



# **FORM 10-Q**

**CYMER INC - CYMI**

**Filed: November 07, 2006 (period: September 30, 2006)**

Quarterly report which provides a continuing view of a company's financial position

# Table of Contents

[10-Q - QUARTERLY REPORT PURSUANT TO SECTIONS 13 OR 15\(D\)](#)

## [PART I.](#)

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- [ITEM 1.](#)      [Financial Statements](#)  
[ITEM 2.](#)      [Management's Discussion and Analysis of Financial Condition and Results of Operations](#)  
[Item 3.](#)      [Quantitative and Qualitative Disclosures About Market Risk](#)  
[ITEM 4.](#)      [Controls and Procedures](#)

## [PART II.](#)

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- [ITEM 1.](#)      [Legal Proceedings](#)  
[ITEM 1A.](#)     [Risk Factors](#)  
[ITEM 2.](#)      [Unregistered Sales of Equity Securities and Use of Proceeds](#)  
[ITEM 3.](#)      [Defaults Upon Senior Securities](#)  
[ITEM 4.](#)      [Submission of Matters to a Vote of Security Holders](#)  
[ITEM 5.](#)      [Other Information](#)  
[ITEM 6.](#)      [Exhibits](#)  
SIGNATURES  
[EX-10.1 \(EX-10.1\)](#)  
  
[EX-10.2 \(EX-10.2\)](#)  
  
[EX-31.1 \(EX-31.1\)](#)  
  
[EX-31.2 \(EX-31.2\)](#)  
  
[EX-32.1 \(EX-32.1\)](#)  
  
[EX-32.2 \(EX-32.2\)](#)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2006

OR

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-21321

**CYMER, INC.**

(Exact name of registrant as specified in its charter)

**Nevada**  
(State or other jurisdiction of incorporation or organization)

**33-0175463**  
(I.R.S. Employer Identification No.)

**17075 Thornmint Court, San Diego, CA**  
(Address of principal executive offices)

**92127**  
(Zip Code)

**(858) 385-7300**  
(Registrant's telephone number, including area code)

**N/A**  
(Former name, former address and former fiscal year, if changed since last report).

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 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 Rule 12b-2 of the Exchange Act).  Yes  No

The total number of shares of Common Stock, with \$0.001 par value, outstanding on November 2, 2006 was 37,132,327.

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**CYMER, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended September 30, 2006**

**INDEX**

**PART I. FINANCIAL INFORMATION**

ITEM 1. Financial Statements (unaudited)

Consolidated Balance Sheets as of December 31, 2005  
and September 30, 2006

Consolidated Statements of Operations for the  
three and nine months ended September 30, 2005 and 2006

Consolidated Statements of Cash Flows for the  
nine months ended September 30, 2005 and 2006

Notes to Consolidated Financial Statements

ITEM 2. Management's Discussion and Analysis of Financial  
Condition and Results of Operations

ITEM 3. Quantitative and Qualitative Disclosures About  
Market Risk

ITEM 4. Controls and Procedures

**PART II. OTHER INFORMATION**

ITEM 1. Legal Proceedings

ITEM 1A. Risk Factors

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

ITEM 3. Defaults Upon Senior Securities

ITEM 4. Submission of Matters to a Vote of Security Holders

ITEM 5. Other Information

ITEM 6. Exhibits

**SIGNATURES**

## ITEM 1. Financial Statements

### CYMER, INC. CONSOLIDATED BALANCE SHEETS (UNAUDITED) (In thousands, except share data)

	December 31, 2005	September 30, 2006
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 233,745	\$ 254,233
Short-term investments	130,204	198,112
Accounts receivable	89,818	114,998
Accounts receivable - related party	588	2,189
Foreign currency forward exchange contracts	1,776	822
Inventories	89,046	104,526
Deferred income taxes	33,338	33,362
Prepaid expenses and other assets	6,497	7,323
Total current assets	585,012	715,565
PROPERTY AND EQUIPMENT - NET	117,251	110,811
LONG-TERM INVESTMENTS	29,395	9,847
DEFERRED INCOME TAXES	34,429	24,557
GOODWILL	8,358	8,833
INTANGIBLE ASSETS - NET	10,474	16,642
OTHER ASSETS	6,457	6,135
<b>TOTAL ASSETS</b>	<b>\$ 791,376</b>	<b>\$ 892,390</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 17,710	\$ 14,282
Accounts payable - related party	4,975	4,541
Accrued warranty and installation	30,775	30,519
Accrued payroll and benefits	12,461	20,437
Accrued patents, royalties and other fees	7,180	6,121
Income taxes payable	7,268	5,592
Unearned income	1,726	2,489
Other current liabilities	3,247	2,113
Total current liabilities	85,342	86,094
CONVERTIBLE SUBORDINATED NOTES	140,722	140,722
OTHER LIABILITIES	10,582	15,359
Total liabilities	236,646	242,175
MINORITY INTEREST	16,276	7,454
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock - \$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding	—	—
Common stock - \$.001 par value per share; 100,000,000 shares authorized; 38,036,000 and 41,399,000 shares outstanding at December 31, 2005 and September 30, 2006, respectively	38	41
Additional paid-in capital	407,549	537,716
Treasury stock at cost (1,943,000 and 4,536,000 common shares)	(50,000)	(150,704)
Accumulated other comprehensive loss	(9,025)	(4,421)
Retained earnings	189,892	260,129
Total stockholders' equity	538,454	642,761

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

\$ 791,376 \$ 892,390

See Notes to Unaudited Consolidated Financial Statements.

**CYMER, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)**  
(In thousands, except per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	2006	2005	2006
<b>REVENUES:</b>				
Product sales	\$ 99,415	\$ 142,711	\$ 279,821	\$ 399,694
Product sales - related party	177	1,098	177	6,461
Other	61	109	857	259
Total revenues	<u>99,653</u>	<u>143,918</u>	<u>280,855</u>	<u>406,414</u>
<b>COSTS AND EXPENSES:</b>				
Cost of product sales	57,480	72,487	168,242	211,734
Research and development	15,922	18,940	47,483	55,867
Sales and marketing	6,281	8,427	18,832	22,643
General and administrative	7,789	9,085	20,115	27,895
Total costs and expenses	<u>87,472</u>	<u>108,939</u>	<u>254,672</u>	<u>318,139</u>
OPERATING INCOME	<u>12,181</u>	<u>34,979</u>	<u>26,183</u>	<u>88,275</u>
<b>OTHER INCOME (EXPENSE):</b>				
Foreign currency exchange gain (loss) - net	(165)	(243)	(932)	856
Gain on debt extinguishment	—	—	2,220	—
Interest and other income	2,693	5,415	7,691	17,894
Interest and other expense	(1,525)	(1,474)	(5,428)	(4,381)
Total other income - net	<u>1,003</u>	<u>3,698</u>	<u>3,551</u>	<u>14,369</u>
INCOME BEFORE INCOME TAX PROVISION AND MINORITY INTEREST	13,184	38,677	29,734	102,644
INCOME TAX PROVISION	1,187	12,547	2,099	34,680
MINORITY INTEREST	687	902	1,449	2,273
NET INCOME	<u>\$ 12,684</u>	<u>\$ 27,032</u>	<u>\$ 29,084</u>	<u>\$ 70,237</u>
<b>EARNINGS PER SHARE:</b>				
Basic earnings per share	<u>\$ 0.36</u>	<u>\$ 0.71</u>	<u>\$ 0.81</u>	<u>\$ 1.85</u>
Weighted average common shares outstanding	<u>35,501</u>	<u>37,819</u>	<u>36,070</u>	<u>37,995</u>
Diluted earnings per share	<u>\$ 0.35</u>	<u>\$ 0.68</u>	<u>\$ 0.80</u>	<u>\$ 1.75</u>
Weighted average common and dilutive potential common shares outstanding	<u>36,131</u>	<u>41,185</u>	<u>36,502</u>	<u>41,635</u>

See Notes to Unaudited Consolidated Financial Statements.

**CYMER, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(In thousands)

	For the nine months ended September 30,	
	2005	2006
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 29,084	\$ 70,237
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on debt extinguishment	(2,220)	—
Depreciation and amortization	21,512	18,939
Non-cash stock-based compensation	953	7,567
Amortization of unearned compensation	16	—
Minority interest	(1,449)	(2,273)
Provision for deferred income taxes	22	9,410
Loss on disposal and impairment of property and equipment	54	94
Change in assets and liabilities:		
Accounts receivable – net	26,882	(25,180)
Accounts receivable – related party	(259)	(1,601)
Foreign currency forward exchange contracts	(2,952)	1,154
Inventories	23,869	(15,480)
Prepaid expenses and other assets	(2,388)	(1,089)
Accounts payable	(75)	(3,428)
Accounts payable - related party	4,169	(434)
Accrued expenses and other liabilities	(2,733)	10,304
Unearned income	(4,152)	763
Income taxes payable	109	(1,676)
Net cash provided by operating activities	<u>90,442</u>	<u>67,307</u>
<b>INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(14,769)	(9,976)
Purchases of investments	(276,968)	(188,229)
Proceeds from sold or matured investments	323,612	140,823
Acquisition of patents	—	(8,200)
Acquisition of minority interest	—	(7,024)
Net cash provided by (used in) investing activities	<u>31,875</u>	<u>(72,606)</u>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	12,639	103,656
Redemption of convertible subordinated notes	(57,336)	—
Cash investment received from minority shareholder	11,120	—
Excess tax benefits from stock option exercises	—	18,947
Payments on capital lease obligations	(20)	—
Repurchase of common stock into treasury	(50,000)	(100,704)
Net cash provided by (used in) financing activities	<u>(83,597)</u>	<u>21,899</u>
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(698)	3,888
NET INCREASE IN CASH AND CASH EQUIVALENTS	38,022	20,488
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	<u>114,246</u>	<u>233,745</u>
CASH AND CASH EQUIVALENTS AT END OF THE PERIOD	<u>\$ 152,268</u>	<u>\$ 254,233</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Interest paid	<u>\$ 6,850</u>	<u>\$ 5,150</u>
Income taxes paid, net	<u>\$ 3,502</u>	<u>\$ 7,860</u>



## CYMER, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Three and Nine Months Ended September 30, 2006 (Unaudited)

#### 1. BASIS OF PRESENTATION

*Unaudited Interim Financial Data* – The accompanying consolidated financial information has been prepared by Cymer, Inc., and its wholly-owned and majority-owned subsidiaries (collectively, “Cymer”), without audit, in accordance with the instructions to Form 10-Q. In the opinion of management, the unaudited consolidated financial statements for the interim periods presented reflect all material adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial position and results of operations as of and for such periods indicated. These unaudited consolidated financial statements and notes hereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005. Results for the interim periods presented herein are not necessarily indicative of results that may be reported for any other interim period or for the entire fiscal year.

*Principles of Consolidation* – The accompanying consolidated financial statements include our accounts and the accounts of our wholly owned subsidiaries – Cymer Japan, Inc. (“Cymer Japan”), Cymer Singapore Pte Ltd. (“Cymer Singapore”), Cymer B.V. in the Netherlands (“Cymer B.V.”), Cymer Southeast Asia, Ltd, in Taiwan (“Cymer SEA”), Cymer Semiconductor Equipment Shanghai Co., Ltd, in the People’s Republic of China (“Cymer PRC”), Cymer Korea, Inc. (“Cymer Korea”), and our majority-owned subsidiary, TCZ Pte Ltd., a company incorporated in Singapore (“TCZ Singapore”).

On January 2, 2006, we acquired the remaining 19% minority interest in Cymer Korea. We paid a total of \$7.0 million for this 19% interest. This transaction increased our total interest in Cymer Korea from 81% to 100%. Cymer Japan is currently our only subsidiary that sells excimer light source systems. Cymer Japan also provides field service to customers in Japan. Cymer Singapore, Cymer B.V., Cymer SEA, and Cymer PRC are field service offices for customers in their respective countries. Cymer Korea provides refurbishment manufacturing, field service, and administrative activities for Korea and the Asia-Pacific region.

We formed TCZ Singapore in September 2006 in connection with our TCZ joint venture with Carl Zeiss SMT AG, a German corporation (“SMT”) and Carl Zeiss Laser Optics Beteiligungsgesellschaft mbH, a German limited liability company (“LOB”). LOB and SMT, together with their affiliated entities, are collectively referred to as “Zeiss.” Per the terms of our original joint venture agreement, TCZ GmbH, a Swiss limited liability company (“TCZ Switzerland”), was formed and Switzerland was designated as the location for the TCZ joint venture. In September 2006 we moved the location of the TCZ joint venture from Switzerland to Singapore. See Footnote 4 for more details. We own 60% of TCZ Singapore and Zeiss owns 40%. TCZ is currently developing, and will integrate, market and sell, and support tools employing an excimer laser beam to induce crystallization of low-temperature poly-silicon (“LTPS”) processing for the manufacture of flat panel displays.

All significant intercompany balances and transactions have been eliminated in consolidation.

*Accounting Estimates* – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

#### *Accounting Pronouncements Adopted*

In November 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 151 (“SFAS No. 151”), “Inventory Costs, an Amendment of ARB 43 Chapter 4”. This statement amended Accounting Research Bulletin No. 43 (“ARB No. 43”) Chapter 4, to clarify accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted

material. SFAS No. 151 requires that those items be recognized as current-period charges. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. We adopted SFAS No. 151 on January 1, 2006. The adoption of SFAS No. 151 did not have an impact on our consolidated financial statements.

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154 (“SFAS No. 154”), “Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3”. This Statement replaces APB Opinion No. 20, “Accounting Changes” and FASB Statement 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. When a pronouncement includes specific transition provisions, those provisions should be followed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We adopted SFAS No. 154 on January 1, 2006. The adoption of SFAS No. 154 did not have an impact on our consolidated financial statements.

Effective January 1, 2006, we adopted the provisions of FASB Statement of Financial Accounting Standards No. 123R (“SFAS No. 123R”) “Share-Based Payment” which replaces Statement of Financial Accounting Standards No. 123 (“SFAS No.123”), “Accounting for Stock-Based Compensation” and supersedes Accounting Principles Board Opinion No. 25 (“APB No. 25”), “Accounting for Stock Issued to Employees”. Under the fair value recognition provisions of SFAS No. 123R, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense over the requisite service period, or the vesting period. We elected the modified-prospective method in implementing SFAS No. 123R which does not require us to revise prior period financial statements for comparative purposes. We elected to use the Black-Scholes option pricing model to determine the fair value of our stock options under SFAS No. 123R. The valuation provisions of SFAS No. 123R apply to new options granted on or after January 1, 2006. We also elected to attribute the value of share-based compensation to expense using the straight-line method for awards granted on or after January 1, 2006. Estimated compensation expense for grants that were outstanding and unvested as of the effective date will be recognized over the remaining service period using the compensation cost estimated for the SFAS No. 123 pro forma disclosures which uses an accelerated expense recognition method for those awards with a graded vesting schedule. The adoption of SFAS No. 123R had a material impact on our consolidated financial statements. See Footnote 2 for more detailed information on our adoption of SFAS No. 123R.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3 “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards”. We have elected to adopt the “short-cut” method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS No. 123R. The “short-cut” method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (“APIC pool”) related to the tax effects of share-based compensation, and to determine the subsequent impact on the APIC pool, the consolidated statements of cash flows, and earnings per share of the tax effects of share-based compensation awards that were outstanding upon adoption of SFAS No. 123R.

In accordance with SFAS No. 123R, beginning in the first quarter of 2006, we have presented excess tax benefits for the exercise of share-based compensation awards as a financing activity in the consolidated statement of cash flows. Prior to the adoption of SFAS No. 123R, we presented the tax benefits for deductions resulting from the exercise of stock options as an operating cash flow activity.

*Reclassifications* – Certain amounts in the prior year consolidated financial statements have been reclassified to conform to current period presentation.

## 2. STOCKHOLDERS' EQUITY

### Stock-Based Compensation Valuation Assumptions

We estimate the fair value of our stock options using a Black-Scholes option pricing model, consistent with the provisions of SFAS No. 123R. In addition, we used this same option pricing model to calculate the fair value of our stock options included in our prior period pro forma disclosures as required by SFAS No. 123.

The fair value of stock options granted is recognized to expense over the requisite service period. For stock options granted after the SFAS No. 123R effective date of January 1, 2006, the straight-line attribution approach is used. For stock options granted prior to January 1, 2006, which are continuing to vest, we will continue to record expense using the FASB Interpretation No. 28 ("FIN 28") accelerated attribution approach.

Upon the adoption of SFAS No. 123R, we used a combination of historical and implied volatility ("blended volatility") to value our stock options. Historical volatility is based on a period commensurate with the expected term of the options. Implied volatility was derived based on six-month traded options of our common stock. Prior to January 1, 2006, we used only historical stock price volatility in accordance with SFAS No. 123 for purposes of our pro forma stock compensation calculation. The expected term of our stock options represents the period of time options are expected to be outstanding and is based on observed historical exercise patterns for our company which we believe are indicative of future exercise behavior. For the risk free interest rate, we use the then currently available rate on zero coupon U.S. Government issues with a remaining period commensurate with the expected term for valuing options.

The following weighted average assumptions were used for grants issued in the three and nine months ended September 30, 2005 under the SFAS No. 123 requirements and in the three and nine months ended September 30, 2006 under the SFAS No. 123R requirements:

	Three months ended September 30,		Nine months ended September 30,	
	2005	2006	2005	2006
Dividend yield	None	None	None	None
Volatility rate:				
Options	75%	56%	75%	56%
ESPP	n/a	n/a	75%	n/a
Risk free interest rate:				
Options	4.04%	4.59%	3.95%	4.77%
ESPP	n/a	n/a	3.33%	n/a
Expected term:				
Options	4.38 years	3.14 years	4.31 years	3.15 years
ESPP	n/a	n/a	.5 years	n/a

In our pro forma disclosures prior to the adoption of SFAS No. 123R, we accounted for forfeitures as they occurred. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised if necessary in subsequent periods if actual forfeiture rates differ from those estimates. Forfeitures were estimated based on historical activity for our company. For the three and nine months ended September 30, 2006, we estimated a 3% annual forfeiture rate. We amended our Employee Stock Purchase Plan ("ESPP") in May 2005, and as a result, our ESPP is treated as a noncompensatory plan.

## Impact of SFAS No. 123R

The following table presents the impact to our consolidated financial statements as a result of our adoption of SFAS No. 123R for the three and nine months ended September 30, 2006 (in thousands, except per share amounts):

	<u>Three months ended September 30, 2006</u>	<u>Nine months ended September 30, 2006</u>
Stock-based compensation expense by type of award:		
Employee stock options	\$ 2,137	\$ 6,627
Stock units	174	495
Total stock-based compensation	2,311	7,122
Tax effect on stock-based compensation	(750)	(2,407)
Net effect on net income	\$ 1,561	\$ 4,715
Effect on earnings per share:		
Basic	\$ 0.04	\$ 0.12
Diluted	\$ 0.04	\$ 0.11
Impact of stock option deductions on:		
Cash flows from operations	\$ (1,175)	\$ (18,947)
Cash flows from financing activities	\$ 1,175	\$ 18,947

As of September 30, 2006, the unamortized compensation expense related to outstanding unvested options was approximately \$10.2 million with a weighted average remaining vesting period of 1.28 years. We expect to amortize this expense over the remaining vesting period of these stock options.

The amount of stock-based compensation costs capitalized into inventory during the nine months ended September 30, 2006 was immaterial.

We account for options granted to non-employees under SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments that are Issued to other than Employees for Acquiring or in Conjunction with Selling Goods or Services". We measure the fair value of such options using the Black-Scholes option pricing model at each financial reporting date. We account for changes in fair values between reporting dates in accordance with FIN 28. Stock-based compensation expense for options granted to non-employees and for those employees who changed status during the nine months ended September 30, 2005 and 2006 was \$949,000 and \$445,000, respectively.

Prior to the adoption of SFAS No. 123R, we applied the intrinsic value-based method of accounting required by APB No. 25 for options granted to employees and provided the pro forma disclosures of SFAS No. 123 as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure". During 2005, we recorded no compensation expense related to the grant of options to employees since the exercise price of such options equaled or exceeded the market value of the underlying common stock on the date of grant.

## Pro Forma for 2005 Under SFAS No. 123

The following table compares the earnings per share that we reported to the pro forma amounts that we would have reported had we recognized compensation expense for our stock-based compensation plans in accordance with SFAS No. 123 (in thousands, except per share amounts):

	<u>Three months ended September 30, 2005</u>	<u>Nine months ended September 30, 2005</u>
Net income, as reported	\$ 12,684	\$ 29,084
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	546	886
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	<u>(2,889)</u>	<u>(18,840)</u>
Pro forma net income	<u>\$ 10,341</u>	<u>\$ 11,130</u>
Earnings per share:		
Basic - as reported	<u>\$ 0.36</u>	<u>\$ 0.81</u>
Basic - pro forma	<u>\$ 0.29</u>	<u>\$ 0.31</u>
Diluted - as reported	<u>\$ 0.35</u>	<u>\$ 0.80</u>
Diluted - pro forma	<u>\$ 0.29</u>	<u>\$ 0.30</u>

In February 2005, our board of directors approved the acceleration of the vesting of stock options that had exercise prices of \$30.50 per share or higher held by employees. This acceleration of stock options excluded directors, executive officers and certain vice presidents. The purpose of this acceleration of vesting was to enable us to eliminate the recognition in our statement of operations of the compensation expense associated with these "out of the money" stock options in future periods, upon our adoption of SFAS No. 123R on January 1, 2006. The acceleration of vesting of these stock options in the nine months ended September 30, 2005 contributed approximately \$10.4 million of pro forma stock-based compensation expense.

### Stock Option Plans

Currently, we grant stock options and awards from our 2005 Equity Incentive Plan (the "2005 Plan"), which provides for the grant or award of various equity instruments to our employees, directors and consultants. Upon approval of the 2005 Plan by stockholders in May 2005, we discontinued the use of our 1996 Stock Option Plan and 2000 Equity Incentive Plan. Options issued under the 2005 Plan expire ten years after the options are granted. It is our practice to generally grant options that vest and become exercisable ratably over a four-year period following the date of grant. A total of 1,000,000 shares of common stock are reserved for issuance under the 2005 Plan and it provides for the issuance of incentive stock options, nonstatutory stock options, stock appreciation rights, stock bonus awards, stock purchase awards, stock unit awards and other stock awards. Options and awards to purchase 630,327 shares are outstanding and 369,537 shares remain available for grant under the 2005 Plan as of September 30, 2006.

The following describes our other stock option plans from which we no longer issue awards although options to purchase shares are still outstanding under these plans and continue to vest and may be exercised:

*1996 Stock Option Plan (the "1996 Plan")* – The 1996 Plan provided for the grant of incentive stock options to our employees and nonqualified stock options to our employees, directors and consultants. The exercise prices of stock options granted under the 1996 Plan were at least equal to the fair market value of our common stock on the dates of grant. Options issued under the 1996 Plan expire five to ten years after the options were granted and generally vest and become exercisable ratably over a four-year period following the date of grant. A total of 7,900,000 shares of common stock were reserved for issuance under the 1996 Plan. Of these shares, options to purchase 1,819,741 million shares are outstanding as of September 30, 2006.

*2000 Equity Incentive Plan (the "2000 Plan")* – In August 2000, our board of directors adopted the 2000 Plan which provides for the grant of options to our employees or consultants who are neither directors nor officers. The exercise prices of the options granted under the 2000 Plan were equal to the quoted market value of our common stock at the date of grant. Options issued under the 2000 Plan expire ten years after the options were granted and generally vest and become exercisable ratably over a four year period following the date of grant. A total of 4,950,000 shares of common stock were reserved for issuance under the 2000 Plan. Of these shares, options to purchase 1,445,067 million shares are outstanding as of September 30, 2006.

## Stock Options

The following is a summary of stock option activity under all stock option plans for the nine months ended September 30, 2006 (in thousands, except per share data):

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price Per Share</u>	<u>Weighted Average Contractual Term (in years)</u>
Balance at January 1, 2006	6,924	\$ 32.15	
Granted	277	\$ 44.82	
Exercised	(3,149)	\$ 30.70	
Forfeited	(144)	\$ 30.02	
Expired	(31)	\$ 48.52	
Balance at September 30, 2006	<u>3,877</u>	<u>\$ 34.19</u>	<u>6.08</u>
Exercisable at September 30, 2006	<u>2,952</u>	<u>\$ 33.76</u>	<u>5.29</u>

The following table summarizes information as of September 30, 2006 concerning currently outstanding and exercisable options:

<u>Range of Exercise Prices</u>	<u>Options Outstanding</u>				<u>Options Exercisable</u>		
	<u>Number Outstanding As of 9/30/06 (in thousands)</u>	<u>Weighted Average Remaining Contractual Term (in years)</u>	<u>Weighted Average Exercise Price</u>	<u>Aggregate Intrinsic Value (in thousands)</u>	<u>Number Exercisable As of 9/30/06 (in thousands)</u>	<u>Weighted Average Exercise Price</u>	<u>Aggregate Intrinsic Value (in thousands)</u>
\$12.75 - \$15.73	4	1.92	\$ 12.75	\$ 114	4	\$ 12.75	\$ 115
\$16.32 - \$19.98	237	5.84	\$ 19.23	\$ 5,854	229	\$ 19.21	\$ 5,655
\$20.00 - \$24.22	356	4.76	\$ 22.73	\$ 7,528	319	\$ 22.62	\$ 6,801
\$24.29 - \$31.66	809	6.84	\$ 28.41	\$ 12,545	561	\$ 28.51	\$ 8,634
\$31.69 - \$38.66	1,529	5.52	\$ 35.53	\$ 12,803	1,220	\$ 35.97	\$ 9,681
\$39.37 - \$48.64	705	7.33	\$ 43.40	\$ 361	432	\$ 43.10	\$ 351
\$48.73 - \$55.13	237	5.66	\$ 50.24	\$ —	187	\$ 50.64	\$ —
\$12.75 - \$55.13	<u>3,877</u>	<u>6.08</u>	<u>\$ 34.19</u>	<u>\$ 39,205</u>	<u>2,952</u>	<u>\$ 33.76</u>	<u>\$ 31,237</u>

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value, based on a per share price of \$43.91, the closing price of our common stock on September 30, 2006 as reported

by The NASDAQ Global Select Market, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money stock options exercisable as of September 30, 2006 was 2.5 million.

