Part II, Item 8 of this Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our most recent quarter that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting, except for steps taken to remediate the material weaknesses described immediately below.

Remediation of Material Weaknesses

As disclosed in our 2004 annual report on Form 10-K, management had identified a material weakness related to the lack of segregation of duties defined within our enterprise resource planning (“ERP”) system, as certain employees had access in our ERP system to record transactions outside of their assigned job responsibilities. The ERP system interacts with most of our major processes including manufacturing, payables, receivables and inventory controls. Management has taken the following steps in remediating this material weakness:

- Reassigned access in the ERP system for each employee to be more consistent with his or her job responsibilities;
- Reviewed and tested the reassigned access to identify and assess segregation of duties issues;
- Hired an independent consulting firm to review and test the reassigned access to determine if the reassigned access establishes appropriate segregation of duties and to advise management accordingly; and
- Implemented a policy whereby proposed changes to the assigned access for each employee must be reviewed and approved by management prior to implementation to aid in preventing future segregation of duty issues.

Management has reviewed and tested the reassigned access and has concluded that the material weakness no longer exists as of December 31, 2005.

Also disclosed in our 2004 annual report on Form 10-K was management’s identification of two significant deficiencies in our Japan operations, which when considered together represented a material weakness. The first significant deficiency related to the fact that both of our Japan facilities have their own unique information system, neither of which was the corporate ERP system discussed above but both of which had similar segregation of duties issues. The second significant deficiency in Japan was the lack of sufficient human resources for proper segregation of duties and oversight at the local level. Management has taken the following steps in remediating this material weakness in our Japan operations:

- Relocated a division controller from the corporate headquarters to Japan to provide oversight at the local level and hired a President and Representative Director of Japan; and
- Implemented the corporate ERP system in Japan, including training the staff in Japan. Through the implementation of the corporate ERP system in Japan, management also ensured that proper segregation of duties was defined within the system.

Management has reviewed and tested the system implementation and has concluded that the material weakness no longer exists as of December 31, 2005.

ITEM 9B. OTHER INFORMATION

None.

PART III

In accordance with General Instruction G(3) of Form 10-K, the information required by this Part III is incorporated by reference to Advanced Energy’s definitive proxy statement relating to its 2006 Annual Meeting of Stockholders (the “2006 Proxy Statement”), as set forth below. The 2006 Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after the close of the Company’s fiscal year end.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information set forth in the 2006 Proxy Statement under the headings “Proposal No. 1/ Election of Directors—Nominees” and “Section 16(a) Beneficial Ownership Reporting Compliance” is incorporated herein by reference. The information under the heading “Executive Officers of the Registrant” in Part I of this Form 10-K is also incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information set forth in the 2006 Proxy Statement under the headings “Executive Compensation” and “Stock Performance Graph” is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information set forth in the 2006 Proxy Statement under the headings “Common Stock Ownership by Management and Other Stockholders” and “Equity Compensation Plan Information” is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth in the 2006 Proxy Statement under the caption “Certain Transactions with Management” is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information set forth in the 2006 Proxy Statement under the caption “Fees Billed by Independent Public Accountants” is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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- 10.31 Asset Purchase Agreement dated November 23, 2005, by and between Advanced Energy Industries, Inc. and iWatt, Inc., a California corporation.
- 21.1 Subsidiaries of Advanced Energy Industries, Inc.

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 - 24.1 Power of Attorney.(12)
 - 31.1 Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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- * Compensation Plan
 - + Confidential treatment has been granted for portions of this agreement.
-

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADVANCED ENERGY INDUSTRIES, INC.

(Registrant)

/s/ Hans Georg Betz

Hans Georg Betz
Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Hans Georg Betz Hans Georg Betz	Chief Executive Officer, President (Principal Executive Officer)	March 22, 2006
/s/ Mark D. Hartman Mark D. Hartman	Principal Financial Officer and Principal Accounting Officer	March 22, 2006
/s/ Douglas S. Schatz Douglas S. Schatz	Chairman of the Board	March 22, 2006
/s/ Richard P. Beck Richard P. Beck	Director	March 22, 2006
/s/ Joseph R. Bronson Joseph R. Bronson	Director	March 22, 2006
/s/ Trung Doan Trung Doan	Director	March 22, 2006
/s/ Barry Z. Posner Barry Z. Posner	Director	March 22, 2006
/s/ Elwood Spedden Elwood Spedden	Director	March 22, 2006

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- + Confidential treatment has been granted for portions of this agreement.

**ADVANCED ENERGY INDUSTRIES, INC.
2003 STOCK OPTION PLAN**

RESTRICTED STOCK UNITS AGREEMENT

**Stock Unit
Transferability**

This grant is an award of restricted stock units in the number set forth on the cover sheet, subject to the vesting conditions described below (“*RSUs*”). Your *RSUs* may not be transferred, assigned, pledged or hypothecated, whether by operation of law or otherwise, nor may your *RSUs* be made subject to execution, attachment or similar process.

Vesting

Your *RSUs* shall vest according to the schedule set forth on the cover sheet; *provided*, that, you remain in Service on the relevant vesting dates. If your Service terminates for any reason, you will forfeit any *RSUs* in which you have not yet become vested.

**Delivery of Stock
Pursuant to Vesting of
RSUs**

A certificate for the shares of Stock represented by your *RSUs* typically shall be delivered to you upon vesting, unless the Administrator (in its sole discretion) allows you elect to defer delivery of such Stock and you make such election in a timely manner. If your Service terminates for a reason other than for Cause prior to such date, you will instead be delivered a certificate for the vested portion of your *RSUs* represented by this Agreement. If your Service terminates for Cause, you shall forfeit of all of your *RSUs*.

Notwithstanding the preceding paragraph:

If you are a “key employee” within the meaning of Section 409A of the Code and shares would otherwise be delivered to you on account of your separation from Service, then such shares shall not be delivered to you until six months after your separation from Service; and

If the shares relating to the vested *RSUs* would otherwise be delivered during a period in which you are (i) subject to a lock-up agreement restricting your ability to sell shares of Stock in the open market or (ii) restricted from selling shares of Stock in the open market because you are not then eligible to sell under the Company’s insider trading or similar plan as then in effect (whether because a trading window is not open or you are otherwise restricted from trading), delivery of the shares related to the vested *RSUs* may be delayed until no earlier than the first date on which you are no longer prohibited from selling shares of Stock due to a lock-up agreement or insider trading plan restriction; provided, however, that the delivery of the shares related to vested *RSUs* will be

made within 2 1/2 months after the end of taxable year in which the RSUs vest, or such other time as is required to comply with the requirements of Section 409A of the Internal Revenue Code.

Deferral of Delivery of Stock

The American Jobs Creation Act of 2004 added new Section 409A to the Internal Revenue Code. Section 409A of the Internal Revenue Code provides that deferred compensation that is not structured to satisfy Section 409A may result in accelerated federal income taxation, a 20% penalty tax applied in addition to federal income tax otherwise owed and, potentially, interest for any underpayment of tax at the ordinary underpayment rate plus one percentage point. While the full impact of Section 409A on awards granted under the plan is still uncertain, RSUs that allow for deferral of delivery of stock following vesting are likely to be impacted. For this reason, unless you have received written notice otherwise, the Administrator does not intend to allow for such deferral, unless and until the likely impact of Section 409A on including feature in your RSUs is better understood.

Withholding Taxes

You agree, as a condition of this grant, that you will make acceptable arrangements to pay any withholding or other taxes that may be due as a result of vesting in RSUs or your acquisition of Stock under this grant. In the event that the Company determines that any federal, state, local or foreign tax or withholding payment is required relating to your RSUs, the Company will have the right to: (i) require that you arrange such payments to the Company, (ii) withhold such amounts from other payments due to you from the Company or any affiliate, or (iii) cause an immediate forfeiture of shares of Stock subject to the RSUs granted pursuant to this Agreement in an amount equal to the withholding or other taxes due.

Employment Rights

This Agreement does not confer on the Grantee any right with respect to continuance of employment or other service with the Company or of its affiliates, nor will it interfere in any way with any right the Company or its affiliates would otherwise have to terminate or modify the terms of such Grantee's employment or other service at any time.

Grantee acknowledges and understands that this grant of RSUs and any future RSUs granted under the Plan are wholly discretionary in nature and are not to be considered part of any normal or expected compensation that is or would be subject to severance, resignation, redundancy or similar

pay, other than to the extent required by local law.

Shareholder Rights

You do not have any of the rights of a shareholder with respect to the RSUs, unless and until the Stock relating to the RSUs has been delivered to you.

Adjustments

In the event of a stock split, a stock dividend or a similar change in the Company stock, the number of RSUs covered by this grant will be adjusted (and rounded down to the nearest whole number) in accordance with the terms of the Plan.

Applicable Law

This Agreement will be interpreted and enforced under the laws of the State of Colorado, other than any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Agreement to the substantive law of another jurisdiction.

Consent to Electronic Delivery

The Company may choose to deliver certain statutory materials relating to the Plan in electronic form. By accepting this grant you agree that the Company may deliver the Plan prospectus and the Company's annual report to you in an electronic format. If at any time you would prefer to receive paper copies of these documents, as you are entitled to receive, the Company would be pleased to provide copies. Please contact the Stock Plan Administrator to request paper copies of these documents.

Consent to Process Personal Data

Grantee acknowledges that in order to perform its requirements under this Plan, the Company and its affiliates may process sensitive personal data about Grantee. Such data include but are not limited to the information provided above and any changes thereto and other appropriate personal and financial data about Grantee. Grantee hereby gives explicit consent to the Company to process any such personal data and/or sensitive personal data. Grantee also hereby gives explicit consent to the Company to transfer any such personal data and/or sensitive personal data outside the country in which Grantee is employed, and to the United States. The legal persons for whom such personal data are intended are Advanced Energy Industries, Inc. and E*TRADE. Grantee has been informed of his/her right of access and correction to his/her personal data by applying to Advanced Energy's stock plan administrator.

The Plan

The text of the Plan is incorporated in this Agreement by reference. This Agreement and the Plan constitute the entire understanding between you and the Company regarding this grant of RSUs. Any prior agreements, commitments or negotiations concerning this grant are superseded. The Plan will control in the event any provision of this Agreement should appear to be inconsistent with the terms of the Plan.

Grantee understands that the Company has reserved the right to amend or terminate the Plan at any time, and that the grant of an RSU under the Plan at one time does not in any way obligate the Company or its affiliates to grant additional RSUs in any future year or in any given amount.

By signing the cover sheet of this Agreement, you agree to all of the terms and conditions described above and in the Plan.

**ADVANCED ENERGY INDUSTRIES, INC.
2003 STOCK OPTION PLAN**

RESTRICTED STOCK UNIT AGREEMENT ADDENDUM

This Addendum is incorporated into the Restricted Stock Unit Agreement (“Agreement”), granted under the Advanced Energy Industries, Inc. 2003 Stock Option Plan, as amended (the “Plan”). The provisions set forth below shall apply to certain Grantees performing services outside the United States as specified herein. As designated below, the provisions set forth in this Addendum shall substitute the identified corresponding provisions of the Agreement in their entirety.

The following shall apply with respect to the vesting of an RSU if, on the date of such vesting, the Grantee is resident in **China**:

**Delivery of Stock
Pursuant to Vesting of
RSUs**

Upon the vesting of this RSU, Grantee shall authorize the Company to direct the broker to immediately sell any and all shares of Stock that otherwise would have been delivered net of applicable withholding taxes and acquisition consideration due to the Company. This Agreement shall serve as Grantee’s express authorization to immediately sell any and all shares of Stock to be acquired upon the vesting of this RSU. As soon as reasonably practical, Grantee shall be entitled to payment of the proceeds resulting from such sale, net of the applicable tax withholding and acquisition consideration (if any) due to the Company.

Withholding Taxes

You agree, as a condition of this grant, that the Company shall have the right to cause an immediate forfeiture of a number of shares of Stock subject to the RSUs granted pursuant to this Agreement in an amount equal to the withholding or other taxes due to the Company.

EXECUTION COPY

ASSET PURCHASE AGREEMENT

by and among

iWatt, Inc.

IKOR Acquisition Corporation

and

Advanced Energy Industries, Inc.

Dated November 23, 2005

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ASSET PURCHASE AGREEMENT

THIS ASSET PURCHASE AGREEMENT (this "Agreement") is made and entered into as of November 23, 2005 (the "Effective Date"), by and among iWatt, Inc., a California corporation (the "Parent"), IKOR Acquisition Corporation, a Delaware corporation and wholly owned subsidiary of Parent (the "Buyer"), and Advanced Energy Industries, Inc., a Delaware corporation (the "Seller"), each, a "Party," together, the "Parties".

RECITALS

WHEREAS, Seller is currently engaged in, among other things, the Business (as defined below) in its IKOR division;

WHEREAS, Parent and Buyer wish to purchase all assets, tangible and intangible, of Seller used in or necessary for the operation of the Business;

WHEREAS, Seller wishes to sell such assets to Parent and Buyer; and

WHEREAS, the Parties desire that certain current employees of Seller become employees of Buyer.

NOW, THEREFORE, in consideration of the covenants, promises, representations and warranties set forth herein, and for other good and valuable consideration (the receipt and sufficiency of which are hereby acknowledged by the Parties), intending to be legally bound hereby, the Parties agree as follows:

Article 1 **DEFINITIONS**

1.1 Defined Terms.

The following capitalized terms shall have the meanings set forth below:

(a) "Affiliate" means with respect to a Person, a Person that directly, or indirectly through one or more intermediaries, Controls or is Controlled by, or is under common Control with, such Person, including any Subsidiary of such Person. A "Subsidiary" means with respect to a Person, a Person that directly, or indirectly through one or more intermediaries, is Controlled by such Person. For the purposes of this definition of "Affiliate", "Control" (including derivative forms such as "Controlling," "Controlled by" and "under common Control with") means the ownership or possession, direct or indirect by the controlling Person of: (a) voting shares or other securities, representing more than fifty percent (50%) of the outstanding shares or securities entitled to vote for the election of the board of directors or similar managing authority of such controlled Person; or (b) if such controlling Person does not have voting shares or other securities, more than fifty percent (50%) of the ownership interest that represents the right to make decisions, including the election of directors, for such controlled Person.

(b) “Assigned IPR” means (i) the Assigned Patents and (ii) the Assigned Trademarks.

(c) “Assigned Patents” means each of the Patents and invention disclosures set forth in Schedule 1.1(c) and any Patents that are a member of the same Patent Family as any one of such scheduled Patents, in each case whether pending, issued, expired, abandoned or closed, and all foreign counterparts of any such Patent.

(d) “Assigned Trademarks” means each of the Trademarks listed or described in Schedule 1.1(d), in each case whether or not such Trademarks are Registered IP or registerable as Registered IP.

(e) “Benefit Plan” means any plan, program, policy, practice, contract, agreement or other arrangement providing for compensation, severance, termination pay, deferred compensation, performance awards, stock or stock-related awards, fringe benefits or other employee benefits or remuneration of any kind, whether written or unwritten or otherwise, funded or unfunded, including without limitation, each “employee benefit plan,” within the meaning of Section 3(3) of ERISA which is maintained, contributed to, or required to be contributed to, by Seller or any ERISA Affiliate for the benefit of any Employee, or with respect to which Seller or any ERISA Affiliate has or may have any liability or obligation.

(f) “Bill of Sale” means one or more fully executed bills of sale for the Transferred Tangible Assets, in a form set forth in Schedule 1.1(f).

(g) “Books and Records” means the books and records of Seller and its Affiliates that are or have been related to, used in or necessary for the operation of the Business, the Transferred Assets or the Designated Employees, including books of account; the sales records; customer lists and information; supplier lists and information; Transferred Product records; marketing materials; distributor and other sales information; copies of Transferred Contracts; product and design materials (for internal or external use); plans; drawings; general financial and accounting data; documentation sufficient to fully utilize, understand and implement the Transferred Assets (including the Transferred Tangible Assets and Assigned IPR); technical and operating materials (for internal or external use); in each case in whatever form (hard copy or electronic) relating to the Transferred Assets, copies of policies and procedures or other communications regarding marketing and customer matters, and the Patent Files.

(h) “Business” means the development, sale, licensing, distribution and support of power supply components, modules and systems utilized in computing, office automation and communications products, including the business, intellectual property, technology, assets and operations of Seller and its Affiliates currently conducted in its “IKOR” business unit, and the activities and operations of the Designated Employees.

(i) “Closing Date” means the date upon which the Closing occurs in accordance with Section 2.1.

(j) “Code” means the Internal Revenue Code of 1986, as amended.

(k) “Confidential Information” means any nonpublic information disclosed by one Party (the “Disclosing Party”) to the other (the “Receiving Party”) (including any nonpublic information disclosed in the course of the performance of the Transition Services): (a) which relates to the actual or anticipated business or research and development of the Disclosing Party, technical data, trade secrets or know-how, including, but not limited to, research, product plans or other information regarding the Disclosing Party’s products or services and markets therefor, customer lists and customers, software, developments, inventions, processes, formulas, technology, designs, drawings, engineering, hardware configuration information, marketing, finances or other business information or (b) which is otherwise deemed to be “Confidential Information” by the terms of this Agreement, other than information the Receiving Party can demonstrate was in the public domain at the time of disclosure through no act or omission on the part of the Receiving Party.

(l) “Consent” means any consent, approval, permit, or authorization of any Person not a Party to this Agreement.

(m) “Control,” “Controls,” “Controlled” or “Controlling” means, with respect to any Intellectual Property Rights, the possession by Seller or its Affiliates of the right to grant a license or sublicense under such Intellectual Property Rights of the scope provided herein without incurring an obligation to pay additional consideration to a third party (except for payments among such Party and its Affiliates, and payments to employees for inventions made by them while employed by such Party or its Affiliates made in the ordinary course of their employment).

