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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2007

OR

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

For the transition period from _____ to _____

Commission file number: 000-24838

mattson
Mattson Technology, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation or organization)

77-0208119
(I.R.S. Employer
Identification Number)

47131 Bayside Parkway, Fremont, California 94538
(Address of principal executive offices, zip code)

(510) 657-5900
(Registrant's telephone number, including area code)

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.
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

Number of shares of common stock outstanding as of October 26, 2007: 51,076,751.

MATTSON TECHNOLOGY, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

**MATTSON TECHNOLOGY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS**
(unaudited, in thousands, except par value)

	<u>September 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 124,875	\$ 91,416
Short-term investments.....	41,279	47,469
Accounts receivable, net.....	44,826	55,957
Advance billings.....	3,931	10,463
Inventories.....	39,007	40,532
Inventories - delivered systems.....	-	1,879
Prepaid expenses and other current assets.....	10,749	11,109
Total current assets.....	<u>264,667</u>	<u>258,825</u>
Property and equipment, net.....	29,029	27,838
Goodwill.....	17,182	18,497
Intangibles, net.....	7,208	7,591
Other assets.....	9,368	4,001
Total assets.....	<u>\$ 327,454</u>	<u>\$ 316,752</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable.....	\$ 19,571	\$ 19,330
Accrued liabilities.....	30,637	37,635
Deferred revenue.....	11,858	16,782
Total current liabilities.....	<u>62,066</u>	<u>73,747</u>
Income taxes payable, noncurrent.....	13,709	3,675
Other liabilities.....	1,354	400
Total liabilities.....	<u>77,129</u>	<u>77,822</u>
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, 2,000 shares authorized; none issued and outstanding.....	-	-
Common stock, par value \$0.001, 120,000 authorized shares; 53,455 shares issued and 51,075 shares outstanding in 2007; 52,930 shares issued and 52,555 shares outstanding in 2006.....	53	53
Additional paid-in capital.....	622,191	616,827
Accumulated other comprehensive income.....	17,807	13,525
Treasury stock, 2,380 shares in 2007 and 375 shares in 2006, at cost.....	(22,987)	(2,987)
Accumulated deficit.....	<u>(366,739)</u>	<u>(388,488)</u>
Total stockholders' equity.....	<u>250,325</u>	<u>238,930</u>
Total liabilities and stockholders' equity.....	<u>\$ 327,454</u>	<u>\$ 316,752</u>

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

MATTSON TECHNOLOGY, INC.
CONDENSED CONSOLIDATED INCOME STATEMENTS
(unaudited, in thousands, except per share amounts)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2007</u>	<u>October 1, 2006</u>	<u>September 30, 2007</u>	<u>October 1, 2006</u>
Net sales.....	\$ 58,480	\$ 76,460	\$ 214,965	\$ 198,177
Cost of sales.....	32,800	50,193	116,422	121,473
Gross profit.....	<u>25,680</u>	<u>26,267</u>	<u>98,543</u>	<u>76,704</u>
Operating expenses:				
Research, development and engineering.....	8,099	7,265	26,103	20,563
Selling, general and administrative.....	15,924	15,936	48,993	45,760
Amortization of intangibles.....	128	172	383	516
Gain on disposition of Wet business.....	-	(572)	-	(572)
Total operating expenses.....	<u>24,151</u>	<u>22,801</u>	<u>75,479</u>	<u>66,267</u>
Income from operations.....	1,529	3,466	23,064	10,437
Interest income.....	1,984	1,480	5,354	3,946
Interest expense.....	(30)	(71)	(74)	(156)
Other income (expense), net.....	(285)	164	1,014	441
Income before income taxes.....	<u>3,198</u>	<u>5,039</u>	<u>29,358</u>	<u>14,668</u>
Provision for (benefit from) income taxes.....	<u>(374)</u>	<u>452</u>	<u>6,588</u>	<u>1,236</u>
Net income.....	<u>\$ 3,572</u>	<u>\$ 4,587</u>	<u>\$ 22,770</u>	<u>\$ 13,432</u>
Net income per share:				
Basic.....	\$ 0.07	\$ 0.09	\$ 0.44	\$ 0.26
Diluted.....	\$ 0.07	\$ 0.09	\$ 0.43	\$ 0.25
Shares used in computing net income per share:				
Basic.....	51,397	52,402	52,163	52,309
Diluted.....	52,430	53,128	53,194	53,367