The weighted average per share fair value of the options granted was \$19.97 and \$17.60 during the three months ended September 30, 2005 and 2006, respectively, and was \$17.70 and \$18.82 during the nine months ended September 30, 2005 and 2006, respectively.

The total intrinsic value of options exercised was \$3.7 million and \$2.5 million during the three months ended September 30, 2005 and 2006, respectively, and was \$4.4 million and \$56.6 million during the nine months ended September 30, 2005 and 2006, respectively.

The total cash received from employees as a result of employee stock option exercises during the nine months ended September 30, 2006 was approximately \$96.7 million. In connection with these exercises, the tax benefits recognized by us for the nine months ended September 30, 2006 was \$18.9 million.

We settle employee stock option exercises with newly issued shares of our common stock.

## Stock Units

In January 2006, our board of directors approved the use of annual stock unit awards for non-employee directors pursuant to our 2005 Plan in lieu of quarterly stock options grants. The number of shares subject to each stock unit award is determined by dividing \$100,000 by the closing price per share of our common stock as of the date of grant. During the nine months ended September 30, 2006, 17,948 shares subject to such stock units awards were granted to non-employee directors with a grant date fair value of \$39.00 per share. Each stock unit award shall vest 100% after one year from the date of grant. Stock based compensation expense for stock units for the three and nine months ended September 30, 2006 was \$174,000 and \$495,000, respectively.

A summary of the change in stock unit awards outstanding during the nine months ended September 30, 2006 is as follows (in thousands, except life data):

	Shares	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value as of September 30, 2006
Beginning Outstanding	—		
Awarded	18		
Vested	—		
Forfeited	—		
Ending Outstanding	18	0.29	\$ 788
Ending Exercisable	—	—	

Weighted Average Remaining Recognition Period - 0.29 years

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value based on our closing stock price of \$43.91 as of September 30, 2006.

## Employee Stock Purchase Plan

*1996 Employee Stock Purchase Plan (the "ESPP")* – Our ESPP is intended to qualify for favorable income tax treatment associated with rights granted under an employee stock purchase plan which qualifies under Section 423 of the Internal Revenue Code. Under the ESPP, eligible employees may

purchase shares of our common stock through payroll deductions of up to 15% of his or her compensation (as defined in the plan), at a price per share equal to 95% of the fair market value of our common stock at the end of the purchase period. Our ESPP was amended in 2005. The amendment: a) changed the duration of offering periods under the plan from two years to six months, b) reduced the discount to market price used to determine the purchase price for shares of our common stock under the plan from 15% to 5%, and c) eliminated the “lookback” feature that allowed the purchase price to be determined as of the beginning of an offering period, or enrollment date, if the market price as of the enrollment date was lower than the market price at the end of the offering period. As a result of the amendment the plan became non-compensatory.

On February 7, 2006, our board of directors amended our ESPP to extend the expiration date of the plan until July 31, 2016. In addition, on May 18, 2006, our stockholders approved an amendment to increase the number of shares of common stock reserved for issuance under the plan by 300,000 shares from 1,200,000 shares to 1,500,000 shares.

The number of shares issuable under the ESPP as of September 30, 2006 was 380,235, and 1,119,765 shares have been previously issued. Because our ESPP is a non-compensatory plan as defined by SFAS No. 123R, no stock-based compensation expense is recorded for our ESPP.

The total cash received from employees as a result of ESPP shares issued during the nine months ended September 30, 2006 was approximately \$711,000.

### **Common Stock Warrants**

During 2001, we issued warrants to purchase 200,000 shares of our common stock at a weighted average purchase price of \$31.43 per share in conjunction with the acquisition of certain patents. In May 2006, these warrants were exercised with respect to all 200,000 shares for \$6.3 million in cash.

### **Stock Repurchase Program**

On July 28, 2006, we announced that our board of directors had authorized us to repurchase up to \$150 million of our common stock. The purchases will be made from time to time in the open market or in privately negotiated transactions. The program may be discontinued at any time. Total purchases through September 30, 2006 were \$100.7 million or 2.6 million shares under this program.

## **3. EARNINGS PER SHARE**

*Earnings Per Share* – Basic earnings per share (“EPS”) excludes dilution and is computed by dividing net income or loss attributable to common stockholders by the weighted-average of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock (convertible subordinated notes using the “if-converted” method, warrants to purchase common stock and common stock options using the treasury stock method) were exercised or converted into common stock. Potential dilutive securities are excluded from the diluted EPS computation in loss periods as their effect would be anti-dilutive.

The following table sets forth the basic and diluted EPS for the three and nine months ended September 30, 2005 and 2006 (in thousands, except per share information):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2006	2005	2006
<b>NET INCOME:</b>				
Net income, as reported (used for basic EPS)	\$ 12,684	\$ 27,032	\$ 29,084	\$ 70,237
Adjustment for interest expense on 3.5% convertible subordinated notes, net of taxes	—	948	—	2,742
Net income, as adjusted for assumed conversion (used for diluted EPS)	\$ 12,684	\$ 27,980	\$ 29,084	\$ 72,979
<b>WEIGHTED AVERAGE SHARES:</b>				
Basic weighted average common shares outstanding	35,501	37,819	36,070	37,995
Effect of dilutive securities:				
Warrants	5	—	—	29
Options and stock units	625	552	432	797
Convertible subordinated notes	—	2,814	—	2,814
Diluted weighted average common and potential common shares outstanding	36,131	41,185	36,502	41,635
Earnings per share:				
Basic	\$ 0.36	\$ 0.71	\$ 0.81	\$ 1.85
Diluted	\$ 0.35	\$ 0.68	\$ 0.80	\$ 1.75

For the three months ended September 30, 2005 and 2006, weighted average options and warrants to purchase 3,601,000 and 724,000 shares of common stock, respectively, were outstanding but not included in the computation of diluted earnings per share as their effect was anti-dilutive. In addition, for the three months ended September 30, 2005, weighted average common shares attributable to convertible subordinated notes of 2,814,000 were not included in the computation of diluted earnings per share as their effect was also anti-dilutive.

For the nine months ended September 30, 2005 and 2006, weighted average options and warrants to purchase 4,927,000 and 642,000 shares of common stock were outstanding but not included in the computation of diluted earnings per share as their effect was anti-dilutive. In addition, for the nine months ended September 30, 2005, weighted average common shares attributable to convertible subordinated notes of 3,423,000 were not included in the computation of diluted earnings per share as their effect was also anti-dilutive.

#### 4. AMENDED JOINT VENTURE AGREEMENT

On September 12, 2006, we entered into an Amended and Restated Joint Venture Agreement (the "Amended JV Agreement") with (i) TCZ Switzerland, (ii) SMT, (iii) LOB, and (iv) TCZ Singapore. The purpose of this Amended JV Agreement was to move the location of our TCZ joint venture from Switzerland to Singapore. The terms and conditions of the original joint venture agreement we entered into with TCZ Switzerland, SMT and LOB on July 15, 2005 remain in effect, except for the following: 1) the change in the business location; 2) the addition of TCZ Singapore as a party to the Amended JV Agreement and successor to the rights and obligations of TCZ Switzerland and 3) the updates to the governance provisions to reflect differences in Swiss and Singapore corporate law.

## 5. INVENTORIES

Inventories consisted of the following as of December 31, 2005 and September 30, 2006 (in thousands):

	December 31, 2005	September 30, 2006
<b>INVENTORIES:</b>		
Raw materials	\$ 42,482	\$ 38,200
Work-in-progress	18,408	25,488
Finished goods	38,601	52,063
Allowance for excess and obsolete inventory	(10,445)	(11,225)
Total	<u>\$ 89,046</u>	<u>\$ 104,526</u>

## 6. REPORTING COMPREHENSIVE INCOME

Comprehensive income includes net income, effective unrealized gains and losses on forward contracts, foreign currency translation adjustments, and unrealized gains and losses on available-for-sale securities, which are recorded as short-term and long-term investments in the accompanying consolidated balance sheets.

The following table summarizes the change in each component of accumulated other comprehensive loss for the nine months ended September 30, 2006 (in thousands):

		Translation adjustment	Total unrealized losses on available-for-sale investments, net of tax	Total unrealized gains (losses) on foreign currency forward exchange contracts, net of tax	Accumulated other comprehensive loss
December 31, 2005	Balance	\$ (8,157)	\$ (798)	\$ (70)	\$ (9,025)
	Period net change	3,888	592	124	4,604
September 30, 2006	Balance	<u>\$ (4,269)</u>	<u>\$ (206)</u>	<u>\$ 54</u>	<u>\$ (4,421)</u>

Comprehensive income consisted of the following components (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2006	2005	2006
Net income	\$ 12,684	\$ 27,032	\$ 29,084	\$ 70,237
Foreign currency translation adjustments	(634)	1,196	(413)	3,888
Unrealized gains (losses) on available-for-sale investments, net of tax	(243)	487	(607)	592
Unrealized gains (losses) on foreign currency forward exchange contracts, net of tax	(95)	68	663	124
Comprehensive income	<u>\$ 11,712</u>	<u>\$ 28,783</u>	<u>\$ 28,727</u>	<u>\$ 74,841</u>

## 7. DEVELOPMENT AGREEMENT AND INTELLECTUAL PROPERTY LICENSE AGREEMENT

The research and development agreement we entered into effective as of January 23, 2004 with Intel Corporation (“Intel”) was amended effective on July 17, 2006 (“Amended Development Agreement”). Under the terms of the original agreement, Intel was to provide us with up to a total of \$20.0 million over a three-year period to accelerate the development of production-worthy extreme ultraviolet (“EUV”) lithography light sources. Under the terms of the Amended Development Agreement, most of the mutual obligations between us and Intel have been terminated, including Intel’s obligation to provide us with up to a total of \$20.0 million. As of the date of the amendment, we had received a total of \$8.5 million from Intel under the original agreement, including an advance payment of \$1.3 million paid by Intel at the initiation of the original agreement in 2004. Under the Amended Development Agreement, Intel has no obligation to provide us with further funding beyond the amount we already received and we returned \$347,222, which represents the unearned portion of the advance payment made by Intel. Although we will receive no additional funding from Intel under the Amended Development Agreement, we intend to continue to develop the EUV technology as part of our existing product roadmap. In addition, per the terms of the Amended Development Agreement, we will continue meeting with Intel on a regular basis to review our progress towards developing a production-worthy EUV source system.

The intellectual property license agreement we entered into effective as of January 28, 2004 with Intel was amended on June 28, 2006 (“Amended Intellectual Property License Agreement”). Under the original intellectual property license agreement, pursuant to which we licensed certain patents and trade secrets from Intel related to EUV lithography technology, our obligation to pay license fees to Intel did not commence until our first high volume manufacturing shipment of an EUV lithography light source. The Amended Intellectual Property License Agreement replaces the license fee payments tied to product shipments with an up-front license fee which we paid to Intel in full upon execution of the amendment. The Amended Intellectual Property License Agreement also changes a number of the EUV patents covered by the license. All of the licensed patents under the Amended Intellectual Property License Agreement relate to EUV technology, and we intend to use them in connection with our continuing research and development efforts related to EUV.

We recorded the patent license rights acquired from Intel valued at \$8.2 million under this Amended Intellectual Property License Agreement as an intangible asset in our accompanying consolidated balance sheets. The total value of these patent license rights are being amortized over a period of 16.29 years which represents the average remaining life of all of the patents purchased under this amendment. The amortization of these patents is included in research and development expenses on the accompanying statement of operations since the field of use involves applications which are still in the research and development stages.

## 8. GOODWILL AND INTANGIBLE ASSETS

We account for our goodwill and other intangible assets in accordance with Statement of Financial Accounting Standards No. 142 (“SFAS No. 142”), “Goodwill and Other Intangible Assets”. Under SFAS No. 142, our goodwill is subject to an annual impairment test. During the fourth quarter of 2005, we completed our annual impairment test of goodwill and intangible assets, and concluded that no impairment of goodwill existed.

The following table summarizes the activity in the carrying amount of goodwill as of December 31, 2005 and September 30, 2006 (in thousands):

Goodwill as of December 31, 2005	\$	8,358
Goodwill acquired with acquisition of 19% minority interest of Cymer Korea		475
Goodwill as of September 30, 2006	\$	<u>8,833</u>

Included in intangible assets – net on the accompanying balance sheets are amounts associated with patents that were acquired in 2001, 2003, 2005 and 2006. As of December 31, 2005 and

September 30, 2006, the net carrying amount of these patents was \$10.5 million and \$16.6 million, respectively. The accumulated amortization for these patents at December 31, 2005 and September 30, 2006 was \$8.3 million and \$10.4 million, respectively. Amortization expense for these patents was \$593,000 and \$761,000 for the three months ended September 30, 2005 and 2006, respectively, and \$1.8 million and \$2.0 million for the nine months ended September 30, 2005 and 2006, respectively.

As of September 30, 2006, future estimated amortization expense for these patents is expected to be as follows for (in thousands):

	<u>Future Amortization</u>
Three months ending December 31, 2006	\$ 762
Year ending December 31, 2007	\$ 3,046
Year ending December 31, 2008	\$ 3,046
Year ending December 31, 2009	\$ 1,564
Year ending December 31, 2010	\$ 675
Thereafter	\$ 7,549

## 9. GUARANTEES/WARRANTIES

In the ordinary course of business, we are not subject to potential obligations under guarantees that fall within the scope of Financial Accounting Standards Board Interpretation No. 45 ("FIN 45"), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others", except for standard warranty provisions associated with product sales and indemnification provisions related to intellectual property that are contained within many of our lithography tool manufacturer agreements. All of these provisions give rise only to the disclosure requirements prescribed by FIN 45.

- (a) Product Warranties – Warranty provisions contained within our lithography tool manufacturer agreements are generally consistent with those prevalent in the semiconductor equipment industry. The warranty period and terms for light source systems and spares and consumable parts varies by light source system model. We record a provision for warranty for all products, which is included in cost of product sales in the consolidated statements of operations and is recorded at the time that the related revenue is recognized. We review our warranty provision monthly, which is determined using a statistical financial model which calculates actual historical expenses, product failure rates, and potential risks associated with our different product models. We then use this financial model to calculate the future probable expenses related to warranty and the required level of the warranty provision. Throughout the year we review the risk levels, historical cost information and failure rates used within this model and update them as information changes over the product's life cycle. If actual warranty expenditures differ substantially from our estimates, revisions to the warranty provision would be required. Actual warranty expenditures are recorded against the warranty provision as they are incurred.

The following table summarizes information related to our warranty provision for the nine months ended September 30, 2006 (in thousands):

	<u>2006</u>
Balance, January 1, 2006	\$ 30,191
Liabilities accrued for warranties issued, net of adjustments and expirations	14,899
Warranty expenditures incurred	(15,015)
Balance, September 30, 2006	<u>\$ 30,075</u>

- (b) Intellectual Property Indemnifications – We include intellectual property indemnification clauses within our general terms and conditions with our customers and the general purchase agreements with our three lithography tool manufacturers, ASM Lithography, Canon, and Nikon. In general, these indemnification provisions provide that we will defend our customers against any infringement claims directed against our products. Under the indemnification clauses, we will pay all costs and damages, including attorney’s fees, associated with such settlements or defenses, provided that the lithography tool manufacturer follows specific procedures for notifying us of such claims and allows us to manage the settlement proceedings.

An indemnification provision was also included in the contract manufacturing agreement with Seiko Instruments, Inc. (“Seiko”), which was terminated effective March 31, 2003. As with our indemnification provisions on intellectual property, we continue to honor this indemnification clause within the agreement even after its termination. Seiko and at least one Japanese lithography tool manufacturer have been notified that our light source systems in Japan may infringe certain Japanese patents. We believe, based upon the advice of counsel, that our products do not infringe any valid claim of the asserted patents or that we are entitled to prior use claims in Japan.

As part of the original research and development agreement signed with Intel in 2004, we also agreed to provide Intel with indemnity against any infringement of the intellectual property rights of any third party arising from Intel’s purchase and/or use of our EUV source systems. Although this agreement was recently amended, our obligations to indemnify Intel will be specifically negotiated in any purchase agreement related to such future products.

As part of the supply agreement signed with TCZ in September 2005 and amended in September 2006 in connection with the amendment of the original TCZ joint venture agreement, we agreed to indemnify TCZ Singapore against any infringement of the intellectual property rights of a third party arising from TCZ’s purchase of our products. We will defend such actions at our own expense and will pay the cost and damage awarded in any such action provided that TCZ Singapore grants us sole control of the defense and settlement of such action and also provides us with information required for the defense and settlement of such action.

Due to the nature of the indemnification provisions described above, they are indefinite and extend beyond the term of the actual agreements.

## **10. RELATED PARTY TRANSACTIONS**

As a result of the formation of the TCZ joint venture in July 2005 under the terms of a joint venture agreement which was amended in September 2006, Zeiss is now a related party. In addition to transactions that occur among us, Zeiss and TCZ Singapore related to the joint venture, we also purchase certain optical parts directly from Zeiss and sell our light source system products to Zeiss periodically. We recorded revenue associated with this related party of \$1.1 million and \$6.5 million for the three and nine months ended September 30, 2006, respectively and revenue of \$177,000 for the three and nine months ended September 30, 2005. As of December 31, 2005 and September 30, 2006, we had accounts receivable balances of \$588,000 and \$2.2 million, respectively, and accounts payable balances of \$5.0 million and \$4.5 million, respectively, all of which were associated with these related party transactions with Zeiss.

## **11. CONTINGENCIES AND COMMITMENTS**

We are party to legal actions in the normal course of business. Based in part on the advice of legal counsel, our management does not expect the outcome of legal action in the normal course of business to have a material impact on our financial position, liquidity, or results of operations.

Our former Japanese manufacturing partner, Seiko, and one of our Japanese customers were notified in July 1996 that our light source systems in Japan may infringe certain Japanese patents held by

another Japanese company. We have agreed to indemnify our former Japanese manufacturing partner and our customers against patent infringement claims under certain circumstances, even after the termination date of the contract manufacturing agreement. We believe, based upon the advice of counsel, that our products do not infringe any valid claim of the asserted patents or that we are entitled to prior use claims in Japan.

## **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and notes thereto included in this Quarterly Report on Form 10-Q.*

### **Forward-Looking Statements**

Statements in this Quarterly Report on Form 10-Q that are not strictly historical in nature are forward-looking statements. These statements include, but are not limited to, references to the outlook for the semiconductor industry and us; expected domestic and international product sales and development; our research and development activities and expenditures; adequacy of our capital resources and investments; effects of business cycles in the semiconductor business; our competitive position; and our relationships with customers and third-party manufacturers of our products, and may contain words such as "believes," "anticipates," "expects," "plans," "intends" and words of similar meaning. These statements are predictions based on current information and our expectations and involve a number of risks and uncertainties. The underlying information and our expectations are likely to change over time. Actual events or results may differ materially from those projected in the forward-looking statements due to various factors, including, but not limited to, those contained under the caption "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q. Forward-looking statements herein speak only as of the date of this Quarterly Report on Form 10-Q. Unless required by law, we undertake no obligation to update or revise any forward-looking statements to reflect new information or future events or developments. Thus, you should not assume that our silence over time means that actual events are bearing out as expressed or implied in such forward-looking statements.

### **Overview**

#### *General*

We are the world's leading supplier of light source solutions for the semiconductor industry. Our products provide the essential light source for deep ultraviolet ("DUV") photolithography systems. Almost all consumer electronic devices manufactured in the last several years contain a semiconductor manufactured using light sources such as ours. We currently supply light sources to all three lithography tool manufacturers, ASM Lithography, Canon, and Nikon, who in turn supply their wafer steppers and scanners to chipmakers. In addition, we sell replacement parts and services to the lithography tool manufacturers as well as directly to the chipmakers. Our light source systems currently constitute a substantial majority of all excimer light sources incorporated in lithography stepper and scanner tools. Our headquarters are located in San Diego, California where we develop and manufacture all of our light source systems. As a large portion of our revenue is derived from customers located outside of the U.S., we maintain a spare parts refurbishment facility and field service office in Korea and field service and support offices in Japan, the Netherlands, the People's Republic of China, Singapore and Taiwan. Japan is currently our only subsidiary office that sells excimer light source systems. We also maintain field service offices in the U.S. to service our installed base of light sources located in the U.S.

In July 2005, we entered into a joint venture agreement with (i) Carl Zeiss SMT AG, a German corporation ("SMT"); (ii) Carl Zeiss Laser Optics Beteiligungsgesellschaft mbH, a German limited liability company ("LOB"); and (iii) the Swiss liability company that was formed as part of the JV Agreement and named TCZ GmbH ("TCZ Switzerland"). LOB and SMT, together with their affiliated entities, are collectively referred to as "Zeiss". In September 2006, we entered into an amended joint venture

agreement with Zeiss to move the location of the TCZ joint venture from Switzerland to Singapore and, in connection with the move, formed TCZ Pte Ltd., a company incorporated in Singapore ("TCZ Singapore"). TCZ Singapore is currently developing, and will integrate, market and sell, and support, production tools for the flat panel display manufacturing industry. The joint venture is currently headquartered in Singapore and is owned 60% by us and 40% by Zeiss. The joint venture is targeting the growing market for low-temperature poly-silicon ("LTPS") processing used in the manufacture of liquid crystal displays that are brighter, have higher resolution, and consume less power than displays using today's predominant amorphous silicon films. We currently expect that TCZ Singapore will ship its first production tool, the TCZ 900X, sometime in 2007.

### *Products*

Our products primarily consist of photolithography light source systems, replacement parts, and service.

Our excimer light sources for photolithography produce pulsed light of extremely short wavelengths within the DUV spectrum. The bandwidth of the light is further narrowed through a number of optical techniques. The DUV wavelengths are measured in nanometers (one nanometer is one billionth of a meter), and the light sources are referred to according to either the wavelength or the gases that are mixed to produce the light. Krypton Fluoride ("KrF") gases produce light at a 248 nm wavelength, and Argon Fluoride ("ArF") gases produce light at a 193 nm wavelength. The extremely short wavelengths and highly narrowed bandwidths of light produced by these light sources enable the very fine feature resolution required for patterning or printing the circuitry on silicon wafers. The pulse energy and repetition rate of the light source permit high throughput in wafer processing. We have designed our light sources to be reliable, easy to install and service and compatible with existing semiconductor manufacturing processes. Our light sources are used to pattern or print the integrated circuits, which are also called semiconductors or "chips," that power many of today's advanced consumer and business electronics. In the third quarter of 2006, we sold 67 light source systems at an average selling price of \$1,065,000.

Certain components and subassemblies included in our light sources require replacement or refurbishment following extended operation. We estimate that a light source used in a semiconductor production environment will require one to two replacement chambers per year, depending upon the level of usage. Similarly, certain optical components of the light source deteriorate with continued exposure to DUV light and require periodic replacement. We provide these and other spare and replacement parts for our photolithography light sources as needed by our customers.

As the life and usage of our installed base of light sources in production at chipmakers exceeds the original warranty periods, some chipmakers request service contracts from us. Additionally, we provide billable service or service contracts directly to the three semiconductor lithography tool manufacturers. These service agreements require us to maintain and/or service these light sources either on an on-call or regular interval basis or both. Included in some of the types of service contracts we provide to our customers are the replacement of consumable parts and non-consumable parts. The pricing for such contracts includes the replacement of these parts.

### *Semiconductor Industry Status and Outlook*

Since we derive a substantial portion of our revenues from lithography tool manufacturers, we are subject to the volatile and unpredictable nature of the semiconductor industry. The semiconductor industry is highly cyclical in nature and historically has experienced periodic ups and downs, and the activities of the last several years illustrate this cyclicity. In 2000, the semiconductor industry experienced strong growth, which was followed by a three year decline from 2001 through late 2003. Growth resumed in late 2003, but in late 2004, the industry again declined for several months, then leveled off early in 2005 and began to improve gradually thereafter.

In late 2005, orders for our light sources increased substantially from the levels we had experienced earlier in the year. Our chipmaker customers began indicating that increasing demand for chips would require them to expand production capacity, and our lithography tool manufacturing

customers began placing orders for a growing number of light sources to meet increasing scanner demand. It began to appear that we were again entering an industry growth cycle and upturn.

There were many positive indicators early in 2006 that reinforced our viewpoint that we were entering an upturn in the semiconductor industry. In addition to strong continuing demand for our ArF light sources in the first half of 2006, we also experienced substantial ongoing growth in our non-systems revenue which was driven by high light source utilization at chipmakers and high overall fab utilization. Additionally, there was stronger than anticipated demand for KrF light sources, as chipmakers ordered tools to expand capacity. Our bookings, revenue and profits grew substantially in the first half of 2006 compared to the second half of 2005.

Growth continued in the third quarter of 2006. Our revenue increased to a record \$143.9 million, up six percent from our revenue of \$135.4 million in the second quarter of 2006. Utilization of our light sources at chipmakers continued to rise in the third quarter of 2006, and grew two percent over the previous quarter's level. This drove our non-systems product revenue, which consists of consumables and spare parts, upgrades, and service, to a record \$72.5 million for the third quarter of 2006, equal to 50 percent of total revenue for the quarter. Demand for our most advanced ArF light sources remained robust, and we shipped 32 of our XLA Series light sources in the third quarter of 2006, which equaled the highest quarterly shipment volume since the XLA Series was introduced. Through the first nine months of 2006, our lithography tool manufacturing customers ramped up their first wave of ArF immersion scanner production. Many of the immersion tools delivered thus far in 2006 have been used primarily by chipmakers for process development purposes including defect reduction. Some chipmakers recently experienced success in qualifying their immersion production processes. We expect these chipmakers will continue moving these tools from qualification into full production, and will augment them with additional immersion tool purchases to increase critical layer capacity.

Generally, industry trends remained positive in the third quarter of 2006. However, a number of companies in the semiconductor equipment industry reported that orders for the fourth quarter of this year and early next year had leveled off, indicating flat unit shipments in the short term. Overall fab utilization continued in the low 90 percent range, though some segments of the chip industry have experienced a modest decline in utilization. However, fab managers continued to order equipment in line with demand, and avoided building excess manufacturing capacity in the fab. NAND Flash memory manufacturers continued to expand their capacity, and 300mm fabs continued to be built and populated with equipment.