(n) “Designated Employees” means the individuals listed on Schedule 1.1(n) (including individuals identified between the Effective Date and the Closing Date and added to Schedule 1.1(n) in accordance with Section 6.1) as “Designated Employees.” For clarity, any reference in this Agreement to “Designated Employees” shall include all individuals on Schedule 1.1(n) that are also designated as “Key Employees.”

(o) “Employee” shall mean any current or former employee, consultant or director of Seller or any ERISA Affiliate, who has provided services to the Business.

(p) “Employment Agreement” shall mean each management, employment, severance, consulting, relocation, repatriation, expatriation, visa, work permit or other agreement, contract or understanding between Seller or any ERISA Affiliate and any Employee.

(q) “Employment Liabilities” shall mean any and all claims, debts, liabilities, commitments and obligations, whether fixed, contingent or absolute, matured or unmatured, liquidated or unliquidated, accrued or unaccrued, known or unknown, whenever or however arising, including all costs and expenses relating thereto arising under law, rule, regulation, permit, action or proceeding before any governmental authority, order or consent decree or any award of any arbitrator of any kind relating to any Benefit Plan, Employment Agreement or otherwise relating to an Employee and his or her employment with Seller or any ERISA Affiliate.

(r) “ERISA Affiliate” shall mean each subsidiary of Seller and any other person or entity under common control with Seller or any of its subsidiaries within the meaning of Section 414(b), (c), (m) or (o) of the Code and the regulations issued thereunder.

(s) “ERISA” means the Employee Retirement Income Security Act of 1974, as amended.

(t) “Escrow Agent” means the escrow agent identified in the Escrow Agreement.

(u) “Escrow Agreement” means an Escrow Agreement among Parent, Buyer, Seller and Escrow Agent (as identified therein) effective as of the Closing Date, in the form attached hereto as Exhibit A.

(v) “Excluded Assets” means (a) all of Seller’s tangible assets other than the Transferred Assets, (b) all cash, (c) all amounts prepaid on any insurance policy maintained by the Seller on behalf of the Business and (d) such other assets of Seller as are listed on Schedule 1.1(v).

(w) “Exploit” or “Exploitation” means with respect to any Technology, process or product, to make, have made, use, modify, enhance, sell, offer for sale, market, import, make derivative works from, perform, copy, disclose, or distribute such product or Technology (or derivative thereof) or practice such process (or derivative thereof), as the case may be.

(x) “Governmental Entity” means any court, administrative agency or commission or other federal, state, provincial, county, local or other governmental authority, instrumentality, agency or commission in any country worldwide.

(y) “Hazardous Material” means any substance that has been designated by any Governmental Entity or by applicable federal, state or local law to be radioactive, toxic, hazardous or otherwise a danger to health or the environment, including, without limitation all substances listed as hazardous substances pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, or defined as a hazardous waste pursuant to the United States Resource Conservation and Recovery Act of 1976, as amended, and the regulations promulgated pursuant to said laws.

(z) “Intellectual Property Rights” or “IPR” means any or all of the following and all statutory and/or common law rights throughout the world in, arising out of, or associated therewith: (a) all patents and applications therefor and all reissues, divisions, renewals, extensions, provisionals, continuations and continuations-in-part thereof and all rights that claim priority therefrom, along with each foreign patent or patent application that shares common disclosure therewith (collectively, “Patents”); (b) all inventions (whether patentable or not), invention disclosures and improvements, all trade secrets, proprietary information, know-how and technology; (c) all works of authorship, copyrights, rights in Mask Works, copyright and Mask Work registrations and applications; (d) all industrial designs and any registrations and applications therefor; (e) all trade names, logos, trademarks and service marks; trademark and service mark registrations and applications (collectively, “Trademarks”); (f) all databases and data collections (including knowledge databases, customer lists and customer databases) and all rights therein; (g) all rights in Software; (h) rights to Uniform Resource Locators, Web site addresses and domain names; (i) any similar, corresponding or equivalent rights to any of the foregoing and (j) all moral and equivalent rights throughout the world.

(aa) “Key Employees” means the Designated Employees listed on Schedule 1.1(n) that are specified as “Key Employees”.

(bb) “Liability” means any liability, duty, obligation or indebtedness (whether known or unknown, whether asserted or unasserted, whether absolute or contingent, whether accrued or unaccrued, whether liquidated or unliquidated, whether incurred or consequential and whether due or to become due), including any liability for Taxes.

(cc) “License Agreement” means that license agreement entered into between Seller and Parent and Buyer effective as of the Closing Date, in the form attached hereto as Exhibit F pursuant to which Seller licenses to Parent and Buyer the Licensed IPR.

(dd) “Licensed IPR” means all Intellectual Property Rights (other than the Assigned IPR) used in or necessary for the operation of the Business.

(ee) “Lien” means any mortgage, pledge, lien, security interest, charge, claim, equity, encumbrance, limitation, restriction on use or transfer, conditional sale or other title retention device or arrangement (including, without limitation, a capital lease), transfer for the purpose of subjection to the payment of any indebtedness, or restriction on the creation of any of the foregoing, whether relating to any property or right or the income or profits therefrom.

(ff) “Loss” means any and all Liabilities, losses, damages, claims, costs and expenses, interest, awards, judgments and penalties (including without limitation legal costs and expenses and interest on the amount of any Loss from the date suffered or incurred).

(gg) “Mask Works” means the physical mask works or reticles for the manufacture or customization of a semiconductor device.

(hh) “Open Source Software” means Software or other material that is distributed as “free software,” “open source software” or under a similar licensing or distribution model (including but not limited to the GNU General Public License (GPL) and GNU Lesser General Public License (LGPL)) that require, as a condition of use, modification and/or distribution of such Open Source Software that other Software incorporated into, derived from or distributed with such Open Source Software be (a) disclosed or distributed in source code form; (b) be licensed for the purpose of making derivative works; or (c) be redistributable at no charge.

(ii) “Patent Family” means a set comprised of all Patents that (a) are directly or indirectly linked or entitled to be linked through one or more Priority Claims or by a terminal disclaimer (including under 35 U.S.C. Sec. 253 or 37 CFR 1.321 or the equivalent laws or regulation of any other patent authority); (b) are foreign counterparts, reissues, divisionals, renewals, extensions, parents, continuations or continuations-in-part with respect to any other Patent in such set; or (c) issue from any of the foregoing.

(jj) “Patent Files” means complete prosecution files for the Assigned Patents, including all correspondence and filings with patent authorities with respect to such Patents and any related materials or documents in the possession or control of Seller or its Affiliates or any attorney or patent agent involved in the prosecution or enforcement of such Patents.

(kk) “Person” means an individual, partnership, corporation, limited liability company, association, joint venture, trust, unincorporated organization or Governmental Entity.

(ll) “Priority Claim” means a claim to priority made in any Patent or Patent application to any other Patent or Patent application pursuant to 35 U.S.C. Secs. 120 or 119(e) or the equivalent claim to priority under the laws and regulations applicable to a foreign Patent or Patent application, as the case may be.

(mm) “Product Software” means all Software that is included in or part of any version of the Transferred Products as firmware or otherwise, or that is part of or related to the use, operation, programming, verification, design, simulation, testing, support or application of a Transferred Product or the reference design related thereto, including the Software listed or described on Schedule 1.1(mm), all versions of any of the foregoing, and any Software from which any of the foregoing Software was derived or that was derived from such Software.

(nn) “Registered IP” means all United States, international and foreign: (a) Patents; (b) registered Trademarks, applications to register Trademarks, intent-to-use applications, or other registrations or applications related to Trademarks; (c) registered copyrights and applications for copyright registration; (d) domain name registrations; and (e) any other Intellectual Property Rights that are the subject of an application, certificate, filing, registration or other document issued, filed with, or recorded by any Governmental Entity.

(oo) “Software” means any and all computer software and code, including assemblers, applets, compilers, source code, object code, data (including image and sound data), design tools and user interfaces, in any form or format, however fixed. Software includes source code listings and documentation.

(pp) “Tax” and “Taxes” means (a) any and all federal, provincial, state, and local taxes in any country worldwide (including estimated taxes), assessments, and other governmental charges, duties, impositions and liabilities, including taxes based upon or measured by gross receipts, income, profits, sales, use and occupation, and value-added, ad valorem, transfer, franchise, withholding, payroll, recapture, employment, excise and property taxes, together with all interest, penalties and additions imposed with respect to such amounts; (b) any liability for the payment of any amounts of the type described in clause (a) of this definition as a result of being a member of an affiliated, consolidated, combined or unitary group for any period; and (c) any liability for the payment of any amounts of the type described in clause (a) or (b) of this definition as a result of any express or implied obligation to indemnify any other person or as a result of any obligations under any agreements or arrangements with any other person or entity with respect to such amounts and including any liability for taxes of a predecessor entity.

(qq) “Technology” means all technology, including all know-how, show-how, techniques, design rules, trade secrets, inventions (whether or not patented or patentable) and invention disclosures, algorithms, routines, Software, files, databases, works of authorship, processes, devices, prototypes, lab notebooks, reference designs, test boards, test fixtures, test programs, development and lab equipment, schematics, netlist, Mask Works, test methodologies, documentation, hardware development tools, any media on which any of the foregoing is recorded, and any other tangible embodiments of any of the foregoing.

(rr) “Transferred Claims” means all rights and claims of Seller or its Subsidiaries related to the Business against any third parties, including all rights under express or implied warranties relating to the Business or the ownership, use, function or value of any Transferred Asset.

(ss) “Transferred Contracts” means those contracts listed on Schedule 1.1(ss), and all open purchase agreements and other agreements to purchase work in progress with respect to the Transferred Products.

(tt) “Transferred Inventory” means any and all inventory, wherever located, including raw materials, work in process, finished products, recycled materials, inventoriable supplies, and spare parts owned by Seller and its Affiliates and related to, used in, or necessary for the operation of the Business, and any rights of Seller and its Affiliates to the warranties received from suppliers of such inventory and any and all rights of Seller and its Affiliates to related claims, credits, rights of recovery and setoff with respect to such inventory, but only to the extent such rights are assignable.

(uu) “Transferred Permits” means all governmental permits and licenses, certificates of inspection, approvals or other authorizations issued to Seller with respect to the Business or the premises used in connection with the Business and necessary for the operation or conduct of the Business as currently conducted under applicable laws.

(vv) “Transferred Personal Property” means any and all personal property (including equipment, computers, servers, machinery, furniture, office equipment, furnishings, office supplies, storage devices, etc.) that are or have been, related to, used in or necessary for the operation of the Business. For the avoidance of doubt, such Transferred Personal Property shall include any personal property related to, used in or necessary for the operation of the Business that was previously provided to Seller under a leasing arrangement that is not covered under a Transferred Contract (e.g. copy machines, phone systems, etc.).

(ww) “Transferred Products” means any and all products, in whatever stage of development and in whatever form, that are (a) designed by or for, or related to, the Business; or (b) otherwise listed or described on Schedule 1.1(ww) and any Product Software that is part of such Transferred Products, and any reference designs or development boards or platforms for such Transferred Products (including boards and systems for the simulation, test or verification of such Products) (x) that are of the type provided to actual or potential purchasers for use with or evaluation of such Transferred Products or (y) otherwise listed or described on Schedule 1.1(ww).

(xx) “Transferred Tangible Assets” means all tangible assets of any type or nature, other than Excluded Assets, that are or have been: (a) used in or necessary for the operation of the Business, including the Transferred Products, Transferred Personal Property and Transferred Inventory; (b) reflected on the Business’s balance sheet, including accounts receivable; or (c) otherwise described on Schedule 1.1(xx).

(yy) “Transferred Technology” means all Technology used in or necessary to the operation of the Business or constituting any of the Transferred Products or otherwise listed or described on Schedule 1.1(yy) and including all (a) know-how and other Technology known by any

and all Designated Employees, whether or not such Technology was reduced to any tangible media on or prior to the Closing Date; (b) copies and versions of the Product Software; (c) Technology that is used in the design, development, manufacture or testing Transferred Products (including all versions of any design tools or development environments used in the design of any Transferred Product); (d) Mask Works, netlists, GERBER files and other representations of any Transferred Product; and (e) files necessary for the operation of the Transferred Websites, including all of the content therein.

(zz) “Transferred Websites” means those Web sites (including content) and the Uniform Resource Locators set forth in Schedule 1.1(zz).

(aaa) Each of the following terms is defined in the Section or Exhibit set forth opposite such term:

<u>TERM</u>	<u>SECTION/EXHIBIT</u>
“Allocation”	Section 2.6
“Assumed Liabilities”	Section 2.3
“Audit Completion Date”	Section 5.3
“Buyer Indemnitee”	Section 8.2
“Buyer Indemnities”	Section 8.2
“Cash Amount”	Section 2.5(a)
“Claim”	Section 8.4(a)
“Closing”	Section 2.1
“Closing Date”	Section 2.1
“COBRA”	Section 6.5
“Collateral Agreements”	Section 2.7(b)
“Conflict”	Section 3.3
“Disclosing Party”	Section 1.1(k)
“Disclosure Schedule”	Article 3
“Employee Excluded Liabilities”	Section 6.6(a)
“Escrow Amount”	Section 2.5(b)
“Excluded Liabilities”	Section 2.4
“Indemnifiable Audit Costs”	Section 5.3
“International Employee Plan”	Section 3.11(a)
“IP Assignments”	Section 2.7(b)
“M&A Qualified Beneficiaries”	Section 6.5
“Multiemployer Plan”	Section 3.11(a)
“Non-Assignable Contract”	Section 5.4
“Non-Paying Party”	Section 2.9(c)
“Patents”	Section 1.1(z)
“Paying Party”	Section 2.9(c)
“Pension Plan”	Section 3.11(a)
“Purchase Price”	Section 2.5(b)
“Receiving Party”	Section 1.1(k)
“Selling Group”	Section 6.5
“Straddle Period Taxes”	Section 2.9(c)

<u>TERM</u>	<u>SECTION/EXHIBIT</u>
“Tax Returns”	Section 2.9
“Termination Date”	Section 9.1
“Trademarks”	Section 1.1(z)
“Transfer Taxes”	Section 2.11
“Transferred Assets”	Section 2.2
“Transition Services”	Section 5.6
“Transition Services Fees”	Section 5.6

Article 2
TRANSFER OF ASSETS

2.1 **Closing.** Subject to the terms hereof, the closing of the transactions contemplated by this Agreement (the “**Closing**”) will take place on a date occurring as promptly as reasonably practicable but no later than two (2) days following the date on which all conditions set forth in **Sections 7.1** and **7.2** have been satisfied or waived, or on such date as may be agreed upon by the Parties (the “**Closing Date**”), at the offices of Wilson Sonsini Goodrich & Rosati, Professional Corporation, 650 Page Mill Road, Palo Alto, CA 94304.

2.2 **Transfer of Assets.** Upon the terms and subject to the conditions set forth in this Agreement, effective as of the Closing Date, Seller shall, and shall cause its Affiliates to, grant, deliver, sell, convey, transfer and assign to Buyer or its Affiliate(s) (with the allocation among such entities to be designated by Buyer) all rights, title and interest in and to the following assets (the “**Transferred Assets**”), free and clear of all Liens:

- (a) the Transferred Tangible Assets;
- (b) the Transferred Contracts;
- (c) the Assigned IPR;
- (d) the Books and Records;
- (e) the Transferred Permits;
- (f) the Transferred Claims;
- (g) the Transferred Websites;
- (h) the Transferred Technology; and
- (i) all goodwill relating to the Business.

For the purposes of this **Section 2.2**, Assigned IPR shall include the right to register, prosecute, maintain or record any of such Intellectual Property Rights with any Governmental Entity and the right to all past and future income, royalties, damages and payments due with respect to such

Intellectual Property Rights, including without limitation rights to damages and payments for past, present or future infringements or misappropriations thereof, as well as all goodwill associated with such Intellectual Property Rights or the Business. Notwithstanding the foregoing transfers, Buyer shall grant to Seller a royalty-free, perpetual, non-exclusive, non-assignable, non-transferable, license (without right to sublicense) under the Assigned Patents to make, use, sell, offer to sell and import any products (and modifications and derivatives thereof) offered by units of Seller other than the IKOR unit Business as of the Closing Date, all of which Seller represents, warrants and covenants are unrelated to and are not and will not be competitive with any products offered or under development by the Business.

2.3 Assumption of Liabilities. Upon the terms and subject to the conditions set forth in this Agreement, effective at the time of the Closing Date, Buyer shall assume the following Liabilities, and only the following Liabilities, of Seller (collectively, the “Assumed Liabilities”):

(a) Liabilities under or arising out of the Transferred Contracts, which are required to be paid or performed from or after the Closing Date, through no act, omission or fault of Seller (other than the Liabilities of Seller under Section 5.4 and Section 5.5).

(b) Liabilities relating to any warranty, returns, refunds, support obligation or similar claims with respect to any Transferred Products sold prior to the Closing Date and required to be performed after the Closing Date, which obligations arise under any Transferred Contract; and

(c) Trade accounts payable of the Business existing on the Closing Date, it being understood that Seller will continue to pay all trade payables at the times and in a manner consistent with prior practices from the Effective Date until the Closing Date.

(d) Liabilities arising out of Parent’s or Buyer’s operation and ownership of the Transferred Assets, but only to the extent such Liabilities accrue after the Closing Date.

