



# **FORM 10-Q**

**CYMER INC - CYMI**

**Filed: May 08, 2007 (period: March 31, 2007)**

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

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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 March 31, 2007

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 May 4, 2007 was 36,068,221.

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**CYMER, INC.**

**FORM 10-Q**

**For the Quarterly Period Ended March 31, 2007**

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**ITEM 1. Financial Statements**

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

	December 31, 2006	March 31, 2007
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 302,098	\$ 327,810
Short-term investments	207,943	193,331
Accounts receivable - net	115,857	113,082
Accounts receivable - related party	834	1,712
Foreign currency forward exchange contracts	652	108
Inventories	104,296	112,167
Deferred income taxes	46,943	43,975
Prepaid expenses and other assets	7,143	7,823
Total current assets	785,766	800,008
PROPERTY AND EQUIPMENT - NET	112,074	110,775
LONG-TERM INVESTMENTS	8,384	22,113
DEFERRED INCOME TAXES	12,766	12,783
GOODWILL	8,833	8,833
INTANGIBLE ASSETS - NET	15,880	15,119
OTHER ASSETS	5,391	5,278
<b>TOTAL ASSETS</b>	<b>\$ 949,094</b>	<b>\$ 974,909</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 18,711	\$ 22,474
Accounts payable - related party	4,858	4,212
Accrued warranty and installation	29,974	30,680
Accrued payroll and benefits	21,707	16,617
Accrued patents, royalties and other fees	4,262	4,503
Income taxes payable	13,293	1,448
Unearned income	2,544	2,781
Foreign currency forward exchange contracts	—	53
Other current liabilities	3,715	2,320
Total current liabilities	99,064	85,088
CONVERTIBLE SUBORDINATED NOTES	140,722	140,722
INCOME TAXES PAYABLE	—	16,069
OTHER LIABILITIES	14,781	15,478
Total liabilities	254,567	257,357
MINORITY INTEREST	6,633	5,918
<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; 41,774,000 and 41,840,000 shares outstanding at December 31, 2006 and March 31, 2007, respectively	42	42
Additional paid-in capital	557,082	560,005
Treasury stock at cost - 4,536,000 common shares at December 31, 2006 and March 31, 2007, respectively	(150,704)	(150,704)
Accumulated other comprehensive loss	(4,066)	(3,928)
Retained earnings	285,540	306,219

Total stockholders' equity	687,894	711,634
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	<u>\$ 949,094</u>	<u>\$ 974,909</u>

See Notes to Unaudited Consolidated Financial Statements.

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

	Three months ended	
	March 31,	
	2006	2007
<b>REVENUES:</b>		
Product sales	\$ 124,902	\$ 126,159
Product sales - related party	2,154	466
Other	61	89
Total revenues	<u>127,117</u>	<u>126,714</u>
<b>COSTS AND EXPENSES:</b>		
Cost of product sales	68,691	65,066
Research and development	18,124	19,302
Sales and marketing	6,849	6,969
General and administrative	9,180	8,810
Total costs and expenses	<u>102,844</u>	<u>100,147</u>
OPERATING INCOME	<u>24,273</u>	<u>26,567</u>
<b>OTHER INCOME (EXPENSE):</b>		
Foreign currency exchange gain - net	619	427
Interest and other income	6,986	6,417
Interest and other expense	(1,402)	(1,579)
Total other income - net	<u>6,203</u>	<u>5,265</u>
INCOME BEFORE INCOME TAX PROVISION AND MINORITY INTEREST	30,476	31,832
INCOME TAX PROVISION	10,554	12,227
MINORITY INTEREST	681	716
NET INCOME	<u>\$ 20,603</u>	<u>\$ 20,321</u>
<b>EARNINGS PER SHARE:</b>		
Basic earnings per share	<u>\$ 0.55</u>	<u>\$ 0.55</u>
Weighted average common shares outstanding	<u>37,278</u>	<u>37,269</u>
Diluted earnings per share	<u>\$ 0.52</u>	<u>\$ 0.52</u>
Weighted average common and dilutive potential common shares outstanding	<u>41,126</u>	<u>40,617</u>

See Notes to Unaudited Consolidated Financial Statements.

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

	For the three months ended March 31,	
	2006	2007
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 20,603	\$ 20,321
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,484	6,364
Non-cash stock-based compensation	2,519	1,356
Minority interest	(681)	(716)
Provision for deferred income taxes	4,230	8,089
Loss on disposal and impairment of property and equipment	6	5
Change in assets and liabilities:		
Accounts receivable — net	(21,753)	2,775
Accounts receivable — related party	(2,201)	(878)
Foreign currency forward exchange contracts	1,636	606
Inventories	(12,206)	(7,871)
Prepaid expenses and other assets	680	(762)
Accounts payable	6,201	3,763
Accounts payable - related party	(818)	(646)
Accrued expenses and other liabilities	2,246	(4,889)
Unearned income	56	237
Income taxes payable	(6,133)	(610)
Net cash provided by operating activities	<u>869</u>	<u>27,144</u>
<b>INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(3,661)	(4,114)
Purchases of investments	(54,484)	(38,834)
Proceeds from sold or matured investments	33,572	39,974
Acquisition of minority interest	(7,024)	—
Net cash used in investing activities	<u>(31,597)</u>	<u>(2,974)</u>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	54,090	1,254
Excess tax benefits from stock option exercises	10,154	313
Net cash provided by financing activities	<u>64,244</u>	<u>1,567</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<u>2,676</u>	<u>(25)</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<u>36,192</u>	<u>25,712</u>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD</b>	<u>233,745</u>	<u>302,098</u>
<b>CASH AND CASH EQUIVALENTS AT END OF THE PERIOD</b>	<u>\$ 269,937</u>	<u>\$ 327,810</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Interest paid	<u>\$ 2,522</u>	<u>\$ 2,551</u>
Income taxes paid, net	<u>\$ 1,536</u>	<u>\$ 4,202</u>

See Notes to Unaudited Consolidated Financial Statements.

## CYMER, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Three Months Ended March 31, 2007 (Unaudited)

#### 1. BASIS OF PRESENTATION

*Unaudited Interim Financial Statements* — 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. The consolidated balance sheet at December 31, 2006 was derived from the audited financial statements at that date; however it may not include all disclosures required by accounting principles generally accepted in the United States.

In the opinion of management, the unaudited consolidated financial statements for the interim period 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, 2006. 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”). We own 60% of TCZ Pte Ltd.

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.

#### 2. STOCK-BASED COMPENSATION

We grant stock options and awards from our 2005 Equity Incentive Plan (the “2005 Plan”), which 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 to our employees, directors and consultants. Options issued under the 2005 Plan expire ten years after the options are granted and generally vest and become exercisable ratably over a four-year period following the date of grant. Stock unit awards issued under the 2005 Plan generally vest one year from the date granted.

During the three months ended March 31, 2006 and 2007, we recognized stock-based compensation expense related to stock options of \$2.4 million and \$1.3 million, respectively; of which \$146,000 and \$176,000, respectively, are related to stock unit awards. We also recognized an income tax benefit related to stock-based compensation during the three months ended March 31, 2006 and 2007 of \$10.2 million and \$313,000, respectively. The fair value of stock-based options granted, less expected forfeitures, is recognized to expense over the requisite service period.

#### 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 (in thousands, except per share information):

	Three months ended March 31,	
	2006	2007
<b>NET INCOME:</b>		
Net income, as reported (used for basic EPS)	\$ 20,603	\$ 20,321
Adjustment for interest expense on convertible subordinated notes, net of taxes	873	822
Net income, as adjusted for assumed conversion (used for diluted EPS)	\$ 21,476	\$ 21,143
<b>WEIGHTED AVERAGE SHARES:</b>		
Basic weighted average common shares outstanding	37,278	37,269
Effect of dilutive securities:		
Warrants	57	—
Options and stock units	977	534
Convertible subordinated notes	2,814	2,814
Diluted weighted average common and potential common shares outstanding	41,126	40,617
<b>Earnings per share:</b>		
Basic	\$ 0.55	\$ 0.55
Diluted	\$ 0.52	\$ 0.52

For the three months ended March 31, 2006, weighted average options and warrants to purchase shares of common stock totaling approximately 1.0 million shares were not included in the computation of diluted earnings per share as their effect was anti-dilutive. For the three months ended March 31, 2007, weighted average options to purchase shares of common stock totaling approximately 739,000 shares were not included in the computation of diluted earnings per share as their effect was anti-dilutive.