In the near term, we believe light source demand will be affected by a variety of factors, including under- or over-capacity in individual chip sectors, the rate at which chip designs shrink at individual chipmakers, and the lithography tool manufacturer customers' manufacturing capacity for their new model lithography tools. Early in the fourth quarter of this year, we received requests from among the lithography tool manufacturer customers to delay certain XLA 300 light source shipments, as we believe their factories reached capacity for their most advanced tools. As the currently existing inventory of XLA 300s is absorbed, and our customers' new manufacturing capacity is realized, we expect the shipment rate of XLA 300 light sources to increase. Looking at medium- and longer-term market conditions, we expect demand for DUV lithography will continue to grow. We believe we are well positioned as the leader in the most rapidly growing segment of the lithography market – ArF light sources for both dry and immersion applications. We expect demand for ArF will extend well into the future through the use of both immersion and double patterning production techniques. However, macro-economic factors, such as high energy prices and rising interest rates, could have a negative impact on consumer spending, including spending on electronic devices. Additionally, geopolitical turmoil can create a heightened sense of uncertainty that can cause consumers to become more cautious about their spending. Either or both of these factors would have a negative effect on demand for our products.

We entered 2006 focusing our efforts on creating shareholder value through improved profitability, overall financial performance and execution. During the third quarter of 2006, our gross margin increased to 50 percent compared to 48 percent in the prior quarter. Although our gross margins have been steadily improving over the last seven consecutive quarters, we expect that improvements over the current 50% level will come more slowly and we expect a slight decrease in gross margin in the fourth quarter of 2006

due to changes in product mix. In the third quarter of 2006, we generated \$50.0 million in cash from operations, significantly more than the \$16.4 million in cash from operations generated in the second quarter of 2006. We expect to continue generating substantial levels of cash from operations in the fourth quarter of 2006 and we will continue to explore opportunities for the most effective use of our cash including additional buybacks of our common stock under our current board approved plan.

## **Critical Accounting Policies and Estimates**

### *General*

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and use judgment that may impact the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities. As a part of our ongoing internal processes, we regularly evaluate our estimates and judgments associated with revenue recognition, valuation of parts used in our refurbishment manufacturing process, inventory allowances, warranty provisions, stock-based compensation, income taxes, allowances for bad debts, long-lived assets valuation, intangible assets valuation, and contingencies and litigation. We base these estimates and judgments upon historical information and other facts and assumptions that we believe to be valid and/or reasonable under the circumstances. These assumptions and facts form the basis for making judgments and estimates and for determining the carrying values of our assets and liabilities that are not apparent from other sources. Actual results could vary from our estimates if we were to use different assumptions and conditions.

We believe that revenue recognition, valuation of parts used in our refurbishment manufacturing process, inventory allowances, warranty provisions, stock-based compensation, and income taxes require more significant judgments and estimates in the preparation of our consolidated financial statements than do other of our accounting estimates and judgments.

### *Revenue Recognition*

Our revenues consist of product sales, which include sales of light source systems, consumable and spare parts, upgrades, service, service contracts, training, and limited refurbishments of light source systems. Our revenues also consist of certain funded development activities performed for our customers and under government contracts and license agreements.

The sales of our light source systems generally include training and installation services. We determined these elements qualify as one unit of accounting under Emerging Issues Task Force (“EITF”) Bulletin No. 00-21, “Revenue Arrangements with Multiple Deliverables” as we do not have evidence of fair value for the undelivered training and installation elements. Furthermore, we determined that the undelivered training and installation elements are perfunctory performance obligations and are not essential to the functionality of our light source systems. Therefore, in accordance with the provisions of Staff Accounting Bulletin No. 104, we recognize revenue when the revenue recognition criteria are met for the light source system, and accrue the costs of providing the training and installation services. We recognize light source system revenue at one of following three points, depending on the terms of our arrangement with our customer – 1) shipment of the light source system 2) delivery of the light source system or 3) receipt of an acceptance certificate. For the majority of our light source system sales, the shipping terms are F.O.B. shipping point and revenue is recognized upon shipment. For our arrangements which include F.O.B. destination shipping terms, revenue is recognized upon delivery of the light source system to our customer. Lastly, one of our arrangements includes an acceptance provision, which is satisfied by the issuance of an acceptance certificate by the customer. For these transactions, we recognize revenue upon receipt of the acceptance certificate. In addition, we test our light source systems in environments similar to those used by our customers prior to shipment to ensure that they meet published specifications.

Revenue from consumables and spare parts sales is recognized at the point that legal title passes to the customer, which is upon shipment from our facility. For a significant portion of our spare parts sales, our customers return the consumed assembly to us as part of the sale of the new part. We reuse some of the material within these core assemblies, mainly metal components, for the future build of core assemblies. As a result, our revenue consists of both cash and the value of the reusable parts received from our customers as consideration for these spare part sales. Revenue associated with our customers' return of core assemblies is recognized upon receipt of the returned core assembly. The amount of the revenue is determined based upon the fair value of the reusable parts that we expect to yield from the returned core assembly based on historical experience. Service and training revenue is recognized as the services are rendered.

On a very limited basis, we refurbish light source systems owned by our customers to their original or new condition. Revenue from refurbished light source systems is recognized when the refurbishment process has been completed and, depending upon the customer, the proper delivery or acceptance terms have been met.

For funded development contracts, which are included in other revenue, funds received are accounted for on the percentage-of-completion method based on the relationship of costs incurred to total estimated costs. Revenues generated from these types of funded development contracts are derived from cost sharing contracts between certain customers and us. If milestones on these funded development contracts require that specific results be achieved or reported by us, revenue is not recognized until that milestone is completed. For some of the funded development contracts that we enter into with customers and government agencies, we evaluate certain criteria to determine whether recording the funds received as revenue is appropriate. If certain conditions are met, these funds are not recorded as revenue but rather are offset against our own internal research and development expenses in the period that the milestone is achieved.

#### *Valuation of Parts Used in Refurbishment Manufacturing Process*

Over the last several years as part of our regular business activities, we have conducted significant parts refurbishment and material reclaim activities related to some of our core assemblies, in particular our chamber assemblies. The volume of this activity significantly increased in 2004 and we expect volumes to increase over time as our installed base of light sources continues to rise and we become more efficient in these refurbishment activities and develop capabilities to reclaim material from and refurbish other core assemblies. These activities involve arrangements with our customers where we sell a new part to the customer at a reduced sales price if the customer returns the consumed assembly that the new part replaces. These returned core assemblies contain a certain amount of material, primarily metal components, that may be reused by us in future core assemblies. Upon receipt of these consumed assemblies from our customers, either we record an entry to recognize the estimated fair value of the reusable components as inventory and revenue or a reduction in cost of product sales sold depending on the reason for the part replacement. The value of the reusable parts contained within the consumed assembly is determined based upon historical data on the value of the reusable parts that we typically yield from a consumed assembly. As part of our normal excess and obsolete inventory analysis, these consumed assemblies are also reviewed on a monthly basis and an inventory allowance is recorded as appropriate for these parts. The value that we assign to these core assemblies can be affected by the current demand for the reusable parts in our manufacturing operations and the actual yield rate achieved for parts within these consumed core assemblies. We believe that our methodology for valuing the reusable parts within these returned core assemblies is reasonable, but any changes in the demand for the parts or the yield of the parts included in these core assemblies could have a material adverse effect on our financial condition and results of operations.

#### *Inventory Allowance*

We perform an analysis of our inventory allowances on at least a quarterly basis to determine the adequacy of this allowance on our financial statements. The amount of the inventory allowance is determined by taking into consideration certain assumptions related to market conditions and future

demands for our products, including changes to product mix, new product introductions, and/or product discontinuances, which may result in excess or obsolete inventory. We determine the level of excess and obsolete inventory associated with our raw materials and production inventory, which includes all parts on hand from our refurbishment activities, by comparing the on hand inventory balances and inventory on order to the next 12 months of forecasted demand. We then adjust this calculation for inventory that has a high likelihood of use beyond one year or can be used in other products that may have lower demands. After this adjustment, we arrive at our total exposure for excess and obsolete inventory within our raw materials and production inventory. As part of this analysis, we also determine whether there are potential amounts owed to vendors as a result of cancelled or modified raw material orders. We estimate and record a separate liability, which is included in accrued and other liabilities in the accompanying balance sheets for such amounts owed.

The inventory allowance totaled \$10.4 million and \$11.2 million at December 31, 2005 and September 30, 2006, respectively. The increase in the inventory allowance at September 30, 2006 as compared to December 31, 2005 was primarily due to increased excess and obsolete allowances for both raw materials and consumable and spare parts from period to period offset by decreased excess and obsolete requirements for parts that are used in our material reclaim and refurbishment activities.

The methodologies used to analyze excess and obsolete inventory and determine the inventory allowance are significantly affected by future demand and usage of our products. There are many factors that could potentially affect the future demand or usage of our products, including the following:

- Overall condition of the semiconductor industry, which is highly cyclical in nature;
- Rate at which our lithography tool manufacturers and chipmaker customers take delivery of our light source systems and our consumable and spare parts;
- Loss of any of our three major customers or a significant change in demand from any of these three customers;
- Overall mix of light source system models or consumable and spare parts and any changes to that mix required by our customers; and
- Utilization rates of our light sources at chipmakers.

Based upon our experience, we believe that the estimates we use in calculating the inventory allowance are reasonable and properly reflect the risk of excess and obsolete inventory. If actual demand or the usage periods for our inventory are substantially different from our estimates, adjustments to our inventory allowance may be required, which could have a material adverse effect on our financial condition and results of operations.

#### *Warranty Provision*

We maintain an accrual for the estimated cost of product warranties associated with our product sales. Warranty costs include the replacement parts and labor costs to repair our products during the warranty periods. At the time revenue is recognized, we record a warranty provision, which is included in cost of product sales in the accompanying consolidated statements of operations. The warranty coverage period and terms for light source systems and consumable and spare parts varies by light source system model. The warranty provision for our products is reviewed monthly and determined by using a statistical financial model, which takes into consideration actual historical expenses, product failure rates, and potential risks associated with our different products. This model is then used to estimate future expenses related to warranty and the required warranty provision. The risk levels and historical cost information and failure rates used within this model are reviewed throughout the year and updated as these inputs change over the product's life cycle. Due to the highly technical nature of our light source system products, the newer model light sources and the modules contained within them have higher inherent warranty risks with their initial shipments and require higher warranty provisions until the technology becomes more mature.

The total balance in the warranty provision accrual as of December 31, 2005 and September 30, 2006 was \$30.2 million and \$30.1 million, respectively. This slight decrease is primarily due to

improved warranty performance of both light source systems and consumable and spare parts resulting in lower warranty provision requirements as calculated by our financial model and updated in 2006. This improved overall warranty performance and the resulting decrease in the provision requirements was almost completely offset by the higher level of consumables and spare parts sales in the first nine months of 2006 as compared to the same time period in 2005.

We actively engage in product improvement programs and processes to limit our warranty costs, but our warranty obligation is affected by the complexity of our product, product failure rates and costs incurred to correct those product failures at customer sites. The industry in which we operate is subject to rapid technological change, and as a result, we periodically introduce newer, more complex light sources. Although we classify these newly released light source models as having a higher risk in our warranty model resulting in higher warranty provisions, we are more likely to have differences between the estimated and actual warranty costs for these new products. This is due to limited or no historical product performance data on which to base our future warranty costs. Warranty provisions for our older and more established light source models are more predictable as we have more historical information available on these products. If actual product failure rates or estimated costs to repair those product failures were to differ from our estimates, revisions to our estimated warranty provision would be required, which could harm our financial condition and results of operations.

#### *Stock-Based Compensation*

We grant options to purchase our common stock to our employees and grant stock unit awards to our non-employee directors under our current stock plan. The benefits provided under this plan are share-based payments subject to the provisions of SFAS No. 123R. Effective January 1, 2006, we adopted the requirements of SFAS No. 123R which address the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. As a result of this new accounting requirement, our consolidated financial statements for the nine months ended September 30, 2006 include compensation expense as calculated per the provisions of SFAS No. 123R. In adopting SFAS No. 123R, we elected to use the modified prospective transition method, thus our consolidated financial statements for periods prior to January 1, 2006 do not include any impact of SFAS No. 123R. We also elected to attribute the value of share-based compensation to expense using the straight-line method for awards granted after December 31, 2005 upon our adoption of SFAS No. 123R. Compensation expense for awards outstanding as of December 31, 2005 are being recognized over the remaining service period using the compensation expense calculated according to the pro forma disclosure provisions under SFAS No. 123 which uses an accelerated expense recognition method for those awards with a graded vesting schedule. Share-based compensation expense related to stock options and stock units was \$2.3 million and \$7.1 million, before taxes for the three and nine months ended September 30, 2006, respectively.

Upon adoption of SFAS No. 123R on January 1, 2006, we elected to value our share-based payment awards using the Black-Scholes option pricing model, as we had under the pro forma provisions of SFAS No. 123. The determination of fair value of stock-based payment awards on the date of grant is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These assumptions include our expected stock price volatility over the term of the awards and the expected term of stock options.

We determined our expected volatility by using a combination of historical and implied volatility, or blended volatility, to derive our expected volatility assumption as allowed under SFAS 123R and SAB 107. Implied volatility was based on our six-month traded options on our common stock. We determined that the volatility calculated using a blend of implied volatility and our historical volatility was more reflective of expected volatility than using only historical volatility. The expected term of stock options represents the weighted-average period the stock options are expected to remain outstanding. We determined the expected term of our stock options based on observed historical exercise patterns for our company, which we believe are indicative of future exercise behavior.

Other assumptions required for estimating fair value under the Black-Scholes option pricing model include the expected risk-free interest rate and expected dividend yield of our stock. Our risk-free interest rate assumption is based upon currently available rates on zero coupon U.S. Government issues for the expected term of our stock options. The expected dividend rate is not applicable to us as we have not historically declared or paid dividends nor do we anticipate paying cash dividends in the future.

SFAS No. 123R also requires forfeitures to be estimated at the time of grant and we have estimated our forfeitures based on historical experience. We will revise this estimate, if necessary, in subsequent periods if actual forfeiture rates differ from our estimates. In our pro forma information required under SFAS No. 123 for periods prior to January 1, 2006, we accounted for forfeitures as they occurred.

If we change any of the key assumptions that we use in the Black-Scholes option pricing model such as expected volatility or expected term or if we decide to use a different valuation model in the future or change our forfeiture rate, the compensation expense that we record under SFAS No. 123R may differ significantly in the future from what we have recorded in the current period. In addition, as the guidance by regulators for SFAS No. 123R is relatively new, the application of these principles may be subject to further interpretation and refinement over time.

### *Income Taxes*

We account for income taxes in accordance with Statement of Financial Accounting Standards No. 109 ("SFAS No. 109"), "Accounting for Income Taxes." Pursuant to SFAS No. 109, a deferred tax asset or liability is generally recognized for the estimated future tax effects attributable to temporary differences, net operating loss ("NOL") carryforwards and tax credit carryforwards. Deferred tax assets are to be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized within the carryback or carryforward periods. Information about an enterprise's current financial position and its results of operations for the current and preceding years, as well as all currently available information about future years should be considered.

We have considered our industry's outlook for the future, our historical performance and estimated future taxable income, and ongoing tax planning strategies in assessing the need for a valuation allowance. Using this information, we have prepared a model to forecast our expected taxable income in future years and to estimate when the benefits of our deferred tax assets are likely to be realized. Based upon the analysis, with the exception of TCZ Singapore, we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize our deferred tax assets within the period covered by our model and, as such, no valuation allowance against deferred tax assets is provided. However, in the case of our joint venture, TCZ, we do not feel that there is sufficient evidence or operating history to conclude that the future operating profits of TCZ are likely to allow it to utilize its NOL carryforwards and, consequently, a full valuation allowance has been provided against those loss carryforwards.

A material adverse change in the outlook for worldwide lithography tool sales, the expected selling prices or profit margins for our products or our expected share of the global market for lithography light sources, could cause us to determine that additional valuation allowances are needed for some or all of our deferred tax assets, and would result in an increase to our income tax provision in the period in which such determination is made.

We have not provided for U.S. federal income and foreign withholding taxes on \$55.4 million of undistributed earnings from non-U.S. operations as of September 30, 2006 as it is our intention to reinvest undistributed earnings of our foreign subsidiaries and thereby indefinitely postpone their remittance. Accordingly, no provision has been made for foreign withholding taxes or U.S. income taxes which may become payable if undistributed earnings of foreign subsidiaries were paid to us as dividends.

## RESULTS OF OPERATIONS

The following table sets forth certain items in our consolidated statements of operations as a percentage of total revenues for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2005	2006	2005	2006
<b>Revenues:</b>				
Product sales	99.7%	99.2%	99.6%	98.3%
Product sales - related party	0.2	0.7	0.1	1.6
Other	0.1	0.1	0.3	0.1
Total revenues	100.0%	100.0%	100.0%	100.0%
<b>Cost and expenses:</b>				
Cost of product sales	57.7	50.4	59.9	52.1
Research and development	16.0	13.1	16.9	13.7
Sales and marketing	6.3	5.9	6.7	5.6
General and administrative	7.8	6.3	7.2	6.9
Total costs and expenses	87.8	75.7	90.7	78.3
Operating income	12.2	24.3	9.3	21.7
Total other income - net	1.0	2.6	1.3	3.5
Income before income tax provision and minority interest	13.2	26.9	10.6	25.2
Income tax provision	1.2	8.7	0.7	8.5
Minority interest	0.7	0.6	0.5	0.6
Net income	12.7%	18.8%	10.4%	17.3%
Gross margin on product sales	42.3%	49.6%	39.9%	47.9%

### THREE MONTHS ENDED SEPTEMBER 30, 2005 AND 2006

*Revenues.* The types of revenue that we generate and how we recognize revenue for each is explained above under the heading "Critical Accounting Policies and Estimates."

The following table summarizes the components of our revenue (in thousands, except units sold):

	For the three months ended September 30,	
	2005	2006
<b>Light source systems:</b>		
Revenue	\$ 53,848	\$ 71,352
Units sold	55	67
Average selling price (1)	\$ 944	\$ 1,065
<b>Consumable and spare parts and service products</b>		
Other revenue	\$ 61	\$ 109
Total revenue	\$ 99,653	\$ 143,918

- (1) Calculation of average selling price excludes \$1.9 million of deferred light source revenue that was recognized for the three months ended September 30, 2005. We had one arrangement where a portion of the light source system fee was not payable until the system was installed successfully at the end-user. This arrangement expired in March 2005.

Product sales increased 44% from \$99.6 million for the three months ended September 30, 2005 to \$143.8 million for the three months ended September 30, 2006. This increase in product sales was due to higher light source system revenues and higher consumable and spare parts and service products revenues for the three months ended September 30, 2006 compared to the three months ended September 30, 2005. Light source system revenues increased 33% from \$53.8 million for the three months ended September 30, 2005 to \$71.4 million for the three months ended September 30, 2006. A total of 55 light source systems were sold in the three months ended September 30, 2005 at an average selling price of \$944,000, compared to 67 light source systems sold in the three months ended September 30, 2006 at an average selling price of \$1.1 million. On a foreign currency adjusted basis, the average selling price for the three months ended September 30, 2005 was \$952,000 compared to \$1.1 million for the three months ended September 30, 2006. The increase in the average selling price from period to period reflects the shift in the product mix from capacity driven lower priced KrF products in the three months ended September 30, 2005 to higher priced technology buys of advanced ArF products in the three months ended September 30, 2006. The increase in quantities of light source systems sold from period to period was due to the slight slowdown and flattening of the industry in the beginning of 2005 compared to the upturn in the semiconductor industry in 2006. Chipmakers' expanded capacity needs have impacted the demand for our light source systems, and that combined with our growing installed base of light source systems has increased the demand for our consumables and spare parts and service products. This increased consumable and spare parts demand and rising tool utilization resulted in an increase in consumables and spare parts and service revenues of 58% from \$45.7 million for the three months ended September 30, 2005 to \$72.5 million for the three months ended September 30, 2006. Revenues from funded development contracts were \$61,000 for three months ended September 30, 2005, compared to \$109,000 for the three months ended September 30, 2006. There were no revenues recorded or earned associated with the TCZ joint venture for the three months ended September 30, 2006. We expect that our fourth quarter 2006 revenue will decrease slightly compared to the third quarter 2006 levels.

Our backlog at September 30, 2005 was \$73.8 million compared to \$90.3 million at September 30, 2006. Bookings for the three months ended September 30, 2005 and September 30, 2006 were \$97.7 million and \$142.0 million, respectively. The book-to-bill ratio for the quarter ended September 30, 2005 was 0.98 compared to 0.99 for the quarter ended September 30, 2006. The increase in the backlog is due to the changing condition of the semiconductor industry from period to period and rising ASPs due to continued adoption of the advanced ArF tools. The backlog as of September 30, 2005 reflected the brief slowdown and flattening in the semiconductor industry that started in late 2004, whereas the backlog as of September 30, 2006 reflects the recent growth phase and upturn in the semiconductor industry. The increase in bookings from period to period was primarily due to increased orders of light source systems and consumables and spare parts in the third quarter of 2006 as a result of this recent upturn in the semiconductor industry. The book-to-bill ratio for the quarter ended September 30, 2006 was negatively impacted by us shipping a significant number of the competitive replacement lasers during the third quarter of 2006 under a laser replacement purchase order which was booked in full during the first quarter of 2006.

We installed 52 light sources at chipmakers and other end-users during the quarter ended September 30, 2005 compared to 91 light sources installed during the quarter ended September 30, 2006.

Our sales are generated primarily by shipments to customers in Europe, Japan, Korea, Taiwan, and the U.S. Approximately 83% and 84% of our sales for the three months ended September 30, 2005 and 2006, respectively, were derived from customers outside the U.S. We maintain a wholly owned Japanese subsidiary, Cymer Japan, which sells to our Japanese customers. Revenues from Japanese customers, generated primarily by Cymer Japan, accounted for 31% and 19% of total revenues for the three months ended September 30, 2005 and 2006, respectively. The activities of Cymer Japan are limited to sales and service of products purchased by Cymer Japan from us as the parent corporation. We anticipate that international sales will continue to account for a significant portion of our sales.

*Cost of Product Sales.* Cost of product sales includes direct material and labor, warranty expenses, license fees, and manufacturing and service overhead, and foreign exchange gains and losses

on foreign currency forward exchange contracts (“forward contracts”) associated with purchases of our products by Cymer Japan for resale under firm third-party sales commitments. Shipping costs associated with our product sales are also included in cost of product sales. We do not charge our customers for shipping fees and such costs are not significant.

The cost of product sales increased 26% from \$57.5 million for the three months ended September 30, 2005 to \$72.5 million for the three months ended September 30, 2006. This increase in the cost of product sales was primarily due to higher light source system sales and sales of consumables and spare parts and service products in the three months ended September 30, 2006 compared to the three months ended September 30, 2005. This increase in cost of product sales was partially offset by a decrease in warranty costs from period to period. The gross margin on product sales was 42.3% for the three months ended September 30, 2005 as compared to 49.6% for the three months ended September 30, 2006. This higher gross margin from period to period was primarily due to increased factory yield and utilization, reduced lead and cycle times and improved warranty performance. We anticipate that our gross margin may decrease slightly in the fourth quarter of 2006 from the third quarter levels due to an expected change in product mix.

*Research and Development.* Research and development expenses include costs of internally-funded and externally-funded projects as well as continuing product development support expenses, which consist primarily of employee and material costs, depreciation of equipment and other engineering related costs. Our research and development expenses are offset by amounts associated with certain of our externally funded research and development contracts. Research and development expenses increased 19% from \$15.9 million for the three months ended September 30, 2005 to \$18.9 million for the three months ended September 30, 2006 due primarily to costs associated with our LTPS product development efforts and EUV light source development. Research and development expenses were offset by amounts related to our externally funded research and development contracts of \$604,000 for the three months ended September 30, 2005 and there were no such offsets recorded for the three months ended September 30, 2006. In addition to our development of EUV and LTPS technologies, we also continued to focus on next generation ArF and KrF products. Included in our ArF product development efforts for 2006 is the design of an enhanced universal platform for our XL series light sources and associated derivative products based on this platform. As a percentage of total revenues, research and development expenses decreased from 16.0% for the three months ended September 30, 2005 to 13.1% for the three months ended September 30, 2006 due primarily to revenues increasing at a faster rate than research and development expenses in 2006 as compared to 2005. As a result of our decision to enter the flat panel display manufacturing tools market with the formation of the TCZ joint venture, our research and development expenses going forward will also include a greater focus on LTPS product development efforts. We expect that our investment in research and development expenses will continue.

*Sales and Marketing.* Sales and marketing expenses include the expenses of the sales, marketing and customer support staff and other marketing expenses. Sales and marketing expenses increased 34% from \$6.3 million for the three months ended September 30, 2005 to \$8.4 million for the three months ended September 30, 2006. The increase in sales and marketing expenses from period to period primarily reflects increases in profit sharing and bonuses, stock-based compensation expense associated with the new SFAS 123R requirements which were adopted in the first quarter of 2006, and increased salary and benefits associated with increased sales and marketing head count from period to period. As a percentage of total revenues, such sales and marketing expenses decreased from 6.3% for the three months ended September 30, 2005 to 5.9% for the three months ended September 30, 2006. We anticipate that sales and marketing expenses may remain relatively flat for the fourth quarter of 2006 compared to the third quarter levels.

*General and Administrative.* General and administrative expenses consist primarily of management and administrative personnel costs, professional services, including external audit fees, and administrative operating costs. General and administrative expenses increased 17% from \$7.8 million for the three months ended September 30, 2005 to \$9.1 million for the three months ended September 30, 2006 primarily due to stock-based compensation expense recorded in the third quarter of 2006 as a result of our adoption of SFAS 123R on January 1, 2006. General and administrative expenses in the third

quarter of 2006 also included increased profit sharing and bonus expenses, and increased external audit fees as compared to the third quarter of 2005. General and administrative expenses were also higher in the third quarter of 2006 compared to the third quarter of 2005 as a result of expenses associated with our TCZ joint venture which was formed in July 2005. As a percentage of total revenues, general and administrative expenses decreased from 7.8% for the three months ended September 30, 2005 to 6.3% for the three months ended September 30, 2006. We anticipate that general and administrative expenses may remain relatively flat for the fourth quarter of 2006 compared to the third quarter levels.