2.4 Excluded Liabilities. Notwithstanding the foregoing, unless otherwise expressly set forth in this Agreement and other than the Assumed Liabilities, nothing set forth herein shall constitute the transfer to, or the assumption by, Parent or Buyer of any Liability or Lien of the Seller, including but not limited to the following (collectively, the “Excluded Liabilities”):

(a) any indebtedness of Seller;

(b) any Liability with respect to any Employee who does not accept in writing an offer of employment with Buyer by the Closing Date;

(c) any Liability to an Affiliate of Seller;

(d) any Liability not disclosed on the Disclosure Schedule or the Financial Statements;

(e) Employee Excluded Liabilities;

(f) any Liability related to or arising from any asset that is not a Transferred Asset; or

(g) any Liability of Seller for Taxes for any taxable period, and any Liability for Taxes arising from or attributable to the Business, the Transferred Assets or Seller's operation of the Business for all taxable periods (or portions thereof) ending on or prior to the Closing Date, including any Transfer Taxes for which Seller is liable pursuant to Section 2.11 and the portion of any Straddle Period Taxes allocated to Seller pursuant to Section 2.9(c) (and all Employment Liabilities).

2.5 Payments to Seller. In consideration of the grant, delivery, sale, conveyance, transfer and assignment of the Transferred Assets, and in addition to the assumption of certain Liabilities, upon the terms and subject to the conditions set forth in this Agreement:

(a) At the Closing, Parent shall pay to Seller, in cash by wire transfer of immediately available funds to an account number provided to Parent by the Seller prior to the Closing, a total of \$9,425,000 (the "Cash Amount").

(b) At the Closing, Parent shall deposit \$1,000,000 (the "Escrow Amount," together with the Cash Amount, the "Purchase Price") in the Escrow Fund pursuant to the Escrow Agreement and Section 8.5.

2.6 Allocation of Purchase Price. Within ninety (90) days of the Closing Date, Parent or Buyer shall provide Seller with an allocation of the Purchase Price (and the Assumed Liabilities to the extent properly taken into account) among the Transferred Assets and any other rights acquired hereunder in accordance with Section 1060 of the Code and the regulations promulgated thereunder (the "Allocation") (as adjusted to take into account any indemnity payments pursuant to Article 8). The Parties agree that the amount allocated to the Transferred Personal Property shall be the depreciated book value of such property as of the Closing Date. The Allocation shall be conclusive and binding upon Parent, Buyer and Seller for all purposes, and the parties agree that all returns and reports (including IRS Form 8594) and all financial statements shall be prepared in a manner consistent with (and the Parties shall not otherwise file a Tax Return position inconsistent with) the Allocation unless required by the IRS or any other applicable taxing authority.

2.7 Closing Deliveries: Collateral Agreements.

(a) On the Closing Date, Seller shall, and shall cause its Affiliates to, at Seller's sole cost, in the manner and form and to the locations specified by Buyer, deliver to Buyer all of the Transferred Assets, or in the case of the Assigned IPR or other intangible assets, deliver such instruments as are necessary or desirable to transfer title to such assets from Seller (or its Affiliates) to Buyer. Transfer and delivery of the Transferred Tangible Assets shall include physical or electronic delivery of all Transferred Technology, including delivery or production of Books and Records and other appropriate documentation thereof as reasonably requested by Buyer to facilitate the transfer and operation of the Business. The Parties shall cooperate in good faith to define and transfer such Transferred Technology, but it is understood and acknowledged that Seller is ultimately responsible for delivering all Transferred Tangible Assets. It is further understood and acknowledged that any Transferred Tangible Assets not delivered on the Closing Date shall be held by Seller for and on behalf of Buyer until such time as Buyer is granted possession thereof and that, during that period, Seller shall bear all risk of loss with respect to such Transferred Tangible Assets. To the maximum extent practicable, all Software to be delivered hereunder shall be delivered by

electronic means in a manner specified by Buyer. Seller shall not retain in its possession or control any Transferred Tangible Assets or Transferred Technology or any copy thereof.

(b) On the Closing Date, Seller shall deliver to Buyer (i) the Bill of Sale; (ii) fully executed documents in a form reasonably satisfactory to Parent and Buyer, sufficient to enable transfer of all Assigned IPR and proper recordation thereof in each jurisdiction in which such Assigned IPR exist or have been filed, registered or issued (“IP Assignments”); (iii) the sublease, in the form attached hereto as Exhibit E, covering the space presently occupied by the Business at 4424 Innovation Drive, Fort Collins, Colorado as set forth in Section 7.1(d) hereof; (iv) the Escrow Agreement; (v) the License Agreement; and (vi) any other transfer documents reasonably requested by, and in a form reasonably satisfactory to, Buyer (collectively, the “Collateral Agreements”).

2.8 Further Assurances, Conveyances, Agreement to Perform Necessary Acts.

(a) From time to time following the Closing, Seller and Buyer shall, and shall cause their respective Affiliates to, execute, acknowledge and deliver all such further conveyances, notices, assumptions, releases and acquittances and such other instruments, and shall take such further actions, as may be necessary or appropriate to fully and effectively transfer, assign and convey onto Buyer and its Affiliates and their respective successors or assigns, all of the properties, rights, titles, interests, estates, remedies, powers and privileges intended to be conveyed to Buyer under this Agreement and the Collateral Agreements, to fully and effectively transfer, assign and convey onto Buyer and its Affiliates and their successors and assigns, any Assumed Liabilities and obligations intended to be assumed by Buyer under this Agreement and the Collateral Agreements, to otherwise make effective the transactions contemplated hereby and thereby and to confirm Buyer’s title to or interest in the Transferred Assets, to put Buyer in actual possession and operating control thereof and to assist Buyer in exercising all rights with respect thereto. If it is determined that any material Transferred Asset (including any Patent owned or Controlled by Seller) that falls within the definition of a “Transferred Asset,” was not included on a Schedule and transferred to Buyer as of the Closing, Seller shall promptly, without payment of further consideration by Parent or Buyer, transfer and assign such asset to Seller, which assignment shall be deemed to have been effective as of the Closing Date, and the relevant Schedule shall be amended accordingly.

(b) Seller agrees that, if requested by Parent or Buyer, it will cooperate with Parent or Buyer in enforcing the terms of any agreements between Seller and any third party involving the Business, including without limitation terms relating to confidentiality and the protection of Intellectual Property Rights. In the event that Parent or Buyer is unable to enforce its Intellectual Property Rights against a third party as a result of a rule or law barring enforcement of such rights by a transferee of such rights, Seller agrees to reasonably cooperate with Parent or Buyer by assigning to Parent or Buyer such rights as may be required by Parent or Buyer to enforce its Intellectual Property Rights in its own name. If such assignment still does not permit Parent or Buyer to enforce its Intellectual Property Rights against the third party, Seller agrees to initiate proceedings against such third party in Seller’s name, *provided* that Seller shall be entitled to participate in such proceedings, all at Parent’s or Buyer’s expense.

(c) Following the Closing and without demanding further consideration therefor, Seller shall, and shall cause its Affiliates and its and their Employees (including any named

inventors on any Patents included in the Transferred Assets) and agents, to provide Parent or Buyer with access to relevant information and otherwise to provide Parent or Buyer with reasonable cooperation and assistance in the enforcement or prosecution of any Assigned IPR and the proper recordation of the transfer thereof. Assistance under this Section 2.8 shall include, upon Parent's or Buyer's reasonable request, the execution, acknowledgment and recordation of specific assignments, oaths, declarations and other documents on a jurisdiction-by-jurisdiction and/or a country-by-country basis and such other instruments of sale, transfer, conveyance, and assignment as Parent or Buyer may reasonably request.

(d) Seller hereby grants Parent and Buyer the irrevocable power of attorney to represent Seller, where such representation is legally permissible, without restrictions towards legal entities and natural persons, public authorities and courts, to do, sign under hand (or, as required, under personal seal), deliver, receive and perform all and any acts, matters, statements and things which may be necessary to put Buyer or its Affiliates in ownership, possession, and operating control of the Transferred Assets, including execution, acknowledgment and recordation of specific assignments, oaths, declarations and other documents on a country-by-country basis and such other instruments of sale, transfer, conveyance, and assignment as may be required for this purpose. Under this power of attorney, Parent and Buyer is entitled to enter into transactions on behalf of Seller with itself in its own name or in its capacity as attorney-in-fact of a third party and, therefore, Parent and Buyer are released from any prohibition or restriction of self-dealing which may exist under any applicable law. Parent and Buyer shall be entitled to delegate the rights granted to it by this power-of-attorney and to grant dispensation from any legal prohibition or restriction of self-dealing that may exist. The foregoing power of attorney is coupled with an interest and as of the closing shall be irrevocable. Notwithstanding anything to the contrary in this Section 2.8(d), Parent and Buyer shall not exercise the foregoing power of attorney unless and to the extent Seller does not comply with its obligations under this Section 2.8.

2.9 Responsibility for Taxes and Tax Returns.

(a) Subject to Section 2.9(c) below, Seller will be responsible for the preparation and filing of all returns, estimates, information statements and reports required to be filed with a taxing authority ("Tax Returns") (including Tax Returns required to be filed after the Closing Date), to the extent such Tax Returns include or relate to the operation of the Business or the use or ownership of the Transferred Assets on or prior to the Closing Date. Seller will be responsible for and make all payments of Taxes shown to be due on such Tax Returns to the extent they relate to the Transferred Assets or the Business.

(b) Parent will be responsible for the preparation and filing of all Tax Returns it is required to file with respect to Buyer's ownership or use of the Transferred Assets or its operation of the Business attributable to taxable periods (or portions thereof) commencing after the Closing Date. Parent will make all payments of Taxes shown to be due on such Tax Returns to the extent they relate to the Transferred Assets or the Business.

(c) In the case of any real or personal property taxes (or other similar Taxes) attributable to the Transferred Assets for which Taxes are reported on a Tax Return covering a period commencing before the Closing and ending thereafter (a "Straddle Period Tax"), any such Straddle Period Taxes shall be prorated between Parent and Seller on a per diem basis. The party

required by law to pay any such Straddle Period Tax (the “Paying Party”) shall file the Tax Return related to such Straddle Period Tax within the time period prescribed by law and shall timely pay such Straddle Period Tax. To the extent any such payment exceeds the obligation of the Paying Party hereunder, the Paying Party shall provide the other party (the “Non-Paying Party”) with notice of payment, and within ten (10) days of receipt of such notice of payment, the Non-Paying Party shall reimburse the Paying Party for the Non-Paying Party’s share of such Straddle Period Taxes.

(d) To the extent relevant to the Business or the Transferred Assets, each Party shall (a) provide the other with such assistance as may reasonably be required in connection with the preparation of any Tax Return and the conduct of any audit or other examination by any taxing authority or in connection with judicial or administrative proceedings relating to any liability for Taxes and (b) retain and provide the other with all records or other information that may be relevant to the preparation of any Tax Returns, or the conduct of any audit or examination, or other proceeding relating to Taxes. Seller shall retain all documents, including prior years’ Tax Returns, supporting work schedules and other records or information with respect to all sales, use and employment tax returns and, absent the receipt by Seller of the relevant tax clearance certificates, shall not destroy or otherwise dispose of any such records for six (6) years after Closing Date without the prior written consent of Parent or Buyer.

2.10 Withholding Rights. Parent shall be entitled to deduct and withhold from the consideration otherwise payable pursuant to this Agreement such amounts as Parent is required to deduct and withhold with respect to the making of such payment under the Code or any provision of state, local or foreign Tax law. To the extent that amounts are so withheld by Parent, such withheld amounts shall be treated for all purposes of this Agreement as having been paid to Seller.

2.11 Transfer Taxes . All sales, use, value-added, gross receipts, excise, registration, stamp duty, transfer or other similar taxes or governmental fees (“Transfer Taxes”) imposed or levied by reason of, in connection with or attributable to this Agreement and the transactions contemplated hereby shall be borne by Seller; provided, however, the sales tax on the transfer of the Transferred Personal Property to Buyer pursuant to this Agreement by the state of Colorado shall be shared equally by Seller and Parent. The Parties shall cooperate with each other to the extent reasonably requested and legally permitted to minimize any such Transfer Taxes. The Party required by law to file a Tax Return with respect to such Transfer Taxes shall do so within the time period prescribed by law, and the other Party shall reimburse the filing Party for its share of such tax upon receipt of notice that such Transfer Taxes have been paid.

Article 3 **REPRESENTATIONS AND WARRANTIES OF SELLER**

Seller represents and warrants to Parent and Buyer, subject to such exceptions as are specifically set forth in the disclosure schedule (referencing the appropriate Section numbers) attached hereto as Exhibit C (the “Disclosure Schedule”) and dated as of the Closing Date, as follows. Nothing in the Disclosure Schedule shall be deemed adequate to disclose an exception to a representation or warranty made herein, however, unless the Disclosure Schedule identifies the exception with reasonable particularity and describes the relevant facts in reasonable detail. Without

limiting the generality of the foregoing, the mere listing (or inclusion of a copy) of a document or other item shall not be deemed adequate to disclose an exception to a representation or warranty made herein unless the representation or warranty has to do with the existence of the document or other item itself.

3.1 Organization of Seller. Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware and has full power and authority (corporate and governmental) to conduct the Business as it is presently being conducted and to own and lease its properties and assets including the Transferred Assets. Seller is duly qualified to do business as a foreign corporation and is in good standing in each jurisdiction where the character of its properties owned or leased or the nature of its activities make such qualification necessary, except where the failure to be so qualified or in good standing would not, either individually or in the aggregate, have a material adverse effect on the Transferred Assets or Business.

3.2 Authorization of Transaction. Seller has all requisite corporate power and authority to enter into this Agreement, the Collateral Agreements and all related agreements and instruments to be executed and delivered by Seller and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement, the Collateral Agreements and all related agreements and instruments to be executed and delivered by Seller and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all other necessary corporate action on the part of Seller. The signatory officers of Seller have the power and authority to execute and deliver this Agreement and the Collateral Agreements and to consummate the transactions contemplated hereby and thereby and to take all other actions required to be taken by Seller pursuant to the provisions hereof and thereof. This Agreement and the Collateral Agreements have been duly executed and delivered by Seller and constitute the legal, valid and binding obligation of Seller, enforceable in accordance with their terms, except as such enforceability may be subject to the laws of general application relating to bankruptcy, insolvency and the relief of debtors and rules of law governing specific performance, injunctive relief or other equitable remedies.

3.3 Non-contravention; Consents.

(a) None of the execution, delivery or performance of this Agreement or the Collateral Agreements, the consummation of the transactions contemplated hereby or thereby, nor compliance by Seller with any of the provisions hereof or thereof, will, with or without the passage of time or the delivery of notice or both, (a) violate or conflict with any terms, conditions or provision of the certificate of incorporation or bylaws, each as in effect, of Seller, (b) violate, conflict with, result in a breach of or constitute a default under, or result in the termination of, or accelerate the performance required by, or result in a right to terminate, accelerate or modify under, or require a notice under, or result in the creation of any Lien upon any of the Transferred Assets under any contract, lease, sublease, license, sublicense, franchise, patent, permit, indenture, agreement for borrowed money or mortgage, instrument of indebtedness, security interest or other arrangement to which Seller or any Affiliate of Seller is a party or by which it is bound or to which any of its assets are subject, (c) violate any statute, ordinance, law, rule, regulation, order, writ, injunction or decree of any Governmental Entity, or (d) impose any Lien on any Transferred Assets or the Business (any such event, a "Conflict").

(b) Except as set forth on Schedule 3.3(b), no consent, waiver, or order of, or registration, declaration or filing with, any Governmental Entity or any third party is required by or with respect to Seller or any of its Affiliates in connection with the execution and delivery of this Agreement or the Collateral Agreements or the consummation of the transactions contemplated hereby or thereby.

(c) There is no agreement (not to compete or otherwise), commitment, judgment, injunction, order or decree to which Seller or any Affiliate of Seller is a party or otherwise binding upon Seller or any of its Affiliates which has or may have the effect of prohibiting the transactions contemplated by this Agreement or the Collateral Agreements or impairing the Business or the Transferred Assets or the value thereof in any material respect. Neither Seller nor any Affiliate of Seller has entered into any agreement that restricts Seller or any of its Affiliates with respect to selling, licensing or distributing the Transferred Products, providing services related to the Transferred Products, or otherwise conducting the Business.

3.4 Title of Properties; Absence of Liens and Encumbrances; Condition. Seller has good and valid title to all of the Transferred Assets and the unrestricted power and the unqualified right to sell, assign and deliver to Buyer the Transferred Assets free and clear of any Liens, and at Closing Seller will transfer to Buyer good, valid and marketable title to all of the Transferred Assets free and clear of any Liens. To the knowledge of the Seller, no basis exists for the assertion of any claim which, if adversely determined, would result in a Lien on any Transferred Asset or result in a material adverse effect. The Transferred Tangible Assets are (i) adequate for the conduct of the Business by Seller as currently conducted and as currently contemplated to be conducted, and (ii) in good operating condition, regularly and properly maintained, subject to normal wear and tear. Except as set forth on Schedule 3.4, Seller is in custody and control of all the Transferred Assets being sold and transferred by Seller to Buyer pursuant to this Agreement and the Collateral Agreements.

3.5 Intellectual Property Rights.

(a) Schedules. All schedules referenced in this Section 3.5 are complete and accurate in all material respects.