#### 4. INVENTORIES

Inventories are carried at the lower of cost, which approximates the first-in, first-out method, or market and consisted of the following (in thousands):

	December 31, 2006	March 31, 2007
<b>INVENTORIES:</b>		
Raw materials	\$ 33,472	\$ 35,303
Work-in-progress	19,373	21,504
Finished goods	51,451	55,360
Total	\$ 104,296	\$ 112,167

#### 5. REPORTING COMPREHENSIVE INCOME

Comprehensive income includes net income, effective unrealized gains and losses on forward contracts, foreign currency translation adjustments, net unrealized pension gains and losses, 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 three months ended March 31, 2007 (in thousands):

	Translation adjustment	Total unrealized gain (loss) on available-for-sale investments, net of tax	Total unrealized gain on derivatives, net of tax	Net unrealized pension loss	Accumulated other comprehensive loss
Balance, December 31, 2006	\$ (3,984)	\$ (92)	\$ 17	\$ (7)	\$ 4,066
Period, net change	(27)	159	6	—	138
Balance, March 31, 2007	\$ (4,011)	\$ 67	\$ 23	\$ (7)	\$ (3,928)

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

	Three months ended March 31,	
	2006	2007
Net income	\$ 20,603	\$ 20,321
Foreign currency translation adjustments	2,674	(27)
Unrealized gains on available- for-sale investments, net of tax	44	159
Unrealized gains on foreign currency forward exchange contracts, net of tax	84	6
Comprehensive income	\$ 23,405	\$ 20,459

## 6. GOODWILL AND INTANGIBLE ASSETS

We account for our goodwill and other indefinite life intangible assets in accordance with Statement of 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 2006 we completed our annual impairment test of goodwill and intangibles and concluded that no impairment of goodwill or intangibles existed. The carrying amount of goodwill was \$8.8 million as of December 31, 2006 and March 31, 2007.

Intangible assets — net, within the accompanying balance sheets represent amounts associated with patents that were acquired in 2001, 2003, 2005 and 2006. As of December 31, 2006 and March 31, 2007, the net carrying amount of these patents was \$15.9 million and \$15.1 million, respectively. The accumulated amortization of these patents at December 31, 2006 and March 31, 2007 was \$11.1 million and \$11.9 million, respectively. Amortization expense for our patents was \$635,000 and \$762,000, for the three months ended March 31, 2006 and 2007, respectively.

As of March 31, 2007, future estimated amortization expense for these patents for the next five years and beyond is expected to be as follows (in thousands):

	<u>Future Amortization</u>
Nine months ending December 31, 2007	\$ 2,285
Year ending December 31, 2008	3,046
Year ending December 31, 2009	1,564
Year ending December 31, 2010	675
Year ending December 31, 2011	675
Thereafter	6,874

## 7. INCOME TAXES

We adopted the provisions of Financial Accounting Standard Board (“FASB”) Interpretation No. 48 (“FIN 48”), Accounting for Uncertainty in Income Taxes, on January 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in FIN 48 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position.

As of the date of adoption, our gross liability for income taxes associated with uncertain tax positions totaled \$19.6 million, including interest and penalties. As a result of the implementation of FIN 48, we recognized an increase of \$9.4 million to reserves for uncertain tax positions, of which \$5.7 million was recorded to deferred tax assets, \$3.4 million was recorded to income taxes receivable, \$687,000 was recorded to tax expense and the remaining \$358,000 was recorded as a cumulative effect adjustment to increase retained earnings. The FIN 48 liability is presented net of the related income tax receivable balance on the accompanying consolidated balance sheet. Included in the balance of unrecognized tax benefits at January 1, 2007 is \$10.5 million of tax benefits that, if recognized, would affect our effective tax rate. Also included in the balance of unrecognized tax benefits at January 1, 2007 is \$9.1 million of tax benefits that, if recognized, would result in adjustments to other tax accounts, primarily deferred tax assets and income taxes receivable.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of January 1, 2007, we had approximately \$640,000 of accrued interest and penalties related to uncertain tax positions.

We are subject to taxation in the United States and in various states and foreign jurisdictions. We are currently under Internal Revenue Service (“IRS”) audit for the 2003 and 2004 tax years. Though the estimated completion date of the audit is not known, it is possible that the audit will be completed within the next twelve months. The completion of this audit could require a material change to our gross unrecognized tax benefits. However, based on the status of this audit and the protocol for finalizing such audits, it is not possible to estimate the impact of this audit on previously recorded uncertain tax positions. In addition, we do not foresee material changes to the state or foreign uncertain tax positions within the next twelve months.

Our tax years 2003 and forward are subject to examination by the IRS, our tax years 2000 and forward are subject to examination by material state jurisdictions, and our tax years 2002 and forward are subject to examination by material foreign jurisdictions.

## 8. GUARANTEES/WARRANTIES

In the ordinary course of business, we are not subject to potential obligations under guarantees that fall within the scope of FASB 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 except for product warranties.

- (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 three months ended March 31, 2007 (in thousands):

Balance, January 1, 2007	\$	29,450
Liabilities accrued for warranties issued, net of adjustments and expirations		5,085
Warranty expenditures incurred		<u>(4,335)</u>
Balance, March 31, 2007	\$	<u>30,200</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, ASML, Canon, and Nikon. In general, these indemnification provisions provide that we defend our customers against any infringement claims directed against our products. Under the indemnification clauses, we 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 Corporation (“Intel”) in 2004 and amended in July 2006, we 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. Under the terms of this agreement, as 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 and restatement of the original TCZ joint venture agreement, we agreed to indemnify TCZ 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 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, these provisions are indefinite and extend beyond the term of the actual agreements.

## **9. RELATED PARTY TRANSACTIONS**

As a result of the formation of our TCZ joint venture in July 2005 and under the terms of the joint venture agreement which was amended in September 2006, Zeiss is 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 periodically sell our light source system products to Zeiss. We recorded revenue associated with this related party of \$2.2 million and \$466,000 for the three months ended March 31, 2006 and 2007, respectively. As of December 31, 2006 and March 31, 2007, we had accounts receivable balances of \$834,000 and \$1.7 million, respectively, and accounts payable balances of \$4.9 million and \$4.2 million, respectively, all of which were associated with these related party transactions with Zeiss.

## **10. 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.

## 11. SUBSEQUENT EVENT

On April 24, 2007, we announced that our board of directors authorized us to repurchase up to \$300 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 May 4, 2007 were \$54.9 million or 1,334,500 shares under this program.

## 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 each of the three DUV lithography tool manufacturers, ASML, 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 and the majority of our replacement parts. 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.

Our TCZ joint venture which is headquartered in 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 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. Although TCZ’s product is currently in the development phase, TCZ performed extensive customer demonstrations on its first generation demonstration tool in 2006 and we expect that TCZ will ship its first production tool, the TCZ 900X, in late 2007 or early 2008.

### *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 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 first quarter of 2007, we sold 51 light source systems at an average selling price of \$1.2 million.

Our product development strategy has been to develop new products in rapid succession to meet continually evolving needs in the marketplace, and to obsolete our own products as quickly as possible, thus rendering our competitors’ products obsolete. This strategy strengthens our market leadership position since the ongoing reduction of critical dimension (“CD”) on the wafer drives demand for newer, more advanced, higher value-added light sources.

Over the years, we have developed and sold a wide variety of photolithography light source products. These products can be divided into KrF and ArF product categories and include a number of current products as well as legacy products that we continue to service in our installed base.

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 downturn from 2001 through late 2003. Growth resumed in late 2003, but one year later, in late 2004, the industry again declined for several months. Business activity then leveled off early in 2005 and began to slightly improve quarter-over-quarter thereafter until late 2005, when orders for our light sources increased substantially from the levels seen 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 demand for scanners. By the end of 2005, it appeared that we were again entering a strong industry growth cycle and upturn.