*Total Other Income (Expense) - Net.* Net other income (expense) consists primarily of interest income and expense, foreign currency exchange gains and losses associated with fluctuations in the value of the functional currencies of our foreign subsidiaries against the U.S. dollar, and gains and losses associated with debt extinguishment transactions. Net other income totaled \$1.0 million and \$3.7 million for the three months ended September 30, 2005 and 2006, respectively. The increase in net other income was primarily due to an increase in interest income from period to period. The increase in interest income from 2005 to 2006 reflects higher market interest rate yields on larger cash and investment balances which resulted from higher earnings and significant proceeds from stock option and warrant exercises during 2006. Foreign currency exchange losses totaled \$165,000, interest income and other income totaled \$2.7 million and interest expense totaled \$1.5 million the three months ended September 30, 2005, compared to a foreign currency exchange loss of \$243,000, interest and other income of \$5.4 million, and interest expense of \$1.5 million for the three months ended September 30, 2006.

*Income Tax Provision.* The tax provision of \$1.2 million and \$12.5 million for the three months ended September 30, 2005 and 2006, respectively, reflects an annual effective rate of 7.06% and 33.8%, respectively. The change in the annual effective tax rate from period to period was primarily attributable to the increase in pre-tax earnings as well as a reduction in tax benefits from U.S. export incentive programs and the expiration of the federal research credit. The annual effective tax rate for the three months ended September 30, 2006 was less than the U.S. statutory rate of 35% primarily as a result of permanent book/tax differences and tax credits and is a function of current tax law and geographic location of pre-tax income. The federal Research and Experimentation Credit expired December 31, 2005. The ETI was repealed by the American Jobs Creation Act of 2004 subject to certain transition rules. The ETI exclusion is being replaced with a Manufacturing Activity deduction under IRC Section 199 with a phase out of ETI benefits in 2005 and 2006. Our estimated ETI benefit for 2006 reflects the transition rules.

#### NINE MONTHS ENDED SEPTEMBER 30, 2005 AND 2006

The following table summarizes the components of our revenue (in thousands, except units sold):

	For the nine months ended September 30,	
	2005	2006
<b>Light source systems:</b>		
Revenue	\$ 157,181	\$ 212,016
Units sold	159	212
Average selling price (1)	\$ 962	\$ 1,000
<b>Consumable and spare parts and service products</b>		
	\$ 122,817	\$ 194,139
Other revenue	\$ 857	\$ 259
<b>Total revenue</b>	<b>\$ 280,855</b>	<b>\$ 406,414</b>

- (1) Calculation of average selling price excludes \$4.2 million of deferred light source revenue that was recognized for the nine months ended September 30, 2005. We had one arrangement where a portion of the light source system fee was not payable until the system was installed successfully at the end-user. This arrangement expired in March 2005.

Product sales increased 45% from \$280.0 million for the nine months ended September 30, 2005 to \$406.2 million for the nine months ended September 30, 2006. This increase in product sales was due to higher light source system revenues and higher consumable and spare parts and service products revenues for the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005. Light source system revenues increased 35% from \$157.2 million for the nine months ended September 30, 2005 to \$212.0 million for the nine months ended September 30, 2006. A total of 159 light source systems were sold in the nine months ended September 30, 2005 at an average selling price of \$962,000, compared to 212 light source systems sold in the nine months ended September 30, 2006 at an average selling price of \$1.0 million. On a foreign currency adjusted basis, the average selling price for the nine months ended September 30, 2005 was \$961,000 compared to \$996,000 for the nine months ended September 30, 2006. The slight increase in the average selling price from period to period reflects the higher percentage of our light source systems sales coming from higher priced advanced ArF products in the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. The increase in quantities of light source systems sold from period to period was due to the slight slowdown and flattening of the industry in the beginning of 2005 compared to the upturn in the semiconductor industry in 2006. Chipmakers expanded capacity needs have impacted the demand for our light source systems, and that combined with our growing installed base of light source systems has increased demand for our consumables and spare parts and service products. This increased demand for consumable and spare parts and the rising tool utilization resulted in an increase in consumable and spare parts and service revenues of 58% from \$122.8 million for the nine months ended September 30, 2005 to \$194.1 million for the nine months ended September 30, 2006. Consumable and spare parts and service products revenue was also favorably impacted by the revenue recorded under a laser replacement agreement we entered into at the beginning of 2006. Revenues from funded development contracts were \$857,000 for nine months ended September 30, 2005, compared to \$259,000 for the nine months ended September 30, 2006. There were no revenues recorded or earned associated with the TCZ joint venture for the nine months ended September 30, 2006.

Sales to our three lithography tool manufacturing customers, ASM Lithography, Canon, and Nikon, amounted to 32%, 8% and 25%, respectively, of total revenue for the nine months ended September 30, 2005, and 38%, 6% and 15%, respectively, of total revenue for the nine months ended September 30, 2006.

Approximately 84% of our sales for both the nine months ended September 30, 2005 and 2006, were derived from customers outside the U.S. Revenues from Japanese customers, generated primarily by Cymer Japan, accounted for 32% and 21% of total revenues for the nine months ended September 30, 2005 and 2006, respectively.

*Cost of Product Sales.* The cost of product sales increased 26% from \$168.2 million for the nine months ended September 30, 2005 to \$211.7 million for the nine months ended September 30, 2006. This increase in the cost of product sales was primarily due to higher light source system sales and sales of consumables and spare parts and service products in the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005. The increased product sales and overall mix of products resulted in improved gross margin on product sales from period to period. The gross margin on product sales was 39.9% for the nine months ended September 30, 2005 as compared to 47.9% for the nine months ended September 30, 2006. This higher gross margin from period to period was primarily due to increased factory yield, improved overall efficiencies, reduced lead and cycle times and improved warranty performance.

*Research and Development.* Research and development expenses increased 18% from \$47.5 million for the nine months ended September 30, 2005 to \$55.9 million for the nine months ended September 30, 2006 due primarily to costs associated with our LTPS product development efforts, EUV light source development and ArF product development efforts for the design of an enhanced universal platform for our XL series light sources and associated derivative products based on this platform. Research and development expenses were offset by amounts related to our externally funded research and development contracts of \$2.4 million and \$154,000 for the nine months ended September 30, 2005 and 2006, respectively. In addition to our development of EUV and LTPS technologies, we also continued

to focus on next generation ArF and KrF products. As a percentage of total revenues, research and development expenses decreased from 16.9% for the nine months ended September 30, 2005 to 13.7% for the nine months ended September 30, 2006 due primarily to increased research and development activities and higher revenues in 2006 as compared to 2005. As a result of our decision to enter the flat panel display manufacturing tools market with the formation of the TCZ joint venture, our research and development expenses going forward will also include a greater focus on LTPS product development efforts.

*Sales and Marketing.* Sales and marketing expenses increased 20% from \$18.8 million for the nine months ended September 30, 2005 to \$22.6 million for the nine months ended September 30, 2006. The increase in sales and marketing expenses from period to period primarily reflects increases in profit sharing and bonuses, stock-based compensation expense associated with the new SFAS 123R requirements which were adopted in the first quarter of 2006, increased salary and benefits associated with an increase in sales and marketing head count from period to period, and employer payroll taxes related to stock option exercises which occurred in the first nine months of 2006. In addition, sales and marketing expenses were higher in the first nine months of 2006 compared to the first nine months of 2005 as a result of expenses associated with our TCZ joint venture which was formed in July 2005. Sales and marketing expenses in the nine months ended September 30, 2005 also included higher expenses than in the first nine months of 2006 associated with our chipmaker customers at our foreign locations. As a percentage of total revenues, such sales and marketing expenses decreased from 6.7% for the nine months ended September 30, 2005 to 5.6% for the nine months ended September 30, 2006.

*General and Administrative.* General and administrative expenses increased 39% from \$20.1 million for the nine months ended September 30, 2005 to \$27.9 million for the nine months ended September 30, 2006 primarily due to stock-based compensation expense recorded in the first nine months of 2006 upon our adoption of SFAS 123R in January 2006. In addition, general and administrative expenses in 2006 also included increased profit sharing and bonus expenses, employer payroll taxes associated with stock option exercises that occurred in the first nine months of 2006 and increased external audit fees during the period. General and administrative expenses were also higher in the first nine months of 2006 compared to the first nine months of 2005 as a result of expenses associated with our TCZ joint venture which was formed in July 2005. As a percentage of total revenues, general and administrative expenses decreased from 7.2% for the nine months ended September 30, 2005 to 6.9% for the nine months ended September 30, 2006.

*Total Other Income (Expense) - Net.* Net other income totaled \$3.6 million and \$14.4 million for the nine months ended September 30, 2005 and 2006, respectively. The increase in net other income was primarily due to a significant increase in interest income, the receipt of \$3.2 million in life insurance proceeds following the death of one of our executive officers in the first quarter of 2006, a decrease in interest expense and a foreign currency exchange gain recorded in the first nine months of 2006 as compared to a foreign currency exchange loss recorded in the first nine months of 2005. The increase in interest income from 2005 to 2006 reflects higher market interest rate yields on larger cash and investment balances which resulted from higher earnings and significant proceeds from stock option and warrant exercises during the first nine months of 2006. The decrease in interest expense from period to period was due to our lower debt balances as a result of the repurchase of our convertible subordinated notes that we made in the second quarter of 2005. Other income was positively impacted in 2005 by a \$2.2 million gain on debt extinguishment which resulted from the repurchase of these convertible subordinated notes. Foreign currency exchange loss totaled \$932,000, interest income and other income totaled \$7.7 million, interest expense totaled \$5.4 million and the gain on debt extinguishment totaled \$2.2 million for the nine months ended September 30, 2005, compared to a foreign currency exchange gain of \$856,000, interest and other income of \$17.9 million, and interest expense of \$4.4 million for the nine months ended September 30, 2006.

*Income Tax Provision.* The tax provision of \$2.1 million and \$34.7 million for the nine months ended September 30, 2005 and 2006, respectively, reflects an annual effective rate of 7.06% and 33.8%, respectively. The change in the annual effective tax rate from period to period was primarily attributable to the increase in pre-tax earnings as well as a reduction in tax benefits from U.S. export incentive programs

and the expiration of the federal research credit. The annual effective tax rate for the nine months ended September 30, 2006 was less than the U.S. statutory rate of 35% primarily as a result of permanent book/tax differences and tax credits.

## LIQUIDITY AND CAPITAL RESOURCES

Historically we have funded our operations primarily from cash generated from operations, the proceeds of the note offerings, bank borrowings, and the proceeds from employee stock option exercises. As of September 30, 2006, we had approximately \$254.2 million in cash and cash equivalents, \$198.1 million in short-term investments, \$9.8 million in long-term investments, and \$629.5 million in working capital.

In February 2002, we issued \$250.0 million in aggregate principal amount in a private placement of notes. These notes are due on February 15, 2009 with interest payable semi-annually on February 15 and August 15 of each year at 3.50% per annum. The notes are convertible into shares of our common stock at a conversion rate of 20 shares per \$1,000 principal amount or an effective conversion price of \$50.00 per share. We used a portion of the net proceeds from this private placement to redeem the previously issued notes that were then outstanding. The remaining proceeds are being used for our operating, investing and financing activities. With the approval of our board of directors, we have periodically repurchased these notes in the open market. We repurchased \$60.0 million principal amount of these notes in 2005. As of September 30, 2006, there were \$140.7 million principal amount of notes outstanding.

Net cash provided by operating activities was approximately \$90.4 million and \$67.3 million for the nine months ended September 30, 2005 and 2006, respectively. Although net income for the nine months ended September 30, 2006 was significantly higher than the same period in 2005, cash provided by operating activities was much lower in the first nine months of 2006 as compared to the first nine months of 2005. This is primarily attributable to significant increases in accounts receivable and inventories for the nine months ended September 30, 2006 compared to decreases in these same items for the nine months ended September 30, 2005. The increase in accounts receivable is the result of higher revenues recorded during the third quarter of 2006 compared to the same period in 2005. The increase in inventory balances for the nine months ended September 30, 2006 is primarily the result of the increased demand for spares and consumable parts to support our growing installed base of light source systems, particularly our more advanced XLA series systems. In addition, cash from operations was negatively impacted for the nine months ended September 30, 2006 as a result of classifying excess tax benefits from stock option exercises in the amount of \$18.9 million in financing activities in 2006 rather than operating activities in accordance with SFAS 123R which we adopted on January 1, 2006.

Net cash provided by investing activities was approximately \$31.9 million for the nine months ended September 30, 2005 compared to \$72.6 million used in investing activities for the nine months ended September 30, 2006. Net cash provided by investing activities during the nine months ended September 30, 2005 reflects the timing of short-term and long-term investments that matured and were reinvested during the period, and the acquisition of \$14.8 million of property and equipment. Net cash used in investing activities for the nine months ended September 30, 2006 was due primarily to the timing of short-term and long-term investments that matured and were reinvested during the period, a \$7.0 million payment to acquire the final 19% minority interest in our Cymer Korea subsidiary, a \$8.2 million payment to acquire certain patent license rights and the acquisition of \$10.0 million of property and equipment.

Net cash used in financing activities was approximately \$83.6 million for the nine months ended September 30, 2005, compared to net cash provided by financing activities of \$21.9 million for the nine months ended September 30, 2006. Net cash used in financing activities for the nine months ended September 30, 2005 reflects the repurchase of treasury stock of \$50.0 million and the purchase of approximately \$60.0 million principal amount of our convertible subordinated notes, at a discount to par, in the first and second quarters of 2005. The treasury stock and note purchases were offset by proceeds received from the exercise of employee stock options totaling \$12.6 million and the minority interest

investment received from Zeiss in the TCZ joint venture of \$11.1 million during the nine months ended September 30, 2005. Net cash provided by financing activities for the nine months ended September 30, 2006 reflects the proceeds received from the exercise of employee stock options, the proceeds from the exercise of warrants, and proceeds from the employee stock purchase plan totaling \$103.7 million. In addition, cash from financing activities in 2006 was positively affected by the excess tax benefits for the period from stock option exercises which totaled \$18.9 million. This cash provided by financing activities was offset by the repurchase of treasury stock totaling \$100.7 million during the second quarter of 2006.

We require substantial working capital to fund our business, particularly to finance inventories, including purchase orders with our vendors, accounts receivable, and for capital expenditures. Our future capital requirements depend on many factors, including our manufacturing activity, the timing and extent of spending to support product development efforts, expansion of sales and marketing and field service and support, competitive labor market compensation requirements, the timing of introductions of new products and enhancements to existing products, and the market acceptance of our products. We believe that cash generated from operations along with the liquidity provided by our existing cash balances and short-term investments will be sufficient to sustain operations and provide for any potential future expansion of our business for at least the next 12 months.

At September 30, 2005 and 2006, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, variable interest, or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we did not engage in trading activities involving non-exchange traded contracts. As a result, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have relationships and transactions with persons and entities that derive benefits from their non-independent relationship with us or our related parties except as disclosed herein.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

In November 2005, the FASB issued FASB Staff Position FAS 115-1 and FAS 124-1 (“FSP 115-1 and 124-1”), “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments”. FSP 115-1 and 124-1 applies to debt and equity securities accounted for under Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities”. The objective of FSP 115-1 and 124-1 is to provide guidance for identifying other-than-temporarily impaired investments. FSP 115-1 and 124-1 also provides new disclosure requirements for investments that are deemed to be temporarily impaired. The disclosure requirements are effective in annual financial statements for fiscal periods beginning after December 15, 2005. We do not believe that the implementation of FSP FAS 115-1 and FAS 124-1 will have a material impact on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 (“FIN 48”), “Accounting for Uncertainty in Income Taxes”. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes”, and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently assessing the impact that the adoption of FIN 48 will have on our consolidated financial statements.

In September 2006, FASB issued Statement of Financial Accounting Standards No. 157 (“SFAS No. 157”), “Fair Value Measurements”. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (“GAAP”), and expands disclosures related to fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does

not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. This Statement is effective for us on January 1, 2008. We are currently evaluating the impact of this pronouncement on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (“SFAS No. 158”), “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an Amendment of FASB Statements No. 87, 88, 106, and 132(R)”. SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through other comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. SFAS No. 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. We do not believe that the adoption of SFAS No. 158 will have a material effect on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 108 (“SAB No. 108”), “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements”, which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Early application is encouraged, but not required. We are required to adopt SAB No. 108 for our fiscal year ending December 31, 2006. We are currently assessing the impact, if any, the adoption of SAB No. 108 in the fourth quarter of 2006 will have on our consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### **Foreign Currency Risk**

We conduct business in several international currencies through our global operations. Due to the large volume of our business that we conduct in Japan, the Japanese operation poses our greatest foreign currency risk. We use financial instruments, principally forward contracts, to manage our foreign currency exposures. We enter into forward contracts in order to reduce the impact of currency fluctuations related to purchases of our inventories by Cymer Japan in U.S. dollars for resale under firm third-party sales commitments denominated in Japanese yen, as well as other foreign currency exposures including exposures related to intercompany debt. We do not enter into forward contracts for speculative purposes.

As of September 30, 2006, we had outstanding forward contracts to buy U.S. \$30.6 million for 3.8 billion yen under foreign currency exchange facilities with contract rates ranging from 109.76 yen to 117.33 yen per U.S. dollar. These contracts expire on various dates through February 2007.

Our forward contracts generally qualify for hedge accounting treatment per the provisions of Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities”. As a result, we defer changes in the fair value for the effective portion of these hedges and record the amount in other comprehensive income (loss) and subsequently reclassify the gain or loss to cost of product sales in the same period that the related sale is made to the third party. The fair value of all of our forward contracts and the deferred gain (net of tax) for those that qualify for hedge accounting treatment totaled \$822,000 and \$54,000 respectively, as of September 30, 2006.

The fair value of these forward contracts as of September 30, 2006 would have fluctuated by \$3.1 million if the foreign currency exchange rate for the Japanese yen to the U.S. dollar on these forward contracts had changed by 10%.

#### **Investment and Debt Risk**

We maintain an investment portfolio consisting primarily of government and corporate fixed income securities, certificates of deposit and commercial paper. While it is our general intent to hold such

securities until maturity, we will occasionally sell certain securities for cash flow purposes. Therefore, our investments are classified as available-for-sale and are carried on the balance sheet at fair value. Due to the conservative nature of the investment portfolio, a sudden change in interest rates would not have a material effect on the value of the portfolio.

In February 2002, we issued \$250.0 million principal amount of unsecured fixed rate 3.50% Convertible Subordinated Notes due February 15, 2009. Interest on these notes is payable on February 15 and August 15 of each year. The notes are convertible into shares of our common stock at a conversion rate of 20 shares per \$1,000 principal amount subject to adjustment under certain conditions. We may redeem the notes after February 20, 2005 at certain redemption prices expressed as a percentage of the principal amount. The notes are subordinated to our existing and future senior indebtedness and effectively subordinated to all indebtedness and other liabilities of our subsidiaries. Because the interest rate is fixed, we believe there is no risk of increased interest expense. These notes are recorded at face value on the consolidated balance sheets. In the third quarter of 2004 and the second quarter of 2005, we repurchased, at a discount to par, approximately \$49.2 million and \$60.0 million principal amount, respectively, of these notes. As of September 30, 2006, \$140.7 million principal amount of the notes were outstanding. The fair value of such debt based on quoted market prices on September 30, 2006 was \$145.3 million.

#### **ITEM 4. Controls and Procedures**

*Evaluation of disclosure controls and procedures.* For the third quarter of 2006, our chief executive officer and our chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of September 30, 2006, and concluded that as of such date, our disclosure controls and procedures were not effective in ensuring that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission.

This conclusion was based solely on our assessment of the company's processes and controls related to our accounting for income taxes described in our 2005 Form 10-K, more specifically those policies and procedures over the reconciliation of income tax accounts which were not designed with adequate precision and our policies and procedures over foreign tax provisions that did not provide for adequate review. These deficiencies resulted in errors in our consolidated tax provision for our year ended December 31, 2005. Such errors were corrected prior to the issuance of our consolidated financial statements at and for the year ended December 31, 2005. These deficiencies also resulted in a more than remote likelihood that a material misstatement to our consolidated financial statements would not be prevented or detected. As described in Part II, Item 9A of our Form 10-K for the year ended December 31, 2005, we have implemented a plan to remediate this material weakness.

*Changes in internal control over financial reporting.* There has been no change in our internal control over financial reporting during the quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting other than the steps taken by us to remediate the material weakness that was first disclosed by us in our 2005 Form 10-K relating to our accounting for income taxes.

We have taken the following remediation steps during the nine months ended September 30, 2006 to improve our internal controls over our accounting for income taxes:

- Improved the procedures for reviewing our consolidated tax provisions and reconciling all subsidiary office tax accounts; and
- Increased the level of communication with our subsidiary office accountants over the preparation of our foreign quarterly and annual tax provisions.

We have been conducting our testing of these new internal controls since early 2006 and will continue to do so for the remainder of the year. We will not be able to completely remediate this material weakness in our accounting for income taxes until we can conduct testing of the 2006 end of year internal controls for income taxes in early 2007.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

None.

### ITEM 1A. Risk Factors

*The risks described below may not be the only risks we face. Additional risks that we do not currently think are material may also impair our business operations. The risk factors set forth below with an asterisk (\*) next to the title contain changes to the description of the risk factors associated with our business as previously disclosed in Item 1A to our Annual Report on Form 10-K for the fiscal year ended December 31, 2005. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.*

Our revenues and operating results from quarter-to-quarter have varied in the past and our future operating results may continue to fluctuate significantly.

Factors that contribute to fluctuations in our revenues and operating results include:

- demand for semiconductors in general and, in particular, for leading edge devices with smaller circuit geometries;
- cyclical nature in the market for semiconductor manufacturing equipment;
- rates at which chipmakers take delivery of photolithography tools from lithography tool manufacturers;
- rates at which our customers take delivery of light source systems from us;
- timing and size of orders from our customer base;
- changes in market penetration by our competitor;
- product lead time demands from lithography tool manufacturers and chipmakers;
- mix of light source models, consumable and spare parts and service revenues in our total revenues;
- changes in the price and profitability of our products;
- our ability to develop and implement new technologies and introduce new products;
- utilization rates of light sources and sales of consumable and spare parts and services;
- our ability to manage our manufacturing requirements;
- our ability to manage customer satisfaction, product reliability, and direct field service and support effectiveness;
- foreign currency exchange rate fluctuations, principally with respect to the Japanese yen (in which sales by our Japanese subsidiary are denominated);
- worldwide political instability;
- changing global economic conditions, including rising energy prices; and
- intellectual property protection.

We have historically derived a large portion of our quarterly and annual revenues from selling a small number of light source systems. Because we sell a small number of products, the precise time that we recognize revenue from an order may have a significant impact on our total revenue for a particular

period. Our customers may cancel or reschedule orders with little or no penalty. Orders expected in one quarter could shift to another period due to changes in the anticipated timing of our customers' purchase decisions or rescheduled delivery dates requested by our customers. Our operating results for a particular quarter or year may be adversely affected if our customers, particularly our three largest customers, cancel or reschedule orders, or if we cannot fill orders in time due to unexpected delays in manufacturing, testing, shipping, and product acceptance.

We manage our expense levels based, in large part, on expected future revenues. As a result, our expenses are relatively fixed for the short term, and if our actual revenue decreases below the level we expect, our operating results will be adversely affected. As a result of these or other factors, we could fail to achieve our expectations as to future revenue, gross profit and operating income. Our failure to meet the performance expectations set and published by external sources could result in a sudden and significant drop in the price of our stock, particularly on a short-term basis, and could negatively affect the value of any investment in our stock.

**Our business depends on the semiconductor and the semiconductor capital equipment industries, which are highly volatile and unpredictable.\***

We derive a substantial portion of our revenues from photolithography tool manufacturers, or original equipment manufacturer ("OEM") customers, who incorporate our light source systems in photolithography tools that they sell to semiconductor manufacturers, or chipmakers, and from chipmakers who purchase consumables, spare parts, upgrades and service directly from us. Like us, our OEM customers depend on demand for their products from the chipmakers. The capital equipment and related operating expenditures of chipmakers depend on a number of factors, including the current and anticipated market demand for semiconductors and the many products using semiconductors. That demand is highly volatile and unpredictable.

As a result of the cyclicity of the semiconductor industry, the semiconductor capital equipment industry historically has experienced periodic ups and downs. The cyclical nature of the semiconductor and the semiconductor capital equipment industries affects our ability to accurately predict future revenue and therefore our ability to manage our future expense levels. When cyclical fluctuations result in lower than expected revenue levels, operating results may be adversely affected and cost reduction measures may be necessary in order for us to remain competitive and financially sound. During a down cycle or slowdown, we must be in a position to adjust our cost and expense structure to prevailing market conditions while still being able to motivate and retain our key employees. During periods of rapid growth, we must be able to increase manufacturing capacity and personnel to meet customer demand. We can provide no assurance that these objectives can be met in a timely manner in response to industry cycles. We are not able to predict with any certainty the duration of any industry cycle or the timing or order of magnitude of any recovery.

Downturns in the semiconductor industry often result in decreases in demand for semiconductor manufacturing equipment, including the photolithography tools that our OEM customers produce. The most recent downturn in the semiconductor industry had a severe effect on the demand for semiconductor manufacturing equipment. Fluctuating levels of investment by chipmakers and resulting pricing volatility will continue to materially affect our aggregate bookings, revenues and operating results. Even during periods of reduced revenues we believe we must continue to invest in research and development and to maintain extensive ongoing worldwide customer service and support capabilities to remain competitive. Continued spending in furtherance of these objectives may temporarily harm our financial results. Semiconductor industry downturns and slowdowns are likely to continue to adversely affect our business, financial condition and operating results, and our operating results may fall below the expectations of public market analysts or investors in future quarters. Any failure to meet such expectations could materially adversely affect the price of our common stock.

Our OEM customers try to manage their inventories and production requirements to appropriate levels that reflect their expected sales to chipmakers. Market conditions in the semiconductor industry and our OEM customers' production efficiency can cause them to expand or reduce their orders for new light

source systems as they try to manage their inventories and production requirements. We continue to work with our OEM customers to better understand these issues. However, we cannot guarantee that we will be successful in understanding our OEM customers' inventory management and production requirements or that our OEM customers will not build up an excess inventory of light source systems. If our OEM customers retain an excess inventory of light source systems, our revenue could be reduced in future periods as the excess inventory is utilized, which could adversely affect our operating results, financial condition and cash flows. If our OEM customers demand shorter product lead times to improve their inventory and cash positions, our inventory management and cash position may be negatively impacted, which may adversely affect our operating results, financial condition and cash flows.