(b) Assigned IPR. Schedule 3.5(b) lists all Transferred Assets that are Registered IP, including the Assigned Patents and Assigned Trademarks. All such Registered IP is currently in compliance with formal legal requirements (including payment of filing, examination and maintenance fees and proofs of use), and is not subject to any unpaid maintenance fees or taxes or actions falling due within one hundred twenty (120) days after the date hereof. All Assigned IPR is, to the best of Seller's knowledge, valid and subsisting and is free and clear of all Liens. There are no proceedings or actions known to Seller before any court, tribunal (including the United States Patent and Trademark Office or equivalent authority anywhere in the world) related to any such Assigned IPR. Seller has not made any misrepresentations to any Governmental Entity in the prosecution and maintenance of any Transferred Assets that are Registered IP, or otherwise impaired the enforceability of such Registered IP through action or inaction. Immediately prior to the Closing, all Assigned Patents are solely and exclusively owned by Seller, and all assignments of the Assigned Patents (from the inventors thereof and any and all intermediate assignees) are effective and have been properly recorded with the appropriate Governmental Entity. The Assigned

IPR transferred to Buyer and the Licensed IPR hereunder constitute all of the Intellectual Property Rights of Seller, which absent such transfer would be infringed by the operation of the Business by Parent or Buyer following the Closing in the manner the Business as conducted by Seller immediately prior to the Closing.

(c) Non-Infringement. To the best of Seller's knowledge, neither (i) the Transferred Assets when Exploited by Buyer after the Closing (including the development, use, distribution, sales, licensing and support of the Transferred Products), nor (ii) conduct of the Business or the use of Transferred Assets or Licensed IPR by Seller prior to the Closing will or did: (A) infringe or misappropriate the Intellectual Property Rights of any Person, (B) violate the rights of any Person (including rights to privacy or publicity), or (C) constitute unfair competition or trade practices under the laws of any jurisdiction. Neither Seller nor any of its Affiliates have received notice from any Person claiming or alleging any such infringement, misappropriation, or violation. To the best of Seller's knowledge, there has been and is no unauthorized use, disclosure, infringement or misappropriation of any Assigned IPR by any person or entity, including any employee or former employee of Seller. Seller has not brought any action, suit or proceeding for infringement of Assigned IPR against any third party and does not currently have any plans to do so.

(d) Ownership. Seller owns and has the right to transfer ownership to Buyer of all Assigned IPR and Transferred Technology free and clear of all Liens. Following the Closing, Buyer will own exclusively all such Transferred Technology and Assigned IPR except pursuant to non-exclusive licenses pursuant to the Transferred Contracts. All of the Transferred Technology and the Intellectual Property Rights therein and thereto, either (i) were created by an Employee of Seller, within the scope of that Employee's employment, such that ownership of and all Intellectual Property Rights in and to the Transferred Assets has vested in Seller pursuant to a written agreement under which the Employee agreed to assign ownership of all inventions to Seller, or (ii) were created by another Person exclusively for Seller, and Seller has a written agreement with that Person that has been provided to Buyer under which Seller has obtained ownership of, and is the exclusive owner of, all such Transferred Technology and Intellectual Property Rights. Seller has taken all steps that are reasonably required to protect Seller's rights in confidential information and trade secrets of Seller or provided by any other person to Seller, including entering into a binding proprietary information, confidentiality and assignment agreement with each of its current and former Employees, consultants and contractors, each of which have been provided to Buyer. Except with respect to any individuals separately identified on Schedule 3.5(d), all current and former employees, consultants and contractors of Seller who have created or modified any of the Transferred Technology have executed such an agreement assigning all of such employees', consultants' and contractors' rights in and to the Transferred Technology and the Intellectual Property Rights to Seller. With respect to any individuals identified on Schedule 3.5(d), the description of such individual's activities related to the Transferred Technology and Intellectual Property Rights provided in Schedule 3.5(d) is accurate and complete in all material respects. Except as set forth in Schedule 3.5(d), neither Seller nor any of its Affiliates has transferred ownership of or, granted any exclusive licenses to, any Intellectual Property Rights of Seller or any of its Affiliates otherwise required to be transferred to Buyer as a Transferred Asset.

(e) Transferred Products and Product Software.

(i) Schedule 1.1(ww) together with Schedule 3.5(e) is a complete and accurate list of all Transferred Products that are or have been sold or offered for sale by Seller or its Affiliates in the five year period prior to the Effective Date or that are currently under development by Seller or any of its Affiliates.

(ii) Seller has taken reasonable steps and implemented reasonable procedures (based on standard industry practices) to ensure that the Transferred Products are free from defects, bugs, viruses and other disabling codes that would have an adverse effect on the Transferred Products, and Seller has disclosed to Parent and Buyer all information about material defects, bugs, viruses and other disabling codes in the Transferred Products about which Seller has knowledge, and has used a system and a procedure for tracking those bugs, the results of which have been shared with Parent and Buyer and are included in the Transferred Assets. Each of the Transferred Products complies in all material respects with the specifications therefor. There are no defects or errors in any of the designs for any of the Transferred Products. All of the Transferred Products when manufactured in accordance with the design and specifications therefor will be free from defects.

(iii) To the extent the Transferred Products or other Transferred Technology include or incorporate any open source, public source or freeware code, or any modification or derivative thereof, including any version of any Open Source Software, Seller has disclosed and described to Parent and Buyer, in writing, the manner in which such Open Source Software is incorporated or included. No third party possesses any copy of any material source code to any Product Software or other Software included in the Transferred Assets. Other than as explicitly set forth in Section 2.8, as of the Closing Seller will have delivered to Parent and Buyer, and neither Seller nor any of its Affiliates will have retained any copy of, any source code to any Product Software or other material Software included in the Transferred Assets.

(iv) With respect to Transferred Products in commercial production as of the Closing Date, all design databases, GERBER files and other information necessary to manufacture, design, test and simulate, and necessary for the verification of, all of such Transferred Products will correspond in all material respects (except with respect to the GERBER files which shall correspond exactly) to such Transferred Products at the time of the relevant Closing. Schedule 1.1(mm) lists any Product Software and other material Software that is included in or part of the current version of the Transferred Products as firmware or otherwise or that is part of, used in or necessary to the use, operation, programming, verification, testing, support or application Software of any Transferred Product or the reference design related thereto that is owned by a third Person, and neither Seller nor its Affiliates is a party or subject to any contract, license or agreement with respect to such Product Software or other material Software except as set forth on Schedule 3.5(f)(i).

(f) Agreements.

(i) Schedule 3.5(f)(i) lists all contracts, licenses or agreements to which Seller or any Affiliate of Seller is a party (A) related to the licensing to, or acquisition of, any third party Intellectual Property Rights or Technology related to or used in the Business or incorporated

into the Transferred Products or (B) related to the sale or licensing of any Assigned IPR, including any covenants not to sue thereunder, other than non-exclusive object code-only licenses granted by Seller in the ordinary course and *provided* that forms of such licenses have been provided to Parent and Buyer. There are no contracts, licenses or agreements between Seller and any other Person with respect to the Transferred Assets under which there is any dispute or, to the knowledge of Seller, any threatened dispute regarding the scope of such agreement or performance under such agreement.

(ii) Neither this Agreement nor the transactions contemplated by this Agreement, including the assignment to Buyer, by operation of law or otherwise, of any contracts or agreements to which Seller is a Party, will result, under the terms of any contract, license or agreement of Seller, in (A) Buyer granting to any third party any right to or with respect to any Technology or Intellectual Property Rights Right owned by, or licensed to, Buyer, (B) Parent or Buyer being bound by, or subject to, any non-compete or other restriction on the operation or scope of its businesses, or (C) Parent or Buyer being obligated to pay any royalties or other amounts to any third party in excess of those payable by Parent or Buyer upon Closing.

(iii) The Transferred Contracts when transferred to Buyer in accordance with Section 2.8 will confer and grant to Buyer all rights and licenses with respect to third party Intellectual Property Rights and Technology previously licensed to Seller under such agreements that are necessary to enable Parent or Buyer to operate the Business following the Closing without infringing the Intellectual Property Right or incurring any liability to such third parties (other than as expressly set forth in such Transferred Contracts).

(g) Standards Bodies. Schedule 3.5(g) lists all industry standards bodies or similar organizations related to the Business or Transferred Assets to which Seller or its Affiliates participates and has or is required to contribute or disclose any Technology or Intellectual Property Rights related to the Business or the Transferred Assets.

3.6 Brokers' and Finders' Fees. Except as set forth on Schedule 3.6, neither Seller nor any of its Affiliates has employed any broker or finder or incurred, nor will they, Parent or Buyer (except for Parent or Buyer with respect to any such person engaged directly by Parent or Buyer) incur, directly or indirectly, any liability for brokerage or finders' fees or agents' commissions or any similar charges in connection with the Agreement or any transaction contemplated hereby.

3.7 Legal and Other Compliance. Seller and each Affiliate of Seller have been and are in compliance with all applicable laws (including rules, regulations, codes, plans, injunctions, judgments, orders, decrees, rulings, and charges thereunder) of Governmental Entities applicable to the Business, Transferred Assets, and Designated Employees, and no action, suit, proceeding, hearing, investigation, charge, complaint, claim, demand, or notice alleging any failure to so comply has been made, filed or commenced. Neither Seller nor any Affiliate of Seller holds, nor is it required by any applicable law, rule or regulation of any Governmental Entity to hold, any permits, government approvals, licenses, registrations, clearances, authorizations or consents necessary for the conduct of the Business.

3.8 Transferred Assets and Transferred Technology. The Transferred Assets comprise all of the tangible and intangible assets, properties and rights of every type and description (other than real property) used in or necessary to the operation of the Business and are sufficient for the

operation of the Business by Parent and Buyer following the Closing in the manner the Business was conducted by Seller immediately prior to the Closing. The Transferred Technology comprises all of the Technology used in or necessary to the operation of the Business by Parent and Buyer following the Closing in the manner the Business was conducted by Seller immediately prior to the Closing. Neither Seller nor any Affiliate of Seller has made or entered into any agreement, written or oral, to sell or transfer any part of the Transferred Assets, or has sold or transferred any part of the Transferred Assets, to any party other than Parent and Buyer.

3.9 Environmental Matters. No Hazardous Materials are present in, on or under any property, including the land and the improvements, ground water and surface water thereof, that Seller or any of its Affiliates has at any time owned, operated, occupied or leased in connection with operation of the Business. Neither Seller nor any of its Affiliates have, in connection with operation of the Business, transported, stored, used, manufactured, disposed of, released or exposed its Employees or others to Hazardous Materials or any product containing a Hazardous Material in violation of any rule, regulation, treaty or statute promulgated by any Governmental Entity in effect prior to or as of the Effective Date. No action, proceeding, revocation proceeding, amendment procedure, writ, injunction or claim is pending or, to the knowledge of Seller or any of its Affiliates, threatened concerning any activities of Seller or any of its Affiliates related to Hazardous Materials in connection with operation of the Business. Neither Seller nor any of its Affiliates have knowledge of any fact or circumstance which could involve any Person in any environmental litigation or impose upon any Person any environmental liability in connection with operation of the Business.

3.10 Litigation. There are no claims, actions, suits, inquiries, proceedings or investigations against Seller or any of its Affiliates relating to the Business, the Designated Employees or the Transferred Assets which are currently pending or, to Seller's knowledge, threatened, at law or in equity or before or by any Governmental Entity. There are no grievance or arbitration proceedings pending or, to Seller's knowledge, threatened. There are no judgments, orders, decrees, citations, fines or penalties heretofore assessed against Seller or any of its Affiliates affecting or involving the Business, the Designated Employees or the Transferred Assets under any foreign, federal, state, provincial or local law.

3.11 Employment Matters.

(a) Definitions. The following terms, when used in this Section 3.11, shall have the following meanings:

(i) "International Employee Plan" shall mean each Benefit Plan that has been adopted or maintained by Seller or any ERISA Affiliate, whether informally or formally, or with respect to which Seller or any ERISA Affiliate will or may have any liability, for the benefit of Employees who perform or performed services outside the United States.

(ii) "Multiemployer Plan" means any Pension Plan which is a "multiemployer plan," as defined in Section 3(37) of ERISA.

(iii) "Pension Plan" shall mean each Benefit Plan which is an "employee pension benefit plan," within the meaning of Section 3(2) of ERISA.

(b) Designated Employees and Key Employees. Schedule 1.1(n) contains a complete and accurate list of the Employees and shows: (i) Employee name, position held, annual base salary, target incentive compensation and equity compensation; (ii) net credited service date; (iii) vacation eligibility for calendar year 2005; (iv) visa status; (v) leave status (including type of leave, expected return date for non-disability related leaves and expiration dates for disability leaves); and (vi) the name of any union, collective bargaining agreement or other similar labor agreement covering such Employee.

(c) Pension and Benefit Plans.

(i) Neither Seller nor any ERISA Affiliate has ever maintained, established, sponsored, participated in, contributed to, or had or could have any obligation to, any (A) Pension Plan which is subject to Part 3 of Subtitle B of Title I of ERISA, Title IV of ERISA or Section 412 of the Code, (B) multiple employer plan or to any plan described in Section 413 of the Code, or (C) Multiemployer Plan. The Seller does not now, nor has it ever had the obligation to, maintain, establish, sponsor, participate in, or contribute to any International Employee Plan.

(ii) Section 3.11(c)(ii) of the Disclosure Schedule contains a complete list of all Benefit Plans for which Employees are eligible or that that currently provide, or have provided, benefits to Employees. Seller and, as applicable, its ERISA Affiliates, are in material compliance with Benefit Plan terms and all applicable laws for each Benefit Plan including, but not limited to, ERISA and the Code.

(d) No Post-Employment Obligations. No Benefit Plan provides, or has any liability to provide, life insurance, medical or other employee benefits to any current or former Employee upon his or her retirement or termination of employment for any reason, except as may be required by statute, and neither Seller nor any of its ERISA Affiliates has ever represented, promised or contracted (whether in oral or written form) to any Employee (either individually or to Employees as a group) that such Employee(s) would be provided with life insurance, medical or other employee welfare benefits upon their retirement or termination of employment, except to the extent required by statute.

(e) Employment Matters. Seller and its ERISA Affiliates: (i) are in compliance with all applicable federal, state and local laws, rules and regulations respecting employment, employment practices, terms and conditions of employment and wages and hours, in each case, with respect to Employees; (ii) have withheld and reported all amounts required by law or by agreement to be withheld and reported with respect to the wages, salaries and other payments to Employees by virtue employment, the transactions specifically contemplated by this Agreement or otherwise; (iii) are not liable for any arrears of wages or any taxes or any penalty for failure to comply with any of the foregoing; and (iv) are not liable for any payment to any trust or other fund or to any governmental or administrative authority, with respect to unemployment compensation benefits, social security or other benefits or obligations for Employees (other than routine payments to be made in the normal course of business and consistent with past practice). There are no pending or, to the knowledge of Seller or any ERISA Affiliate, any threatened or reasonably anticipated claims or actions against Seller or any ERISA Affiliate under any worker's compensation policy or long-term disability policy with respect to any Employees.

(f) Labor. No work stoppage or labor strike against Seller or any ERISA Affiliate is pending, threatened or reasonably anticipated with respect to the Business. Seller does not know of any activities or proceedings of any labor union to organize any current Employees (including Designated Employees). There are no actions, suits, claims, labor disputes or grievances pending, or, to the knowledge of Seller, threatened or reasonably anticipated relating to any labor, safety or discrimination matters involving any Employee (including Designated Employees), including, without limitation, charges of unfair labor practices or discrimination complaints, which, if adversely determined, would, individually or in the aggregate, result in any material liability to Seller or any of its subsidiaries. Neither Seller nor any of its subsidiaries has engaged in any unfair labor practices within the meaning of the National Labor Relations Act. Seller is not presently, nor has it been in the past, a party to, or bound by, any collective bargaining agreement or union contract with respect to Employees (including Designated Employees) and no collective bargaining agreement is being negotiated with respect to Employees (including Designated Employees).

(g) No payment or benefit which will or may be made by Seller or its ERISA Affiliates with respect to any Employee or any other “disqualified individual” (as defined in Code Section 280G and the regulations thereunder) will be characterized as a “parachute payment,” within the meaning of Section 280G(b)(2) of the Code.

3.12 Bulk Transfer Laws. There are no current or past creditors of Seller to whom any law, rule or regulation requires the delivery of notice or from whom any form of consent is required in conjunction with undertaking the transactions contemplated by this Agreement, and the “bulk transfer laws” of any state in which the Transferred Assets are located do not apply to the transfer of those Transferred Assets under this Agreement.

3.13 Business Financial Information.

(a) Seller has delivered to Parent and Buyer, and Schedule 3.13(a) contains, true, correct and complete copies of (i) the unaudited partial balance sheet of the Business at September 30, 2005 which includes only the categories of Transferred Assets and Assumed Liabilities as of such date and (ii) unaudited statements of revenue and direct expenses of the Business for the year ended December 31, 2004 and the nine months ended September 30, 2005 (the “Financial Statements”). The Financial Statements were compiled from books and records regularly maintained by management of Seller used to prepare financial statements of Seller and fairly present the financial condition and results of operations at the date and for the periods covered thereby.

(b) Since September 30, 2005, there has not occurred any event or condition of any character that has had or is reasonably likely to have a material adverse effect on the Business, the Transferred Products or the Transferred Assets, or any damage, destruction or loss, whether or not covered by insurance.

(c) Except as and to the extent reflected on the Financial Statements or on Schedule 3.13(c), Seller does not have Liabilities that are within the definition of Assumed Liabilities and are of a nature customarily reflected on a balance sheet. The amount of Seller’s warranty obligations with respect to the Transferred Products sold by Seller prior to Closing Date does not exceed \$75,000.

3.14 Contracts; No Defaults.

(a) Contracts. Schedule 3.14(a) sets forth a complete and accurate list, with respect to the Business, the Transferred Assets and the Designated Employees, of each agreement, contract, understanding or commitment (including, without limitation, any of the Transferred Contracts) entered into by Seller or any of its Affiliates with respect to the Business or the Transferred Assets.