Several trends that continued throughout 2006 drove our revenue and net income to record levels for the year. These trends included:

- Strong continuing demand for our ArF light sources as chipmakers purchased systems to enable production at advanced technology nodes.
- Stronger than anticipated demand for our KrF light sources, which chipmakers purchased to expand production capacity and pattern a growing number of less critical layers with DUV light sources.
- Substantial ongoing growth in our non-systems revenue which was driven by high light source utilization at chipmakers and high overall fab utilization.

In the fourth quarter of 2006, however, we experienced delays in our anticipated shipment schedule when a customer requested that we reschedule shipment of a number of our most advanced ArF light sources, specifically the XLA 300, into the first quarter of 2007. Again in March 2007, one of our customers requested that we delay shipment of a certain number of our light sources, several models of both KrF and ArF products. This was due to a major rescheduling and product mix shift of their scanner deliveries, which required that they change mix configuration and push out receipt of a number of our light sources into the second half of the 2007. As a result, in the first quarter of 2007, we shipped 51 light sources and revenue totaled \$126.7 million, compared to shipment of 68 light sources and total revenue of \$137.4 million in the fourth quarter of 2006. Utilization of our light source systems at chipmakers continued to increase in the first quarter of 2007 compared to the fourth quarter of 2006. This increased utilization when coupled with our growing installed base of light sources systems drove our non-systems product revenue, which consists of consumables and spare parts, upgrades, and service, to \$67.8 million for the first quarter of 2007, equal to 53% of total revenue for the quarter, slightly higher than the \$66.9 million in non-systems revenue recorded in the fourth quarter of 2006, equal to 49% of total revenue. Operating income totaled \$26.6 million, yielding an operating margin of 21.0% for the first quarter of 2007, compared to operating income of \$30.9 million and operating margin of 22.5% in the fourth quarter of 2006. Net income for the first quarter of 2007 was \$20.3 million, equal to \$0.52 per share fully diluted, compared to net income of \$25.4 million, equal to \$0.65 per share fully diluted, in the fourth quarter of 2006. The positive effects of our ongoing operational efficiency improvements are evident in our gross margin for the first quarter of 2007 coming in at 48.6% compared to 49.4% gross margin in the fourth quarter of 2006, even though first quarter 2007 revenue declined 8% compared to the prior quarter's revenue.

In general, the longer-term technology and industry trends that affect photolithography are positive. Demand for our most advanced ArF light sources remained strong in the first quarter of 2007 and we shipped 32 of our XLA Series light sources during the quarter. With ArF immersion lithography a production reality in leading NAND Flash memory manufacturers' fabs near the end of 2006, lithography tool manufacturers have been seeing growing demand for ArF immersion scanners. Further, NAND Flash memory manufacturers continue to aggressively shrink CDs, and will move from 55nm production at this time toward 45nm by the end of 2007, and to pattern the growing number of critical layers with immersion scanners, these manufacturers will need to make additional immersion tool purchases to increase critical layer capacity. Immersion lithography is in production in a growing number of chipmakers' fabs, and we anticipate that an increasing number of chipmakers will adopt this advanced production technique over the next several years.

To meet this demand for advanced immersion tools for the 45nm production node and below, we have developed the XLR 500i, a new light source based on our production proven dual chamber Master Oscillator Power Amplifier (“MOPA”) architecture. This light source replaces the traditional power amplifier with a regenerative ring amplifier, which results in improved stability and control during manufacturing, and a significant reduction in cost of operation for the chipmaker. We shipped the first XLR 500i to one of our lithography tool manufacturing customers in April 2007, and anticipate the adoption ramp for this product will begin in the second half of this year, and increase in the first half of 2008. We anticipate that the XLR 500i will become the light source of choice for 45nm production.

Demand for ArF immersion tools in the dynamic random access memory (“DRAM”) segment of the market is expected to grow this year as these manufacturers begin using the most advanced ArF tools in production before year-end. Immersion demand from integrated device manufacturers (“IDMs”) should become more significant next year. Additionally, the 65 nm production ramp is well underway, and a significant number of new fabs are expected to be in or entering production at that node by the end of 2007. Currently, there are significant research and development efforts underway at the 45 nm node, which is driving demand, and the first leading edge chipmakers are expected to begin production at 45 nm by the end of 2007.

Recently, many industry and market forecasters have been lowering their expectations for 2007. The FLASH segment of the market continues to experience significant price pressure and we anticipate a decrease in its investments in capacity expansion in the second half of this year. DRAM prices have been recently firming, and this has led to significant difficulty in forecasting investment allocation decisions between FLASH and DRAM capacity and absolute delivery timing requirements at memory manufacturers. However, memory manufacturers have not announced reductions in their overall strategic capital spending plans. DUV foundry utilization picked up in the first quarter of 2007, and industry analysts anticipate that they will begin to expand capacity and increase their spending as the year progresses. Some manufacturers in the logic segment of the industry are reducing spending, but we expect such spending reduction to be offset by other manufacturers who may spend more to continue their rapid CD shrink. Though we continue to believe that semiconductor capital spending this year will decrease slightly from 2006 spending levels, we expect the DUV lithography market to grow due to an increase in production of critical layers at the 65 nm node and development at the 45 nm node, and we believe that we are well-positioned to benefit from these trends. However, macro-economic factors, such as high energy prices and interest rates and a slower U.S. housing market, 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 in their spending. Either or both of these factors would have a negative effect on the demand for our products.

As we progress through 2007, we anticipate continuing to focus on better serving our customers, building a better company, and creating shareholder value. We continue on our path of technology leadership and innovation, and expect to introduce new, paradigm-shifting light sources in advance of market needs. We will continue our numerous efforts to add even higher levels of value for our customers and increase customer satisfaction, while pursuing our many initiatives to enhance overall operating efficiencies and improve financial performance and cash generation. In the first quarter of 2007, we generated \$27.1 million in cash from operations and on April 24, 2007, we announced that our Board of Directors authorized the repurchase of up to \$300 million of our common stock. We expect to continue generating substantial levels of cash from operations in 2007 and we will continue to explore opportunities for the most effective use of our cash.

## **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, 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, except as noted below, included in other revenue, and 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. These funded development contracts are not material to our operations.

#### *Accounting for 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 core assemblies from our customers, we record an entry to recognize the estimated fair value of the reusable components either 1) as revenue if the return of the core assembly relates to a spare part replacement sale or 2) as a reduction in cost of product sales if the return of the core assembly is related to a part being replaced under our warranty or per the terms of an active service contract with our customer. 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 reusable parts contained within these consumed core assemblies. We believe that our methodology for valuing the reusable parts within these returned core assemblies is reasonable, but any decreases in the demand for the parts or any changes in the yield of the reusable parts included in these core assemblies could have a material adverse effect on our financial condition and results of operations. In the first quarter of 2007, the amount by which the value of these core assemblies was affected by decreases in demand and changes in yields was immaterial.

#### *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 \$15.1 million and \$13.1 million at December 31, 2006 and March 31, 2007, respectively. The decrease in the inventory allowance at March 31, 2007 as compared to December 31, 2006 was primarily due to certain parts in inventory previously reserved that were either scrapped or sold during the first quarter of 2007 as well as changes to the 12 month demand for certain raw materials which resulted in lower reserve requirements during the quarter as compared to December 31, 2006. These were partially offset by a new vendor liability incurred during the first quarter of 2007 related to excess and obsolete inventory.

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;
- Utilization rates of our light sources at chipmakers; and
- Engineering change orders.

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, additional inventory allowances may be required, and may 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, 2006 and March 31, 2007 was \$29.5 million and \$30.2 million, respectively. This slight increase from period to period is primarily due to the higher level of consumables and spare parts sales in the first quarter of 2007 as compared to the fourth quarter of 2006 and the required warranty reserves for those sales and additional reserves which were recorded for specific parts on our XLA model light sources during the three months ended March 31, 2007. These increases to the warranty provision were partially offset by a lower number of light source systems being under warranty from period to period.