**A significant percentage of our revenue is derived from sales to the three lithography tool manufacturers, and if we are not able to retain these customers, or they reschedule, reduce or cancel orders, or delay or default on payments, our revenues would be reduced and our financial condition and cash flows would suffer.\***

Three large companies, ASM Lithography, Canon and Nikon dominate the photolithography tool business. Collectively, these three companies accounted for the following percentage of our total revenue during the periods indicated:

	Nine months ended September 30,	
	<u>2005</u>	<u>2006</u>
ASM		
Lithography	32%	38%
Canon	8%	6%
Nikon	<u>25%</u>	<u>15%</u>
<b>Total</b>	<u>65%</u>	<u>59%</u>

Collectively, these three companies accounted for the following percentage of our total accounts receivable at the dates indicated:

	<u>December 31, 2005</u>	<u>September 30, 2006</u>
ASM Lithography	36%	47%
Canon	5%	3%
Nikon	<u>25%</u>	<u>21%</u>
<b>Total</b>	<u>66%</u>	<u>71%</u>

We expect that sales of our light source products to these three customers will continue to account for a substantial portion of our revenue in the foreseeable future. None of our customers are obligated to purchase a minimum number of our products in the aggregate or during any particular period. We can provide no assurance that any of our customers will continue to purchase our products at past or current levels. For example, revenue attributable to sales to Canon has declined significantly since 2004. Sales to Canon or any of these customers may be affected by many factors, some of which are beyond our control. These factors include:

- a change in a customer's competitive position in its industry;
- a customer experiencing lithography tool production problems;
- a decision to purchase light sources from other suppliers;
- changes in economic conditions in the semiconductor or the photolithography tool industries; and
- a decline in a customer's financial condition.

The loss of any significant business from or production problems for any one of these three customers would harm our business and financial condition.

**A substantial percentage of our revenue is derived from the sale of a limited number of primary products.**

Our only current product line is excimer light source systems, including KrF and ArF systems, and support, including consumable and spare parts and service support. We expect these light source systems and the related support to continue to account for a substantial majority of our revenues in the near term. Continued market acceptance of our light source system products is, therefore, critical to our future success. The primary market for excimer light sources is in the use of DUV photolithography equipment for manufacturing deep-submicron semiconductor devices using smaller circuit geometries. The demand for our products depends in part on the rate at which chipmakers further adopt excimer light sources as the chosen light source for their photolithography tools.

The rate with which chipmakers adopt excimer light sources may vary for a variety of reasons, including:

- inadequate performance of photoresists used in advanced DUV photolithography;
- potential shortages of specialized materials used in DUV optics;
- productivity of 300 mm photolithography tools relative to 200 mm tools; and
- consolidation of chipmakers.

We cannot guarantee that these factors can or will be overcome or that the demand for our excimer light source products will not be materially reduced. The demand for our light source products, and therefore our operating results, financial condition and cash flows, could be adversely affected by a number of factors, including:

- a decline in demand for our customers' DUV photolithography tools;
- a failure to achieve continued market acceptance of our products;
- a failure to manage customer satisfaction, product reliability, and direct field service and support effectiveness;
- an improved version of products being offered by a competitor in the market in which we participate;
- technological change that we are unable to address with our products; and
- a failure to release new enhanced versions of our products on a timely basis.

**We depend on the introduction of new products for our success, and we are subject to risks associated with rapid technological change.\***

Rapid technological changes in semiconductor manufacturing processes subject us to increased pressure to develop technological advances enabling such processes. We believe that our future success depends in part upon our ability to develop, manufacture, timely introduce and support new light source products with improved capabilities and to continue to enhance our existing light source systems and process capabilities. Due to the risks inherent in transitioning to new products, we must forecast accurate demand for new products while managing the transition from older products.

Our most significant product introduction in recent years consisted of a technology change from a single-discharge-chamber excimer light source to a dual-discharge-chamber design called MOPA. The MOPA design represents a paradigm shift from previously accepted lithography technology and offers chipmakers higher power, tighter bandwidth and lower cost of operation for their current – and we expect for their future – optical lithography applications. As originally designed, the MOPA architecture was projected to provide its benefits across all three DUV wavelengths – 248 nm, 193 nm, and 157 nm – but at this time, the semiconductor industry has only adopted MOPA at the 193 nm wavelength, due to the successful extension of 248 nm single chamber technology, and the omission of 157 nm lithography from the roadmap. There are risks inherent in the ongoing transition to the MOPA technology, including effective execution of our product development roadmap, continuing adoption of the product by lithography tool manufacturers and chipmakers, manufacturability, cost effectiveness, and product

performance in the field of the new products and the development of a comparable product by our competitor.

At this time, chipmakers are continuing to expand their manufacturing capacity at 90 nm, while manufacturers of certain types of memory chips are in the early stages of production at 65 nm and planning for production of chips with even smaller CDs. These efforts, along with initial development of ArF immersion lithography capabilities among a number of chipmakers, are driving demand for our most advanced ArF light sources. At the same time chipmakers also need tools for the less critical layers on wafers, and there remains strong demand for our KrF light source products for DUV photolithography systems as well. After chipmakers have built their capacity to levels appropriate to meet existing demand, their demand for our light source products will depend, in part, on their sales forecasts and their estimates regarding the duration and magnitude of the current industry cycle and whether their projected manufacturing process yields will enable ongoing investments in whatever capacity seems necessary.

Future technologies such as EUV, electron projection lithography, and maskless lithography may render our excimer light source products obsolete. We must manage product transitions, as introduction of new products could adversely affect our sales of existing products. If new products are not introduced on time, or have reliability or quality problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may not be able to develop and introduce new products or enhancements to our existing products and processes in a timely or cost effective manner that satisfies customer needs or achieves market acceptance. Failure to develop and introduce these new products and enhancements could materially adversely affect our operating results, financial condition and cash flows.

We expect to face significant competition from current and future competitors. We believe that other companies are developing systems and products that are competitive to ours and are planning to introduce new products to this market, which may affect our ability to sell our new products. Furthermore, new products represent significant investments of our resources and their success, or lack thereof, could have a material effect on our financial results.

**Failure to maintain effectively our direct field service and support organization could have a material adverse effect on our business.\***

We believe it is critical for us to provide quick and responsive service directly to the chipmakers throughout the world that use our light source products in their photolithography systems, and that it is essential to maintain our own personnel or trained third-party resources to provide these services. Accordingly, we have an ongoing effort to develop our direct support system with locations in Europe, Korea, Japan, the People's Republic of China, Singapore, Taiwan and the U.S. This requires us to do the following:

- recruit and train qualified field service personnel;
- identify qualified independent firms; and
- maintain effective and highly trained organizations that can provide service to our customers in various countries.

We may not be able to attract and train qualified personnel to maintain our direct support operations successfully. We may not be able to find and engage qualified third-party resources to supplement and enhance our direct support operations. Further, we may incur significant costs in providing these support services. Failure to implement our direct support operation effectively could harm our operating results, financial condition and cash flows.

**We must develop and manufacture enhancements to our existing products and introduce new products in order to continue to grow our business. We may not effectively manage our growth and integrate these new enhancements and products, which could materially harm our business.**

To continue to grow our business, our existing light source products and their process capabilities must be enhanced, and we must develop and manufacture new products to serve other semiconductor applications. We cannot guarantee that we will be able to manage our business to grow effectively. Nor can we guarantee that we will be able to accelerate the development of new enhancements to our existing products and create new products. Further, we may not be able to effectively integrate new products and applications into our current operations. Any of these risks could materially harm our business, financial condition and results of operations.

**We must effectively manage changes in our business.\***

In order to respond to the business cycles of the semiconductor industry, in the past few years we have sharply expanded and contracted the scope of our operations and the number of employees in many of our locations and departments. As the semiconductor industry cycle moves between growth and contraction we will need to:

- improve our product reliability through quality control, and our order fulfillment, field service and customer support capabilities;
- closely manage our global operations;
- improve our process and other internal management systems;
- quickly adapt to changing sales and marketing channels;
- effectively manage our inventory levels; and
- attract, train, retain and manage key personnel.

If we fail to effectively manage changes in our business, our operating results, financial condition and cash flows will be adversely affected.

**We depend on a few key suppliers for purchasing components and subassemblies that are included in our products.\***

We purchase a limited number of components and subassemblies included in our light source products from a single supplier or a small group of suppliers. For certain optical, control system and pulse power components and subassemblies used in our light source systems, we currently utilize a single supplier. To reduce the risk associated with this single supplier, we carry a significant strategic inventory of these components. Strategic inventories are managed as a percentage of future demand. We have also negotiated to have vendor-managed inventory of critical components to further reduce the risk of a single supplier. In addition, we contract the manufacture of various subassemblies of our products and depend on our contract manufacturers to deliver to our required specifications, schedule, and quality standards. Further, some of our suppliers have specialized in supplying equipment or manufacturing services to semiconductor equipment manufacturers and therefore are susceptible to industry ups and downs and subject to the same risks and uncertainties regarding their ability to respond to changing market conditions. Because many of these suppliers reduce the size of their workforce in an industry downturn and increase it in an upturn, they may not be able to meet our requirements or respond quickly enough as an upturn begins and gains momentum. Due to the nature of our product development requirements, these key suppliers must rapidly advance their own technologies and production capabilities in order to support the introduction schedule of our new products. These suppliers may not be able to provide new modules and subassemblies when they are needed to satisfy our product schedule requirements. If we cannot purchase enough of these materials, components or subassemblies, or if these items do not meet our quality standards, there could be delays or reductions in our product shipments, which would harm our operating results, financial condition and cash flows.

**We face competition from one company and may face competition from additional competitors who enter the market.\***

We currently have one significant competitor that sells light sources for DUV photolithography applications. This competitor, Gigaphoton, is a joint venture between two large companies, Komatsu and Ushio, and is headquartered in Japan. Gigaphoton is aggressively trying to gain larger market penetration

in the excimer light source industry. We know that our customers have purchased products from this competitor and that our customers have approved this competitor's light sources for use with their products. We know that Gigaphoton has been approved by and has an installed base of services at chipmakers in Japan, the U.S. and elsewhere for producing excimer light sources.

Larger companies with substantially greater resources, such as other manufacturers of industrial light sources for advanced lithography, may attempt to sell competitive products to our customers. Potential competitors may also be attracted to our growing installed base of light sources which represents a steady and significant consumable and spare parts revenue stream for us, and they may attempt to supply consumable and spare parts to that installed base. If any existing or future competitors gain market acceptance we could lose market share and our growth could slow or decline, which could have a material adverse effect on our operating results, financial condition and cash flows.

**Chipmakers' prolonged use of our products in high volume production may not produce the results they desire and, as a result, our reputation and that of our customers who supply photolithography tools to the chipmakers could be damaged in the semiconductor industry.\***

Over time, our light source products may not meet chipmakers' production specifications or operating cost requirements after the light source has been used for a long period in high volume production. If any chipmaker cannot successfully achieve or sustain their volume production using our light sources, our reputation could be damaged with chipmakers and lithography tool manufacturers. This would harm our business.

**We depend on key personnel, especially management and technical personnel, who may be difficult to attract and retain.**

We are highly dependent on the services of many key employees in various areas, including:

- research and development;
- engineering;
- sales and marketing;
- field service and support;
- manufacturing; and
- management.

In particular, there are a limited number of experts in excimer light source technology, and we require highly skilled hardware and software engineers. Competition for qualified personnel is intense and we cannot guarantee that we will be able to continue to attract and retain qualified personnel as needed. We do not have employment agreements with most of our employees. We believe that our future growth and operating results will depend on:

- the continued services of our research and development, engineering, sales and marketing, field service and support, manufacturing and management personnel;
- our ability to attract, train and retain highly-skilled key personnel; and
- the ability of our personnel and key employees to continue to expand, train and manage our employee base.

If we are unable to hire, train and retain key personnel as required, our operating results, financial condition and cash flows could be adversely affected.

**Economic, political, regulatory and other events in geographic areas where we have significant sales or operations could interfere with our business.\***

We serve an increasingly global market. A large portion of our total revenues is derived from customers located outside of the U.S. We expect our international sales to continue to account for a very

large portion of our total revenues. In order to support our foreign customers, we maintain a manufacturing and field service subsidiary in Korea as well as field service and support subsidiaries in Japan, the Netherlands, the People's Republic of China, Singapore and Taiwan.

We may not be able to manage our operations to address and support our global customers effectively. Further, our investments in these types of activities may not make us competitive in the global market or we may not be able to meet the service, support, and manufacturing levels required by our global customers.

Additionally, we are subject to the risks inherent in doing business globally, including:

- unexpected changes in regulatory requirements;
- fluctuations in exchange rates and currency controls;
- political and economic conditions and instability;
- imposition of trade barriers and restrictions, including changes in tariff and freight rates, foreign customs and duties;
- difficulty in coordinating our management and operations in several different countries;
- difficulties in staffing and managing foreign subsidiary and branch operations;
- limited intellectual property protection in some countries;
- potentially adverse tax consequences in some countries;
- the possibility of accounts receivable collection difficulties;
- in the case of Asia, the risk of business interruption and damage from earthquakes;
- the effect of acts of terrorism and war; and
- the burdens of complying with a variety of foreign laws.

Many of our major customers and many of the chipmakers who use our light source products in their photolithography systems are located in Asia. Economic problems and currency fluctuations affecting these regions in Asia could create a larger risk for us. Further, even though it has not been difficult for us to comply with U.S. export controls, these export rules could change in the future and make it more difficult or impossible for us to export our products to many countries. Any of these vulnerabilities could have a material adverse effect on our business, financial condition and results of operations.

**Our ability to compete could be jeopardized if we are unable to protect our intellectual property rights. These types of claims could seriously harm our business or require us to incur significant costs.\***

We believe our success and ability to compete depend in large part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect our proprietary rights.

As of September 30, 2006, we owned 247 U.S. patents covering certain aspects of technology related to light sources and piezo techniques. These patents will expire at various times during the period from January 2008 to September 2025. As of September 30, 2006, we had applied for 138 additional patents in the U.S. As of September 30, 2006, we owned 376 foreign patents and had 377 patent applications pending in various foreign countries.

Our pending patent applications and any future applications might not be approved. Our patents might not provide us with a competitive advantage and may be challenged by third parties. In addition, third parties' patents might have an adverse effect on our ability to do business. As a result of cost constraints, we did not begin seeking patent protection in Japan and other countries for our inventions that are covered by U.S. patents and patent applications until 1993. As a result we do not have the right to seek foreign patent protection for some of our early inventions. Additionally, laws of some foreign countries in which our products are or may be developed, manufactured or sold, including various countries in Asia, may not protect our products or intellectual property rights to the same extent as do the laws of the U.S. Thus, the likelihood of piracy of our technology and products is greater in these countries.

Further, third parties might independently develop similar products, duplicate our products, or design around patents that are granted to us.

Other companies or persons may have filed or may file in the future patent applications that are similar or identical to ours. We may have to participate in appropriate proceedings in the courts or the patent offices to determine the priority of inventions. These proceedings may determine that these third-party patent applications have priority over our patent applications. Loss of priority in these interference proceedings could result in substantial cost to us.

We also rely on the following to protect our confidential information and our other intellectual property:

- trade secret protection;
- employee nondisclosure agreements;
- third-party nondisclosure agreements; and
- other intellectual property protection methods.

However, we may not be successful in protecting our confidential information and intellectual property, particularly our trade secrets, because third parties may:

- independently develop substantially the same proprietary information and techniques;
- gain access to our trade secrets; or
- disclose our technology.

**The parties to whom we provide research and development services may dispute the ownership of the intellectual property that we develop performing these services.\***

In the past, funds from research and development arrangements with third parties have been used to pay for a portion of our own research and development expenses. We receive these funds from government-sponsored programs and customers, in connection with our designing and developing specific products. Periodically, funds from lithography tool manufacturers and chipmakers are used to fund a small portion of our research and development expenses. In providing these research and development services to these manufacturers, we try to make clear who owns the intellectual property that results from the research and development services we perform. However, disputes over the ownership or rights to use or market this intellectual property may arise between the funding organizations and us. Any dispute over ownership of the intellectual property we develop could restrict our ability to market our products and have a material adverse effect on our business.

**In the future, we may be subject to patent litigation to enforce patents issued to us and defend ourselves against claimed infringement by our competitor or any other third party.\***

Third parties have notified us in the past, and may notify us in the future, that we are infringing their intellectual property rights. Also, we have notified third parties in the past, and may notify them in the future, that they may be infringing our intellectual property rights.

Specifically, Komatsu has notified us that we may be infringing some of its Japanese patents. During our subsequent discussions, Komatsu also asserted that our former Japanese manufacturing partner, Seiko, or we may be infringing on some of Komatsu's U.S. patents and a number of its additional Japanese patents. Komatsu has also notified one of our customers, Nikon, of its belief that our light sources infringe several of Komatsu's Japanese and U.S. patents. As a result, we started proceedings in the Japanese Patent Office to oppose certain patents and patent applications of Komatsu. The Japanese Patent Office has dismissed our opposition claims. Thus, litigation may result in connection with Komatsu's Japanese patents or U.S. patents. Also, Komatsu might claim that we infringe other or additional patents. Komatsu notified Seiko that it intends to enforce its rights against Seiko with respect to its Japanese patents if Seiko continued to engage in manufacturing activities for us. In connection with our former manufacturing agreement with Seiko, we agree to pay Seiko under certain conditions for damages

associated with these types of claims. Seiko may not prevail in any litigation against Komatsu, and therefore, we may be required to pay Seiko for such damages.

We have notified our competitor and others of our U.S. patent portfolio. Specifically, we have notified Komatsu that it may be infringing some of our U.S. patents. We have discussed with Komatsu our claims against each other. Komatsu challenged one of our U.S. patents in the United States Patent and Trademark Office (“USPTO”) but our patent was subsequently re-issued by the USPTO. Also, Komatsu transferred its lithography light source business to our competitor, Gigaphoton. We also have had discussions with a former competitor, Lambda-Physik (a subsidiary of Coherent, Inc.), regarding allegations by each party against the other for possible patent infringement. Any of these discussions with our competitor or former competitor may not be successful and litigation could result.

In the future, patent litigation may result due to a claim of infringement by our competitor or any other third party or may be necessary to enforce patents issued to us. Any such litigation could result in substantial cost to us and diversion of our effort, which would have an adverse effect on our business, financial condition and operating results. Furthermore, our customers and the end-users of our products might assert other claims for indemnification that arise from infringement claims against them. If these assertions are successful, our business, financial condition and operating results may be materially affected. Instead of litigation, or as a result thereof, we may seek a license from third parties to use their intellectual property. However, we may not be able to obtain a license. Alternatively, we may design around the third party’s intellectual property rights or we may challenge these claims in legal proceedings. Any adverse determination in a legal proceeding could result in one or more of the following, any of which could harm our business, financial condition and operating results:

- loss of our proprietary rights;
- exposure to significant liabilities by other third parties;
- requirement that we get a license from third parties on terms that are not favorable; or
- restriction from manufacturing or selling our products.

Any of these actions could be costly and would divert the efforts and attention of our management and technical personnel, which would materially adversely affect our business, financial condition and results of operations.

**We may acquire a business or enter a new market that will involve numerous risks. We may not be able to address these risks successfully without substantial expense, delay or other operational and financial challenges.**

The risks involved with acquiring a new company, forming a joint venture, or entering a new market include the following:

- diversion of management’s attention and resources to integrate the new company or new business opportunity;
- failure to retain key personnel;
- client dissatisfaction or performance problems with the acquired company or new product in a new market;
- amortization of acquired definite-lived intangible assets and deferred compensation;
- the cost associated with acquisitions and joint ventures and the integration of acquired operations;
- the cost associated with developing, marketing, introducing and supporting a new product in a new market;
- failure to commercialize purchased technologies;
- ability of the acquired companies, joint ventures or new markets to meet their financial projections;
- assumption of unknown liabilities or other unanticipated events or circumstances; and
- compliance with the Sarbanes-Oxley Act of 2002, new SEC regulations, Nasdaq Stock Market rules and new accounting pronouncements as they relate to the new company or joint venture.

Mergers, acquisitions and joint ventures as well as entering new markets are inherently subject to multiple significant risks, and the inability to effectively manage these risks could have a material adverse effect on our business. In July 2005, we formed our TCZ joint venture with Zeiss to produce tools for the manufacture of flat panel displays. This is a new market for both Cymer and Zeiss and may involve numerous risks. Any of these risks could materially harm our business, financial condition and operating results. Further, any business that we acquire, joint venture that we form or new market we may enter may not achieve anticipated revenues or operating results.

**Compliance with changing regulations of corporate governance and public disclosure may result in additional expenses\*.**

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, including accelerated SEC filing timelines and new Proxy rules, Nasdaq Stock Market rules, and new accounting pronouncements are creating uncertainty and additional complexities for companies such as ours. In particular, the Section 404 internal control requirements under the Sarbanes-Oxley Act have added and will continue to add complexity and costs to our business and require a significant investment of our time and resources to complete each year. We take these requirements seriously and expect to continue to make every effort to ensure that we receive clean attestations on our internal controls each year from our outside auditors. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with all other evolving standards. These investments may result in increased general and administrative expenses and a diversion of management time and attention from strategic revenue generating and cost management activities.

**Trademark infringement claims against our registered and unregistered trademarks would be expensive and we may have to stop using such trademarks and pay damages.**

We registered the trademarks “CYMER” and “INSIST ON CYMER” and others in the U.S. and in some other countries. We are also trying to register additional trademarks in the U.S. and in other countries. We use these trademarks and many other marks in our advertisements and other business materials, which are distributed throughout the world. We may be subject to trademark infringement actions for using these marks and other marks on a worldwide basis and this would be costly to defend. If a trademark infringement action were successful, we would have to stop using the mark and possibly pay damages.

**Decreased effectiveness of equity compensation could adversely affect our ability to attract and retain employees, and changes in accounting for equity compensation could adversely affect earnings.**

We have historically used broad based stock option programs and other forms of equity-related incentives as a key component of our employee compensation packages. We believe that stock options and other long-term equity incentives directly motivate a broader base of employees to maximize long-term stockholder value and, through the use of long-term vesting, encourage employees to remain with us. In December 2004, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 123R (“SFAS No. 123R”), “Share-Based Payment – An Amendment to Statement Nos. 123 and 95,” which we adopted on January 1, 2006. This new rule requires us to record an expense to earnings for employee stock option grants and other equity incentives. Moreover, applicable stock exchange listing standards relating to obtaining stockholder approval of equity compensation plans has made it more difficult and expensive for us to grant options to employees, which has resulted in changes to our equity compensation strategy, including a significant reduction in the number of stock options granted to employees. We have developed alternative cash compensation arrangements for our employees to replace the majority of these stock option programs and may be

required to offer additional alternative cash compensation arrangements in the future. These and other developments in the provision of equity compensation to employees could make it more difficult to attract, retain and motivate employees, and such a change in accounting rules and alternative cash compensation programs may adversely impact our future operating results, financial condition and cash flows.

**We are dependent on air transport to conduct our business and disruption of domestic and international air transport systems could adversely affect our business.**

We depend on regular and reliable air transportation on a worldwide basis for many of our routine business functions. If civil aviation in the U.S. or abroad is disrupted by terrorist activities or security responses to the threat of terrorism or for any other reason, our business could be adversely affected in the following ways:

- supplies of raw materials and components for the manufacture of our products or our customers' products may be disrupted;
- we may not be able to deliver our products to our customers in a timely manner;
- we may not be able to provide timely service or support of installed light sources for chipmakers; and
- our sales and marketing efforts may be disrupted.

**We are exposed to risks related to the fluctuations in the currency exchange rates for all foreign currencies in which we do business, but particularly for the Japanese yen.**

When we sell products to our Japanese subsidiary, the sale is denominated in U.S. dollars. When our Japanese subsidiary sells our products directly to customers in Japan, the sale is denominated in Japanese yen. Thus, our results of operations may fluctuate based on the changing value of the Japanese yen to the U.S. dollar. We manage the exposure of our Japanese subsidiary to these fluctuations through forward contracts to hedge the subsidiary's purchase commitments. We will continue to monitor our exposure to these currency fluctuations, and, when appropriate, use hedging transactions to minimize the effect of these currency fluctuations. However, exchange rate fluctuations may still have a material adverse effect on our operating results. In the future, we may need to sell a more significant portion of our products in foreign currencies other than the Japanese yen and the management of more currency fluctuations will be more difficult and expose us to greater risks in this area.

**We are subject to many standards and regulations of foreign governments and, even though we intend to comply, we may not always be in compliance with these rules, or we may be unable to design or redesign our products to comply with these rules.**

Many foreign government standards and regulations apply to our products. These standards and regulations are always being amended. Although we intend to meet all foreign standards and regulations, our products may not comply with these foreign government standards and regulations. Further, it might not be cost effective for us to redesign our products to comply with these foreign government standards and regulations. Our inability to design products to comply with foreign standards therefore could have a material adverse effect on our business.

**We are dependent on our manufacturing facilities and subcontractors to assemble and test our products.**

Operations at our primary manufacturing facility and our subcontractors are subject to disruption for a variety of reasons, including work stoppages, terrorism, fire, earthquake, energy shortages, flooding or other natural disasters. Such disruptions could cause delays in shipments of our products to our customers. We cannot ensure that alternate production capacity would be available if a major disruption were to occur or that, if it were available, it could be obtained on favorable terms. Such disruption could result in cancellation of orders or loss of customers, which would have a material adverse effect on our operating results, financial condition and cash flows.

**Our operations are subject to environmental and other government regulations that may expose us to liabilities for noncompliance.**

We are subject to federal, state and local regulations, such as regulations related to the environment, land use, public utility utilization and the fire code, in connection with the storage, handling, discharge and disposal of substances that we use in our manufacturing process and on our facilities. We believe that our activities comply with current government regulations that are applicable to our operations and current facilities. We may be required to purchase additional capital equipment or other requirements for our processes to comply with these government regulations in the future if they change. Further, these government regulations may restrict us from expanding our operations. Adopting measures to comply with changes in the government regulations, our failure to comply with environmental and land use regulations, or restrictions on our ability to discharge hazardous substances, could subject us to future liability or cause our manufacturing operations to be reduced or stopped.