(b) Defaults. Neither Seller nor any Affiliate of Seller is in default under or with respect to any judgment, order, writ, injunction or decree of any Governmental Entity. There does not exist any default by Seller or, to the knowledge of Seller, by any other Person, or event that, with notice or lapse of time, or both, would constitute a default under any agreement, contract, understanding or commitment (including, without limitation, any of the Transferred Contracts) entered into by Seller or any of its Affiliates with respect to the Business or the Transferred Assets, and no notices of breach thereof have been received by Seller or any of its Affiliates. Except as set forth on Schedule 3.14(b), neither the Seller nor any Affiliate of Seller is a party to or bound by any agreement, contract, understanding, or commitment with respect to the Business or the Transferred Assets which is not immediately terminable by Seller without penalty. Each of the Transferred Contracts is fully assignable to Buyer without giving rise to any obligation, loss of rights or penalty and when assigned to Buyer, shall place Buyer in the position of Seller (or its Affiliate) under the terms of such Transferred Contract.

3.15 Warranties; Defects; Liabilities. Each Transferred Product manufactured, sold, licensed, leased or delivered by Seller, and all services performed by Seller, have been in conformity with all applicable contractual commitments and all express and implied warranties except where the failure to be in such conformity would not have a material adverse effect. Except for Seller's standard product warranty, the Seller has no Liability (and to the knowledge the Seller, there is no current reasonable basis for any present or future action, suit, proceeding, hearing, investigation, charge, complaint, claim or demand against any of them giving rise to any Liability) for replacement or repair thereof or other damages in connection therewith. No Transferred Product manufactured, sold, licensed, leased, or delivered by Seller, and no service performed by Seller, is subject to any guaranty, warranty or other indemnity beyond the applicable standard terms and conditions of sale, license or lease or beyond that implied or imposed by applicable law. Schedule 3.15 includes copies of the standard terms and conditions of license or services for Seller (each Contract setting forth such standard terms and conditions for licensing a Transferred Product shall be referred to herein as a "Standard Product License Agreement") and sets forth all Contracts under which Seller has manufactured, sold, or licensed Transferred Products or performed services or provided any guaranty, warranty or indemnity to a third party in connection therewith which contains terms that materially deviate from such standard terms and conditions.

3.16 Insurance. There is no claim by Seller pending under any insurance policy or fidelity bond covering the Business, the Transferred Products or the Transferred Assets. All premiums payable under all such policies and bonds have been paid, and Seller is otherwise in compliance with the terms of such policies and bonds. To the knowledge of the Seller, such policies of insurance and bonds are of the type and in amounts customarily carried by persons conducting businesses similar to those of Seller in the jurisdictions in which Seller operates.

3.17 Tax Matters.

(a) To the extent relevant to the Transferred Assets or the Business, Seller has prepared and timely filed all required Tax Returns relating to any and all Taxes concerning or attributable to the Seller and such Tax Returns are true and correct and have been completed in accordance with applicable law.

(b) To the extent failure to do so could adversely impact Parent or Buyer, the Business, the Transferred Assets, or Parent's or Buyer's use or ownership of the Transferred Assets or operation of the Business, Seller has timely paid all Taxes it is required to pay and has timely withheld and paid over to the appropriate Governmental Entity all income taxes, social security and national insurance contributions and other Taxes required to be withheld.

(c) Neither Parent nor Buyer shall have any liability or obligation, nor shall Parent or Buyer incur any loss, expense or cost, and none of the Transferred Assets shall be subject to any Liens, by reason of any Taxes arising out of (i) the Business as conducted by Seller prior to the consummation of the sale hereunder of the Transferred Assets or (ii) any other operations or activities of Seller whether conducted prior to the date hereof or hereafter. Seller is not aware of, and has no knowledge of a factual basis for the assertion of, any claim for Taxes for which Parent or Buyer would become liable as a result of the transactions contemplated by this Agreement.

(d) To the extent failure to do so could adversely impact Parent or Buyer, the Business, the Transferred Assets, or Parent's or Buyer's use or ownership of the Transferred Assets or operation of the Business, as of the Closing Date, Seller will not be delinquent in the payment of any Tax, nor will there be any Tax deficiency outstanding, assessed or proposed against Seller.

(e) Seller has not executed any waiver of any statute of limitations on or extending the period for assessment or collection of any Tax.

(f) No audit or other examination of any Tax Return of Seller's with respect to the Business or Transferred Assets is presently in progress, nor has any Seller been formally or informally notified of any request for such an audit or other examination.

3.18 Accounts Receivable. All of the accounts receivable of the Business (a) arose from bona fide sales transactions in the ordinary course of business, and are payable on ordinary trade terms, (b) are legal, valid, and binding obligations of the respective debtors enforceable in accordance with their respective terms, (c) are not subject to any valid set-off or counterclaim, and (d) do not represent obligations for goods sold on consignment, on approval or on a sale-or-return basis or subject to any other repurchase or return arrangement. No person has any Lien on any accounts receivable of the Business and no request or agreement for deduction or discount has been made with respect to any accounts receivable of the Business.

3.19 Inventory. The Transferred Inventory is of a quality and quantity usable and salable in the ordinary course of business. All items included in the Transferred Inventory of the Business are the property of the Seller, free and clear of any Lien, have not been pledged as collateral, are not held on consignment from others and conform in all material respects to all standards applicable to such Transferred Inventory and its use or sale imposed by any Governmental Entity.

3.20 Representations and Disclosures Complete. Seller is not aware of any facts or circumstances that affect the Business, the Transferred Assets or the Designated Employees in a material adverse manner or that are reasonably likely to affect the Business, the Transferred Assets or the Designated Employees in a material adverse manner. None of the representations or warranties made by Seller (as modified by the Disclosure Schedule), nor any statement made in any Schedule, Exhibit, agreement or certificate furnished by Seller pursuant to this Agreement, contains or will contain at the Closing any untrue statement of a material fact, or omits or will omit at the Closing to state any material fact necessary in order to make the statements contained herein or therein, in light of the circumstances under which made, not misleading. Seller has delivered or made available true and complete copies of each existing document that has been requested by Parent, Buyer or its counsel.

Article 4
REPRESENTATIONS AND WARRANTIES OF PARENT AND BUYER

Parent and Buyer represent and warrant to Seller as follows:

4.1 Organization. Parent is duly organized, validly existing, and in good standing under the laws of the jurisdiction of the State of California. Buyer is duly organized, validly existing, and in good standing under the laws of the jurisdiction of the State of Delaware.

4.2 Authority for Agreement. Parent and Buyer have all requisite corporate power and authority to enter into this Agreement, the Collateral Agreements to which Parent and Buyer are a party and all related agreements and instruments to be executed and delivered by Parent and Buyer and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement, the Collateral Agreements to which Parent and Buyer are a party and the related agreements and instruments and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of Parent and Buyer. This Agreement has been duly executed and delivered by Parent and Buyer and constitutes, and the related agreements and instruments, when duly executed and delivered by Parent and Buyer, will constitute the valid and binding obligations of Parent and Buyer, enforceable in accordance with their terms, except as such enforceability may be subject to the laws of general application relating to bankruptcy, insolvency and the relief of debtors and rules of law governing specific performance, injunctive relief or other equitable remedies.

4.3 Noncontravention(a) . As of the Closing Date, neither the execution and the delivery of this Agreement, the related agreements and instruments to be executed and delivered by Parent and Buyer nor the consummation of the transactions contemplated hereby or thereby, will (a) violate any provision of the certificate of incorporation or bylaws, each as in effect, of each of Parent and Buyer or (b) Conflict with any material agreement, contract, lease, license, instrument, or other arrangement to which Parent and Buyer are a party or by which it is bound or to which any of its assets is subject except for such Conflicts which would not, either individually or in the aggregate, have a material adverse effect on Parent and Buyer.

Article 5
ADDITIONAL AGREEMENTS OF THE PARTIES

5.1 Operation of the Business.

(a) Between the Effective Date and the Closing Date, unless otherwise agreed in writing in advance by Parent or Buyer, Seller shall: (i) except as otherwise allowed or required pursuant to the terms of this Agreement, conduct the Business in the usual, regular and ordinary course in substantially the same manner as heretofore conducted; (ii) pay the debts, trade payables and Taxes of the Business when due and in a manner consistent with prior practices; (iii) pay or perform other obligations of the Business when due; (iv) preserve intact the current business organization of Seller relating to the Business, keep available the services of the Designated Employees, and maintain the relations and goodwill with the suppliers, customers, distributors, licensors, licensees, landlords, trade creditors, Employees, agents, and others having business relationships with Seller relating to the Business, with the goal of preserving unimpaired the goodwill and ongoing business of the Business; (v) maintain all of the Transferred Assets in their current condition, ordinary wear and tear excepted, and, in the event of any damage to or destruction of any of the Transferred Assets prior to the Closing Date, promptly replace, repair or restore such Transferred Assets; (vi) promptly notify Parent and Buyer in writing of any event or occurrence not in the usual, regular and ordinary course of the operation of the Business, or that has resulted, will result, or is reasonably likely to result, in the failure to satisfy any of the conditions specified in this Section 5.1 hereof;

(b) Except as otherwise expressly permitted by this Agreement, between the Effective Date and the Closing Date, Seller will not, without the prior written consent of Parent or Buyer:

(i) sell, lease or otherwise transfer or dispose of, or enter into any outbound license agreement with respect to any of the Transferred Assets;

(ii) take any action to impair, encumber, create a Lien against or otherwise adversely affect the Transferred Assets;

(iii) revalue any of the Transferred Assets, including without limitation writing down the value of any inventory;

(iv) amend or modify, or violate the terms of, any of the Transferred Contracts;

(v) make or change any election in respect of Taxes, adopt or change any accounting method in respect of Taxes, enter into any closing agreement, settle any claim or assessment in respect of Taxes, or consent to any extension or waiver of the limitation period applicable to any claim or assessment in respect of Taxes, in each case relating to the Business, the Transferred Products or the Transferred Assets;

(vi) create, incur or assume any Liability that would materially and adversely affect the Business, the Transferred Assets or Parent's and Buyer's ability to conduct the

Business in substantially the same manner and condition as conducted by Seller on the Effective Date;

(vii) commence or settle any legal actions or proceedings or obtain any releases of threatened actions or proceedings involving or relating to the Business or the Transferred Assets;

(viii) accelerate any accounts receivable or defer any accounts payable in any manner outside the ordinary course of business;

(ix) take any action, or fail to take any action, that would result in any of the representations and warranties set forth in Article 3 not being true and correct on and as of the Closing Date with the same force and effect as if such representations and warranties had been made on and as of the Closing Date; or

(x) agree to take any action described in subsection (i) through (ix) above.

5.2 Access.

(a) During the period commencing on the Effective Date and continuing through the Closing Date, Seller will permit Parent and Buyer to make a full and complete investigation of the Transferred Assets and the Business and to receive all information of Seller relating to the Transferred Assets or reasonably related to Seller's conduct of the Business. In addition, to the maximum extent permitted by applicable laws and regulations, Seller will provide Parent and Buyer access to the employee files of the Designated Employees or Employees that would potentially be Designated Employees. Without limitation on this right, Seller, upon reasonable prior notice from Parent or Buyer to Seller, will (i) afford to Parent and Buyer and their representatives, at all reasonable times during normal business hours, full and complete access to the Transferred Assets and Seller's personnel, professional advisors, properties, contracts, files, Books and Records, and other documents and data; (ii) furnish Parent or Buyer and its representatives with copies of all such Transferred Contracts, Books and Records, and other existing documents and data as Parent or Buyer may reasonably request; and (iii) furnish Parent or Buyer and their representatives with such additional financial (including Tax Returns and supporting documentation), operating, and other data and information as Parent or Buyer may reasonably request, in each case relating to the Business. Seller shall maintain and make available the information and records specified in this Section 5.2 in the ordinary course of Seller's business and document retention policies, as if the transactions contemplated by this Agreement had not occurred. No information or knowledge obtained in any investigation pursuant to this Section 5.2 shall affect or be deemed to modify any representation or warranty contained herein or the conditions to the obligations of the Parties hereto to consummate the transactions contemplated hereby.

(b) During the period commencing on the Effective Date and continuing through the Closing Date, each Party shall provide the other Party (at such other Party's expense) with such reasonable assistance, including the provision of available relevant records or other information and reasonable access to and cooperation of any personnel within their employ, as may be reasonably requested by either of them in connection with the preparation of any financial statement or Tax

Return, or any audit or examination by any taxing authority, or any judicial or administrative proceeding relating to liability for Taxes.

(c) For two (2) years after the Closing Date, Seller shall give Parent and Buyer reasonable access, during normal business hours, to all books, records and files requested by Parent and Buyer that are reasonably necessary in order for Parent and Buyer to respond to any third party or governmental inquiries, investigations, claims or audits related to the Transferred Assets or the Business.

5.3 Post-Closing Audits of Business Financial Statements. During the period commencing on the Closing Date and ending on the date that the audits of the Business's financial statements for the years ended December 31, 2004 and the period from January 1, 2005 through the Closing Date by third party auditors are completed (the "Audit Completion Date"), Seller shall provide Parent (at Seller's expense) with such reasonable assistance, including the provision of available relevant records or other information and reasonable access to and cooperation of any personnel within Seller's employ, as may be reasonably requested by Parent in connection with the preparation of the audits of the Business's financial statements for the years ended December 31, 2004 and the period from January 1, 2005 through the Closing Date (the "Post-Closing Audits"). Parent shall select the third party auditor for the Post-Closing Audits and will bear the fees of the third party auditor for the Post-Closing Audits up to \$125,000 for a so-called "carve out" audit. Any third party auditor fees in excess of \$125,000 for the "carve out" audit shall be referred to as "Indemnifiable Audit Costs" and shall constitute "Losses" for purposes of Article 8.

5.4 Third Party Consents; Assignment of Transferred Contracts.

(a) Seller, Parent and Buyer shall use reasonable best efforts to obtain, within the applicable time periods required, all waivers, permits, consents, assignments and approvals and to effect all registrations, filings and notices with or to third parties or Governmental Entities that are necessary to consummate the transactions contemplated by this Agreement, including without limitation by cooperating in good faith to effect any required assignment to Buyer or its designees of each of the Transferred Contracts in such a manner that Buyer or its designees shall assume only those obligations under such Transferred Contracts arising from Buyer's or its designee's performance or non-performance of its obligations under such Transferred Contracts from and after the Closing Date.

(b) With respect to contracts that are to be Transferred Assets, Seller shall use prior to the Closing commercially reasonable efforts to obtain the consent of the other Persons to the assignment thereof to Buyer or its designees (at no cost to Buyer) such that Buyer or its designees shall be able to secure the benefits of such Transferred Contracts directly. If such consent is not obtained prior to the Closing, or if an attempted assignment thereof would be ineffective or would adversely affect the rights thereunder so that Buyer or its designees would not receive substantially all such rights, (i) this Agreement shall not constitute an agreement to assign such contracts (a "Non-Assignable Contract") and (ii) Seller shall (x) continue to use reasonable best efforts to obtain the consent of the other Persons for the assignment thereof to Buyer or its designees, and (y) use reasonable best efforts so as to ensure that Buyer or its designees would obtain the benefits and assume the obligations thereunder in accordance with this Agreement, including subcontracting, sublicensing or subleasing to Buyer or its designees, or enter into

arrangements under which Seller would enforce for the benefit of Buyer or its designees, with Buyer or its designee, assuming Seller's obligations, any and all rights of Seller against a third party thereto. Seller shall promptly pay to Parent all monies received by Seller with respect to such Non-Assignable Contracts, except to the extent the same represents an Excluded Asset. To the extent the benefits therefrom and obligations thereunder have been provided by alternative arrangements as provided above reasonably acceptable to Parent or Buyer, any such Non-Assignable Contract shall be deemed to be a Transferred Asset or Assumed Liability, as the case may be, provided Parent and Buyer shall not be responsible for any Liabilities (i) arising out of a claim of breach of such Non-Assignable Contract due to the establishment of the alternative arrangements, or (ii) arising out of such Non-Assignable Contract as a result of Seller's action without Parent's or Buyer's approval in a manner inconsistent with the alternative arrangements. Parent and Buyer will use commercially reasonable efforts to assist Seller in obtaining such consents (such commercially reasonable efforts shall not include the payment of money).

(c) In furtherance, and not in limitation of the foregoing subsection (a), in the event that Seller is unable to obtain any required consent to the transfer at the Closing to the Buyer or its designees of any Non-Assignable Contract and Seller and Buyer have failed to agree on alternate arrangements to an assignment reasonably satisfactory to Buyer, then (i) the party thereto shall remain a party and shall continue to be bound by such Non-Assignable Contract, (ii) Buyer or its designee shall pay, perform and discharge fully all of the obligations of such party from and after the Closing Date, upon the terms and subject to the conditions of such Non-Assignable Contract, (iii) such party shall, without further consideration therefor, pay, assign and remit to Buyer or its designee promptly all monies, rights and other consideration received in respect of such Non-Assignable Contract on and after the Closing Date, and (iv) such party shall, without further consideration therefor, exercise its rights and options under such Non-Assignable Contract in the manner and only to the extent directed by Buyer. If and when any consent shall be obtained following the Closing Date with respect to the transfer by Seller to Buyer of any such Non-Assignable Contract or such Non-Assignable Contract shall otherwise become assignable following the Closing Date, Seller shall promptly assign all of its rights and obligations thereunder to Buyer or its designee, without further consideration therefor, and Buyer shall, without further consideration therefor, assume such rights and obligations, to the fullest extent permitted and such Non-Assignable Contract shall be deemed to be a Transferred Asset or Assumed Liability, as the case may be. The existence of the provisions of this Section 5.4 shall not reduce or otherwise adversely affect any party's ability to enforce any of its rights under this Agreement.