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 2005 Equity Incentive Plan. The benefits provided under this plan are share-based payments subject to the provisions of Statement of Financial Accounting Standards No. 123R (“SFAS No. 123R”), “Share-Based Payment”. SFAS No. 123R addresses 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 accounting requirement, our consolidated financial statements include compensation expense as calculated per the provisions of SFAS No.123R. We attribute the value of share-based compensation to expense using the straight-line method for awards granted after December 31, 2005. Compensation expense for awards outstanding and unvested 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, “Accounting for Stock-Based Compensation” 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 \$2.4 million and \$1.3 million before taxes for the three months ended March 31, 2006 and 2007, respectively.

We value our share-based payment awards using the Black-Scholes option pricing model. 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 the expected term of stock options and our expected stock price volatility over the expected term of the awards.

We determine 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 No. 123R and Staff Accounting Bulletin No. 107. Implied volatility is 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 is 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 determine 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 the most current 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 have revised this estimate in the past and will revise this estimate, as necessary, in subsequent periods if actual forfeiture rates differ from our current estimates.

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.

### *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 exceptions noted below, we believe that it is more likely than not that the results of future operations will generate sufficient taxable income to realize all of our deferred tax assets within the period covered by our model and, as such, no valuation allowance has been provided against these deferred tax assets. However, a valuation allowance has been provided against certain deferred tax assets related to TCZ’s business and our French branch operations in the total amount of \$1.3 million, as these businesses have not yet developed sufficiently to allow us to assert that these assets will ultimately be realized.

At March 31, 2007, we had federal tax credit carryforwards of \$11.7 million which begin to expire in 2018. At March 31, 2007, we had state tax credit carryforwards of \$14.2 million, which may be carried forward indefinitely. At March 31, 2007, we had foreign NOL carryforwards of \$2.6 million which may be carried forward indefinitely.

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.

It is our intention to reinvest undistributed earnings of our foreign subsidiaries and thereby indefinitely postpone their remittance, with the exception of our TCZ joint venture. Accordingly, we have not provided U.S. federal income and foreign withholding taxes on \$60.0 million of undistributed earnings from non-U.S. operations as of March 31, 2007. It is not practicable to estimate the amount of the deferred tax liability on such unremitted earnings.

## 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 March 31,	
	2006	2007
<b>Revenues:</b>		
Product sales	98.2%	99.5%
Product sales – related party	1.7	0.4
Other	0.1	0.1
<b>Total revenues</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Cost and expenses:</b>		
Cost of product sales	54.0	51.3
Research and development	14.3	15.2
Sales and marketing	5.4	5.5
General and administrative	7.2	7.0
<b>Total costs and expenses</b>	<b>80.9</b>	<b>79.0</b>
<b>Operating income</b>	<b>19.1</b>	<b>21.0</b>
<b>Other income – net</b>	<b>4.9</b>	<b>4.1</b>
<b>Income before income tax provision and minority interest</b>	<b>24.0</b>	<b>25.1</b>
Income tax provision	8.3	9.6
Minority interest	0.5	0.6
<b>Net income</b>	<b>16.2%</b>	<b>16.0%</b>
<b>Gross margin on product sales</b>	<b>45.9%</b>	<b>48.6%</b>

### *Three Months Ended March 31, 2006 and 2007*

*Revenues.* The following table summarizes certain measures and the components of our revenue (in thousands, except units sold):

	For the three months ended March 31,	
	2006	2007
<b>Light source systems:</b>		
Revenue	\$ 68,035	\$ 58,869
Units sold	70	51
Average selling price	\$ 972	\$ 1,154
<b>Consumable and spare parts and service products</b>		
	\$ 59,021	\$ 67,756
<b>Other revenue</b>	<b>\$ 61</b>	<b>\$ 89</b>
<b>Total revenue</b>	<b>\$ 127,117</b>	<b>\$ 126,714</b>

Product sales decreased slightly from \$127.1 million for the three months ended March 31, 2006 to \$126.6 million for the three months ended March 31, 2007. This decrease in product sales was due to a decline in light source system sales which was offset by an increase in consumable and spare parts and service product sales for the three months ended March 31, 2007 as compared to the three months ended March 31, 2006. Light source system revenues decreased 14% from \$68.0 million for the three months ended March 31, 2006 to \$58.9 million for the three months ended March 31, 2007. A total of 70 light



source systems were sold in the three months ended March 31, 2006 at an average selling price of \$972,000, compared to 51 light source systems sold in the three months ended March 31, 2007 at an average selling price of \$1.2 million. On a foreign currency adjusted basis, the average selling price for the three months ended March 31, 2006 was \$970,000 compared to \$1.2 million for the three months ended March 31, 2007. The increase in the average selling price from period to period reflects the shift in the product mix to higher priced technology buys of advanced ArF products which represented 80% of light source systems revenue for the three months ended March 31, 2007 as compared to only 59% of light source system revenue for the three months ended March 31, 2006. The decrease in quantities of light source systems sold from period to period was due to an unanticipated push out of light source systems deliveries from one of our direct customers from the first quarter of 2007 to the second half of 2007.

Growth in the installed base and steady utilization of our light source systems continues to increase demand for consumables and spare parts and service products. The increase in consumable and spare parts demand resulted in an increase in consumables and spare parts and service product revenue of 14% from \$59.0 million for the three months ended March 31, 2006 to \$67.8 million for the three months ended March 31, 2007. Revenues from funded development contracts were \$61,000 and \$89,000 for three months ended March 31, 2006 and 2007, respectively. There were no revenues recorded or earned associated with the TCZ joint venture for the three months ended March 31, 2006 or 2007.

For the period ended March 31, 2007, our backlog totaled \$83.4 million and total bookings were \$115.7 million which yielded a book-to-bill ratio of 0.91 compared to the period ended March 31, 2006, where our backlog was \$99.3 million and total bookings were \$135.6 million which yielded a book-to-bill ratio of 1.07. The decrease in our backlog and book to bill ratio primarily reflects operational efficiency improvements we have made over the last nine months which has resulted in lower lead times and product cycle times, particularly for our light source systems. As a result of these improvements, we are able to take an order for a light source system and ship it within the quarter for a higher percentage of our orders.

We installed 63 light sources at chipmakers and other end-users during the quarter ended March 31, 2006 as compared to 47 light sources installed during the quarter ended March 31, 2007.

Sales to our three lithography tool manufacturing customers, ASML, Canon, and Nikon, amounted to 35%, 8% and 17%, respectively, of total revenue for the three months ended March 31, 2006, and 38%, 6% and 14%, respectively, of total revenue for the three months ended March 31, 2007.

Our sales are generated primarily by shipments to customers in Europe, Japan, Korea, Taiwan, and the U.S. Approximately 83% and 86% of our sales for the three months ended March 31, 2006 and 2007, 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 24% and 20% of total revenues for the three months ended March 31, 2006 and 2007, 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, manufacturing and service overhead. Cost of product sales also includes 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 and are not charged to our customers.

The cost of product sales decreased 5% from \$68.7 million for the three months ended March 31, 2006 to \$65.1 million for the three months ended March 31, 2007. This decrease in cost of product sales was primarily due to lower light source system sales and a decrease in warranty costs for the three

months ended March 31, 2007 compared to the three months ended March 31, 2006. The gross margin on product sales was 46% for the three months ended March 31, 2006 as compared to 49% for the three months ended March 31, 2007. This higher gross margin from period to period was primarily due to increased factory yield and utilization, reduced product lead and cycle times and reduced warranty costs which resulted from our on-going product reliability improvements. We will continue to look for opportunities to enhance operating efficiencies and benefits from our on-going product cost reduction activities for the remainder of 2007.

*Research and Development.* Research and development expenses include costs of internally-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 7% from \$18.1 million for the three months ended March 31, 2006 to \$19.3 million for the three months ended March 31, 2007 due primarily to costs associated with our LTPS product development efforts and EUV light source development. 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 2007 is the design of an enhanced universal platform for our XL series light sources. As a percentage of total revenues, research and development expenses increased from 14.3% for the three months ended March 31, 2006 to 15.2% for the three months ended March 31, 2007. We expect that our investment in research and development will continue.