**Our products are subject to potential product liability claims if personal injury or death results from their use.**

We are exposed to significant risks for product liability claims if personal injury or death results from the use of our products. We may experience material product liability losses in the future. We maintain insurance against product liability claims. However, our insurance coverage may not continue to be available on terms that we accept. This insurance coverage also may not adequately cover liabilities that we incur. Further, if our products are defective, we may be required to recall or redesign these products. A successful claim against us that exceeds our insurance coverage level, or any claim or product recall that results in adverse publicity against us, could have a material adverse effect on our business, financial condition and results of operations.

**The price of our common stock has fluctuated and may continue to fluctuate widely.\***

The price of our common stock has fluctuated in the past. The market price of our common stock will continue to be subject to significant fluctuations in the future in response to a variety of factors, including the risk factors contained in this report.

Various factors may significantly affect the market price of our common stock, including:

- the cyclical nature of the semiconductor industry;
- actual or anticipated fluctuations in our operating results, including our net income, product gross margins and free cash flow;
- conditions and trends in the light source device and other technology industries;
- announcements of innovations in technology;
- new products offered by us or our competitor;
- developments of patents or proprietary rights;
- changes in financial estimates by securities analysts;
- general worldwide political, economic, and market conditions;
- U.S. political, economic, and market conditions; and
- failure to properly manage any single or combination of risk factors listed in this section.

In addition, the stock market has experienced extreme price and volume fluctuations that have particularly affected the market price for many high technology companies. Such fluctuations have in some cases been unrelated to the operating performance of these companies. Severe price fluctuations in a company's stock have frequently been followed by securities litigation. Any such litigation can result in substantial costs and a diversion of management's attention and resources and therefore could have a material adverse effect on our business, financial condition and results of operations.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

- (a) Not applicable
- (b) Not applicable
- (c) On July 28, 2006, we announced that our board of directors had authorized us to repurchase up to \$150 million of our common stock. The purchases have been made from time to time in the open market or in privately negotiated transactions. The program does not have a fixed expiration date and may be discontinued at any time.

The following table provides information with respect to the shares of common stock repurchased by us during the three months ended September 30, 2006:

<u>Period</u>	<u>Total number of shares purchased</u>	<u>Average price paid per share</u>	<u>Total number of shares purchased as part of publicly announced plans or programs</u>	<u>Approximate dollar value of shares that may yet be purchased under the plans or programs</u>
July 1, 2006 to July 31, 2006	207,815	\$ 38.95	207,815	\$ 141.9 Million
August 1, 2006 to August 31, 2006	2,385,057	\$ 38.80	2,385,057	\$ 49.3 Million
September 1, 2006 to September 30, 2006	—	\$ —	—	\$ 49.3 Million
Total	<u>2,592,872</u>	<u>\$ 38.81</u>	<u>2,592,872</u>	

## ITEM 3. Defaults Upon Senior Securities

None.

## ITEM 4. Submission of Matters to a Vote of Security Holders

None.

## ITEM 5. Other Information

- (a) None.
- (b) There were no material changes to the procedures by which security holders may recommend nominees to our board of directors.

**ITEM 6. Exhibits**

- 10.1\*           Amendment of Cymer Corporation and Intel Corporation Development Agreement, effective July 17, 2006.
- 10.2\*           Amended and Restated Joint Venture Agreement, dated September 12, 2006, among TCZ GmbH, Cymer, Inc., Carl Zeiss SMT AG and Carl Zeiss Laser Optics Beteiligungsgesellschaft mbH and TCZ Pte Ltd.
- 31.1            Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
- 31.2            Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.
- 32.1            Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act.
- 32.2            Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.

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\* Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Securities and Exchange Commission.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this quarterly report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

CYMER, INC.

Date: November 7, 2006

By: /s/ Nancy J. Baker

Nancy J. Baker  
Senior Vice President and  
Chief Financial Officer  
(Duly Authorized Officer and  
Principal Financial Officer)

\*\*\* Text Omitted and Filed Separately  
Pursuant to a Confidential Treatment Request  
under 17 C.F.R. §§ 200.80(b)(4) and 240.24b-2(b)(1)

**AMENDMENT OF  
CYMER CORPORATION and INTEL CORPORATION  
DEVELOPMENT AGREEMENT**

This Amendment of the January 23, 2004 Development Agreement (the “Amended Agreement”) is entered into as of July 17, 2006 by and between Cymer, Inc., a Nevada corporation, having a place of business at 17075 Thornmint Court, San Diego, CA 92127 and its wholly owned subsidiaries (hereinafter “Cymer”), and Intel Corporation, a Delaware corporation, having its principal place of business at 2200 Mission College Blvd., Santa Clara CA 95052 and its subsidiaries (hereinafter “Intel”). Cymer and Intel are sometimes referred to as a “Party” and collectively as the “Parties”.

**RECITALS**

**WHEREAS**, Intel and Cymer have decided to amend various terms of the above Agreement,

**NOW, THEREFORE**, for good and valuable consideration, the receipt and sufficiency of which is acknowledged, the Parties agree to amend the Development Agreement as follows:

**AGREEMENT**

**1. CONSTRUCTION AND DEFINITIONS**

- (a) Delete paragraph 1.2(a) and re-write as follows:  
  
EUV Source System shall mean a system including all apparatus to deliver debris-free, in-band, collected photons to the intermediate focus of the EUV lithography system.
- (b) Delete paragraph 1.2(c)
- (c) Re-write paragraph section 1.2(d) Production Units shall mean EUV Source Systems made available for sale by Cymer to Intel and other third parties.
- (d) Delete paragraph 1.2(e)
- (e) Delete paragraph 1.2(f)

Insert new paragraph

- 1.2(g) Cymer’s Plan means the technical plan, established in accordance with Cymer’s internal decisions, to develop an EUV Source System.

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**2. SCOPE OF WORK**

Delete paragraphs 2.1, 2.2 and 2.3

Delete paragraphs 2.4 and re-write as follows

Meetings. Intel and Cymer agree they will regularly schedule and participate in, [ . . . \* \* \* . . . ] technical reviews relative to Cymer’s EUV Source System technology development and Cymer’s Plan.

Re-write paragraph 2.5 as follows

Coordination of Efforts with Third Party Suppliers. Cymer agrees to engage, coordinate and work with other third party suppliers and sub suppliers as necessary to develop an EUV Source System. This may include, but is not limited to, buying components from other suppliers, collaborating with other suppliers, or licensing other supplier’s intellectual property. Additionally, Cymer agrees, at its sole discretion, to evaluate whether to work in the same manner with other third party suppliers with whom Intel has undertaken EUV source or source component development efforts.

**3.** Delete all of Paragraph 3

**4.** Delete all of Paragraph 4

**5.** Delete all of paragraph 5 and re-write as follows:

Change Heading to [ . . . \* \* \* . . . ]

Re-write paragraph 5.4 as follows

Cymer shall provide Intel with a [ . . . \* \* \* . . . ] (“[ . . . \* \* \* . . . ]”) with respect to the EUV Source System.

Add new paragraph 5.6 as follows

The [ . . . \* \* \* . . . ] shall grant to Intel the right to purchase, for [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]) [ . . . \* \* \* . . . ] commencing with the [ . . . \* \* \* . . . ] (for which notice shall be promptly delivered by Cymer to Intel in writing) a [ . . . \* \* \* . . . ] of [ . . . \* \* \* . . . ]% of Cymer’s [ . . . \* \* \* . . . ] for [ . . . \* \* \* . . . ] under the [ . . . \* \* \* . . . ] that Cymer grants to [ . . . \* \* \* . . . ]. The [ . . . \* \* \* . . . ] rights shall be exercisable by Intel per the “[ . . . \* \* \* . . . ]” Agreement of 6/24 2004, however, it shall be

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understood that [ . . . \* \* \* . . . ] and [ . . . \* \* \* . . . ] as used in the [ . . . \* \* \* . . . ] Agreement shall now mean [ . . . \* \* \* . . . ] and [ . . . \* \* \* . . . ], as used in this paragraph 5.6, respectively.

10. TERM, TERMINATION AND SURVIVAL OF TERMS.

Delete paragraph 10.1 and re-write as follows

Term. This Amended Agreement shall terminate on [ . . . \* \* \* . . . ] or [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]) [ . . . \* \* \* . . . ] after Cymer notifies Intel in writing of the EUV Source System availability, whichever is earlier,

Delete paragraph 10.2 and re-write as follows

Termination. Cymer may terminate this Amended Agreement if Intel materially fails to engage in [ . . . \* \* \* . . . ] and fails to remedy said failure within [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]) days notice from Cymer, at which time termination of the Agreement shall be Cymer's sole and exclusive remedy in connection therewith. Intel may terminate this Amended Agreement for [ . . . \* \* \* . . . ] upon providing Cymer with [ . . . \* \* \* . . . ] prior written notice.

Delete paragraph 10.3

Delete paragraph 10.4 and re-write as follows

Survival. Sections 1, 6, 7 (but Section 7.4 only upon Agreement expiration as incorporated into a CPA), 8.1, 9, 10, 11 and 12 shall survive expiration or termination of this Amended Agreement for any reason. No termination or expiration of the Agreement shall serve to terminate any EUV Source System purchase order issued by Intel pursuant to the terms of this Agreement prior to the effective date of such termination or expiration.

11. FORCE MAJEURE, BUSINESS CONTINUITY AND LICENSE RIGHTS

Delete paragraph 11.1 and amend as follows

Force Majeure. If the performance of this Agreement or any obligations hereunder (other than payment of money) is prevented, restricted, or interfered with by the reasons of acts of God, acts of an governmental authority, riot, revolution, fires, or war, or other cause beyond the reasonable control of the Parties hereto ("Force Majeure"), the Party so effected shall be excused from such performance until such Force Majeure

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**AMENDED AND RESTATED**

**JOINT VENTURE AGREEMENT**

**AMONG**

**TCZ GMBH**

**CYMER, INC.**

**CARL ZEISS SMT AG**

**CARL ZEISS LASER OPTICS BETEILIGUNGSGESELLSCHAFT MBH**

**AND**

**TCZ PTE. LTD.**

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## TABLE OF CONTENTS

		<u>Page</u>
ARTICLE 1	Definitions	2
ARTICLE 2	Representations and Warranties	6
ARTICLE 3	Purposes of the Company	7
ARTICLE 4	Percentage Interests; Capital Contributions	8
ARTICLE 5	Distributions	9
ARTICLE 6	Corporate Governance	10
ARTICLE 7	Accounting and Tax Matters	16
ARTICLE 8	Certain Covenants	17
ARTICLE 9	Exculpation and Indemnification	18
ARTICLE 10	Disposition of Interests	18
ARTICLE 11	Termination, Dissolution and Liquidation	20
ARTICLE 12	Miscellaneous	24

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**AMENDED AND RESTATED  
JOINT VENTURE AGREEMENT**

This Amended and Restated Joint Venture Agreement is made on 12 September 2006 amongst:

- (1) **TCZ GmbH** of Bionstrasse 5, 9015 St. Gallen, Switzerland (“**TCZ Switzerland**”);
- (2) **Cymer, Inc.**, a Nevada corporation (“**Cymer**”);
- (3) **Carl Zeiss SMT AG**, a stock corporation organized under the laws of Germany (“**Zeiss SMT**”);
- (4) **Carl Zeiss Laser Optics Beteiligungsgesellschaft mbH**, a limited liability company organized under the laws of Germany and an indirect wholly-owned subsidiary of Zeiss SMT (“**Zeiss LOB**”); and
- (5) **TCZ Pte. Ltd.**, a company incorporated in Singapore (registration no. 200609581M), whose registered office is at 1 Temasek Avenue #27-01, Singapore 039192 (the “**Company**”);

Capitalized terms used herein but not defined when used have the meanings assigned to such terms in Article 1.

**RECITALS:**

- (A) On 15 July 2005, TCZ Switzerland, Cymer, Zeiss SMT and Zeiss LOB entered into a joint venture agreement (as amended by an amendment agreement no. 1 dated 16 September 2005 entered into amongst the parties) (together, the “**Original JV Agreement**”) to establish TCZ Switzerland as a joint venture to develop, integrate, market, sell and support tools employing a beam generated by an excimer laser to induce crystallization for Low Temperature Poly-Silicon (LTPS) processing (the “**Products**”) for the manufacture of flat panel displays, including LCDs, LCD SOGs and OLEDs, to engage in related application development and to search for other business opportunities for process tools for the manufacture of flat panel displays.
- (B) The Original JV Agreement provided for (i) the governance of the affairs of TCZ Switzerland, (ii) the rights, obligations and understandings of Cymer and Zeiss LOB in relation to TCZ Switzerland and (iii) the [ . . . \* \* \* . . . ] under the Original JV Agreement.
- (C) Cymer, Zeiss SMT and Zeiss LOB have agreed to move their joint venture vehicle to Singapore in the form of the Company with effect from 12 September 2006 (or such other date as may be agreed amongst the parties) (the “**Effective Date**”) and in this regard, are desirous of amending and restating the Original JV Agreement in the manner provided herein.

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- (D) As at the date of this Agreement, the Company has a paid-in capital of [ . . . \* \* \* . . . ] consisting of [ . . . \* \* \* . . . ] shares of which [ . . . \* \* \* . . . ] shares are held by Cymer and [ . . . \* \* \* . . . ] shares are held by Zeiss LOB.
- (E) For the avoidance of doubt, the Original JV Agreement remains in full force and effect as amongst TCZ Switzerland, Cymer, Zeiss SMT and Zeiss LOB until this Amended and Restated Joint Venture Agreement is deemed to take effect as of the Effective Date.

NOW, THEREFORE, the parties hereto agree as follows:

ARTICLE 1  
DEFINITIONS

Section 1.01. *Definitions.* (a) As used herein, the following terms have the following meanings:

“**ACRA**” means the Accounting & Corporate Regulatory Authority of Singapore.

“**Act**” means the Companies Act (Chapter 50 of Singapore), as amended, supplemented or otherwise modified from time to time.

“**Additional Funding Date**” means 13 September 2006 (or such other date as may be agreed by and among the parties).

“**Administrative Services Agreements**” means the Administrative Services Agreement dated as of 16 September 2005 entered into between Cymer and TCZ Switzerland (which has been novated to the Company by way of a deed of novation executed on or around the Effective Date), as amended, supplemented or otherwise modified from time to time.

“**Affiliate**” means, with respect to any Person, any other Person directly or indirectly controlling, controlled by or under common control with such Person. As used herein, “**control**” (and the derivative terms “**controlling**” and “**controlled**”) means the direct or indirect ownership of more than fifty percent (50%) of the equity securities or other ownership interests and voting rights of, and the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise. No party or its Affiliates shall by reason of this Agreement be deemed to be an affiliate of the other party or its Affiliates. The term “**affiliated**” shall have a corresponding meaning. Notwithstanding the foregoing definition, when used with respect to Zeiss SMT or Zeiss LOB, the term “**Affiliate**” shall exclusively mean (a) Zeiss SMT and any Person under the control of Zeiss SMT and (b) IMT and any Person under the control of IMT. Notwithstanding the foregoing definition, for purposes of this Agreement, the Company and its subsidiaries shall not be considered an Affiliate of either Member.

“**Agreement**” means this Joint Venture Agreement, as amended, supplemented or otherwise modified from time to time.

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“**Area of Responsibility**” means each area of the R&D Effort in which one Member or the Company has primary responsibility for directing and carrying out research, as specified from time to time in the then current Business Plan.

“**Budget Year**” means the period commencing on the date of this Agreement and ending on December 31, 2006 and each successive one-year period thereafter.

“**Capital Call Notice**” means a written request delivered by the Company to each Member from time to time requesting that each Member provide funds to the Company. Such notice shall specify in reasonable detail (i) the amount being requested, (ii) the Company’s anticipated use of funds and the timing of such use, and (iii) wire transfer instructions.

“**Confidentiality Agreement**” means the Confidentiality Agreement dated as of 16 September 2005 entered into among Cymer, Zeiss SMT, IMT and TCZ Switzerland (which has been novated to the Company by way of a deed of novation executed on or around the Effective Date), as amended, supplemented or otherwise modified from time to time.

“**Cymer Supply Agreement**” means the Supply Agreement dated as of 16 September 2005 entered into between Cymer and TCZ Switzerland (which has been novated to the Company by way of a deed of novation executed on or around the Effective Date), as amended, supplemented or otherwise modified from time to time.

“**Deliverable**” means work product or deliverables of any type to be developed or delivered by a Member during the course of a Project.

“**Facilities License Agreement**” means the Facilities License Agreement entered into between TCZ USA LLC and Cymer relating to use by TCZ USA LLC of certain facilities in the United States, as amended, supplemented or otherwise modified from time to time.

“**FRS**” means Financial Reporting Standards, which Singapore-incorporated companies are obliged to follow in preparing their accounts and which are set out in the Companies (Accounting Standards) Regulations.

“**GAAP**” means United States generally accepted accounting principles, consistently applied.

“**IMT**” means Carl Zeiss Industrielle Messtechnik GmbH.

“**IMT IP Side Letter**” means the side letter to the Intellectual Property Agreement dated 16 September 2005 executed by IMT (which has been novated to the Company by way of a deed of novation executed on or around the Effective Date), as amended, supplemented or otherwise modified from time to time.

“**Intellectual Property Agreement**” means the intellectual property agreement dated as of 16 September 2005 among TCZ Switzerland, Cymer and Zeiss SMT (which has been novated to the Company by way of a deed of novation executed on or around the Effective Date), as amended, supplemented or otherwise modified from time to time.

“**Intellectual Property**” means any or all of the following: (i) works of authorship, including, without limitation, computer programs, algorithms, routines, source code and executable code, whether embodied in software, firmware or otherwise, documentation, designs, files, records and data, (ii) inventions (whether or not patentable), improvements, and technology, (iii) proprietary and confidential information, including, without limitation, technical data and customer and supplier lists, trade secrets, know-how and techniques, (iv) databases, data compilations and collections and technical data, (v) logos, trade names, trade dress, trademarks and service marks, (vi) domain names, web addresses and sites, (vii) tools, methods, processes, devices, prototypes, schematics and test methodologies, and (viii) any and all instantiations of the foregoing in any form and embodied in any media.

“**Intellectual Property Rights**” means any or all of the following and all rights in, arising out of, or associated therewith, whether arising from statute or common law: (i) all United States and foreign patents and utility models and applications therefor and all reissues, divisions, re-examinations, renewals, extensions, provisionals, continuations and continuations-in-part thereof, and equivalent or similar rights anywhere in the world in inventions and discoveries, including, without limitation, invention disclosures, (ii) all trade secrets and other rights in know-how and confidential or proprietary information, (iii) all copyrights, copyright registrations and applications therefor and all other rights corresponding thereto throughout the world, (iv) all industrial designs and any registrations and applications therefor throughout the world, (v) all rights in World Wide Web addresses and domain names and applications and registrations therefor, all trade names, logos, common law trademarks and service marks, trademark and service mark registrations and applications therefor and all goodwill associated therewith throughout the world, and (vi) any similar, corresponding or equivalent rights to any of the foregoing throughout the world.

“**Interest**” means, with respect to any Member, the aggregate shares in the Company held by such Member.

“**Joint Venture Documents**” means, collectively, this Agreement, the Intellectual Property Agreement, the Supply Agreements, the Administrative Services Agreements, the Facilities License Agreement and the Confidentiality Agreement.

“**Member**” means Cymer, Zeiss LOB or any other Person who, at such time, is admitted to the Company as a Member in accordance with the terms of this Agreement, each in its capacity as a shareholder of the Company.

“**Members Meeting**” means a meeting of the Members held in accordance with the provisions of this Agreement, the Singapore Corporate Documents and the Act.

“**Member Parent**” means, with respect to any Member, (i) in the case of Cymer or any Member that is an Affiliate of Cymer, Cymer, Inc., (ii) in the case of Zeiss LOB or any Member that is an Affiliate of Zeiss SMT, Carl Zeiss SMT AG and (iii) in the case of any Member that is not an Affiliate of either Cymer or Zeiss SMT, the ultimate parent company of such Member.

“**Net Income**” shall mean, for any period, the Company’s net income as determined under FRS.

“**Percentage Interest**” means, with respect to any Member, such Member’s percentage Interest as set forth in Section 4.01.

“**Person**” means an individual, corporation, partnership, association, trust, limited liability company or any other entity or organization, including a government or political subdivision or an agency or instrumentality thereof.

“**R&D Effort**” means research and development undertaken by either Member reasonably related to the Business.

“**subsidiary**” bears the same meaning as set out in section 5 of the Act.

“**Supplier**” means, with respect to any Supply Agreement, the Person identified as the Supplier in such Supply Agreement, including any transferee of all or substantially all of the assets of a Supplier that has assumed such Supply Agreement in accordance therewith.

“**Supply Agreements**” means the Cymer Supply Agreement and the Zeiss Supply Agreement.

“**S\$**” or “**\$**” means the lawful currency of the Republic of Singapore.

“**Transfer**” means any direct or indirect sale, assignment, disposition, exchange, mortgage, pledge or grant of a security interest in, foreclosure or any other transfer of any portion of, or economic or voting interest in, an Interest, but shall not include any sale, assignment, disposition, exchange, mortgage, pledge or grant of a security interest in, foreclosure or any other transfer of any capital stock of a Member Parent. A “Transfer” shall also include any sale, assignment or other transfer by a Member Parent of any direct or indirect interest in the Member that is its Affiliate. When used as a verb, the term “Transfer” refers to entering into any transaction or series of transactions that results in a “Transfer.”

“**US\$**” means the lawful currency of the United States of America.

“**Work Plan**” means a mutually agreed written schedule setting forth a description of a Project to be performed under this Agreement.

“**Zeiss Supply Agreement**” means the Supply Agreement dated as of 16 September 2005 entered into between Carl Zeiss Laser Optics GmbH and TCZ Switzerland (which has been novated to the Company by way of a deed of novation executed on or around the Effective Date), as amended, supplemented or otherwise modified from time to time.

(b) Each of the following additional terms is defined in the Section set forth opposite such term:

Term	Section
Annual Maximum Required Funding Contribution	4.02(a)
Board	6.01(a)
Business	3.02
Business Plan	6.03(a)

Term	Section
Chief Executive Officer	6.01(a)
Company	Preamble
Director	6.01(a)
Fiscal Year	7.01
Gate Reviews	6.03(a)
Liquidating Event	11.05
Liquidator	11.06
Major Customer	11.04(a)
Non-Affiliate Transfer	10.02(a)
Non-Compete Period	11.02(b)
Non-Transferring Member	10.02(a)
Non-Triggering Party	11.02(a)
Other FPD Business Opportunities	3.02
Permitted Transferee	10.01(a)
Products	Recital A
Project	6.03(a)
Proposed Transferee	10.02(a)
Required Funding Contributions	4.02(a)
Singapore Corporate Documents	12.13
Transferring Member	10.02(a)
Triggering Event	11.02(a)
Triggering Party	11.02(a)
Triggering Separation	11.04(b)

## ARTICLE 2 REPRESENTATIONS AND WARRANTIES

Section 2.01. *Representations And Warranties.* (a) Cymer hereby represents and warrants that as of the date hereof (i) it is a corporation duly organized, validly existing and in good standing under the laws of the State of Nevada, (ii) it has the requisite power and authority to execute and deliver this Agreement and the other Joint Venture Documents and to fully perform its obligations hereunder and thereunder, (iii) the execution, delivery and performance of this Agreement and the other Joint Venture Documents have been duly authorized on the part of Cymer, (iv) it is not party to or affected by contractual or other legal obligations that would in any material respect interfere with its full performance of this Agreement or the other Joint Venture Documents, and (v) the individuals executing this Agreement on behalf of Cymer have the authority to do so.

(b) Zeiss LOB hereby represents and warrants that (i) it is a limited liability company duly organized, validly existing and in good standing under the laws of Germany, (ii) it has the requisite power and authority to execute and deliver this Agreement and the other Joint Venture Documents and to fully perform its obligations hereunder and thereunder, (iii) the execution, delivery and performance of this Agreement and the other Joint Venture Documents have been duly authorized on the part of Zeiss LOB, (iv) it is not party to or affected by contractual or other legal obligations that would in any material respect interfere with its full performance of this Agreement or

the other Joint Venture Documents, and (v) the individuals executing this Agreement on behalf of Zeiss LOB have the authority to do so.

(c) Zeiss SMT hereby represents and warrants that (i) it is a stock corporation duly organized, validly existing and in good standing under the laws of Germany, (ii) it has the requisite power and authority to execute and deliver this Agreement and the other Joint Venture Documents to which it is a party and to fully perform its obligations hereunder and thereunder, (iii) the execution, delivery and performance of this Agreement and the other Joint Venture Documents to which it is a party have been duly authorized on the part of Zeiss SMT, (iv) it is not party to or affected by contractual or other legal obligations that would in any material respect interfere with its full performance of this Agreement or the other Joint Venture Documents to which it is a party, (v) the individuals executing this Agreement on behalf of Zeiss SMT have the authority to do so, and (vi) all right, title and interest in and to Foreground Technology (as defined in the Intellectual Property Agreement) conceived or reduced to practice by IMT or any Person under the control of IMT will be owned by SMT and that, upon execution and delivery of the IMT IP Side Letter by IMT, SMT will obtain all rights from IMT to fully perform its obligations under the Intellectual Property Agreement.

(d) Notwithstanding any other provision contained in this Agreement, the Company shall be authorized to execute, deliver and perform this Agreement and the other Joint Venture Documents to which it is a party and all documents, agreements, certificates, or statements contemplated thereby or related thereto, exclusive of any future amendments, without any further act, vote or approval of any Member or any other Person.

### ARTICLE 3 PURPOSES OF THE COMPANY

Section 3.01. *Name.* The initial name of the Company shall be “TCZ Pte. Ltd.”. The business of the Company shall be conducted under such name or names as the Members may from time to time determine in accordance with the provisions hereof.