5.5 Renewal Fees. In furtherance, and not in limitation of the foregoing Section 5.4, Seller agrees to pay for Buyer's renewal fees of all agreements and licenses with respect to third party Software previously licensed to Seller that are (i) listed on Schedule 5.5; (ii) Non-Assignable Contracts or (iii) otherwise necessary to enable Parent or Buyer to operate the Business following the Closing.

5.6 Transition Services. For a period of not more than 9 months from the Closing Date, Seller will continue to provide Parent and Buyer with support services to the Business as detailed in Exhibit B-1 (the "Transition Services"). The cost of such support services will be paid by Parent or Buyer to Seller at the rates set forth on Exhibit B-1 (the "Transition Services Fees"), pro-rated for partial months. Parent and Buyer may terminate each or all of such Transition Services at any time, provided, however, that Seller's provision of IT system services shall not be terminated until Parent

or Buyer implements a system capable of handling such IT system services. For any support service that Parent and Buyer is utilizing after 90 days, the Transition Services Fees will increase for such services by 20% each quarter after such 90 days. Seller agrees to transfer all data of or related to the Business which resides on Seller's IT system for use with Parent's or Buyer's IT system, at Parent's or Buyer's request and at Seller's cost. Seller shall provide the Transition Services, or cause the Transition Services to be provided, in a diligent and workmanlike manner, in good faith and in a manner consistent with the historical provision of such services in the ordinary course of business, with at least the same degree of skill, duty, care and timeliness as such services have been provided in Seller's Fort Collins facilities prior to the Closing Date, but in no event less than reasonable care. Seller will provide the Transition Services to Parent and Buyer with the same priority as it provides similar services to its own subsidiaries and businesses, including similar treatment with respect to critical and time-sensitive needs. Seller shall not have the right to subcontract the provision of the Transition Services without the prior written consent of Parent or Buyer except to the extent such Services were subcontracted prior to the Closing Date. Prior to termination of such Transition Services, Seller will provide any transition-related assistance and migrate to Parent or Buyer all data reasonably necessary for Parent or Buyer to effect the transition of Transition Services, so that Parent or Buyer will be able to perform the Transition Services itself or through a third party service provider. Seller will be responsible for costs or expenses incurred in support of Parent's or Buyer's migration plan.

5.7 Software Other than IT Systems

Seller has provided Parent and Buyer, and attached hereto as Exhibit B-2, a complete list of third-party software presently utilized by Employees of the Business including the relicensing costs which are required to continue such use after the Closing. Seller has allowed Parent a credit against the purchase price for the Transferred Assets to enable Parent or Buyer to acquire such software as Parent or Buyer deems necessary. All license payments to third parties shall be at Parent's and Buyer's expense. Seller shall allow Parent and Buyer to acquire an unlimited, perpetual license to Seller's P-Tools software in exchange for a onetime payment of \$10,000. Such license to Seller's P-Tools software shall be transferable in the event of a change in control or acquisition of Parent or Buyer.

5.8 Technology Documentation. Commencing on the Effective Date, Seller shall fully cooperate with Parent and Buyer to perform a detailed technical review of all Transferred Technology and shall diligently prepare such documentation sufficient to enable Parent and Buyer to fully utilize, understand and implement the Transferred Technology for delivery to Buyer at the Closing. It is understood and acknowledged that any Technology created solely or jointly by either Party in the creation of such documentation shall be Transferred Tangible Assets, and any Intellectual Property Rights therein shall be Assigned IPR.

5.9 Intellectual Property.

(a) Except as otherwise expressly permitted by this Agreement, between the Effective Date and the Closing Date, Seller will not, without the prior written consent of Parent or Buyer:

(i) enter into any inbound license agreement with respect to Intellectual Property Rights or Technology of any third party to be incorporated in or used in connection with the Transferred Assets or the Business;

(ii) sell, lease or otherwise transfer or dispose of or encumber (including any Lien), or enter into any outbound license agreement (including any covenant not to sue a third party) with respect to, any of the Transferred Assets or the Business;

(iii) propose, enter into or negotiate a contract with any Person, other than Parent and Buyer, providing for the possible acquisition, transfer or disposition (whether by way of merger, purchase of capital stock, purchase of assets or otherwise) of any of the Transferred Assets or the Business; or

(iv) enter into any other contract relating to (A) the sale or distribution of any Transferred Technology; (B) the provision of any services related to the Business; or (C) any other of the Transferred Assets.

(b) Between the Effective Date and the Closing Date, Seller shall, and shall cause its Affiliates to, take all actions, and not omit to take any action, necessary to preserve and maintain all Assigned IPR, including payment of any Patent issuance, maintenance or other fees when due and the filing of any documents, certificates or notices when due related to the prosecution or maintenance of any Assigned IPR.

5.10 Reasonable Best Efforts . The Parties shall use reasonable best efforts (a) to cause to be fulfilled and satisfied all of the conditions to the Closing to be fulfilled and satisfied by each of them and (b) to cause to be performed all of the matters required of each of them at the Closing.

5.11 No Other Bids. Until the earlier to occur of (a) the Closing or (b) the termination of this Agreement pursuant to its terms, neither Seller nor any of its Affiliates, officers, directors, Employees, stockholders, agents or other representatives shall, directly or indirectly: (i) initiate, solicit, entertain or encourage (including by way of furnishing information regarding the Business or the Transferred Assets) any proposals, inquiries or offers, or make any statements to third parties which may reasonably be expected to lead to any proposal, inquiry or offer, from any Person concerning the acquisition or license of all or any material portion of the Business or the Transferred Assets; or (ii) negotiate, engage in any substantive discussions, or enter into any agreement, with any Person concerning the acquisition or license of all or any material portion of the Business or the Transferred Assets. Seller will promptly inform Parent and Buyer in writing of any third party inquiries or proposals received by Seller and shall provide to Parent and Buyer the name of such third party and the terms of any such proposal. The covenants in this Section 5.11 will apply to any and all discussions in which Seller is currently involved with third parties, and Seller shall immediately terminate all such discussions.

5.12 Confidentiality; Public Announcements.

(a) The Receiving Party shall treat as confidential all of the Disclosing Party's Confidential Information and shall not use or disclose to third parties such Confidential Information except as expressly permitted under this Agreement. Without limiting the foregoing, the Receiving Party shall use at least the same degree of care that it uses to prevent the disclosure of its own confidential information, but in no event with less than reasonable care, to prevent the disclosure of the Disclosing Party's Confidential Information.

(b) Notwithstanding the foregoing Section 5.12(a), after the Closing the following shall be deemed the Confidential Information of Parent and Buyer and the obligations set forth in Section 5.12(a) shall no longer apply to Parent and Buyer with respect thereto: any Confidential Information related to the Business or the Transferred Assets or constituting or included with the Transferred Assets.

(c) Seller agrees that the terms, conditions and existence of this Agreement shall be treated as Confidential Information of Parent and Buyer and that no reference to this Agreement or the transactions contemplated herein may be made by Seller in any form of public or commercial announcement or advertising without the prior written consent of the other; *provided, however*, that Seller may disclose, upon prior written notice to the other, the terms, conditions and existence of this Agreement: (a) as required by any Governmental Entity (including the United States Securities and Exchange Commission) in which case, the Parties shall confer as to the appropriate disclosure; (b) as otherwise required by law; (c) in confidence, to legal counsel and accountants of Seller; or (d) in confidence, in connection with the enforcement of this Agreement or Seller's rights under this Agreement.

(d) In the event the Receiving Party must disclose the Disclosing Party's Confidential Information pursuant to the order or requirement of a court, administrative agency, or other Governmental Entity, the Receiving Party shall provide prompt notice thereof to the Disclosing Party to allow the Disclosing Party to obtain a protective order, and the Receiving Party shall also use its reasonable efforts to obtain a protective order, assist Disclosing Party in obtaining a protective order or otherwise prevent public disclosure of such information.

(e) The Parties agree that Seller's Confidential Information related to the Business and known to the Designated Employees is included in the Transferred Assets under this Agreement. Accordingly, to the extent a Designated Employee hired by Buyer would, as a result of an employment or other agreement between Seller and that Designated Employee, be restricted from disclosing Confidential Information to Parent or Buyer or from using information on Parent's or Buyer's behalf or otherwise in connection with its employment by Parent or Buyer, Seller agrees to, and hereby does waive, in favor of Parent and Buyer, any right that it may have to enforce such restrictions and consents to Parent's or Buyer's use and disclosure of such information for its own benefit and on its own behalf, without restriction.

5.13 Covenant Not to Compete. Beginning on the Closing Date and ending on the third (3rd) anniversary of the Closing Date, neither Seller nor any of its Affiliates or permitted successors or assigns shall, directly or indirectly, without the prior written consent of Parent or Buyer, engage anywhere in the world in (whether as an agent, consultant, advisor, independent contractor,

proprietor, partner, officer, director or otherwise), or have any ownership interest in, or participate in the financing, operation, management or control of, any firm, partnership, corporation, entity or business that engages or participates in the design, development, manufacture, marketing or sale of Transferred Products or other products intended for use in the Business, or otherwise engages in the Business; provided, however, that it shall not be a violation of this Section 5.13 for Seller to (a) own debt securities or other debt obligations (other than convertible debt) of any Person, or (b) invest in securities representing less than one percent (1%) of the outstanding capital stock of any Person, whose stock is traded on a national securities exchange or through the automated quotation system of a registered securities association. Notwithstanding Section 1.1(a), any entity that (i) in the future acquires Control of Seller in an acquisition or merger transaction and (ii) at the time of such transaction sells products intended for use in the Business shall not be deemed an “Affiliate” for purposes of this Section 5.13 only.

5.14 Covenant Not to Solicit or Hire.

(a) Beginning on the Closing Date and ending on the third (3rd) anniversary of the Closing Date, neither Seller nor its Affiliates shall, directly or indirectly, without the prior written consent of Parent: (i) hire any employee of Parent or Buyer (including any Designated Employees) for employment by Seller or any of its Affiliates; or (ii) solicit any employee of Parent or Buyer (including any Designated Employees) to terminate his or her employment or consultancy with Parent or Buyer or any of their Affiliates; *provided, however*, that this Section 5.14(a) shall not prohibit Seller or any Affiliate of Seller from: (i) soliciting employees through, or hiring employees who respond to, general job advertisements or similar notices that are not targeted specifically at the employees of a party; or (ii) engaging any recruiting firm or similar organization to identify or solicit persons for employment on its behalf as long as such recruiting firm or organization is not instructed or otherwise informed to target any employee of Buyer.

(b) Beginning on the Closing Date and ending on the third (3rd) anniversary of the Closing Date, neither Parent, Buyer nor their Affiliates shall, directly or indirectly, without the prior written consent of Seller: (i) hire any employee of Seller (other than any Designated Employee) for employment by Parent, Buyer or any of their Affiliates; or (ii) solicit any employee of Seller (other than any Designated Employee) to terminate his or her employment or consultancy with Seller or any Affiliate of Seller; *provided, however*, that Section 5.14(b) shall not prohibit Parent, Buyer or any of their Affiliates from: (i) soliciting employees through, or hiring employees who respond to, general job advertisements or similar notices that are not targeted specifically at the employees of a party; or (ii) engaging any recruiting firm or similar organization to identify or solicit persons for employment on its behalf as long as such recruiting firm or organization is not instructed or otherwise informed to target any employee of Seller.

5.15 Notification of Certain Matters. Seller shall give prompt notice to Parent and Buyer of (a) Seller becoming aware of the occurrence or non-occurrence of any event that is likely to cause any representation or warranty of Seller contained in this Agreement to be untrue or inaccurate in any material respect at or prior to the Closing, and (b) any failure of Seller to comply with or satisfy in any material respect any covenant, condition or agreement to be complied with or satisfied by it hereunder; provided, however, that the delivery of any notice pursuant to this Section 5.15 shall not (i) limit or otherwise affect any remedies available to the party receiving such notice or (ii) constitute an acknowledgment or admission of a breach of this Agreement. No disclosure by pursuant to this

Section 5.15, however, shall be deemed to amend or supplement the Disclosure Schedule or prevent or cure any misrepresentations, breach of warranty or breach of covenant.

5.16 Severability of Covenants. The covenants contained in the preceding paragraphs shall be construed as a series of separate covenants, one for each county, city and state of any geographic area where any business is carried on by Parent or Buyer or their Affiliates. Except for geographic coverage, each such separate covenant shall be deemed identical in terms to the covenant contained in the preceding paragraphs. If, in any judicial proceeding, a court refuses to enforce any of such separate covenants (or any part thereof), then such unenforceable covenant (or such part) shall be eliminated from this Agreement to the extent necessary to permit the remaining separate covenants (or portions thereof) to be enforced. If the provisions of Sections 5.13 and 5.14 are deemed to exceed the time, geographic or scope limitations permitted by applicable law, then such provisions shall be reformed to the maximum time, geographic or scope limitations, as the case may be, permitted by applicable laws.

5.17 SEC Support Letter. Seller covenants to provide a letter to the Securities and Exchange Commission (the "SEC"), similar to the forms provided by Parent to Seller as of the Closing (the "Support Letter"), in support of the request by Parent or Buyer to the SEC for permission to file certain financial information in lieu of the full financial statements that may otherwise be required in any future SEC filings by Parent or Buyer, such as a registration statement on Form S-1 or Form S-4 (the "SEC Request"). Seller shall provide Parent and Buyer with such reasonable assistance, including the provision of available relevant records or other information and reasonable access to and cooperation of any personnel within Seller's employ, as may be reasonably requested by Parent or Buyer, in preparing the SEC Request, providing information requested by the SEC, or complying with the SEC's response to the SEC Request. Seller covenants to provide Parent and Buyer a draft of the Support Letter by December 31, 2005.

Article 6 **EMPLOYEES**

6.1 Seller Cooperation. During the period commencing on the Effective Date and continuing through the Closing Date, Seller shall assist and cooperate with Parent and Buyer to identify Seller's Employees employed in connection with the Business who will be Designated Employees, including by permitting Parent and Buyer to review employee files, compensation data, and job descriptions for any such Employees. In the event Parent or Buyer identifies additional Employees as Designated Employees in its discretion during such period, Parent or Buyer shall notify Seller thereof in writing and Schedule 1.1(n) shall thereafter be amended to include such additional Designated Employees. After the Effective Date, Seller shall promptly provide Parent and Buyer with copies of the employment files of all Designated Employees to the extent not already provided to Parent and Buyer, and shall promptly provide any additional information about such Employees upon Parent's or Buyer's reasonable request. After the Effective Date, Seller shall permit Parent and Buyer to contact and interview Designated Employees at Seller's premises during normal business hours, and Seller shall cooperate fully with Parent and Buyer in all such respects.

6.2 Employment Offers.

(a) It is expected that prior to Closing, Buyer shall make offers of “at-will” employment to all Designated Employees, *provided* that Buyer may elect not to make an offer to any Designated Employees in its sole discretion. Any such “at-will” employment offers will (a) be contingent on Closing; (b) be subject to and in compliance with Parent’s or Buyer’s standard human resources policies and procedures, including requirements for proof evidencing a legal right to work in the offeree’s country of current employment; (c) have terms, including the position, salary and responsibilities of such Employee, which will be determined by Buyer in its sole discretion, except that all Designated Employees will be offered a hiring bonus equal to one month’s base salary and a retention bonus consistent with its prior discussions with Seller; and (d) supersede any prior Employment Agreements and other arrangements with such Employee in effect prior to the Closing Date.

(b) For each day that the Designated Employees start employment with Buyer after the Closing, Parent will reimburse Seller an amount equal to one day’s salary of the Designated Employees who accept employment with Buyer at the time of the Closing, based on the then-current salaries of the Designated Employees with Seller, such payment to be made at the time of Buyer’s first payment to Seller for the Transition Services.

6.3 Waiver. Seller hereby agrees to waive any condition or restriction which it may have the contractual right to impose on the hiring and employment of Designated Employees by Parent or Buyer.

6.4 Employees. Between the Effective Date and the Closing Date, Seller will not, without the prior written consent of Parent or Buyer:

(a) terminate the employment of any Employee, except for cause, provided Seller provides notice to Parent and Buyer prior to any such termination;

(b) reassign any Designated Employee to another business unit of Seller;

(c) hire any employees relating to the Business;

(d) change, increase or amend the rate of remuneration (cash, equity or otherwise) or any other terms of employment of any of the Designated Employees or adopt, grant extend or increase the rate or terms of any bonus, insurance pension or other employee benefit plan, payment or arrangement made to, for or with any Designated Employees, except increases pursuant to any applicable law, rule or regulation;

(e) grant any severance or termination pay (whether payable in cash, stock or other equity instruments) to any Designated Employee, or adopt any new severance plan, amend or modify or alter in any manner any severance plan, agreement or arrangement relating to any Designated Employee on the date hereof; or

(f) adopt or amend any Employment Agreement with a Designated Employee.

6.5 COBRA Continuation Coverage. Seller agrees and acknowledges that the selling group (as defined in Treasury Regulation Section 54.4980B-9, Q&A-3(a)) of which it is a part (the “Selling Group”) will continue to offer a group health plan to employees after the Closing Date and,

accordingly, that Seller and the Selling Group shall be solely responsible for providing continuation coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended (“COBRA”) to those individuals who are M&A qualified beneficiaries (as defined in Treasury Regulation Section 54.4980B-9, Q&A-4(a)) with respect to the transactions contemplated by this Agreement (collectively, the “M&A Qualified Beneficiaries”). Seller shall indemnify, defend and hold harmless Parent and Buyer for, from and against any and all claims, liabilities, losses, costs and expenses (including attorney’s fees) relating to, arising out of, or resulting from any and all COBRA obligations, liabilities and claims related to M&A Qualified Beneficiaries and all other qualified beneficiaries (as defined in Code Section 4980B(g)(1)) with respect to Sellers’ group health plans. Seller further agrees and acknowledges that in the event that the Selling Group ceases to provide any group health plan to any employee prior to the expiration of the continuation coverage period for all M&A Qualified Beneficiaries (pursuant to Treasury Regulation Section 54.4980B-9, Q&A-8(c)), then Seller shall provide Parent and Buyer with (a) written notice of such cessation as far in advance of such cessation as is reasonably practicable (and, in any event, at least thirty (30) days prior to such cessation), and (b) all information necessary or appropriate for Parent or Buyer to offer continuation coverage to such M&A Qualified Beneficiaries.