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

MATTSON TECHNOLOGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Nine Months Ended	
	September 30, 2007	October 1, 2006
Cash flows from operating activities:		
Net income.....	\$ 22,770	\$ 13,432
Adjustments to reconcile net income to net cash provided by operating activities:		
Allowance for doubtful accounts.....	(1,384)	386
Amortization of intangibles.....	383	516
Depreciation	4,743	4,432
Gain on disposition of Wet business.....	-	(572)
Inventory valuation charge.....	378	1,722
Stock-based compensation.....	2,949	1,586
Other non-cash items.....	195	(103)
Changes in assets and liabilities:		
Accounts receivable.....	12,691	(22,338)
Advance billings.....	6,532	1,880
Inventories.....	2,843	(14,375)
Inventories - delivered systems.....	1,879	2,517
Prepaid expenses and other current assets.....	623	3,331
Other assets.....	(263)	(605)
Accounts payable.....	(530)	6,257
Accrued liabilities.....	(6,627)	8,290
Deferred revenue.....	(4,924)	475
Other liabilities.....	4,799	293
Net cash provided by operating activities.....	<u>47,057</u>	<u>7,124</u>
Cash flows from investing activities:		
Purchases of available-for-sale investments.....	(35,910)	(48,292)
Sales and maturities of available-for-sale investments.....	42,638	12,746
Purchases of property and equipment.....	(6,483)	(9,327)
Sales of property and equipment.....	474	283
Net cash provided by (used in) investing activities.....	<u>719</u>	<u>(44,590)</u>
Cash flows from financing activities:		
Proceeds from stock plans.....	2,415	2,861
Purchases of treasury stock.....	(20,000)	-
Net cash provided by (used in) financing activities.....	<u>(17,585)</u>	<u>2,861</u>
Effect of exchange rate changes on cash and cash equivalents.....	3,268	2,097
Net increase (decrease) in cash and cash equivalents.....	<u>33,459</u>	<u>(32,508)</u>
Cash and cash equivalents, beginning of period.....	91,416	116,593
Cash and cash equivalents, end of period.....	<u>\$ 124,875</u>	<u>\$ 84,085</u>

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

MATTSON TECHNOLOGY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2007 (unaudited)

Note 1. Basis of Presentation

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by such accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair statement of financial position and operations have been included. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements of Mattson Technology, Inc. (the Company or Mattson) for the year ended December 31, 2006, which are included in the Company's Annual Report on Form 10-K.

The Company's current year will end December 31, 2007 and include 52 weeks. The Company closes its fiscal quarters on the Sunday closest to March 31, June 30, and September 30, and on December 31. The latest fiscal quarter ended September 30, 2007. The results of operations for the three and nine months ended September 30, 2007 are not necessarily indicative of results that may be expected for future quarters or for the entire year ending December 31, 2007.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Management Estimates

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), which permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. This election is irrevocable. SFAS No. 159 will be effective for the Company on January 1, 2008. The Company is currently assessing the potential impact that the adoption of SFAS No. 159 will have on its financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for the Company beginning January 1, 2008. The Company is currently assessing the potential impact that the adoption of SFAS No. 157 will have on its financial statements.

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) conclusion on Issue No. 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, 'Accounting for Compensated Absences'* (EITF No. 06-02). The EITF concluded that companies should accrue for employee sabbatical leave over the service period in which employees earn the right to sabbatical leave. The Company adopted EITF No. 06-02 on January 1, 2007 as a change in accounting principle, and it has recorded the cumulative effect of adoption of approximately \$0.4 million as an increase in the accumulated deficit in the first quarter of 2007, as permitted by the transition provisions of EITF No. 06-02.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109. This interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. The Company adopted FIN 48 on January 1, 2007 as a change in accounting principle, and it has recorded the cumulative effect of adoption of \$0.7 million as an increase in the accumulated deficit in the first quarter of 2007, as permitted by the transition provisions of FIN 48. See Note 10.