Section 3.02. *Purpose.* The purpose of the Company is to develop, market, sell, integrate and service the Products and to engage in related application development based on the Products (the “**Business**”), and to search for other business opportunities for process tools for the manufacture of flat panel displays, and to take actions reasonably related thereto, in each case as set forth in greater detail in the Business Plan as in effect from time to time. If the Company identifies business opportunities for process tools for the manufacture of flat panel displays other than the Products and applications based on the Products (“**Other FPD Business Opportunities**”), the Company shall bring such Other FPD Business Opportunities to the attention of the Members, and the Members will discuss in good faith whether or not to expand the scope of the Business of the Company to pursue such Other FPD Business Opportunities. For the avoidance of doubt, the “Business” shall not include the development, marketing, selling, integration or services of tools other than the Products, unless the Members so agree and amend this Agreement to expand the definition of the Business accordingly.

Section 3.03. *Place of Business of the Company.* The principal place of business of the Company shall be located at such address as may be designated by the Board from time to time.

Section 3.04. *Registered Office; Registered Agent.* The address of the registered office of the Company in Singapore shall be as determined by the Board and as registered with ACRA.

Section 3.05. *Duration of the Company.* The Company shall continue until its dissolution in accordance with the provisions of Article 11.

Section 3.06. *Title to Company Property.* All property of the Company, whether real or personal, tangible or intangible, shall be deemed to be owned by the Company as an entity, and no Member, in its capacity as such, shall have any direct ownership interest in such property, except upon dissolution of the Company as set forth in Article 11.

Section 3.07. *Limited Liability.* Except as required by mandatory Singaporean law, the debts, obligations and liabilities of the Company, whether arising in contract, tort or otherwise, shall be solely the debts, obligations and liabilities of the Company, and no Member shall be obligated personally for any such debt, obligation or liability of the Company solely by reason of being a Member.

ARTICLE 4  
PERCENTAGE INTERESTS; CAPITAL CONTRIBUTIONS

Section 4.01. *Percentage Interests; Capital Contributions.* (a) The names and Percentage Interests of the Members shall be as follows:

<u>Name</u>	<u>Percentage Interest</u>
Cymer	60%
Zeiss LOB	40%

(b) The Percentage Interests shall not be subject to adjustment unless agreed by the Members, except as otherwise provided in Sections 6.03(c)(iii) or 11.03.

(c) Other than the Members' initial capital contributions and their Required Funding Contributions, no additional funding or capital contribution of the Members shall be required, except as the Members may unanimously agree.

Section 4.02. *Funding Commitments.* (a) The Members from time to time shall be obligated to provide funds to the Company, as provided in this Section 4.02, up to the amount specified in Section 4.02(a)(iii), which each such Member shall make by way of a contribution of capital, in all cases, by wire transfer of immediately available funds.

(i) At the Additional Funding Date, Cymer shall contribute [ . . . \* \* \* . . . ] (equivalent to [ . . . \* \* \* . . . ]) in cash and Zeiss LOB shall contribute [ . . . \* \* \* . . . ] (equivalent to [ . . . \* \* \* . . . ]) in cash in respect of their required funding contributions for 2006.

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(ii) The amount and timing of subsequent required funding contributions under this Section 4.02 (“**Required Funding Contributions**”) shall be determined by the Chief Executive Officer consistent with the then current Business Plan as in effect from time to time, subject to the provisions of Section 4.02(a)(iii). Each Member shall make each such funding contribution within ten business days of receipt of a Capital Call Notice from the Company.

(iii) No Member shall be required to contribute to the Company an amount for any Budget Year that exceeds its proportionate share (determined on the basis of its Percentage Interest) of the annual maximum required funding contribution amount (the “**Annual Maximum Required Funding Contribution**”) for such Budget Year (which shall cover the Company’s expected funding requirements for the period ending 15 months after the beginning of such Budget Year), set forth for such Budget Year in the then current Business Plan as may be in effect from time to time, or, absent an updated Business Plan containing an Annual Maximum Required Funding Contribution for such Budget Year, the amount determined as provided in Section 6.03(c).

(b) If a Member fails to contribute its required portion of any Required Funding Contribution as and when required by this Agreement, the Company shall then notify the Members in writing of such default, specifying the default in reasonable detail, and if the defaulting Member shall not have cured such default within ten business days after receipt of such default notice, such failure shall be deemed a material breach of this Agreement and in addition to, and without prejudice to, any and all other remedies, the non-defaulting Member may treat such default as a “Triggering Event” pursuant to Section 11.02(a), except that the non-defaulting Member shall be treated as the Non-Triggering Party and the defaulting Member shall be treated as the Triggering Party thereunder. The foregoing shall be exercisable by written notice from non-defaulting Member to the defaulting Member, given within 30 days after receipt of the default notice.

Section 4.03. *Other Matters.* (a) Except as otherwise provided in this Agreement, no Member shall demand or receive a return of its capital contributions without the consent of the other Member. Under circumstances requiring a return of any capital contributions, no Member shall have the right to receive property other than cash, except as may be specifically provided herein.

(b) No Member shall receive any interest, salary or drawing with respect to its capital contributions or for services rendered on behalf of the Company or otherwise in its capacity as a Member, except as otherwise contemplated by this Agreement.

## ARTICLE 5 DISTRIBUTIONS

Section 5.01. *Distributions.* After the Effective Date, when, if and as approved by the Board or required by a Member pursuant to Section 5.02, the Company shall make available the Net Income of the Company for distribution to the Members (or to any Affiliate of a Member designated by such Member) in proportion to their Percentage Interests, and each Member agrees to vote its shares in favor of such a distribution; *provided* that Intellectual Property Rights owned or licensed by the Company shall be

distributed only in accordance with the Intellectual Property Agreement or otherwise upon termination and dissolution of the Company in accordance with Article 11. With respect to the amount to which each Member is entitled pursuant to the preceding sentence, such Member may elect, at its sole option, to (i) receive such amount in cash or, if so determined by the Board or (pursuant to Section 5.02) Member, property or (ii) treat such amount as part of such Member's funding contribution for purposes of satisfying its Required Funding Contribution.

Section 5.02. *Member's Right to Require Distribution.* Either Member shall have the right to require a resolution of the Board to be passed to make a distribution of the Net Income of the Company to the Members under Section 5.01, *provided* that the Company will have sufficient available funds on hand after the distribution to meet 110% of its reasonably foreseeable working capital requirements during the 18 months following the date of such distribution based on the more conservative of the (a) the financial projections in the then current Business Plan or (b) the most recent financial projections approved by the Board.

Section 5.03. *Amounts Withheld.* The Company is authorized to withhold from distributions to the Members and to pay over to any governmental or regulatory authorities any amounts which it reasonably determines may be required to be so withheld pursuant to any provisions of any other law (local or otherwise). All amounts withheld pursuant to any provision of any tax law with respect to any distribution to any Member shall be treated as amounts distributed to such Member pursuant to this Article for all purposes under this Agreement.

Section 5.04. *Dissolution.* Upon dissolution and winding up of the Company, the Company shall make distributions in accordance with Article 11.

Section 5.05. *No Distributions in Violation of Law.* Notwithstanding any other provision contained in this Agreement, the Company shall not be required to make a distribution to any Member to the extent that such distribution would violate mandatory Singapore law.

#### ARTICLE 6 CORPORATE GOVERNANCE

Section 6.01. *Board of Directors.* (a) Except as otherwise provided in this Agreement, the business and affairs of the Company shall be managed by the Chief Executive Officer (the "**Chief Executive Officer**") under the supervision of the board of directors (the "**Board**").

(b) Except as otherwise provided in Section 10.02(b), Section 11.03 and Section 11.04, the Board shall consist of five individuals (each a "**Director**"). The Board shall consist of (X) two of such Directors which shall be designated by Cymer, (Y) a further two of such Directors which shall be designated by Zeiss LOB and (Z) the Chief Executive Officer. Each Director (i) shall hold office until a successor shall have been duly designated or if earlier, such Director's death, resignation or removal and (ii) except as otherwise provided in Section 11.03, may be removed only by the Member having designated such Director. A Director shall not be entitled to appoint any person to act as his alternate.

(c) The following actions may not be taken by the Company or by the Chief Executive Officer acting on behalf of the Company without obtaining the approval of the Board as set forth herein:

(i) adoption or amendment of a Business Plan and the product development process as described in Section 6.03(a)(iii);

(ii) entering into or making any loans or advances to, guarantees for the benefit of, or investments by the Company, in excess of US\$100,000, other than trade credit in the ordinary course of business and investments in cash or cash equivalents in accordance with an investment policy adopted by the Board;

(iii) entering into any agreement or commitment (or series of related agreements or commitments) outside the ordinary course of business involving an aggregate value of more than US\$100,000 per year;

(iv) entering into any transaction with any Member or Affiliate of any Member other than the transactions contemplated hereby and by the other Joint Venture Documents for which a final form has been agreed;

(v) any acquisition or disposition (in a single transaction or a series of related transactions) of any assets, business or operations outside the ordinary course of business in an aggregate value of more than US\$100,000;

(vi) subject to the terms of the Intellectual Property Agreement, licensing the Company's Intellectual Property outside the ordinary course of business or commencing or settling any litigation or claim involving the Company's Intellectual Property; or

(vii) commencing or settling any material litigation or claim.

Section 6.02. *Officers.* (a) The Company will be managed by the Chief Executive Officer in accordance with the Company's then current Business Plan as in effect from time to time. Without limiting the generality of the foregoing, the Chief Executive Officer will be responsible for managing the following activities of the Company, in accordance with the Company's then current Business Plan as in effect from time to time: (i) sales and marketing, (ii) application development, (iii) supply management, (iv) service and support to the Company's customers, (v) systems integration, (vi) business development and (vii) accounting, finance, and general and administrative functions. The Chief Executive Officer may delegate any of such authority to the other officers of the Company. The other officers of the Company may include one or more vice presidents or other officers as the Chief Executive Officer may in his or her discretion determine. One person may hold the offices and perform the duties of any two or more of said offices. All of the officers of the Company shall report to the Chief Executive Officer of the Company.

(b) The Member with the greater Percentage Interest shall have the right to appoint the Chief Executive Officer of the Company, *provided* that such appointment shall be subject to the approval of the other Member, which approval shall not be

unreasonably withheld or delayed. The Chief Executive Officer may be removed at any time by the Members.

(c) The officers of the Company (other than the Chief Executive Officer) shall be appointed by the Chief Executive Officer to hold office for such term as the Chief Executive Officer may determine; provided that such appointments shall be subject to the approval of the Board, which approval shall not be unreasonably withheld or delayed. Each such officer shall hold office until his or her successor is appointed, or until the earlier of his or her death, resignation or removal, and may be removed with or without cause at any time by the Chief Executive Officer. The remuneration of each such officer shall be approved by the Board. Each Member may suggest one or more candidates for such other officers, which suggestions the Chief Executive Officer shall consider in good faith, and, if the Chief Executive Officer rejects such suggestions, the Chief Executive Officer shall, if so requested, explain his or her reasons for the rejection. Each Member shall, if so requested by the Chief Executive Officer, reasonably assist the Chief Executive Officer in locating candidates for positions with the Company within the ranks of the Member's employees and in recruiting such candidates to join the Company.

(d) Unless mutually agreed by the Members, commencing no later than ninety (90) days after the Effective Date, each officer of the Company (including the Chief Executive Officer), and each other employee of the Company that has or will be transferred to the Company from either Cymer or Zeiss SMT or their respective Affiliates, shall be a full-time employee of the Company and devote 100% of such person's full professional and business-related time to the Company. Unless mutually agreed by the Members, no officer of the Company shall be permitted to participate in any compensation program of either Member, *provided* that nothing in this provision shall prohibit any officer from retaining and exercising any stock options granted to such officer prior to becoming an officer of the Company or participating in any health and welfare benefits plans of a Member provided to the officer pursuant to an Administrative Services Agreement.

Section 6.03. *Business Plan.* (a) The Company will be subject to and managed in accordance with a Business Plan (the "**Business Plan**") which will cover a rolling period of [ . . . \* \* \* . . . ] Budget Years and will be revised annually. Such initial Business Plan will remain in effect until modified or superseded by the Board in accordance with the terms hereof. The Business Plan will include, without limitation:

- (i) the long-term objectives of the Company in light of its then current strategic, competitive and technology position, the Product roadmap and the broad Areas of Responsibility of each Member;
- (ii) a schedule or timetable with a description of all milestones (including technical milestones, business milestones and financial milestones) and/or Deliverable due dates;
- (iii) a schedule of "**Gate Reviews**" to be held by the Board in accordance with a product development process, which shall be prepared by the Chief Executive Officer of the Company and approved by the Board, during which Gate Reviews the Board will determine whether milestones and/or Deliverable due dates have been met or achieved;

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(iv) a Work Plan for the Members, the Suppliers and the Company with respect to each distinct area of inquiry (each such area, a “**Project**”) containing with respect to such Project (1) the identity of the project managers for the Project and/or the manner in which they will be selected; (2) a description of any performance, status and operational reports to be generated during the Project; (3) quality criteria for assessing the performance of the Suppliers and the Company, as the case may be, during such Project including, but not limited to, performance criteria for milestones, classifications of the severity of errors or failures, and response processes for the correction of any such errors or failures; and (4) any other terms and conditions agreed upon by the Board with respect to a Project;

(v) a Work Plan for the Company with respect to its Area of Responsibility with respect to each Project;

(vi) financial projections (including projected balance sheet, income statement and cash flow, as well as projected Annual Maximum Required Funding Contributions) for each of the [ . . . \* \* \* . . . ] Budget Years covered by the Business Plan;

(vii) the Annual Maximum Required Funding Contribution for the next Budget Year, which shall cover the Company’s expected funding requirements for the period ending [ . . . \* \* \* . . . ] months after the beginning of such Budget Year); and

(viii) performance metrics for the Company for the next Budget Year for use in assessing the performance of the Chief Executive Officer.

(b) With respect to each Budget Year after 2005, the Chief Executive Officer will develop and present to the Board no later than [ . . . \* \* \* . . . ] of each year a proposed revised and updated Business Plan that has been rolled forward for another year. For the avoidance of doubt, unless a new Business Plan is approved by the Board, the Company will be subject to and managed in accordance with the then current Business Plan as in effect from time to time.

(c) During any Budget Year for which the Board has not approved a revised Business Plan by [ . . . \* \* \* . . . ], the Annual Maximum Required Funding Contribution for such Budget Year shall be established as follows:

(i) Each Member shall not later than [ . . . \* \* \* . . . ] notify the Chief Executive Officer and the other Member in writing of its proposal for the Annual Maximum Required Funding Contribution for such Budget Year; *provided* that neither Member’s proposal may be [ . . . \* \* \* . . . ] than [ . . . \* \* \* . . . ]% or [ . . . \* \* \* . . . ] than [ . . . \* \* \* . . . ]% of the [ . . . \* \* \* . . . ] of (A) the [ . . . \* \* \* . . . ] for such [ . . . \* \* \* . . . ] as specified in the [ . . . \* \* \* . . . ] by the [ . . . \* \* \* . . . ], or (B) the [ . . . \* \* \* . . . ] as specified in the [ . . . \* \* \* . . . ] proposed by the [ . . . \* \* \* . . . ].

(ii) The issue shall be immediately escalated for expedited resolution by the Chairman of the board of directors (or equivalent officer) of each Member as provided in Section 12.10(a).

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(iii) If the matter is not resolved by [ . . . \* \* \* . . . ] of any year, then the Member proposing the [ . . . \* \* \* . . . ] Annual Maximum Required Funding Contribution for such Budget Year shall have the option, at its election, by notice given no later than [ . . . \* \* \* . . . ] of the following year either (A) to establish the [ . . . \* \* \* . . . ] amount as the Annual Maximum Required Funding Contribution for such Budget Year and to agree to pay, as an additional capital contribution to the Company, the difference between the amounts last proposed by each Member, and upon such payment the paying Member's Percentage Interest shall be increased to a percentage equal to the [ . . . \* \* \* . . . ] of (x) the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ] by the [ . . . \* \* \* . . . ] since [ . . . \* \* \* . . . ] the Company (including pursuant to [ . . . \* \* \* . . . ], [ . . . \* \* \* . . . ] by (y) the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ] by [ . . . \* \* \* . . . ] (including pursuant to [ . . . \* \* \* . . . ] since [ . . . \* \* \* . . . ] the Company, and the [ . . . \* \* \* . . . ] Percentage Interest shall be [ . . . \* \* \* . . . ] accordingly), or (B) to establish the Annual Maximum Required Funding Contribution for such Budget Year as an amount equal to [ . . . \* \* \* . . . ] of the amounts proposed by each Member.

Section 6.04. *Company Actions Requiring Consent of Members* The following actions may not be taken by the Company without obtaining the consent of all of the Members:

- (a) any amendment of this Agreement, any other Joint Venture Document or the Company's Articles of Association;
- (b) issuance of any new shares or admission of any new Members (and each Member agrees to grant such consent for admission of a Permitted Transferee);
- (c) redemption or repurchase of any shares;
- (d) authorizing or committing the Company to a change in the scope of the Business;
- (e) taking any actions in respect of the dissolution or liquidation or winding-up of the Company (except as permitted pursuant to Section 11.05(b)) or the filing or acquiescing to the filing of a petition in respect of the Company under bankruptcy or insolvency laws, or the making of any assignment for the benefit of creditors;
- (f) any merger, consolidation, reorganization (including conversion) or other business combination involving the Company or any of its Affiliates (other than of a wholly owned Affiliate with or into another wholly owned Affiliate) or any acquisition of the Company or any of its Affiliates by another entity by means of any transaction or series of related transactions or the sale of all or substantially all of the assets of the Company; or
- (g) all matters requiring Members' approval under the Act.

Section 6.05. *Meetings of Board.* (a) *Regular Meetings.* The Board shall hold regular meetings at least quarterly, rotating between a location in the United States determined by Cymer and a location in Germany determined by Zeiss LOB, or such other location as determined by the Board. Written notice of each meeting shall state the place,

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date and hour of such meetings, and include an agenda of matters to be considered at the meeting. Notice shall be given in the manner prescribed herein not fewer than seven days nor more than 60 days before the date thereof.

(b) *Special Meetings.* In addition, any Director may, on at least five business days' prior written notice to the other Directors, call a special meeting of the Board, specifying in reasonable detail in such notice the purpose of such meeting.

(c) *Quorum.* The presence of three Directors shall constitute a quorum for the transaction of business at a duly noticed meeting of the Board. If a quorum shall fail to be present for such a meeting, then any Director may provide a supplemental notice to the other Directors rescheduling such meeting at least 48 hours after such supplemental notice. For the avoidance of doubt, a quorum shall be required at such rescheduled meeting.

(d) *Objections.* Attendance of a Director at a meeting shall constitute a waiver of notice of such meeting, except if such Director attends the meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of business at such meeting because the meeting has not been validly called, noticed or convened.

(e) *Chair of Meeting.* Prior to each meeting, one of the Directors shall be designated as lead Director to serve as chair of the meeting. The lead Director shall rotate from meeting to meeting between a Director designated by Zeiss LOB and a Director designated by Cymer.

(f) *Taking Decisions.* Except where this Agreement specifically provides otherwise, any decision taken at a meeting of the Board shall require the consent of [ . . . \* \* \* . . . ] of all Directors participating at a duly convened meeting at which a quorum is present (in person or by proxy), provided that such [ . . . \* \* \* . . . ] vote must always include the vote of [ . . . \* \* \* . . . ] except that the requirement that the majority include [ . . . \* \* \* . . . ] shall no longer apply and decisions of the Board shall require only the consent of a majority of the Directors participating at a duly convened meeting at which a quorum is present (in person or by proxy) in the event that (I) each Member is entitled to designate a number of Directors that is in proportion to its Percentage Interest as set forth in Section 10.02(b)(ii) of this Agreement or (II) one Member is entitled to designate all the Directors (save for the Chief Executive Officer) pursuant to Section 11.03.

(g) *Expenses.* Each Member shall pay all reasonable travel and other expenses of the Directors designated by such Member in connection with participating in meetings of the Board.

Section 6.06. *Decision by Consent.* Any decision required or permitted to be taken by the Board or the Members, either at a meeting or otherwise, may be taken without a meeting if all Directors or Members consent thereto in writing. Any such decision of the Board, taken without a meeting, must be confirmed in writing by all Directors. Any such decision of the Members, taken without a meeting, shall be confirmed in writing by all the Members.

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Section 6.07. *Telephonic Meetings.* Directors may participate in a meeting of the Board by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and such participation in a meeting shall constitute presence in person at the meeting.

Section 6.08. *Nature of Obligations among Members.* Except as otherwise provided in this Agreement or by written agreement among the Members, no Director shall have any authority to act for or assume any obligation or responsibility on behalf of any Member or the Company, and no Member shall have any authority to act for or assume any obligation or responsibility on behalf of any other Member or the Company.

ARTICLE 7  
ACCOUNTING AND TAX MATTERS

Section 7.01. *Fiscal Year/Independent Auditors.* The fiscal year of the Company (the “**Fiscal Year**”) shall end on December 31st of each year. The Members shall select the Company’s independent auditors, which shall be a recognized international accounting firm.

Section 7.02. *Books and Records.* (a) The Company shall keep, including through bookkeeping services rendered pursuant to the Administrative Services Agreement, adequate books and records at its principal office. Such books and records shall include a current list of the full name and last known business, residence or mailing address of each Member, originals of this Agreement, and any amendments thereto (and any signed powers of attorney pursuant to which any such document was executed), a copy of the Company’s national and other tax returns and reports, if any, and annual financial statements of the Company, for the [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]) most recent [ . . . \* \* \* . . . ], and resolutions passed by the Board and the Members. The Company’s books of account and business records shall be filed and preserved for a period of at least [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]) [ . . . \* \* \* . . . ] or such longer period as required by law.

(b) The Company shall permit each Member and its officers, agents and representatives, upon reasonable advance notice and during normal business hours and such other times as any such Member may reasonably request, to: (i) visit and inspect any of the properties of the Company; (ii) examine the corporate and financial records of the Company and make copies thereof or extracts therefrom, and (iii) discuss the affairs, finances, and accounts of the Company with the Directors, officers, employees, and independent accountants of the Company. In addition, the Company shall require its independent accountants to make available to the Members copies of all reports, investigations and work papers prepared by such accountants during the course of any audit of the Company or otherwise, *provided* that the Members may be required to enter into the standard form of agreement customarily required by such independent accountants as a condition to access to such material. Any Member may, at its own expense, request and obtain a separate audit of the Company’s books by its own accountant, *provided* that such separate audit is not made more frequently than [ . . . \* \* \* . . . ] in each Fiscal Year and that at least [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]) [ . . . \* \* \* . . . ] prior written notice of such request is given to the Chief Executive Officer. The Chief Executive Officer shall cause the Company’s officers and employees to cooperate with such Member’s accountant in the execution and preparation of such audit, including providing customary certifications to such Member’s accountant.

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Section 7.03. *Financial Reports.* The Company, at its expense, shall provide or cause to be provided to each Member, no later than thirty days after the close of each of the first three quarters of the Company's Fiscal Year, and no later than ninety days after the end of each such Fiscal Year, a financial report of the business and operations of the Company prepared in accordance with GAAP and FRS consistently applied, relating to such period, which report shall include (i) a balance sheet as at the end of such period, (ii) a statement of income (loss) containing actual operating performance vs. budgeted operating performance for the current period and the year-to-date, and (iii) a cash flows statement (including sources and uses of funds) for the current period and the year-to-date, and in each case a comparison of the period then ended with the corresponding period in the Fiscal Year immediately preceding such periods, which, in the case of the report furnished after the close of the Fiscal Year, shall be audited by the Company's independent certified public accountants, and which, in the case of the reports furnished after each of the first three quarters of the Company's Fiscal Year, shall be unaudited and shall not include any notes thereto. In addition, the quarterly financial statements shall be accompanied by (x) a statement of changes in Members' equity containing a detail of capital contributions, distributions and income/loss allocations for each of the Members and in total, for the current period and the year-to-date, and (y) an analysis, in reasonable detail, of the variance between the Company's operating results and the corresponding amounts in the then current annual Budget. The quarterly financial reports may in each case be subject to normal year-end adjustments. In addition, the Members shall be entitled to any other financial information, including monthly management reports in the form produced by the Company, that the Members may reasonably request.

Section 7.04. *Tax Matters.* The Company and its Affiliates shall abide by the tax law and regulations in each jurisdiction in which it operates and shall cooperate with the Members to provide documents and information that either Member may need to file its own tax returns in any jurisdiction.

## ARTICLE 8 CERTAIN COVENANTS

Section 8.01. *Press Release.* Upon the Effective Date or such other time as may be mutually agreed, Cymer and Zeiss SMT shall issue a mutually agreed joint press release, announcing the formation of the Company and their collaboration under this Agreement.

Section 8.02. *Non-Competition.* In order to ensure the requisite level of dedication to enable the Company to offer the most competitive products in the marketplace, until such time as a Member ceases to be, directly or through an Affiliate, a Member of the Company (at which time such Member and its Affiliates may become subject to the non-compete covenant set forth in Section 11.02(b)) or the Company is dissolved, neither such Member nor any of its Affiliates shall engage, either directly or indirectly, as a principal for its own account or solely or jointly with others, or as a stockholder in any corporation or joint stock association, in any business engaged in the Business (other than the Company or as contemplated by the Joint Venture Documents). For the avoidance of doubt, without limiting the generality of the foregoing covenant, it is acknowledged and agreed that until such time as a Member ceases to be, directly or through an Affiliate, a Member of the Company (at which time such Member and its Affiliates may become subject to the non-compete covenant set forth in Section 11.02(b))

or the Company is dissolved, neither such Member nor any of its Affiliates shall knowingly supply services, products or components for use in products or services competitive with the Business or the Products of the Company; *provided*, however, that if neither IMT nor any Person under its control continues to act as supplier of Stages (as defined in the Supply Agreement) or other products to the Supplier or an Affiliate of the Supplier under the Zeiss Supply Agreement, IMT and any Person under its control shall cease to be subject to the foregoing covenant [ . . . \* \* \* . . . ] after the date IMT and any person under its control ceased to act as a supplier.