*Sales and Marketing.* Sales and marketing expenses include sales, marketing and customer support staff expenses and other marketing expenses. Sales and marketing expenses increased 2% from \$6.8 million for the three months ended March 31, 2006 to \$7.0 million for the three months ended March 31, 2007. The increase in sales and marketing expenses from period to period primarily reflects an increase in salaries, benefits, profit sharing and bonuses due to an increase in headcount partially offset by a decrease in stock-based compensation expense. As a percentage of total revenues, sales and marketing expenses increased from 5.4% for the three months ended March 31, 2006 compared to 5.5% for the three months ended March 31, 2007. We anticipate that sales and marketing expenses will remain flat or increase slightly in the second quarter of 2007.

*General and Administrative.* General and administrative expenses consist primarily of management and administrative personnel costs, professional services, including external audit and consultant fees, and administrative operating costs. General and administrative expenses decreased 4% from \$9.2 million for the three months ended March 31, 2006 to \$8.8 million for the three months ended March 31, 2007 primarily due to a \$634,000 decline in profit sharing and bonuses and a \$624,000 decline in stock-based compensation expense. These amounts were partially offset by \$795,000 in advisory fees associated with our adoption and implementation of FIN 48. As a percentage of total revenues, general and administrative expenses decreased slightly from 7.2% for the three months ended March 31, 2006 to 7.0% for the three months ended March 31, 2007. We anticipate that general and administrative expenses will remain relatively flat or increase slightly in the second quarter of 2007.

*Total Other Income - Net.* Net other income 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. Net other income totaled \$6.2 million and \$5.3 million for the three months ended March 31, 2006, and 2007, respectively. The decrease in net other income was primarily due to 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, which was partially offset by an increase in interest income of \$2.6 million period over period. The increase in interest income from the first quarter of 2006 to the first quarter of 2007 reflects higher market interest rate yields on larger cash and investment balances. In addition, net other income reflects a decrease in foreign currency exchange gains and an increase in interest and other expenses in the first quarter of 2007 compared to the first quarter of 2006. The increase in interest and other expenses primarily reflects the accretion of interest expenses associated with our long term incentive bonus plan. Foreign currency exchange gains totaled \$619,000, interest income and other income totaled \$7.0 million, and interest and other expense totaled \$1.4 million

for the three months ended March 31, 2006, compared to a foreign currency exchange gain of \$427,000, interest and other income of \$6.4 million, and interest and other expense of \$1.6 million for the three months ended March 31, 2007.

*Income Tax Provision.* The tax provision of \$10.6 million and \$12.2 million for the three months ended March 31, 2006 and 2007, respectively, reflects an annual effective rate of 34.6% and 38.4%, 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. The annual effective tax rate for the three months ended March 31, 2007 was greater than the U.S. statutory rate of 35% primarily as a result of permanent book/tax differences and the effect of foreign earnings taxed at higher rates. The effective tax rate is a function of current tax law and geographic location of pre-tax income.

## **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 March 31, 2007, we had approximately \$327.8 million in cash and cash equivalents, \$193.3 million in short-term investments, \$22.1 million in long-term investments, and \$715.0 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 \$49.2 million and \$60.0 million principal amount of these notes in 2004 and 2005, respectively. As of March 31, 2007, there were \$140.7 million principal amount of notes outstanding.

Net cash provided by operating activities was approximately \$869,000 and \$27.1 million for the three months ended March 31, 2006 and 2007, respectively. Although net income for the three months ended March 31, 2007 was slightly lower than the same period in 2006, cash provided by operating activities was much higher in the first three months of 2007 as compared to the first three months of 2006. Net cash provided by operating activities for the three months ended March 31, 2006 primarily reflects net income for the period and increases in accounts payable and accrued and other liabilities which were almost completely offset by increases in accounts receivable and increases in inventories during the period. The increases in accounts receivable were due to back-end loaded shipments during the quarter and increases in inventory were due to front-end loaded inventory levels. Net cash used in operating activities for the three months ended March 31, 2007 primarily reflects net income for the period, a decrease in accounts receivable balances and increases in inventories and accrued and other liabilities. The decrease in accounts receivable was primarily due to collection efforts during the period and the increase in inventories was primarily due to the unanticipated push out of light source system deliveries from one of our direct customers from the first quarter of 2007 to the second half of 2007.

Net cash used in investing activities was approximately \$31.6 million and \$3.0 million for the three months ended March 31, 2006 and 2007, respectively. Net cash used in investing activities for the three months ended March 31, 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 and the acquisition of \$3.7 million of property and equipment. Net cash used in investing activities during the three months ended March 31, 2007 reflects the timing of short-term and long-term investments that matured and were reinvested during the period, and the acquisition of \$4.1 million of property and equipment.

Net cash provided by financing activities was approximately \$64.2 million and \$1.6 million for the three months ended March 31, 2006 and 2007, respectively. Net cash provided by financing activities for the three months ended March 31, 2006 reflects the proceeds received from the exercise of employee stock options totaling \$54.1 million and excess tax benefits for the period from stock options exercises totaling \$10.2 million. Net cash provided by financing activities for the three months ended March 31, 2007 reflects the proceeds received from the exercise of employee stock options totaling \$1.3 million and the excess tax benefits for the period from stock options exercises totaling \$313,000.

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.

#### **OFF BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS**

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.

We have no significant contractual obligations that are not recorded on our consolidated financial statements or fully disclosed in the notes thereto.

#### **SUBSEQUENT EVENT**

On April 24, 2007, we announced that our board of directors authorized us to repurchase up to \$300 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 May 4, 2007 were \$54.9 million or 1,334,500 shares under this program.

#### **RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the 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 using generally accepted accounting principles, 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, FASB issued SFAS 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)”. We adopted all provisions of SFAS No. 158 in December 2006 except for the provision which will require us to measure the funded status of our pension plans as of the date of our year-end statement of financial position. This provision will be effective for us for the fiscal year ending

December 31, 2008, and we do not expect its adoption to have a material impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159 (“SFAS No. 159”), “The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115”. This statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in net income. This statement also establishes presentation and disclosure requirements to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact of SFAS 159 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 risk 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 March 31, 2007, we had outstanding forward contracts to buy U.S. \$38.0 million for 5.1 billion yen under foreign currency exchange facilities with contract rates ranging from 113.87 yen to 119.46 yen per U.S. dollar. These contracts expire on various dates through December 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 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 \$55,000 and \$23,000 respectively, as of March 31, 2007.

The fair value of these forward contracts as of March 31, 2007 would have fluctuated by \$3.4 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. A change in market interest rates of 1% would have impacted our net income from these investments by approximately \$675,000 for the three months ended March 31, 2007.

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. As of February 21, 2005, we may redeem the notes 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, \$49.2 million and \$60.0 million principal amount, respectively, of these notes. As of March 31, 2007, \$140.7 million principal amount of the notes were outstanding. The fair value of such debt based on quoted market prices on March 31, 2007 was \$145.1 million.

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

*Evaluation of disclosure controls and procedures.* For the first quarter of 2007, 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 March 31, 2007, 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 annual report on Form 10-K for the year ended December 31, 2006, more specifically those policies and procedures which were not designed to include adequate management review of various income tax calculations, reconciliations and related supporting documentation to ensure that our accounting for income taxes was in accordance with generally accepted accounting principles. These deficiencies resulted in material errors in our consolidated tax provision for our year ended December 31, 2006. Such errors were corrected prior to the issuance of our consolidated financial statements at and for the year ended December 31, 2006. 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 annual report on Form 10-K for the year ended December 31, 2006, we have developed and started to implement 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 March 31, 2007 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 disclosed by us in our annual report on Form 10-K for the year ended December 31, 2006, relating to our accounting for income taxes.

As described in Part II, Item 9A of our annual report on Form 10-K for the year ended December 31, 2006, we have identified several steps we will take throughout 2007 with the goal of remediating this material weakness prior to December 31, 2007. Per our remediation plan, we made the following improvements in our internal controls over our accounting for income taxes for the three months ended March 31, 2007:

- Improved the communications between our tax department and our accounting department, and increased the level of involvement of our accounting department in the reviews of income tax reconciliations;
- Redesigned and implemented new review and approval procedures and processes associated with all income tax provision workpapers and the consolidated income tax reconciliation schedules; and
- Identified and started the implementation of an automated tax provision software tool that will reduce the number of manual spreadsheets that we use to calculate and reconcile all income tax accounts on a quarterly and annual basis.