Note 2. Balance Sheet Details

	September 30, 2007	December 31, 2006
	(thousands)	
Cash and cash equivalents:		
Cash in bank.....	\$ 35,516	\$ 38,006
Money market funds.....	59,746	17,483
Commercial paper.....	29,613	35,927
	<u>\$ 124,875</u>	<u>\$ 91,416</u>
Short-term investments:		
United States agency securities.....	\$ 11,989	\$ 37,114
United States corporate bonds.....	29,290	10,355
	<u>\$ 41,279</u>	<u>\$ 47,469</u>

All short-term investments are marked to market with unrealized gains (losses) recorded under other comprehensive income. See Note 12. The maturities of short-term investments as of September 30, 2007 and December 31, 2006 are shown below:

	September 30, 2007	December 31, 2006
	(thousands)	
Due within one year.....	\$ 25,866	\$ 34,644
Due in one to two years.....	15,413	12,825
	<u>\$ 41,279</u>	<u>\$ 47,469</u>

	September 30, 2007	December 31, 2006
	(thousands)	
Inventories, net:		
Purchased parts and raw materials.....	\$ 24,477	\$ 22,964
Work-in-process.....	6,824	9,803
Finished goods.....	7,706	7,765
	<u>\$ 39,007</u>	<u>\$ 40,532</u>

As of September 30, 2007 and December 31, 2006, the reserve for excess and obsolete inventories was \$10.2 million and \$16.6 million, respectively.

	<u>September 30, 2007</u>	<u>December 31, 2006</u>
Property and equipment, net:	(thousands)	
Machinery and equipment.....	\$ 52,105	\$ 47,990
Furniture and fixtures.....	12,158	11,597
Leasehold improvements.....	13,667	12,855
	<u>77,930</u>	<u>72,442</u>
Less: accumulated depreciation.....	(48,901)	(44,604)
	<u>\$ 29,029</u>	<u>\$ 27,838</u>
Accrued liabilities:		
Warranty	\$ 10,915	\$ 15,113
Accrued compensation and benefits.....	10,560	7,633
Other.....	9,162	14,889
	<u>\$ 30,637</u>	<u>\$ 37,635</u>

The number of shares of common stock outstanding at the end of each of the periods presented was reduced by approximately 100,000 shares to reflect an adjustment for certain unredeemed shares related to the acquisition of CFM Technologies, Inc. (CFM) in January 2001 that was identified in the first quarter of 2007. Since the error occurred in 2001, and is not material to any of the periods presented, an adjustment was made to reduce accumulated deficit and additional paid-in capital at the end of each of the periods presented by approximately \$3.5 million.

Note 3. Guarantees

The warranty offered by the Company on its system sales generally ranges from 12 months to 36 months depending on the product. A provision for the estimated cost of warranty, based on historical costs, is recorded as cost of sales when the revenue is recognized. The Company's warranty obligations require it to repair or replace defective products or parts, generally at a customer's site, during the warranty period at no cost to the customer. The actual system performance and/or field expense profiles may differ from historical experience, and in those cases, the Company adjusts its warranty accruals accordingly.

The following table summarizes changes in the product warranty accrual for the three and nine months ended September 30, 2007 and October 1, 2006:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30, 2007</u>	<u>October 1, 2006</u>	<u>September 30, 2007</u>	<u>October 1, 2006</u>
	(thousands)			
Balance at beginning of period.....	\$ 13,550	\$ 13,878	\$ 15,113	\$ 13,458
Accrual for warranties issued during the period....	1,433	6,422	5,063	15,845
Settlements made during the period.....	(2,473)	(4,486)	(9,043)	(13,489)
Changes in liability related to preexisting warranties.....	(1,595)	-	(218)	-
Balance at end of period.....	<u>\$ 10,915</u>	<u>\$ 15,814</u>	<u>\$ 10,915</u>	<u>\$ 15,814</u>

In the three months ended September 30, 2007, the Company recorded an adjustment of \$1.6 million to its product warranty accrual. Of this amount, approximately \$0.6 million related to the transfer of certain warranty obligations to a third party service provider for one of the Company's foreign locations. The Company transferred the obligations at book value, and has no further liability for the systems under those warranties. In addition, during the Company's quarterly review of actual warranty performance, the Company's management reduced its preexisting warranty obligations by approximately \$1.0 million based on favorable warranty experience.