6.6 Employee Liability Claims.

(a) As between the Parties, the Seller and any ERISA Affiliate shall (i) sponsor and (ii) assume or retain, as the case may be, and be solely responsible for all of the following from and after Closing, which will be considered “Employee Excluded Liabilities” for purposes of this Agreement, including Section 2.3 hereof:

(i) Employment Liabilities, including but not limited to payments or entitlements that Seller may owe or have promised to pay to the Designated Employees or any other Employees, including wages, other remuneration, holiday or vacation pay, bonus, severance pay (statutory or otherwise), commission, pension contributions, taxes, and any other liability, payment or obligations related to Employees or contractors;

(ii) all payments with respect to the Designated Employees that are due to be paid prior to or on the Closing Date (including, without prejudice to the generality of the foregoing, pension contributions, insurance premiums and taxation) to any third party in connection with the employment of any of the Designated Employees; and

(iii) any non-forfeitable claims or expectancies of any Designated Employees from their prior employment with Seller or an ERISA Affiliate which have been incurred or accrued on or prior to the Closing Date.

(b) All costs and disbursements incurred in connection with the termination of any employment of a Designated Employee or any other Employee prior to or in connection with the Closing Date (including any Designated Employee who does not accept an offer of employment with Parent or Buyer) shall be borne by Seller.

Article 7
CLOSING, PURCHASE PRICE AND PAYMENTS

7.1 **Conditions to Obligations of Buyer.** The obligations of Parent and Buyer to consummate the transactions contemplated by this Agreement shall be subject to the satisfaction at or prior to the Closing Date of the conditions set forth in this **Section 7.1**, any of which may be waived, in writing, exclusively by Parent:

(a) **Representations and Warranties.** The representations and warranties of the Seller contained in this Agreement shall be true, correct and complete in all material respects (without regard to any materiality qualifications set forth in any such representation or warranty) as of the Effective Date and shall be true, correct and complete in all material respects (without regard to any materiality qualifications set forth in any such representation or warranty) as of the Closing Date as if made on and as of the Closing Date (other than representations and warranties which by their express terms are made solely as of a specified earlier date, which shall be true, correct and complete in all material respects (without regard to any materiality qualifications set forth in any such representation or warranty) as of such specified earlier date). Notwithstanding the foregoing, representations and warranties of the Seller contained in this Agreement that are qualified by reference to materiality shall be true, correct and complete in all respects as of the dates set forth in this **Section 7.1(a)**.

(b) **Performance.** Seller shall have performed and complied in all material respects with each agreement, covenant and obligation required by this Agreement to be so performed or complied with by Seller on or before the Closing Date.

(c) **Employees.** All of the Key Employees and no fewer than ninety percent (90%) of the Designated Employees shall have accepted in writing an offer of employment with Buyer, in a form acceptable to Buyer and substantially in the form attached as **Exhibit D**; **provided, however**, that Buyer chooses in its sole discretion to make such offers to such Key Employees and/or Designated Employees.

(d) **Sublease of Facility.** Seller shall have provided to Buyer a sublease in the form of **Exhibit E** annexed hereto with respect to that portion of the space at 4424 Innovation Drive, Fort Collins, Colorado (approximately 12,000 sq. ft.) which is presently allocated to the Business. The sublease shall be for the same term as the Master Lease (June 30, 2009) provided Buyer may terminate such sublease on not less than 90 days prior notice to Seller and provided further that Buyer will pay Seller full rent (not including utilities and other costs of facility-related services provided by Seller to Buyer) through the later of June 30, 2006 or the date Buyer moves out of the facility and 50% of the rent (not including utilities and other costs of facility-related services provided by Seller to Buyer) from the date Buyer moves out of the facility to September 30, 2006, if Buyer moves out of the facility prior to September 30, 2006. Buyer also acknowledges that under the Master Lease both Seller and Landlord have the right to terminate such Master Lease upon 270 days prior notice in which event the sublease shall terminate at the same time provided Buyer shall have been provided with a copy of the notice of termination at the time it was given or received by Seller. The sublease rent shall be \$6,720 per month, for a total of \$7,100 per month inclusive of all utilities (water, gas and electric).

(e) No Material Adverse Effect. Since the Effective Date, there shall not have occurred any event or condition of any character that has had or is reasonably likely to have a material adverse effect on the Business, the Transferred Products, the Transferred Assets or the financial condition or prospects of the Business.

(f) Closing Certificate. Parent and Buyer shall have received a certificate, dated as of the Closing Date, signed and verified by an officer of Seller on behalf of Seller certifying as to the matters set forth in Sections 7.1(a), (b) and (e).

(g) Consents. All third party consents required to transfer or assign the Transferred Assets (free of any Liens), the Transferred Permits and the Transferred Contracts to Buyer set forth on Schedule 7.1(g) shall have been obtained in a form acceptable to Parent.

(h) Other Agreements. Seller shall have executed and delivered to Parent and Buyer each of the Collateral Agreements, and such agreements shall remain in full force and effect.

(i) No Proceeding or Litigation.

(i) No preliminary or permanent injunction or other order shall have been issued by any Governmental Entity, nor shall any statute, rule, regulation or executive order be promulgated or enacted by any Governmental Entity which prevents the consummation of the transactions contemplated by this Agreement.

(ii) No suit, action, claim, proceeding or investigation before any Governmental Entity shall have been commenced or have been threatened against Seller, Parent or Buyer, or any of their respective Affiliates, associates, officers or directors, seeking to prevent the sale of the Transferred Assets or asserting that the sale of the Transferred Assets would be illegal or create liability for damages.

(j) Documents. This Agreement, any other instruments of conveyance and transfer and all other documents to be delivered by Seller to Parent and Buyer at the Closing and all actions of Seller required by this Agreement or incidental thereto, and all related matters, shall be in form and substance reasonably satisfactory to Parent.

(k) Governmental Filings. Seller, Parent and Buyer shall have made all required filings with Governmental Entities, and any approvals related thereto shall have been obtained or any applicable waiting periods shall have expired.

(l) Series C Preferred Stock Financing. The sale of Parent's Series C Preferred Stock for an aggregate purchase price of at least \$20 million shall have been completed.

7.2 Conditions to Obligations of Seller. The obligations of Seller to consummate the transactions contemplated by this Agreement shall be subject to the satisfaction at or prior to the Closing of the conditions set forth in this Section 7.2, any of which may be waived, in writing, exclusively by Seller:

(a) Representations and Warranties. The representations and warranties of the Parent and Buyer contained in this Agreement shall be true, correct and complete in all material

respects (without regard to any materiality qualifications set forth in any such representation or warranty) as of the Effective Date and shall be true, correct and complete in all material respects (without regard to any materiality qualifications set forth in any such representation or warranty) as of the Closing Date as if made on and as of the Closing Date (other than representations and warranties which by their express terms are made solely as of a specified earlier date, which shall be true, correct and complete in all material respects (without regard to any materiality qualifications set forth in any such representation or warranty) as of such specified earlier date).

(b) Performance. Parent and Buyer shall have performed and complied in all material respects with each agreement, covenant and obligation required by this Agreement to be so performed or complied with by the Parent and Buyer on or before the Closing Date.

(c) Closing Certificate. Seller shall have received a certificate, dated as of the Closing Date, signed and verified by an officer of each of Parent and Buyer on behalf of each of Parent and Buyer certifying as to the matters set forth in Sections 7.2(a) and 7.2(b).

(d) Other Agreements. Parent and Buyer shall have executed and delivered to Seller each of the Collateral Agreements to which Parent and Buyer are a party, and such agreements shall remain in full force and effect.

(e) No Proceeding or Litigation.

(i) No preliminary or permanent injunction or other order shall have been issued by any Governmental Entity, nor shall any statute, rule, regulation or executive order be promulgated or enacted by any Governmental Entity which prevents the consummation of the transactions contemplated by this Agreement.

(ii) No suit, action, claim, proceeding or investigation before any Governmental Entity shall have been commenced or have been threatened against Seller, Parent or Buyer, or any of their respective Affiliates, associates, officers or directors, seeking to prevent the sale of the Transferred Assets or asserting that the sale of the Transferred Assets would be illegal or create liability for damages.

(f) Documents. This Agreement, any other instruments of conveyance and transfer and all other documents to be delivered by Parent and Buyer to Seller at the Closing and all actions of Parent and Buyer required by this Agreement or incidental thereto, and all related matters, shall be in form and substance reasonably satisfactory to Seller.

(g) Governmental Filings. Seller, Parent and Buyer shall have made all required filings with Governmental Entities, and any approvals related thereto shall have been obtained or any applicable waiting periods shall have expired.

Article 8
SURVIVAL OF REPRESENTATIONS,
WARRANTIES AND INDEMNIFICATION

8.1 Survival of Representations and Warranties. The representations, warranties, covenants and agreements of Seller in this Agreement shall survive until the earlier to occur of (i) twelve (12) months after the Closing Date and (ii) ninety (90) days after the Audit Completion Date, and shall thereafter automatically expire; provided, however, that (x) Seller's representations in Section 3.5 (Intellectual Property) shall survive for a period of three (3) years after the Closing Date, and shall thereafter automatically expire; (y) Seller's representations in Section 3.9 (Environmental Matters) and Section 3.17 (Tax Matters) shall survive until the expiration of the applicable statute of limitations; and (z) Seller's representations in Section 3.4 (Title of Properties) and Section 3.8 (Transferred Assets and Transferred Technology) and Seller's obligation to indemnify in Section 8.2(c) (Excluded Assets and Excluded Liabilities), Section 8.2(f) (Transition Services) and Section 8.2(g) (License Agreement) shall survive indefinitely. The representations and warranties of Parent and Buyer in Article 4 shall terminate on the Closing Date. No investigation, or knowledge acquired, by Parent or Buyer or on behalf of Parent or Buyer with respect to any breach of any representation or warranty made by Seller or any other matter shall affect Parent's or Buyer's rights to indemnification pursuant to this Article 8.

8.2 Indemnification by Seller. Subject to the terms and conditions of this Article 8, following the Closing, Seller shall indemnify and hold harmless Parent, Buyer and their Affiliates and each of their officers, directors, employees, agents, successors and assigns ("Buyer Indemnitees") for any and all Losses, whether such Loss exists or accrues prior or subsequent to the Closing Date, arising out of, resulting from or caused by:

(a) any inaccuracy or misrepresentation in or breach of any of the representations or warranties made by Seller contained in this Agreement or any Collateral Agreement, it being understood that solely for purposes of calculating Losses relevant to any such inaccuracy or misrepresentation, materiality and knowledge qualifiers will be disregarded;

(b) any breach of any of the covenants or agreements of Seller contained in this Agreement or any Collateral Agreement (other than the License Agreement);

(c) any of the Excluded Assets or Excluded Liabilities, including any Liability arising out of the ownership or operation of the Assets prior to the Closing Date other than the Assumed Liabilities;

(d) any Indemnifiable Audit Costs;

(e) all Liabilities relating to any warranty, returns, refunds, support obligation or similar claims with respect to any Transferred Products sold prior to the Closing Date to the extent that such Liabilities exceed \$75,000;

(f) any Losses of any kind or nature whatsoever which may be sustained or suffered by any of them arising out of or based upon any gross negligence or willful misconduct on the part of Seller in performing the Transition Services for Parent and Buyer;

(g) any breach of any of the representations, covenants or agreements of Seller contained in the License Agreement; and

(h) any failure to comply with any applicable “bulk sales” law or regulation in connection with the transactions contemplated by this Agreement.

Notwithstanding the foregoing, for purposes of calculating Losses relevant to any breach, inaccuracy or misrepresentation of the first sentence of Section 3.5(c) (the “Non-Infringement Representation”), the knowledge qualifier of the Non-Infringement Representation will be disregarded for twelve (12) months after the Closing Date.

8.3 Limitation on Indemnification. Notwithstanding the foregoing, (i) Seller shall have no liability under Section 8.2 until the aggregate of all such Losses exceeds \$100,000 (at which point the Seller will be obligated to indemnify the Buyer Indemnitees against all Losses relating back to the first dollar of Losses) and (ii) except for intentional fraud or willful misconduct, the aggregate liability for Seller under Section 8.2 for all Losses shall in no event exceed \$1,500,000 for Seller. The limitations in this Section 8.3(ii) shall not apply to matters arising in respect of Section 3.4 (Title of Properties), Section 3.5 (Intellectual Property) (excluding the Non-Infringement Representation), Section 3.8 (Transferred Assets and Transferred Technology), Section 3.9 (Environmental Matters), Section 3.17 (Tax Matters), and the limitations in this Section 8.3(i) and Section 8.3(ii) shall not apply to matters arising in respect of Section 8.2(c) (Excluded Assets and Excluded Liabilities), Section 8.2(f) (Transition Services), and Section 8.2(g) (License Agreement). For purposes of clarity, any Losses related to the Non-Infringement Representation will be subject to Section 8.3(i) and Section 8.3(ii).

8.4 Indemnification Procedure.

(a) Whenever any Loss shall be asserted against or incurred by a Buyer Indemnitee, the Buyer Indemnitee shall give written notice thereof (a “Claim”) to Seller. The Buyer Indemnitee shall furnish to the Seller in reasonable detail such information as the Buyer Indemnitee may have with respect to the Claim (including in any case copies of any summons, complaint or other pleading which may have been served on it and any written claim, demand, invoice, billing or other document evidencing or asserting the same). If the Claim has been provided to the Seller prior to the lapse of the expiration of the right to make a Claim, then the Seller shall continue to have the obligation to indemnify until the resolution of such Claim. The failure to give such notice shall not relieve the Seller of its indemnification obligations under this Agreement.

(b) Any controversy involving only Parent, Buyer and Seller regarding whether a Claim is properly indemnifiable under the terms of this Article 8 shall be settled by binding arbitration administered by the American Arbitration Association (“AAA”) in accordance with its Commercial Arbitration Rules, and judgment upon the award rendered through arbitration may be entered in any court having jurisdiction thereof. Such arbitration shall be held in Santa Clara County, California, unless the parties mutually agree in writing to change the location, before a single neutral arbitrator appointed in the manner prescribed in AAA Commercial Arbitration Rule 13 provided that Parent, Buyer and Seller have attempted to resolve such controversy through negotiations in good faith. Either Parent, Buyer or Seller may seek from any court, interim or

provisional, relief that is necessary to protect the rights or property of such Party, pending the appointment of the arbitrator or the arbitrator's determination of the merits of the controversy. The Parties shall be entitled to conduct discovery in accordance with the Federal Rules of Civil Procedure. The fees and expenses of the arbitrators shall be borne equally by Buyer and Seller. Each Party shall be responsible for its own legal fees and expenses for the proceeding. The decision of the arbitrators shall be final and non-appealable. The arbitration award shall be in writing and shall specify the factual and legal bases for the award. Judgment on the award may be entered in any court having jurisdiction.

(c) If the Claim is based on a claim of a person that is not a party to this Agreement, the Seller shall, at its expense, undertake the defense of such Claim with attorneys of its own choosing reasonably satisfactory to the Buyer Indemnitee provided that the Seller acknowledges the Buyer Indemnitee's right to indemnification for such Claim pursuant to this Agreement. In the event the Seller, within ten (10) business days after receiving notice of a Claim from the Buyer Indemnitee, fails to defend the Claim, the Buyer Indemnitee may, at the Seller's expense, undertake the defense of the Claim and may compromise or settle the Claim, all for the account of the Seller. After notice from the Seller to the Buyer Indemnitee of its election to assume the defense of such Claim, the Seller shall not be liable to the Buyer Indemnitee under this Section 8.4 for any legal expenses subsequently incurred by the Buyer Indemnitee in connection with the defense thereof, except for such expenses incurred in connection with cooperation with, or at the request of, the Seller; *provided, however*, that the Buyer Indemnitee shall have the right to engage counsel to represent it if, in the Buyer Indemnitee's reasonable judgment, based upon the advice of counsel, it is advisable, in light of the separate interests of the Buyer Indemnitee and the Seller, for the Buyer Indemnitee to be represented by separate counsel, and in that event the reasonable fees and expenses of such separate counsel shall be paid by the Seller.

(d) The Seller shall not consent to entry of any judgment, except with the consent of the Buyer Indemnitee (which may be given or withheld in its sole discretion), or enter into any settlement, except with the consent of the Buyer Indemnitee, which such consent shall not be unreasonably withheld or delayed. In the event the Buyer Indemnitee refuses to consent to the entry of a judgment or a settlement for which the Seller is solely and entirely responsible and has indicated its sole and entire responsibility in writing to the Buyer Indemnitee, following such refusal, the liability of the Seller to the Buyer Indemnitee will be fixed at the amount of any money damages provided in the proposed judgment or settlement.