We have additional steps in our remediation plan from those identified above that we intend to implement within the next two quarters and we will report our progress with this remediation plan in future quarterly reports on Form 10-Q. As each of the steps in our remediation plan are completed and

implemented, we plan to test the internal control changes immediately to ensure that they are properly designed and working effectively and will make any changes that management deems necessary based on the results of this testing.

## 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, 2006. 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;
- cyclicity in the market for semiconductor manufacturing equipment;
- rates at which chipmakers take delivery of photolithography tools from lithography tool manufacturers;
- rates at which lithography tool manufacturer customers take delivery of light source systems from us;
- timing and size of orders from our customers;
- changes in market penetration by our competitor;
- product lead time demands from our customers;
- 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 customer satisfaction, product reliability, and direct field service and support effectiveness;
- our ability to manage our manufacturing requirements;
- 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, operating income, net income, earnings per share, and cash flows. 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 lithography tool manufacturers who, as original equipment manufacturers ("OEMs"), 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 in support of the light source products. 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 cyclical nature 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 maintain the longer term strategies of the company as well as 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. Downturns in the semiconductor industry have generally had severe effects on the demand for semiconductor manufacturing equipment and the associated parts and support services. 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, ASML, 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:

	<b>Three months ended</b>	
	<b>March 31,</b>	
	<b>2006</b>	<b>2007</b>
ASML	35%	38%
Canon	8%	6%
Nikon	17%	14%
<b>Total</b>	<b>60%</b>	<b>58%</b>

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

	<b>December 31,</b>	<b>March 31,</b>
	<b>2006</b>	<b>2007</b>
ASML	48%	45%
Cano	3%	4%
Nikon	19%	18%
<b>Total</b>	<b>70%</b>	<b>67%</b>

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. Sales to 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.

At varying degrees, 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, especially new ArF immersion-specific resists;
- potential shortages of specialized materials used in DUV optics;
- productivity of ArF immersion lithography tools, and in the future, productivity of double-patterning ArF lithography 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. There are risks inherent in 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 65 nm, and a growing number of manufacturers of certain types of memory chips are in production at 55 nm and below, and are expected to be in production at 45 nm by the end of 2007. Additionally, other types of chipmakers have a significant level of development underway at 45 nm. These efforts, along with expanding use of ArF immersion lithography in production among certain memory manufacturers, 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, nano-imprint lithography, and certain maskless lithography techniques 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 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.

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.

**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 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 provide no assurance 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.

**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 March 31, 2007, we owned 265 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 March 31, 2007, we had applied for 134 additional patents in the U.S. As of March 31, 2007, we owned 404 foreign patents and had 382 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 notified us in 1996 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 agreed 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 to us; 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;
- costs associated with acquisitions and joint ventures and the integration of acquired operations;
- costs 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 entry into 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, new 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 evaluation 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.

**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 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 and restricted stock unit compensation arrangements for our employees to replace the majority of these stock option program. 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 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 of or support for 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.

**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.

**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.

**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 which would be costly to defend. If a trademark infringement action were successful, we would have to stop using one or more of the marks and possibly pay damages.

**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**

None.

**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 Amended and Restated Employment Agreement, effective as of January 2, 2007, by and between Rae Ann Werner and Cymer.
- 10.2 Summary description of Cymer, Inc. Short-Term Incentive Bonus Plan, as amended (incorporated herein by reference to Exhibit 99.1 to Cymer's Current Report on Form 8-K filed on April 20, 2007).
- 10.3 Summary description of Cymer, Inc. Long-Term Incentive Bonus Plan for 2007, as amended (incorporated herein by reference to Exhibit 99.2 to Cymer's Current Report on Form 8-K filed on April 20, 2007).
- 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.

## 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: May 8, 2007

By: /s/ Nancy J. Baker

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

**AMENDED AND RESTATED EMPLOYMENT AGREEMENT**

**THIS AMENDED AND RESTATED EMPLOYMENT AGREEMENT** (the “*Agreement*”) is made and entered into effective as of January 2, 2007 (“*Effective Date*”) by and between **CYMER, INC.**, a Nevada corporation (the “*Company*”) and the Company’s **Vice President, Controller and Chief Accounting Officer, RAE ANN WERNER** (the “*Employee*”). This Agreement shall replace and supersede that certain Employment Agreement between Employee and the Company entered into effective as of **May 1, 2003** (the “*Original Employment Agreement*”).

**RECITALS**

A. The Company and Employee previously entered into the Original Employment Agreement and desire to amend and restate the Original Employment Agreement in its entirety as set forth herein, effective as of the Effective Date.

B. The Company may from time to time need to address the possibility of an acquisition transaction or change of control event. The Board of Directors of the Company (the “*Board*”) recognizes that such events can be a distraction to the Employee and can cause the Employee to consider alternative employment opportunities. The Board has determined that it is in the best interests of the Company and its stockholders to assure that the Company will have the continued dedication and objectivity of the Employee, notwithstanding the possibility, threat or occurrence of a Change of Control (as defined below) of the Company, although no such Change of Control is now contemplated.

C. The Board believes that it is in the best interests of the Company and its stockholders to provide the Employee with an incentive to continue the Employee’s employment and to motivate the Employee to maximize the value of the Company upon a Change of Control for the benefit of its stockholders.

D. The Board believes that it is imperative to provide the Employee with certain benefits upon a Change of Control and, under certain circumstances, upon termination of the Employee’s employment in connection with a Change of Control, which benefits are intended to provide the Employee with financial security and provide sufficient incentive and encouragement to the Employee to remain with the Company notwithstanding the possibility of a Change of Control.

E. To accomplish the foregoing objectives, the Board has directed the Company, upon execution of this Agreement by the Employee, to agree to the terms provided herein.

F. Certain capitalized terms used in this Agreement are defined in Section 7 below.

**AGREEMENT**

In consideration of the mutual covenants herein contained, and in consideration of the continuing employment of the Employee by the Company, the parties agree as follows:

- 1. Duties and Scope of Employment.** The Company shall employ the Employee in the position of **Vice President, Controller and Chief Accounting Officer** as such position has been defined in terms of responsibilities and compensation as of the Effective Date of this Agreement; *provided, however*, that the Board shall have the right, at any time prior to the occurrence of a Change of Control, to revise such responsibilities and compensation as the Board in its discretion may deem necessary or appropriate. The Employee shall comply with and be bound by the Company's operating policies, procedures and practices from time to time in effect during the Employee's employment. During the term of the Employee's employment with the Company, the Employee shall continue to devote the Employee's full time, skill and attention to the Employee's duties and responsibilities, and shall perform them faithfully, diligently and competently, and the Employee shall use the Employee's best efforts to further the business of the Company and its affiliated entities.
- 2. Base Compensation.** The Company shall pay the Employee as compensation for the Employee's services a base salary, which as the Effective Date of this Agreement is at the annualized rate of **\$240,394.18** (and which may be modified from time to time in accordance with this Agreement, the "**Base Compensation**"). The Base Compensation shall be paid periodically in accordance with normal Company payroll practices. The Board or the Compensation Committee of the Board shall review the Base Compensation according to normal Company practice, but no less frequently than annually, and may in its discretion modify the Base Compensation but may not decrease the Base Compensation below the dollar amount specified above, unless Employee consents to such reduction.
- 3. Incentive Compensation.** During the term of this Agreement, the Employee shall be eligible to receive payments under the Company's various incentive and bonus programs as approved from time to time by the Board or the Compensation Committee of the Board in either's sole discretion. Any payment payable thereunder shall be payable in accordance with the applicable program and the Company's normal practices and policies.
- 4. Employee Benefits.** The Employee shall be eligible to participate in the employee benefit plans and executive compensation programs maintained by the Company applicable to other key executives of the Company, including (without limitation) retirement plans, savings or profit-sharing plans, stock option, stock purchase or other equity plans, incentive bonus program, 3-year bonus program or other long-term incentive programs, bonus programs, life, disability, health, accident and other insurance programs, paid vacations, and similar plans or programs, subject in each case to the generally applicable terms and conditions of the applicable plan or program in question and to the sole determination of the Board or any committee administering such plan or program.
- 5. Employment Relationship.** The Company and the Employee acknowledge that the Employee's employment is and shall continue to be at-will, as defined under applicable law. If the Employee's employment terminates for any reason, the Employee shall not be entitled to any payments, benefits, damages, awards or compensation other than as provided by this Agreement, or as may otherwise be available in accordance with any Company plan or policy approved by the Board.