During the ordinary course of business, the Company's bank provides standby letters of credit or other guarantee instruments on behalf of the Company to certain parties as required. The maximum potential amount that the Company could be required to pay is \$1.6 million, representing standby letters of credit outstanding as of September 30, 2007. The Company has not recorded any liability in connection with these guarantee arrangements beyond that required to appropriately account for the underlying transaction being guaranteed. The Company does not believe, based on historical experience and information currently available, that it is likely that any amounts will be required to be paid under these guarantee arrangements.

The Company is a party to a variety of agreements, pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in the context of contracts under which the Company may agree to hold the other party harmless against losses arising from a breach of representations or with respect to certain intellectual property, operations or tax-related matters. The Company's obligations under these agreements may be limited in terms of time and/or amount, and in some instances the Company may have defenses to asserted claims and/or recourse against third parties for payments made by the Company. It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on the Company's financial position or results of operations. The Company believes if it were to incur a loss in any of these matters, such loss would not have a material effect on the Company's financial position or results of operations.

Note 4. Commitments and Contingencies

The Company leases two buildings previously used to house its manufacturing and administrative functions related to wet surface preparation products in Exton, Pennsylvania. The lease for both buildings will expire March 31, 2019, with a current combined rental cost of approximately \$1.5 million annually. The Company expects to make payments related to the above noted leases over the next twelve years, less any sublet amounts. The lease agreement for both buildings allows for subleasing the premises without the approval of the landlord. In June 2002, the administrative building was sublet for a period of approximately five years, until December 2007. In June 2007, the tenant entered into a new three-year sublease, which will commence upon the expiration of the current sublease and will expire in December 2010, with an option for the subtenant to extend for an additional three years. Total lease payments of approximately \$11.9 million are expected to cover all related costs on the administrative building during the sublease periods. The sublessee for the manufacturing building location vacated the premises in September 2006 and the Company is currently marketing the property to prospective tenants. In determining the facilities lease loss, various assumptions were made, including the time period over which the buildings will be vacant, expected sublease terms and expected sublease rates. As of September 30, 2007, the Company had an accrual balance of \$0.9 million related to these leases. Adjustments to the accrual for these leases will be made in future periods, if necessary, as soon as evidence of any adjustment can be reasonably estimated as future events and circumstances become known.

In connection with the acquisition of Vortek Industries, Ltd. (Vortek), the Company became party to an agreement between Vortek and the Canadian Minister of Industry (the Minister) relating to an investment in Vortek by Technology Partnerships Canada. Under that agreement, as amended, the Company or Vortek agreed to various covenants, including (a) payment by the Company of a royalty to the Minister of 1.4% of revenues from Flash RTP products, up to a total of CAD14,269,290 (approximately \$14.2 million at September 30, 2007), and (b) Vortek maintaining a specified average workforce of employees in Canada through October 27, 2009. If the Company, or Vortek, does not satisfy its obligations, the Minister may demand payment of liquidated damages in the amount of CAD14,269,290 less any royalties paid by Vortek or the Company to the Minister.

In the ordinary course of business, the Company is subject to claims and litigation, including claims that it infringes third party patents, trademarks and other intellectual property rights. Although the Company believes that it is unlikely that any current claims or actions will have a material adverse impact on its operating results or its financial position, given the uncertainty of litigation, the Company cannot be certain of this. Moreover, the defense of claims or actions against the Company, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

From time to time, the Company is party to legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business. While the outcome of these matters is not presently determinable and cannot be predicted with certainty, management does not believe that the outcome of any of these matters or any of the above mentioned legal claims will have a material adverse effect on the Company's financial position, results of operations or cash flows.