ARTICLE 9  
EXCULPATION AND INDEMNIFICATION

Section 9.01. *Exculpation and Indemnification.* Each Member agrees that it shall vote its shares in the Company and take all other necessary action in its capacity as a shareholder of the Company (including, to the extent permissible pursuant to applicable law, causing the Company to call a special meeting of Members) to provide for (a) the elimination of the liability of each Director on the Board to the maximum extent permitted by applicable law (and each Member hereby irrevocably waives any right to pursue and agrees to vote its shares and take all other necessary action in its capacity as a shareholder of the Company not to pursue any such eliminated liability) and (b) indemnification of each Director on the Board for acts on behalf of the Company, if any, to the maximum extent permitted by applicable law.

ARTICLE 10  
DISPOSITION OF INTERESTS

Section 10.01. *General.* (a) No Member may Transfer all or any part of its Interest, and no Member Parent may Transfer its direct or indirect interest in a Member that is its Affiliate (each a “**Transfer of an Interest**”), without the consent of the other Member, except that no consent shall be required for (and the non-Transferring Member shall give any consent that may be required under mandatory Singapore company law to effect) the direct or indirect Transfer by the Member of the entirety of a Member’s Interest or by a Member Parent of the entirety of its interest in a Member that is its Affiliate to:

(i) any Affiliate of such Member; or

(ii) with respect to any Transfer [ . . . \* \* \* . . . ], any other Person if (x) such other Person is not a competitor of the other Member or Member Parent and (y) the aggregate purchases by the Company and its Affiliates of Products containing Core Components (as such terms are defined in the Supply Agreement between the relevant Member or its Affiliate and the Company) from the relevant Member or its Affiliate under the Supply Agreement during the last four fiscal quarters of the Company for which financial statements are available accounted for not more than [ . . . \* \* \* . . . ]% of the Company’s aggregate cost of (A) the bill of materials for goods sold and (B) system integration during the same period (each of the transferees referred to in clauses (i) and (ii) above a “**Permitted Transferee**”); and no Permitted Transferee may Transfer any or all of its Interest, except the entirety of its Interest to another Permitted Transferee. In the event a Member transfers its Interest to an Affiliate, such Affiliate shall, unless otherwise

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agreed by the other Member, assume all of the transferring Member's obligations under this Agreement and such Member hereby agrees to irrevocably and unconditionally guarantee to the Company and the other Member the timely payment and performance by such Affiliate of such Member's obligations thereunder for so long as such transferee remains an Affiliate of the transferring Member.

(b) Any Transfer of an Interest that is not made in compliance with the provisions of this Agreement shall be void, and the Company shall not recognize any such Transfer. Any purported or attempted transfer of any Interest that is not made in compliance with the provisions of this Agreement shall constitute a material breach of this Agreement. Notwithstanding anything else contained herein, no Transfer shall be made except in compliance with applicable law.

(c) For the avoidance of doubt, the provisions of this Article 10 shall not apply to any Transfer of any direct or indirect interest in a Member that could be deemed to occur as a result of a change of control involving the relevant Member Parent.

Section 10.02. *Non-affiliate Transfers.* (a) Prior to any Transfer of an Interest permitted under Section 10.01(a)(ii) above, the Member or Member Parent, as the case may be, who proposes to Transfer its Interest (the "**Transferring Member**") (such transferee, the "**Proposed Transferee**" and such transfer, a "**Non-Affiliate Transfer**") shall give the other Member (the "**Non-Transferring Member**") written notice of its intention, describing the Proposed Transferee, the price and the terms and conditions of the proposed Transfer. The Non-Transferring Member shall have a [ . . . \* \* \* . . . ] to purchase the Transferring Member's Interest at [ . . . \* \* \* . . . ] and upon [ . . . \* \* \* . . . ] by the Proposed Transferee. The Non-Transferring Member shall have thirty (30) days from the receipt of such notice to agree to purchase the Transferring Member's Interest by giving written notice to the Transferring Member. If the Non-Transferring Member fails to exercise its [ . . . \* \* \* . . . ] under this Section 10.02(a), the Transferring Member shall have thirty (30) days thereafter to sell its Interest to the Proposed Transferee at a price and upon terms and conditions [ . . . \* \* \* . . . ] to the Proposed Transferee than specified in the Transferring Member's notice to the Non-Transferring Member of the proposed Transfer. If the Transferring Member does not sell its Interest to the Proposed Transferee during such thirty (30) day period, the Transferring Member shall not thereafter Transfer its Interest, without first offering such Interest to the Non-Transferring Member in the manner provided above.

(b) Following the consummation of a Transfer of an Interest either (x) to a Proposed Transferee pursuant to a Non-Affiliate Transfer or (y) to the Non-Transferring Member upon the exercise of such Member's [ . . . \* \* \* . . . ] pursuant to Section 10.02(a) above:

(i) the Transferring Member and its Affiliates shall be subject to the non-compete covenant set forth in Section 11.02(b) as if the Transferring Member were the Triggering Party; *provided* that the Non-Compete Period shall begin on the date of the [ . . . \* \* \* . . . ] of the Transfer and end on the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ] of such [ . . . \* \* \* . . . ] or the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ]; and

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(ii) (A) the Directors of the Transferring Member shall be automatically removed from the Board and (B) if the Transferring Member is [ . . . \* \* \* . . . ] or one of its Affiliates, then (1) each Member shall be entitled to designate a number of Directors that is in proportion to its Percentage Interest (three Directors for a 60% Percentage Interest, two Directors for a 40% Percentage Interest) and the Chief Executive Officer shall cease to be a Director, (2) actions by or decisions of the Board shall no longer require approval by [ . . . \* \* \* . . . ] but shall only require approval of [ . . . \* \* \* . . . ] of the Directors participating at a duly convened meeting at which a quorum is present (in person or by proxy) and (3) Section 6.04(g) shall cease to be in force and effect.

Section 10.03. *Recognition of Transfers.* (a) Prior to any Transfer of its Interest as permitted by this Article 10, the Member transferring such Interest shall give written notice of such Transfer to the other Member and to the Company. Upon receipt of such written notice, the Company shall notify the transferee of the transfer restrictions contained in this Agreement.

(b) No transferee shall be admitted to the Company as a Member unless the Transfer was permitted hereby. Subject to the foregoing, each such transferee, as a condition to its admission as a Member, shall execute and deliver to the Company such instruments, in form and substance satisfactory to the Members, as the Members shall reasonably deem necessary or desirable to confirm the agreement of such transferee to be bound by all the terms and provisions of this Agreement (as it may be amended in connection with the admission of such transferee as a Member). The Members agree to amend this Agreement to the extent necessary to reflect the transfer and admission of the new Member and to continue the Company without dissolution. Upon execution of such instruments, the transferee shall be admitted to the Company as a Member. Immediately following the admission of the transferee to the Company as a Member, the Member who has thereby transferred all of its Interest shall cease to be a Member of the Company. The transferee, as a Member of the Company, and the other Member are hereby authorized to, and shall, continue the business of the Company without dissolution.

(c) Any transferee who is admitted to the Company as a Member shall succeed to the rights and powers (including distribution preferences), and be subject to the restrictions and liabilities, of the transferor Member to the extent of the Interest transferred.

#### ARTICLE 11 TERMINATION, DISSOLUTION AND LIQUIDATION

Section 11.01. *Term.* The term of the Company shall continue until the Company is dissolved pursuant to this Article.

Section 11.02. *Triggering Events.* (a) Within the first 15 days of each [ . . . \* \* \* . . . ] (beginning in [ . . . \* \* \* . . . ]) either Member (such Member, the “**Triggering Party**”) may, for convenience, notify the other Member (the “**Non-Triggering Party**”) in writing of its election to treat such notice as a notice of a “**Triggering Event**.”

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Upon receipt of a notice of a Triggering Event, the Non-Triggering Party will notify the Triggering Party in writing within 15 days of the Non-Triggering Party's exercise of one of the following options:

(i) purchase the Triggering Party's Interest at a [ . . . \* \* \* . . . ] ([ . . . \* \* \* . . . ]); *provided* that the Triggering Party shall remain liable for any Required Funding Contributions for the Fiscal Year in which the Triggering Event occurs, pro-rated for the period from the beginning of such Fiscal Year to the Triggering Event, and *provided further* that the Triggering Party shall be entitled to receive, in addition to the cash purchase price, any royalties if and as payable to it pursuant to the Intellectual Property Agreement; or

(ii) dissolve and commence winding up of the Company pursuant to Section 11.05(b).

Upon receipt by the Triggering Party, such notice shall be final and irrevocable, unless otherwise agreed by the Triggering Party.

(b) If the Non-Triggering Party has exercised its option (i) pursuant to Section 11.02(a), then effective from the consummation of the purchase of the Triggering Party's Interest by the Non-Triggering Party, the Triggering Party and its Affiliates shall not for a period beginning on the date of such [ . . . \* \* \* . . . ] and ending on the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ] of such [ . . . \* \* \* . . . ] or the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ] (the "**Non-Compete Period**") engage, either directly or indirectly, as a principal for its own account or solely or jointly with others, or as a stockholder in any corporation or joint stock association, in any business engaged in the Business (other than the Company). For the avoidance of doubt, without limiting the foregoing covenant, it is acknowledged and agreed that neither the Triggering Party nor any of its Affiliates shall knowingly supply services, products or components for use in products or services competitive with the Business or the Products of the Company during the Non-Compete Period (other than to the Company and its Affiliates and the Non-Triggering Party).

(c) If the Non-Triggering Party exercises its option (ii) pursuant to Section 11.02(a), (A) the Intellectual Property Rights of the Company shall be distributed to the Members as joint owners of an equal undivided interest therein with no duty to account to the other party and (B) each Member shall be entitled to receive, as soon as possible and in any event within 30 days after the exercise of such option by the Non-Triggering Party, copies of source code, documentation and other materials as may be necessary to continue to develop the Products.

Section 11.03. *Breach under this Agreement or Event of Default under Supply Agreements.* If a material breach of this Agreement, including without limitation any failure by a Member to pay its Required Funding Contributions when due, or an Event of Default (as defined in the Supply Agreements) on the part of the Supplier that is an Affiliate of such Member occurs and remains unremedied for a period of 30 days following notice thereof from the non-defaulting Member and is continuing, in addition to, and without prejudice to, any and all other remedies, the non-defaulting Member may, at its option, either (A) treat such default as a "Triggering Event" pursuant to Section

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11.02(a) except that the non-defaulting Member shall be treated as the Non-Triggering Party and the defaulting Member shall be treated as the Triggering Party thereunder or (B) remove the two Directors on the Board designated by the defaulting Member and designate two Directors selected by the non-defaulting Member in its sole discretion to replace such removed Directors to serve until such time as the material breach or Event of Default has been remedied by the defaulting Member. In addition to replacement of such removed Directors, if the breach is non-payment of a Required Funding Contribution, then without limiting the non-defaulting Member's other rights under this Agreement, (A) the non-defaulting Member shall have the right, in its sole discretion, to pay the defaulting Member's Required Funding Contribution and (B) the non-defaulting Member's Percentage Interest shall be increased to a percentage equal to the quotient of (x) the sum of the cumulative contributions paid by the non-defaulting Member since inception of the Company (including pursuant to this Section 11.03), divided by (y) the sum of the cumulative contributions paid by both Members (including pursuant to this Section 11.03) since inception of the Company, and the other Member's Percentage Interest shall be reduced accordingly; *provided* that if the material breach by the defaulting Member is willful, occurs at any time [ . . . \* \* \* . . . ] and remains unremedied for a period of 30 days following notice thereof from the non-defaulting Member and is continuing, in addition to, and without prejudice to, any and all other remedies (including pursuant to the first part of this Section 11.03), the non-defaulting Member may treat such breach as a "Triggering Event" pursuant to Section 11.02(a) except that the willfully defaulting Member shall be treated as the Triggering Party thereunder and *provided* that the purchase price for the willfully defaulting Member's Interest shall be \$1, and *provided further* that the willfully defaulting Member shall remain liable for its share of all Required Funding Contributions for the Fiscal Year in which the breach occurs.

Section 11.04. *Change of Control.* (a) *Change of Control at Parent Level.* If, through a transaction or series of transactions, a Member Parent of a Member is acquired by, or comes otherwise under the control of, a competitor or Major Customer of the other Member Parent, the other Member may treat such event as a "Triggering Event" pursuant to Section 11.02(a), except that such other Member shall be treated as the Non-Triggering Party and the Member whose Member Parent is affected by such event shall be treated as the Triggering Party thereunder. As used in this Section 11.04, "**Major Customer**" means, with respect to any Member Parent from time to time, a customer that (i) accounts for in excess of [ . . . \* \* \* . . . ]% of the consolidated revenues of such Member Parent during the preceding twelve (12) months for which financial statements are available or (ii) is of material strategic significance to the future development of the consolidated business of such Member Parent due to an expected share of such Member Parent's consolidated revenues in excess of [ . . . \* \* \* . . . ]% during any twelve (12) month period within the next [ . . . \* \* \* . . . ] based upon the projected revenues in such Member Parent's then current business plan, in each case as shall have been certified to the other Member Parent by the chief executive officer of such Member Parent prior to any relevant transaction.

(b) *Supplier and Company Interest No Longer Affiliates.* If, as a result of a transaction or series of transactions other than a Transfer of an Interest to a Permitted Transferee pursuant to Section 10.01(a), a Supplier ceases to be an Affiliate of a Member without becoming an Affiliate of a Person that, as a result of such transaction or series of transactions, becomes a Member or an Affiliate of a Member, then the Member that was

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not an Affiliate of such Supplier immediately prior to such transaction or series of transactions may treat such event (a “**Triggering Separation**”) as a “Triggering Event” pursuant to Section 11.02(a), except that such Member shall be treated as the Non-Triggering Party and the other Member shall be treated as the Triggering Party thereunder.

(c) *Joint Transfer of Supplier and Company Interest.* Notwithstanding any other provision of this Article 11 or Article 10, any Transfer of an Interest by a Member or Member Parent, in a transaction or series of transactions, that does not result in a Triggering Separation shall be permitted at all times, whether or not to a Permitted Transferee, as long as the transferee is not a competitor or Major Customer of the Member Parent of the other Member, subject to compliance with this Section 11.04(c). In connection with any Transfer permitted under this Section 11.04(c), (x) the other Member shall have a [ . . . \* \* \* . . . ] with respect to the Interest and interest in or assets of the Supplier to be Transferred, and any other assets to be transferred as part of such transaction or series of transactions, such right to be exercised in the manner set forth in Section 10.02(a), (y) the transferring Member or Member Parent, as the case may be, and its Affiliates shall be subject to the non-compete covenant set forth in Section 11.02(b) as if the transferring Member were the Triggering Party; *provided* that the Non-Compete Period shall begin on the date of the [ . . . \* \* \* . . . ] of the Transfer and end on the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ] of such [ . . . \* \* \* . . . ] or the [ . . . \* \* \* . . . ] of the [ . . . \* \* \* . . . ], and (z) if as a result of such Transfer, the transferring Member and the Supplier are no longer Affiliates of [ . . . \* \* \* . . . ], the composition and voting of the Board and voting of the Members shall be modified as set forth in Section 10.02(b)(ii). The provisions of this Section 11.04(c) shall not apply to any Transfer of any direct or indirect interest in a Member that could be deemed to occur as a result of a change of control involving the relevant Member Parent.

Section 11.05. *Liquidating Events.* The Company shall dissolve (and where applicable each Member agrees to vote its shares in favor of such dissolution) and commence winding up upon the first to occur of any of the following events (each a “**Liquidating Event**”):

- (a) upon the unanimous written agreement of the Members to dissolve and wind up the Company; and
- (b) upon the exercise of the Non-Triggering Party of its option (ii) upon notice of a Triggering Event in accordance with Section 11.02(a).

Section 11.06. *Winding Up.* Upon the occurrence of a Liquidating Event, the Company shall continue solely for the purposes of winding up its affairs in an orderly manner, distributing its Intellectual Property Rights, liquidating its assets, and satisfying the claims of its creditors and Members, and no Member shall take any action that is inconsistent with, or not necessary to or appropriate for, the winding up of the Company’s business and affairs; *provided* that all covenants contained in this Agreement and obligations provided for in this Agreement shall continue to be fully binding upon the Members until such time as the assets or property or the proceeds from the sale thereof has been distributed pursuant to this Article and the Company has terminated. The Member with the greater Percentage Interest, or in the case of a Liquidating Event pursuant to Section 11.05(b), the Non-Triggering Party, shall be responsible for

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overseeing the winding up of the Company. Such party (the “**Liquidator**”) shall take full account of the Company’s assets and liabilities, and except as otherwise required by law, the Company’s affairs shall be wound up in an orderly manner in accordance with the following procedures:

(a) (A) the Intellectual Property Rights of the Company shall be distributed to the Members as joint owners of an equal undivided interest therein with no duty to account to the other party and (B) each Member shall be entitled to receive, as soon as possible and in any event within 30 days after the Liquidating Event, copies of source code, documentation and other materials as may be necessary to continue to develop the Products.

(b) To the extent that the Liquidator determines that any or all of the assets of the Company (other than the Intellectual Property Rights provided for in Section 11.06(a) above) shall be sold, such assets shall be sold as promptly as possible, but in a business-like manner so as not to involve undue sacrifice, and the proceeds thereof shall be used first to satisfy any liabilities of the Company and then shall be distributed to the Members in accordance with their Percentage Interests.

Section 11.07. *Rights of Members.* Except as otherwise provided in this Agreement, each Member shall look solely to the assets of the Company for the return of its capital contributions and shall have no right or power to demand or receive property other than cash from the Company.

## ARTICLE 12 MISCELLANEOUS

Section 12.01. *Notices.* All notices, requests and other communications to any party or to the Company shall be in writing (including facsimile or similar writing) and shall be given:

if to the Company, to such address as the Company shall notify the other parties hereto as soon as possible after its formation;

if to Cymer, to:

Cymer, Inc.  
17075 Thornmint Court  
San Diego, CA 92127-1712 USA  
Attn: Chief Financial Officer  
Fax No.: (858) 385-6090

with a copy to:

Cooley Godward LLP  
Five Palo Alto Square  
3000 El Camino Real  
Palo Alto, CA 94306-2155 USA  
Attn: Gary H. Moore  
Fax No.: (650) 849-7400

if to Zeiss LOB, to:

Carl Zeiss Laser Optics Beteiligungsgesellschaft mbH  
Rudolf-Eber-Strasse 2  
73447 Oberkochen, Germany  
Attention: Joseph Fatum  
Facsimile No: 011-49-7364-208100  
Telephone No.: [ . . . \* \* \* . . . ]

if to Zeiss SMT, to:

Carl Zeiss SMT AG  
Rudolf-Eber-Strasse 2  
73447 Oberkochen, Germany  
Attention: Dr. Hermann Gerlinger  
Facsimile No: 011-49-7364-208100  
Telephone No.: [ . . . \* \* \* . . . ]

or to such other address or facsimile number as any such party may hereafter specify for the purpose by notice to the other parties. Each such notice, request or other communication shall be effective when received at the address specified in this Section 12.01, or such other address or facsimile number as such party may hereafter specify for the purpose by notice to the other parties hereto. All such notices, requests and other communications shall be deemed received on the date of receipt by the recipient thereof if received prior to 5:00 p.m. in the place of receipt and such day is a business day in the place of receipt. Otherwise, any such notice, request or communication shall be deemed not to have been received until the next succeeding business day in the place of receipt.

Section 12.02. *Amendments; No Waivers.* (a) Any provision of this Agreement may be amended or waived if, and only if, such amendment or waiver is in writing and signed, in the case of an amendment, by each Member, or in the case of a waiver, by the Member against whom the waiver is to be effective.

(b) No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege. The rights and remedies herein provided shall be cumulative and not exclusive of any rights or remedies provided by law.

Section 12.03. *Expenses.* All costs and expenses incurred by the parties hereto in connection with this Agreement shall be paid by the party incurring such cost or expense.

Section 12.04. *Zeiss SMT* [ . . . \* \* \* . . . ]. For so long as Zeiss LOB is controlled by Zeiss SMT, Zeiss SMT [ . . . \* \* \* . . . ] by Zeiss LOB of Zeiss LOB's obligations under this Agreement.

Section 12.05. *Successors and Assigns.* This Agreement is personal to the Members and may not be assigned or otherwise transferred by a Member except to a transferee of such Member's Interest in connection with a transfer permitted by and made in accordance with the terms hereof. Any purported assignment or other transfer in

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violation of this Agreement shall be null and void. The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective permitted successors and assigns. This Agreement is for the sole benefit of the parties hereto and, except as otherwise contemplated herein, nothing herein expressed or implied shall give or be construed to give any Person, other than the parties hereto, any legal or equitable rights hereunder.

Section 12.06. *Headings.* Headings are for ease of reference only and shall not form a part of this Agreement.

Section 12.07. *Entire Agreement.* This Agreement and any documents referred to herein or therein, constitutes the entire agreement of the Members with respect to the subject matter hereof Provided however that nothing herein shall affect the full force and effect of the Original JV Agreement until this Agreement comes into effect on the Effective Date.

Section 12.08. *Governing Law.* This Agreement shall be governed by, and construed under, the laws of [. . . \* \* \* . . .] (without regard to conflicts of laws principles).

Section 12.09. *Waiver of Jury Trial.* EACH OF THE PARTIES HERETO HEREBY IRREVOCABLY WAIVES ANY AND ALL RIGHT TO TRIAL BY JURY IN ANY LEGAL PROCEEDING ARISING OUT OF OR RELATED TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

Section 12.10. *Dispute Resolution; Arbitration.* (a) Any dispute, controversy or claim arising out of or in connection with this Agreement, or any of the Joint Venture Documents, or the alleged breach, termination or invalidity thereof, may be escalated, at the request of either Member, to the Chairman of the board of directors (or equivalent officer) of each Member for resolution. In the event of such a request, the Chairmen shall meet, either in person or by telephone, within thirty (30) days after the date of such request in order to discuss and attempt to resolve such dispute, controversy or claim by mutual agreement.

(b) Any dispute, controversy or claim arising out of or in connection with this Agreement or the alleged breach, termination or invalidity thereof that is not settled by the dispute resolution process set forth in Section 12.10(a) or otherwise by the joint agreement of the Parties shall be finally settled under Rules of Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with the said Rules. Unless otherwise agreed by the Parties, such arbitration shall take place in [. . . \* \* \* . . .] Any award rendered by the arbitrators will be final and binding on the parties, and judgment upon the award may be entered in the [. . . \* \* \* . . .], or any other court having jurisdiction over the award or having jurisdiction over the parties or their assets. The arbitration agreement contained in this Section 12.10 will not be construed to deprive any court of its jurisdiction to grant provisional relief (including by injunction or order of attachment) in aid of arbitration proceedings or enforcement of an award.

Section 12.11. *Counterparts; Effectiveness.* This Agreement may be signed in any number of counterparts, each of which shall be deemed an original. This Agreement

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shall become effective only after and subject to each party having received a counterpart hereof signed by each of the other parties.

Section 12.12. *Severability.* If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such a determination, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner in order that the transactions contemplated hereby be consummated as originally contemplated to the fullest extent possible.

Section 12.13. *Further Assurances; Singapore Corporate Documents.* The Members will execute and deliver such further instruments and do such further acts and things as may be required to carry out the intent and purpose of this Agreement. In particular, and without limiting the generality of the foregoing, each Member agrees (i) that the Company's Memorandum and Articles of Association and other Singapore corporate legal documents (collectively, the "**Singapore Corporate Documents**") shall at all times contain provisions as may be necessary or appropriate to give effect and facilitate the provisions of this Agreement, (ii) that in the event of any inconsistency between the Singapore Corporate Documents and this Agreement, this Agreement shall prevail and (iii) to take such actions with respect to its shares or in its capacity as a shareholder of the Company, including voting its shares at a shareholders meeting and adopting any changes to the Singapore Corporate Documents, all to be consistent with and in accordance with the terms of this Agreement.

[The remainder of this page is intentionally left blank.]

IN WITNESS WHEREOF, the parties hereto have entered into this Agreement as of the date set forth above.

**TCZ GMBH**

By: /s/ Brian C. Klene  
Name: Brian C. Klene  
Title: President and CEO

**CYMER, INC.**

By: /s/ Nancy J. Baker  
Name: Nancy J. Baker  
Title: Sr. Vice President and CFO

**CARL ZEISS LASER OPTICS  
BETEILIGUNGSGESELLSCHAFT MBH**

By: /s/ Axel Jaeger  
Name: Axel Jaeger  
Title: Managing Director

**CARL ZEISS SMT AG**

By: /s/ H. Gerlinger  
Name: Dr. Hermann Gerlinger  
Title: CEO

By: /s/ ppa. Stephan Müller  
Name: Stephan Müller  
Title: Director

**TCZ PTE. LTD.**

By: /s/ Brian C. Klene  
Name: Brian C. Klene  
Title: President and CEO

**CERTIFICATION**

I, Robert P. Akins, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cymer, 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 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 (or persons performing the equivalent functions):
  - 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: November 7, 2006

/s/ Robert P. Akins  
Robert P. Akins  
Chairman, Chief Executive Officer

**CERTIFICATION**

I, Nancy J. Baker, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cymer, 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 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 (or persons performing the equivalent functions):
  - 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: November 7, 2006

/s/ Nancy J. Baker

Nancy J. Baker

Sr. Vice President, Chief Financial Officer

**CERTIFICATION**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. § 1350, as adopted), Robert P. Akins, Chief Executive Officer of Cymer, Inc., a Nevada corporation (the "Registrant"), hereby certifies that, to the best of his knowledge:

1. The Registrant's annual report on Form 10-Q for the period ended September 30, 2006, to which this certification is attached as Exhibit 32.1 (the "Report"), fully complies with the requirements of Section 13(a) of the Exchange Act; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

**In Witness Whereof**, the undersigned has set his hand hereto as of the 7th day of November, 2006.

/s/Robert P. Akins

Robert P. Akins, Chief Executive Officer

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Cymer, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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**CERTIFICATION**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, (the “Exchange Act”) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. § 1350, as adopted), Nancy J. Baker, Chief Financial Officer of Cymer, Inc., a Nevada corporation (the “Registrant”), hereby certifies that, to the best of her knowledge:

1. The Registrant’s annual report on Form 10-Q for the period ended September 30, 2006, to which this certification is attached as Exhibit 32.2 (the “Report”), fully complies with the requirements of Section 13(a) of the Exchange Act; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

**In Witness Whereof**, the undersigned has set her hand hereto as of the 7th day of November, 2006.

/s/Nancy J. Baker

Nancy J. Baker, Chief Financial Officer

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Cymer, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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