## 6. Termination Benefits.

(a) Subject to Sections 8 and 9 below, in the event the Employee's employment terminates as a result of an Involuntary Termination other than for Cause upon or within eighteen (18) months after a Change of Control, then the Employee shall be entitled to receive severance and other benefits pursuant to this Section 6. Notwithstanding the foregoing, Employee shall not be entitled to receive any severance or other benefits pursuant to this Section 6 if the Board, as constituted prior to the Change in Control, determined that Employee was demoted by the Company to a position not eligible for an Employment Agreement prior to the Change of Control from the position held by Employee as of the Effective Date. The foregoing determination may be made at any time by the Board prior to a Change in Control, shall be made in the Board's sole discretion, and shall be binding and conclusive on all persons, including Employee.

(i) **Pay Continuation.** The Employee shall be entitled to monthly payments equal to (A) one-twelfth (1/12) of the greater of the Base Compensation in effect immediately prior to the Change of Control and the Base Compensation in effect immediately prior to such termination plus (B) one-thirty-sixth (1/36) of the aggregate amounts paid to the Employee under the Company's bonus and incentive programs with respect to the three previous calendar years. Such monthly payments shall be paid according to the normal payroll practice of the Company for **12** months following the date of termination (the "**Termination Period**").

### (ii) Incentive Payments.

(1) The Employee shall be entitled to receive a percentage of each of the Employee's Target Incentives for any on-going calendar period in which such termination occurs. Such percentage shall equal a fraction, the numerator of which shall be the number of days in such calendar period up to and including the date of such termination and the denominator of which shall be the number of days in such calendar period. Such amount shall be payable according to the normal practice of the Company with respect to the payment of such compensation. "Target Incentive" shall mean the maximum amount payable to the Employee at the end of a calendar period under any Company bonus or incentive program if all of such program's corporate and individual performance objectives for that period are met. "Target Incentive" does not include amounts payable under the Company's 3-year bonus program.

(2) The unvested portion of any bonus accrued for Employee under the Company's 3-year bonus program shall vest and become payable in full in a lump sum as soon as administratively practicable following the date of termination.

(iii) **Equity Awards.** The unvested portion of any stock option(s) or other equity award(s) held by the Employee under the Company's equity plans shall vest and become exercisable in full upon the date of such termination. The Employee shall be entitled to exercise all of the Employee's vested stock options until the later of (A) the original post-termination exercise period provided in the Employee's stock option agreement or (B) one year from the date of such termination (but not beyond the original contractual life of the option); *provided, however*, that notwithstanding the foregoing, with respect to each stock option granted to the Employee before the Effective Date of this Agreement, such stock option shall not remain exercisable beyond the later of the fifteenth (15th) day of the third (3rd) month following the date at which, or December 31 of the calendar year in which, the stock option would otherwise have expired if the stock option had not been extended, based on the terms of the stock option at

the original grant date, or such later date that would not cause such option to be treated as deferred compensation under 409A of the Code (as defined below).

(iv) **Medical Benefits.** Assuming the Employee timely and accurately elects to continue his health insurance benefits under the Consolidated Omnibus Budget Reconciliation Act of 1985 (“COBRA”), the Company shall pay the COBRA premiums for the Employee **[and his or her qualified beneficiaries]** until the earliest of (i) the end of the Termination Period, (ii) the expiration of the Employee’s continuation coverage under COBRA and any applicable state COBRA-like statute that provides mandated continuation coverage or (iii) the date the Employee becomes eligible for health insurance benefits of a subsequent employer.

(b) In the event the Employee voluntarily resigns employment with the Company within the 30-day period beginning one year after a Change of Control, the Employee shall receive the severance and other benefits set forth in Sections 6(a)(i)-(iv) above.

7. **Definition of Terms.** The following terms referred to in this Agreement shall have the following meanings:

(a) **Cause.** “Cause” shall mean any of the following: (i) any act of personal dishonesty taken by the Employee in connection with the Employee’s responsibilities as an employee and intended to result in substantial personal enrichment of the Employee, (ii) conviction of a felony that is injurious to the Company, (iii) a willful act by the Employee which constitutes gross misconduct and which is injurious to the Company, or (iv) continued violations by the Employee of the Employee’s obligations under Section 1 of this Agreement after there has been delivered to the Employee a written demand for performance from the Company which describes the basis for the Company’s belief that the Employee has not substantially performed the Employee’s duties.

(b) **Change of Control.** “Change of Control” shall mean the occurrence of any of the following events:

(i) The acquisition by any “person” (as such term is used in Sections 13(d) and 14(d) of the Exchange Act) (other than the Company or a person that directly or indirectly is controlled by the Company) of the “beneficial ownership” (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing fifty percent (50%) or more of the total voting power represented by the Company’s then outstanding voting securities; or

(ii) A change in the composition of the Board occurring within a two-year period, as a result of which fewer than a majority of the directors are Incumbent Directors. “Incumbent Directors” shall mean directors who either (A) are directors of the Company as of the date hereof, or (B) are elected to the Board with the affirmative votes of at least a majority of the Incumbent Directors at the time of such election or (C) are nominated for election to the Board by a committee of the Board, at least a majority of whose members are Incumbent Directors at the time of such nomination (but in each case shall not include an individual not otherwise an Incumbent Director whose election or nomination is in connection with an actual or threatened proxy contest relating to the election of directors to the Company); or

(iii) A merger or consolidation of the Company with any other corporation, other than a merger or consolidation which would result in the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) at least fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation.

(c) **Disability.** “Disability” shall mean that the Employee has been unable to substantially perform the Employee’s duties under this Agreement as the result of the Employee’s incapacity due to physical or mental illness, and such inability, at least 26 weeks after its commencement, is determined to be total and permanent by a physician selected by the Company or its insurers; and acceptable to the Employee or the Employee’s legal representative (such agreement as to acceptability not to be unreasonably withheld).

(d) **Exchange Act.** “Exchange Act” shall mean the Securities Exchange Act of 1934, as amended.

(e) **Involuntary Termination.** “Involuntary Termination” shall mean (i) without the Employee’s express written consent, the significant reduction of the Employee’s duties or responsibilities relative to the Employee’s duties or responsibilities in effect immediately prior to such reduction; *provided, however*, that a reduction in duties or responsibilities solely by virtue of the Company being acquired and made part of a larger entity (as, for example, when the Chief Financial Officer of Company remains as such following a Change of Control and is not made the Chief Financial Officer of the acquiring corporation) shall not constitute an “Involuntary Termination”; (ii) without the Employee’s express written consent, a substantial reduction, without good business reasons, of the facilities and perquisites (including office space and location) available to the Employee immediately prior to such reduction; (iii) without the Employee’s express written consent, a material reduction by the Company in the Base Compensation or any Target Incentive of the Employee as in effect immediately prior to such reduction, or the ineligibility of the Employee to continue to participate in any long-term incentive plan of the Company; (iv) a material reduction by the Company in the kind or level of employee benefits to which the Employee is entitled immediately prior to such reduction with the result that the Employee’s overall benefits package is significantly reduced; (v) the relocation of the Employee to a facility or a location more than fifty (50) miles from the Employee’s then present location, without the Employee’s express written consent; (vi) any purported termination of the Employee by the Company which is not effected for death or Disability or for Cause; or (vii) the failure of the Company to obtain the assumption of this Agreement by any Successors contemplated in Section 10 below.

## 8. Limitation on Payments.

(a) In the event that the severance and other benefits provided for in this Agreement or otherwise payable to the Employee (i) constitute “parachute payments” within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the “Code”) and (ii) but for this Section 8 would be subject to the excise tax imposed by Section 4999 of the Code, then the Employee’s termination benefits under Section 6 shall be payable either (i) in full, or (ii) as to such lesser amount which would result in no portion of such termination benefits being subject to

excise tax under Section 4999 of the Code, whichever of the foregoing amounts, taking into account the applicable federal, state and local income taxes and the excise tax imposed by Section 4999, results in the receipt by the Employee on an after-tax basis, of the greatest amount of termination benefits under this Agreement, notwithstanding that all or some portion of such termination benefits may be taxable under Section 4999 of the Code.