Note 5. Common Stock Repurchase Program

In March 2007, the Company's Board of Directors authorized the repurchase of up to \$20.0 million of the Company's shares of common stock through open-market purchases or private transactions. For the three and nine months ended September 30, 2007, approximately 1.0 million and 2.0 million shares had been repurchased under this program at a weighted-average purchase price of \$9.97 and \$9.97, respectively. As of September 30, 2007, the Company had completed the repurchase of the \$20.0 million in common stock authorized under this program. Subsequent to September 30, 2007, the Company announced an expansion of this common stock repurchase program. See Note 13.

Note 6. Stock-Based Compensation

Effective January 1, 2006, Mattson adopted the provisions of SFAS No. 123(R), *Share-Based Payment*. SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, stock-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as expense over the requisite service period of the employee.

The effects of recording stock-based compensation for the three and nine months ended September 30, 2007 and October 1, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2007	October 1, 2006	September 30, 2007	October 1, 2006
	(thousands, except per share amounts)			
Stock-based compensation by type of award:				
Stock options.....	\$ 824	\$ 590	\$ 2,459	\$ 1,299
Restricted stock units.....	139	141	452	243
Employee stock purchase plan.....	14	27	38	44
Total stock-based compensation.....	<u>977</u>	<u>758</u>	<u>2,949</u>	<u>1,586</u>
Tax effect on stock-based compensation.....	-	-	-	-
Effect on net income.....	<u>\$ 977</u>	<u>\$ 758</u>	<u>\$ 2,949</u>	<u>\$ 1,586</u>
Stock-based compensation by category of expense:				
Cost of sales.....	\$ 35	\$ 18	\$ 100	\$ 38
Research, development and engineering.....	126	77	361	192
Selling, general and administrative.....	816	663	2,488	1,356
Effect on net income.....	<u>\$ 977</u>	<u>\$ 758</u>	<u>\$ 2,949</u>	<u>\$ 1,586</u>

The Company has not capitalized any stock-based compensation as inventory or deferred system profit at September 30, 2007 and December 31, 2006, as such amounts were inconsequential.

As of December 31, 2006, the Company had an unrecorded deferred stock-based compensation balance related to stock options of \$6.5 million after estimated forfeitures. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised if necessary in subsequent periods if actual forfeitures differ from those estimates. As of September 30, 2007, the unrecorded deferred stock-based compensation balance related to stock options was \$8.1 million after estimated forfeitures and will be recognized over an estimated weighted average amortization period of 2.9 years.

As of December 31, 2006, the Company had an unrecorded deferred stock-based compensation balance related to restricted stock units of \$1.2 million after estimated forfeitures. The grant-date fair value of the restricted stock units was based on the closing market price of the Company's common stock on the date of award. As of September 30, 2007, the unrecorded deferred stock-based compensation balance related to nonvested restricted stock units was \$1.5 million after estimated forfeitures and will be recognized over an estimated weighted average amortization period of 3.0 years.

The following table summarizes the combined activity under all of the Company's equity incentive plans for the indicated periods, including 10,000 shares outstanding under the plans assumed by the Company from CFM Technologies, Inc. (CFM) as of September 30, 2007:

	Awards Available For Grant (thousands)	Stock Options Outstanding (thousands)	Weighted- Average Exercise Price	Restricted Stock Units Outstanding (thousands)	Weighted- Average Grant Date Fair Value
Balances at December 31, 2006.....	1,486	6,036	\$ 9.27	150	\$ 11.39
Stock options:					
Authorized June 4, 2007.....	2,500	-	-	-	-
Granted.....	(846)	846	9.03	-	-
Exercised.....	-	(452)	4.94	-	-
Cancelled or forfeited.....	244	(251)	12.75	-	-
Restricted stock units:					
Granted.....	(167)	-	-	95	9.10
Released.....	-	-	-	(58)	10.02
Cancelled or forfeited.....	17	-	-	(10)	10.61
Balances at September 30, 2007.....	<u>3,234</u>	<u>6,179</u>	\$ 9.41	<u>177</u>	\$ 10.65

For the nine months ended September 30, 2007, approximately 40,000 shares of common stock were issued upon vesting of restricted stock units, net of approximately 18,000 shares with a vest date fair value of \$0.2 million, which the Company withheld through net share settlements to cover tax withholding obligations. The value of the restricted stock units was based on the closing market price of the Company's common stock on the date of award.