8.5 Escrow. As partial security for the indemnity provided for in Section 8.2 hereof, at the Closing, Buyer will deposit with the Escrow Agent the Escrow Amount into an escrow fund (the "Escrow Fund") maintained by the Escrow Agent and established pursuant to the Escrow Agreement; it being understood that the Escrow Fund shall not be the sole and exclusively remedy of Buyer Indemnitees for the indemnity provided for in Section 8.2. Subject to the following requirements, the Escrow Fund shall be in existence immediately following the initial delivery of the Escrow Fund to the Escrow Agent and shall expire as follows: 50% of the Escrow Fund shall be released twelve (12) months after the Closing Date, and 50% of the Escrow Fund shall be released thirty (30) days after the Audit Completion Date (the "Escrow Period"); *provided* that the Escrow Period shall not terminate with respect to such amount as is necessary, to satisfy any Claims previously asserted and which are being contested. As soon as all such Claims have been resolved,

the Escrow Agent shall deliver to Seller the remaining portion of the Escrow Fund not required to satisfy such Claims.

8.6 Purchase Price Adjustment. Any payment pursuant to this Article 8 shall be treated for all Tax purposes as an adjustment to the Purchase Price.

Article 9
TERMINATION AND ABANDONMENT

9.1 Methods of Termination. The transactions contemplated herein may be terminated and/or abandoned at any time prior to the Closing:

(a) by the mutual written consent of the Parent, Buyer and Seller;

(b) By Parent, Buyer or Seller, if the Closing shall not have occurred on or before December 31, 2005 (the "Termination Date"); *provided, however*, that the right to terminate this Agreement under this clause (b) of Section 9.1 shall not be available to any party whose breach of this Agreement has resulted in the failure of the Closing to occur on or before the Termination Date;

(c) at the election of Parent, Buyer or Seller, if any Governmental Entity shall have issued an order, decree or ruling or taken any other action enjoining or otherwise prohibiting the transactions contemplated under this Agreement and such order, decree, ruling or other action shall have become final and nonappealable;

(d) by the Parent or Buyer if any of the representations and warranties of the Seller contained in this Agreement shall have been inaccurate as of the date of this Agreement or shall have become inaccurate as of any subsequent date (as if made on such subsequent date), in either case such that the condition set forth in Section 7.1(a) would not be satisfied, or if any of the Seller's covenants contained in this Agreement shall have been breached in any respect such that the condition set forth in Section 7.1(b) would not be satisfied; *provided, however*, that if an inaccuracy in any of the representations and warranties of the Seller as of a date subsequent to the date of this Agreement or a breach of a covenant by the Seller is curable by the Seller through the use of commercially reasonable efforts within 10 days after the Parent or Buyer notifies the Seller in writing of the existence of such inaccuracy or breach (the "Seller Cure Period"), then the Parent or Buyer may not terminate this Agreement under this Section 9.1(d) as a result of such inaccuracy or breach prior to the expiration of the Seller Cure Period, provided the Seller, during the Seller Cure Period, continues to exercise commercially reasonable efforts to cure such inaccuracy or breach (it being understood that Parent or Buyer may not terminate this Agreement pursuant to this Section 9.1(d) with respect to such inaccuracy or breach if such inaccuracy or breach is cured prior to the expiration of the Seller Cure Period); or

(e) by the Seller if any of Parent's or Buyer's representations and warranties contained in this Agreement shall have been inaccurate as of the date of this Agreement or shall have become inaccurate as of any subsequent date (as if made on such subsequent date), in either case such that the condition set forth in Section 7.2(a) would not be satisfied, or if any of Parent's or Buyer's covenants contained in this Agreement shall have been breached in any respect such that

the condition set forth in Section 7.2(b) would not be satisfied; provided, however, that if an inaccuracy in any of the representations and warranties of Parent or Buyer as of a date subsequent to the date of this Agreement or a breach of a covenant by Parent or Buyer is curable by Parent or Buyer through the use of commercially reasonable efforts within 10 days after the Seller notifies Parent or Buyer in writing of the existence of such inaccuracy or breach (the "Buyer Cure Period"), then the Seller may not terminate this Agreement under this Section 9.1(e) as a result of such inaccuracy or breach prior to the expiration of the Buyer Cure Period, provided the Parent or Buyer, during the Buyer Cure Period, continues to exercise commercially reasonable efforts to cure such inaccuracy or breach (it being understood that the Seller may not terminate this Agreement pursuant to this Section 9.1(e) with respect to such inaccuracy or breach if such inaccuracy or breach is cured prior to the expiration of the Buyer Cure Period)

9.2 Procedure upon Termination. In the event of termination and abandonment by a Party pursuant to Section 9.1, written notice thereof shall be given to the other Party and the transactions contemplated by this Agreement shall be terminated and/or abandoned, without further action by the Parties. If the transactions contemplated by this Agreement are terminated and/or abandoned as provided herein:

(a) each Party will redeliver all documents, work papers and other material (and all copies thereof) of the other Party relating to the transactions contemplated hereby, whether so obtained before or after the execution hereof, to the other Party furnishing the same; and

(b) all Confidential Information received by either Party hereto with respect to the business of the other Party shall be treated in accordance with Section 5.12, *provided* that either Party shall be free to use or exploit for any purpose the residuals resulting from access to or work with the other Party's Confidential Information. For the purposes of this Section 9.2(b), "residuals" means information retained in the unaided memories of individuals who have had access to such Confidential Information.

9.3 Survival of Certain Provisions. The following provisions of this Agreement shall survive any termination of this Agreement: Section 5.12 (Confidentiality), this Article 9, and Article 10 (General) and any provision which, by its terms, must survive.

Article 10 **GENERAL**

10.1 No Agency. Except as expressly provided herein, each Party shall in all matters relating to this Agreement act as an independent contractor. Neither Party shall have authority, nor shall either Party represent that it has any authority, to assume or create any obligation, express or implied, on behalf of the other, or to represent the other Party as agent or employee or in any other capacity. Neither execution nor performance of this Agreement shall be construed to have established any agency, joint venture, or partnership.

10.2 Fees and Expenses. Whether or not the transactions contemplated by this Agreement are consummated, all expenses, including without limitation all legal, accounting, financial advisory, consulting and other fees, incurred in connection with the negotiation or effectuation of this

Agreement or consummation of the transactions contemplated by this Agreement, shall be the obligation of the respective Party incurring such expenses.

10.3 Notices. Any notice or other communication required or permitted to be delivered to any Party under this Agreement must be in writing and shall be deemed properly delivered, given and received when delivered (by hand, by registered mail, by courier or express delivery service or by facsimile) to the address or facsimile telephone number set forth beneath the name of such Party below (or to such other address or facsimile telephone number as such Party may have specified in a written notice given to the other Party):

if to Parent or Buyer: iWatt, Inc.
 101 Albright Way
 Los Gatos, California 95032-1827
 Attn: Curtis Davis, Chief Executive Officer
 Telephone: (408) 374-4200
 Facsimile: (408) 341-0455

with a copy to: Wilson Sonsini Goodrich & Rosati
 Professional Corporation
 650 Page Mill Road
 Palo Alto, California 94304-1050
 Attn: Neil J. Wolff
 Telephone: (650) 493-9300
 Facsimile: (650) 493-6811

if to Seller: Advanced Energy Industries, Inc.
 1625 Sharp Point Drive
 Fort Collins, Colorado 80525
 Attn: Michael El-Hillow, Chief Financial Officer
 Telephone: (800) 446-9167
 Facsimile: (970) 407-6550

with a copy to: Thelen Reid & Priest LLP
 225 W. Santa Clara Street, 12th Floor
 San Jose, California 95113
 Attn: Jay L. Margulies
 Telephone: (408) 282-1815
 Facsimile: (408) 278-8215

10.4 Governing Law. This Agreement shall be governed in all respects by the laws of the United States of America and the State of California as such laws apply to agreements entered into and to be performed entirely within California by California residents.

10.5 Forum and Venue. Any judicial action or proceeding arising hereunder or relating hereto shall be brought in, and the Parties hereby consent to the exclusive, personal jurisdiction of, the state and federal courts located in the County of Santa Clara, California. Seller hereby consents

to the jurisdiction of such courts and hereby appoints its counsel identified in Section 10.3 as its agent for service of process.

10.6 Construction.

(a) For purposes of this Agreement, whenever the context requires: the singular number will include the plural, and vice versa; the masculine gender will include the feminine and neuter genders; the feminine gender will include the masculine and neuter genders; and the neuter gender will include the masculine and feminine genders.

(b) Any rule of construction to the effect that ambiguities are to be resolved against the drafting Party will not be applied in the construction or interpretation of this Agreement.

(c) As used in this Agreement, the words “include” and “including” and variations thereof, will not be deemed to be terms of limitation, but rather will be deemed to be followed by the words “without limitation.”

(d) Unless the context requires otherwise, the term “Seller” as used herein refers to Seller and its Affiliates.

(e) Except as otherwise indicated, all references in this Agreement to “Schedules,” “Sections” and “Exhibits” are intended to refer to Schedules, Sections and Exhibits to this Agreement.

(f) The headings in this Agreement are for convenience of reference only, will not be deemed to be a part of this Agreement, and will not be referred to in connection with the construction or interpretation of this Agreement.

10.7 Breaches and Remedies. Except as otherwise provided herein, any and all remedies herein expressly conferred upon a Party will be deemed cumulative with and not exclusive of any other remedy conferred hereby, or by law or equity upon such Party, and the exercise by a Party of any one remedy will not preclude the exercise of any other remedy. Without limiting the generality of the foregoing, Seller agrees that if it breaches any provision of Sections 5.13 and 5.14, Parent and Buyer will have available, in addition to any other right or remedy otherwise available, the right to seek an injunction from a court of competent jurisdiction restraining such breach or threatened breach and to specific performance of any such provision of this Agreement without the requirement that Parent or Buyer post a bond.

10.8 Waiver. No failure on the part of a Party to exercise any power, right, privilege, or remedy under this Agreement, and no delay on the part of any Party in exercising any power, right, privilege, or remedy under this Agreement, will operate as a waiver of such power, right, privilege, or remedy; and no single or partial exercise of any such power, right, privilege, or remedy will preclude any other or further exercise thereof or of any other power, right, privilege, or remedy. No Party shall be deemed to have waived any claim arising from this Agreement, or any power, right, privilege or remedy under this Agreement, unless the waiver of such claim, power, right, privilege or remedy is expressly set forth in a written instrument duly executed and delivered on behalf of such Party; and any such waiver will not be applicable or have any effect except in the specific instance in which it is given.

10.9 Assignment. Neither Party may assign this Agreement in whole or in part without the prior written consent of the other Party. After the Closing, except as provided herein, Parent and Buyer may assign or transfer this Agreement in whole or part. Any attempted transfer or assignment except as provided herein shall be void and of no effect. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the successors or permitted assigns of the Parties. Nothing set forth herein shall in any way limit the transfer, assignment or licensing by Parent or Buyer of the Transferred Assets in their entirety or in part after the Closing.

10.10 Severability. If, for any reason, a court of competent jurisdiction finds any provision of this Agreement, or portion thereof, to be invalid or unenforceable, such provision of the Agreement will be enforced to the maximum extent permissible so as to effect the intent of the Parties, and the remainder of this Agreement will continue in full force and effect. The Parties agree to negotiate in good faith an enforceable substitute provision for any unenforceable provision that most nearly achieves the intent and economic effect of the unenforceable provision. Notwithstanding the foregoing, if a court of competent jurisdiction determines that any restriction on any license granted herein is invalid or unenforceable, then the license grants to which such restriction relates shall terminate automatically.

10.11 Entire Agreement. This Agreement (including the Collateral Agreements, Schedules and Exhibits hereto) sets forth the entire understanding of the Parties hereto relating to the subject matter hereof and supersedes all prior agreements and understandings between the Parties hereto relating to the subject matter hereof.

10.12 Amendments. This Agreement may not be amended, modified, altered or supplemented other than by means of a written instrument duly executed and delivered on behalf of Seller, Parent and Buyer.

10.13 Counterparts. This Agreement may be executed in counterparts, which, when taken together, shall constitute one agreement.

* * * * *

IN WITNESS WHEREOF, the Parties, by their duly authorized representatives, have executed this Agreement as of the date first written above.

“SELLER”

ADVANCED ENERGY INDUSTRIES, INC.

By: _____

Name: _____

Title: _____

“PARENT”

IWATT, INC.

By: _____

Name: _____

Title: _____

“BUYER”

IKOR ACQUISITION CORPORATION

By: _____

Name: _____

Title: _____

[Asset Purchase Agreement]

List of Schedules and Exhibits

<u>Schedule Number</u>	<u>Title of Schedule</u>
1.1(c)	Assigned Patents
1.1(d)	Assigned Trademarks
1.1(f)	Form of Bill of Sale
1.1(n)	Designated Employees
1.1(mm)	Product Software
1.1(v)	Excluded Assets
1.1(ss)	Transferred Contracts
1.1(ww)	Transferred Products
1.1(xx)	Transferred Tangible Assets
1.1(yy)	Transferred Technology
1.1(zz)	Transferred Websites
5.5	Software Licenses
7.1(g)	Required Consents

<u>Exhibit Number</u>	<u>Exhibit Title</u>
A	Escrow Agreement
B-1	Transition Services
B-2	Third Party Software Licenses
C	Disclosure Schedule
D	Form of Employment Offer Letter
E	Form of Sublease
F	Form of License Agreement

SUBSIDIARIES OF THE REGISTRANT

<u>Name</u>	<u>Jurisdiction of Incorporation or Organization</u>
Advanced Energy Industries GmbH	Germany
Advanced Energy Industries, Inc., Shanghai	China
Advanced Energy Industries Korea, Inc.	South Korea
Advanced Energy Industries (Shenzhen) Co., Ltd.(manufacturing)	China
Advanced Energy Industries U.K. Limited	United Kingdom
Advanced Energy Japan K.K.	Japan
Advanced Energy N.K.	Japan
Advanced Energy Taiwan, Ltd.	Taiwan
AEI International Holdings CV	Netherlands
AEI US Subsidiary, Inc.	Delaware
Aera Corporation	Texas
Aera U.K. Ltd.	United Kingdom
Dressler Hochfrequenztechnik, GmbH	Germany
Sekidenko, Inc.	Washington

Consent of Independent Registered Public Accounting Firm

We have issued our reports dated March 20, 2006, accompanying the consolidated financial statements and schedule and management's assessment of the effectiveness of internal controls over financial reporting included in the Annual Report of Advanced Energy Industries, Inc. on Form 10-K for the year ended December 31, 2005. We hereby consent to the incorporation by reference of said reports in the Registration Statements of Advanced Energy Industries, Inc. on Form S-8 (No. 333-01616), Form S-8 (No. 333-04073), Form S-8 (No. 333-46705), Form S-8 (No. 333-57233), Form S-8 (No. 333-65413), Form S-8 (No. 333-79425), Form S-8 (No. 333-79429), Form S-8 (No. 333-62760), Form S-8 (No. 333-69148), Form S-8 (No. 333-69150), Form S-8 (No. 333-87718), Form S-8 (No. 333-105365), Form S-8 (No. 333-105366), Form S-8 (No. 333-105367), Form S-8 (No. 333-129858), Form S-8 (No. 333-129859) and Form S-3 (No. 333-110534).

/S/ GRANT THORNTON LLP

Denver, Colorado
March 20, 2006

Consent of Independent Registered Public Accounting Firm

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

We consent to the incorporation by reference in the registration statement (No. 333-110534) on Form S-3 and the registration statements (Nos. 333-01616, 333-04073, 333-46705, 333-57233, 333-65413, 333-79425, 333-79429, 333-62760, 333-69148, 333-69150, 333-87718, 333-105365, 333-105366, 333-105367, 333-129858 and 333-129859) on Form S-8 of Advanced Energy Industries, Inc. of our report dated February 20, 2004 (except as to the matters related to the year ended December 31, 2003 disclosed in note 2 to the consolidated financial statements, as to which the date is March 22, 2006) with respect to the consolidated statements of operations, stockholders' equity and comprehensive loss, and cash flows of Advanced Energy Industries, Inc. for the year ended December 31, 2003, and the related financial statement schedule, which report appears in the December 31, 2005 annual report on Form 10-K of Advanced Energy Industries, Inc.

Our report dated February 20, 2004 (except as to the matters related to the year ended December 31, 2003 disclosed in note 2 to the consolidated financial statements, as to which the date is March 22, 2006) contains an explanatory paragraph relating to the fact that effective January 1, 2003, Advanced Energy Industries, Inc. and subsidiaries adopted the provisions of Statement of Financial Accounting Standards No. 145, *Rescission of FASB Statements 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*.

/s/ KPMG LLP

Denver, Colorado
March 22, 2006

I, Hans Georg Betz, certify that:

1. I have reviewed this annual report on Form 10-K of Advanced Energy Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 22, 2006

/s/ Hans Georg Betz

Hans Georg Betz
Chief Executive Officer and President

I, Mark D. Hartman, certify that:

1. I have reviewed this annual report on Form 10-K of Advanced Energy Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 22, 2006

/s/ Mark D. Hartman

Mark D. Hartman
Principal Financial Officer

Certification of the Chief Executive Officer
Pursuant to 18 U.S.C. Section 1350,
as Adopted Pursuant to Section 906
of the Sarbanes–Oxley Act of 2002

In connection with the accompanying annual report on Form 10–K of Advanced Energy Industries, Inc. (the “Company”) for the year ended December 31, 2005 (the “Report”), I, Hans Georg Betz, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 22, 2006

/s/ Hans Georg Betz

Hans Georg Betz
Chief Executive Officer and President

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Certification of the Chief Financial Officer
Pursuant to 18 U.S.C. Section 1350,
as Adopted Pursuant to Section 906
of the Sarbanes–Oxley Act of 2002

In connection with the accompanying annual report on Form 10–K of Advanced Energy Industries, Inc. (the “Company”) for the year ended December 31, 2005 (the “Report”), I, Mark D. Hartman, Principal Financial & Accounting Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 22, 2006

/s/ Mark D. Hartman

Mark D. Hartman
Principal Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.