**(b)** If a reduction in the payments and benefits that would otherwise be paid or provided to the Employee under the terms of this Agreement is necessary to comply with the provisions of Section 8(a), the Employee shall be entitled to select which payments or benefits will be reduced and the manner and method of any such reduction of such payments or benefits (including but not limited to the number of options that would vest under Section 6(a)(iii)) subject to reasonable limitations (including, for example, express provisions under the Company's benefit plans) so long as the requirements of Section 8(a) are met. Within thirty (30) days after the amount of any required reduction in payments and benefits is finally determined in accordance with the provisions of Section 8(c), the Employee shall notify the Company in writing regarding which payments or benefits are to be reduced. If no notification is given by the Employee, the Company will determine which amounts to reduce. If, as a result of any reduction required by Section 8(a), amounts previously paid to the Employee exceed the amount to which the Employee is entitled, the Employee will promptly return the excess amount to the Company.

**(c)** Any determination required under this Section 8 shall be made in writing by a nationally recognized accounting or consulting firm appointed by the Company, which firm shall not then be serving as accountant or auditor for or consultant to the Company or the person or entity that effected the Change in Control and whose determinations shall be conclusive and binding upon the Employee and the Company for all purposes. For purposes of making the calculations required by this Section 8, such firm may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of Sections 280G and 4999 of the Code. The Company and the Employee shall furnish to such firm such information and documents as such firm may reasonably request in order to make a determination under this Section 8. The Company shall bear all costs such firm may reasonably incur in connection with any calculations contemplated by this Section 8.

**9. Application of Code Section 409A.** If the Company determines that any termination benefit provided in Section 6 fails to satisfy the distribution requirement of Section 409A(a)(2)(A) of the Code as a result of Section 409A(a)(2)(B)(i) of the Code, the payment of such benefit shall be accelerated to the minimum extent necessary so that the benefit is not subject to the provisions of Section 409A(a)(1) of the Code. (It is the intention of the preceding sentence to apply the short-term deferral provisions of Section 409A of the Code, and the regulations and other guidance thereunder, to the termination benefits, and the payment schedule as revised after the application of the preceding sentence shall be referred to as the "Revised Payment Schedule.") If there is no Revised Payment Schedule that would avoid the application of Section 409A(a)(1) of the Code, the payment of such benefits shall not be paid pursuant to a Revised Payment Schedule and instead shall be delayed to the minimum extent necessary so that such benefits are not subject to the provisions of Section 409A(a)(1) of the Code (*e.g.*, payments to which Employee would otherwise be entitled during the first six months following separation from service shall accumulate and be paid at the expiration of such period,

unless a permitted distribution event occurs during such period). The Board or the Compensation Committee of the Board may attach conditions to or adjust the amounts paid pursuant to this Section 9 to preserve, as closely as possible, the economic consequences that would have applied in the absence of this Section 9; *provided, however*, that no such condition or adjustment shall result in the payments being subject to Section 409A(a)(1) of the Code.

#### **10. Successors.**

**(a) Company's Successors.** Any successor to the Company (whether direct or indirect and whether by purchase, lease, merger, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and assets shall assume the obligations under this Agreement and agree expressly to perform the obligations under this Agreement in the same manner and to the same extent as the Company would be required to perform such obligations in the absence of a succession. For all purposes under this Agreement, the term "Company" shall include any Successor to the Company's business and assets which executes and delivers the assumption agreement described in this Section 10(a) or which becomes bound by the terms of this Agreement by operation of law.

**(b) Employee's Successors.** The terms of this Agreement and all rights of the Employee hereunder shall inure to the benefit of, and be enforceable by, the Employee's personal or legal representatives, executors, administrators, successors, heirs, devisees and legatees.

**11. Notice.** Notices and all other communications contemplated by this Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or when mailed by U.S. registered or certified mail, return receipt requested and postage prepaid. In the case of the Employee, mailed notices shall be addressed to him at the home address which he most recently communicated to the Company in writing. In the case of the Company, mailed notices shall be addressed to its corporate headquarters, and all notices shall be directed to the attention of its Secretary.

#### **12. Miscellaneous Provisions.**

**(a) Waiver.** No provision of this Agreement shall be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by the Employee and by an authorized officer of the Company (other than the Employee). No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party shall be considered a waiver of any other condition or provision or of the same condition or provision at another time.

**(b) Whole Agreement.** No agreements, representations or understandings (whether oral or written and whether express or implied) which are not expressly set forth in this Agreement have been made or entered into by either party with respect to the subject matter hereof. This Agreement represents the Company's and the Employee's entire understanding with respect to the subject matter contained herein and supersedes all previous understandings, written or oral between the Company and the Employee concerning the subject matters of this Agreement, including but not limited to the Original Employment Agreement.

(c) **Choice of Law.** The validity, interpretation, construction and performance of this Agreement shall be governed by the laws of the State of California.

(d) **Severability.** The invalidity or unenforceability of any provision or provisions of this Agreement shall not affect the validity or enforceability of any other provision hereof, which shall remain in full force and effect.

(e) **Arbitration.** Any dispute or controversy arising out of, relating to or in connection with this Agreement shall be settled exclusively by binding arbitration in San Diego, California, in accordance with the National Rules for the Resolution of Employment Disputes of the American Arbitration Association then in effect. Judgment may be entered on the arbitrator's award in any court having jurisdiction. The arbitrator shall: (i) have the authority to compel adequate discovery for the resolution of the dispute and to award such relief as would otherwise be permitted by law; and (ii) issue a written arbitration decision including the arbitrator's essential findings and conclusions and a statement of the award. Both the Employee and the Company shall be entitled to all rights and remedies they would have in a court of law. The Company shall pay all fees in excess of those which will be required if the dispute were decided in a court of law.

(f) **No Assignment of Benefits.** The rights of any person to payments or benefits under this Agreement shall not be made subject to option or assignment, either by voluntary or involuntary assignment or by operation of law, including (without limitation) bankruptcy, garnishment, attachment or other creditor's process, and any action in violation of this Section 12(f) shall be void.

(g) **Assignment by Company.** The Company may assign its rights under this Agreement to an affiliate, and an affiliate may assign its rights under this Agreement to another affiliate of the Company or to the Company; *provided, however*, that no assignment shall be made if the net worth of the assignee is less than the net worth of the Company at the time of assignment. In the case of any such assignment, the term "Company" when used in a section of this Agreement shall mean the corporation that actually employs the Employee.

(h) **Counterparts.** This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together will constitute one and the same instrument.

[REMAINDER OF THIS PAGE INTENTIONALLY LEFT BLANK]

**IN WITNESS WHEREOF**, each of the parties has executed this Agreement, in the case of the Company by its duly authorized officer, as of the day and year first above written.

**Company:**

**Cymer, Inc.**

By: /s/ Robert P. Akins

Title: CEO.

Date: April 19, 2007

**Employee:**

/s/ Rae Ann Werner

**Rae Ann Werner**

Date: April 19, 2007

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CERTIFICATION

I, Robert P. Akins, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the fiscal quarter ended March 31, 2007 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 (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (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: May 8, 2007

/s/ Robert P. Akins  
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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 for the fiscal quarter ended March 31, 2007 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 (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (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: May 8, 2007

/s/ Nancy J. Baker

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Nancy J. Baker  
Sr. Vice President, Chief Financial Officer

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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), 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 quarterly report on Form 10-Q for the period ended March 31, 2007, 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 8th day of May, 2007.

/s/ Robert P. Akins

Robert P. Akins, Chief Executive Officer

This certification accompanies the quarterly report on 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 quarterly report on Form 10-Q to which it relates), 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 quarterly report on Form 10-Q for the period ended March 31, 2007, 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 8th day of May, 2007.

/s/Nancy J. Baker

Nancy J. Baker, Chief Financial Officer

This certification accompanies the quarterly report on 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 quarterly report on Form 10-Q to which it relates), irrespective of any general incorporation language contained in such filing.

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