Valuation Assumptions

The Company estimates the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of SFAS No. 123(R). The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option valuation model and the straight-line attribution approach with the following weighted-average assumptions:

	Three Months Ended		Nine Months Ended	
	September 30, 2007	October 1, 2006	September 30, 2007	October 1 2006
Expected dividend yield.....	-	-	-	-
Expected stock price volatility....	67%	88%	74%	88%
Risk-free interest rate.....	4.5%	4.5%	4.7%	4.4%
Expected life of options.....	5 years	5 years	5 years	5 years

Option-pricing models require the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. The expected life of each option was determined by analyzing historical exercise and post-vest forfeiture patterns. The risk-free interest rate was determined using the rates for United States Treasury notes for similar terms. The expected stock price volatility assumption was determined using the historical volatility of the Company's common stock.

Supplemental disclosure information about the Company's stock options and restricted stock units is as follows:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u> <u>2007</u>	<u>October 1,</u> <u>2006</u>	<u>September 30,</u> <u>2007</u>	<u>October 1,</u> <u>2006</u>
	(thousands, except weighted-average values)			
Stock options:				
Weighted-average grant date fair value.....	\$ 6.09	\$ 5.53	\$ 5.75	\$ 7.44
Intrinsic value of options exercised.....	\$ 1,307	\$ 144	\$ 2,317	\$ 2,056
Cash received from options exercised.....	\$ 1,007	\$ 94	\$ 2,233	\$ 2,819
Restricted stock units:				
Weighted-average grant date fair value.....	\$ 9.93	—	\$ 9.10	\$ 11.39

Supplemental disclosure information about the Company's stock options outstanding as of September 30, 2007 is as follows:

	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Life</u>	<u>Aggregate Intrinsic Value</u>
	(thousands)		(in years)	(thousands)
Options exercisable at September 30, 2007.....	4,534	\$ 9.44	5.0	\$ 5,185
Options expected to vest at September 30, 2007.....	1,645	\$ 9.32	6.1	\$ 295
Options outstanding at September 30, 2007.....	6,179	\$ 9.41	5.3	\$ 5,480

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on the Company's closing stock price of \$8.65 as of September 28, 2007, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of shares of common stock subject to in-the-money options which were exercisable as of September 30, 2007 was 1.9 million. The Company settles employee stock option exercises with newly issued common shares.

Note 7. Reportable Segments

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments, geographic areas and major customers in financial statements. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Chief Executive Officer of the Company is the Company's chief decision maker. As the Company's business is completely focused on one industry segment, the design, manufacturing and marketing of advanced fabrication equipment for the semiconductor manufacturing industry, management believes that the Company has one reportable segment. The Company's revenues and profits are generated through the sales of products and services for this one segment.

The following shows net sales by geographic areas based on the installation locations of the systems and the location of services rendered:

	Three Months Ended				Nine Months Ended			
	September 30, 2007		October 1, 2006		September 30, 2007		October 1, 2006	
	(thousands)	%	(thousands)	%	(thousands)	%	(thousands)	%
United States.....	\$ 4,567	8	\$ 5,761	8	\$ 14,281	7	\$ 21,155	11
Taiwan.....	14,975	26	13,544	18	56,227	26	49,134	25
Korea.....	6,284	11	14,090	18	43,391	20	48,508	24
Japan.....	7,746	13	23,084	30	41,880	19	39,312	20
Europe and others....	12,514	21	8,553	11	29,923	14	14,112	7
Other Asia.....	12,394	21	11,428	15	29,263	14	25,956	13
	<u>\$ 58,480</u>	<u>100</u>	<u>\$ 76,460</u>	<u>100</u>	<u>\$ 214,965</u>	<u>100</u>	<u>\$ 198,177</u>	<u>100</u>

In the three months ended September 30, 2007, four customers accounted for 18%, 14%, 12% and 11% of net sales, respectively. In the three months ended October 1, 2006, three customers accounted for 18%, 17% and 12% of net sales, respectively. In the nine months ended September 30, 2007, four customers accounted for 18%, 11%, 11% and 10% of net sales, respectively. In the nine months ended October 1, 2006, two customers accounted for 16% and 12% of net sales.

Note 8. DNS Patent Infringement Suit Settlement

On June 24, 2002, the Company entered into a settlement agreement and a license agreement with Dainippon Screen Manufacturing Co., Ltd. (DNS), under which DNS agreed to make payments to the Company totaling between \$75 million (minimum) and \$105 million (maximum), relating to past damages, partial reimbursement of attorney fees and costs, and license fees.

In April 2006, DNS paid the Company the final minimum annual royalty payment of \$6.0 million. In June 2006, DNS paid the Company an additional royalty payment of \$2.4 million for royalties due through March 31, 2006. In June 2007, DNS reported to the Company an additional royalty payment due of \$8.6 million for royalties through March 31, 2007. Royalty payments received by the Company in excess of the minimum annual payments are recorded as royalty revenue and recognized as net sales in the period they are reported to the Company by DNS, which is generally in June of each year. The last royalty payment to be paid by DNS under the license agreement will be due in June 2008.

As of September 30, 2007, DNS has made payments aggregating \$85.8 million under the terms of the settlement and license agreements. The Company did not recognize any DNS royalty revenue for the three months ended September 30, 2007. The Company recognized \$1.4 million of royalty revenue for the three months ended October 1, 2006. The Company recognized \$8.6 million and \$6.5 million of royalty revenue for the nine months ended September 30, 2007 and October 1, 2006, respectively.

Note 9. Derivative Instruments and Hedging Activities

The Company utilizes foreign currency forward exchange contracts to hedge against future movements in foreign exchange rates that affect certain existing and forecasted foreign currency denominated sales and purchase transactions. The Company does not use derivative financial instruments for speculative or trading purposes. For the three months ended September 30, 2007, the Company did not have any hedging activities. For the nine months ended September 30, 2007, the Company recorded a net gain of \$0.2 million in other income (expense). For the three and nine months ended October 1, 2006, the Company did not have any hedging activities. As of September 30, 2007, the Company had no outstanding forward foreign exchange contracts.

Note 10. Income Taxes

The provision for income taxes in the nine months ended September 30, 2007 included a normalized provision of \$3.4 million for Federal and state income taxes and a \$0.9 million provision for foreign taxes. In the second quarter, the Company also recorded \$3.8 million in income tax expense related to a ruling on the applicability of tax law in one of the Company's foreign locations. Additionally, in the third quarter, the Company recorded a benefit of \$0.3 million for Federal taxes and \$1.2 million for foreign taxes based on tax returns filed during the quarter and a change in management's current estimate of future tax benefits. The Company reduced its current tax liability by \$1.3 million through the utilization of certain acquired tax assets, largely consisting of net operating loss carryforwards resulting from the acquisition of STEAG in 2001. The Federal and state tax provision for the nine months ended September 30, 2007, however, does not reflect a benefit for the utilization of these net operating losses, as it was used to reduce the goodwill originally recorded in the acquisition. The provision for income taxes in the nine months ended October 1, 2006 was \$1.2 million, which primarily consisted of a \$0.8 million provision for foreign taxes. On a quarterly basis, the Company evaluates its expected income tax expense or benefit based on its year-to-date operations, and records an adjustment in the current quarter. The net tax provision is the result of the mix of profits earned by the Company and its subsidiaries in tax jurisdictions with a broad range of income tax rates.

The Company adopted FIN 48 on January 1, 2007. As a result of the adoption of FIN 48, the Company recognized a \$0.7 million increase in the liability for unrecognized tax benefits, which was accounted for as an increase to the beginning balance of accumulated deficit in the condensed consolidated balance sheet, as permitted by the transition provisions of FIN 48. Upon adoption, the Company had \$25.8 million of unrecognized tax benefits. Of this total, \$9.3 million represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in any future periods. In accordance with FIN 48, at the beginning of fiscal year 2007 the Company reclassified \$9.3 million of income tax liabilities from current liabilities to long-term deferred tax liabilities in the condensed consolidated balance sheet, as payment of the liabilities is not anticipated within the next 12 months. For the nine months ended September 30, 2007, there have been no material changes to the amount of unrecognized tax benefits other than the \$3.8 million discrete charge recorded in the second quarter.

The Company's practice is to recognize interest and/or penalties related to unrecognized tax benefits in income tax expense. At December 31, 2006, the Company had \$0.6 million accrued for estimated interest and \$0.1 million accrued for estimated penalties. For the three and nine months ended September 30, 2007, recorded income tax expense included estimated interest of \$0.1 million and \$0.4 million, respectively. Included in the balance of unrecognized tax benefits at January 1, 2007 is \$1.4 million related to tax positions and estimated interest and penalties for which it is reasonably possible that the statute of limitations will expire in various foreign jurisdictions within the next twelve months.

The Company and its subsidiaries are subject to United States federal income tax as well as to income taxes in Germany and various other foreign and state jurisdictions. The Company's Federal and state income tax returns are generally not subject to examination by tax authorities for years before 2002. The Company's German income tax returns are currently under examination for the tax years 2001 to 2003. The final outcome of this examination is not yet known. Management does not anticipate any adjustments, however, which would result in material changes to the Company's financial position, results of operations, or cash flows.

Note 11. Net Income Per Share

Net income per share is calculated in accordance with SFAS No. 128, *Earnings Per Share*, which requires dual presentation of basic and diluted net income per share on the face of the income statement. Basic earnings per share is computed by dividing income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period. Diluted net income per share is computed using the weighted-average number of shares of common stock outstanding plus the effect of all dilutive securities representing potential shares of common stock outstanding during the period.

The following table summarizes the incremental shares of common stock from these potentially dilutive securities, calculated using the treasury stock method:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u> <u>2007</u>	<u>October 1,</u> <u>2006</u>	<u>September 30,</u> <u>2007</u>	<u>October 1,</u> <u>2006</u>
	(thousands)			
Weighted average shares outstanding - Basic.....	51,397	52,402	52,163	52,309
Diluted potential common shares from stock options and restricted stock units.....	<u>1,033</u>	<u>726</u>	<u>1,031</u>	<u>1,058</u>
Weighted average shares outstanding - Diluted.....	<u><u>52,430</u></u>	<u><u>53,128</u></u>	<u><u>53,194</u></u>	<u><u>53,367</u></u>

Total stock options outstanding of 3.7 million for the three and nine months ended September 30, 2007, and 3.7 million and 2.8 million for the three and nine months ended October 1, 2006, respectively, were excluded from the computations, as their inclusion would be antidilutive.

Note 12. Comprehensive Income

The balance of accumulated comprehensive income is as follows:

	<u>September 30,</u> <u>2007</u>	<u>December 31,</u> <u>2006</u>
	(thousands)	
Cumulative translation adjustments.....	\$ 17,641	\$ 13,480
Unrealized investment gain.....	<u>166</u>	<u>45</u>
	<u><u>\$ 17,807</u></u>	<u><u>\$ 13,525</u></u>

The following are the components of comprehensive income:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u> <u>2007</u>	<u>October 1,</u> <u>2006</u>	<u>September 30,</u> <u>2007</u>	<u>October 1,</u> <u>2006</u>
	(thousands)			
Net income.....	\$ 3,572	\$ 4,587	\$ 22,770	\$ 13,432
Cumulative translation adjustments.....	2,564	393	4,161	3,336
Unrealized investment gain.....	<u>112</u>	<u>192</u>	<u>121</u>	<u>64</u>
Comprehensive income.....	<u><u>\$ 6,248</u></u>	<u><u>\$ 5,172</u></u>	<u><u>\$ 27,052</u></u>	<u><u>\$ 16,832</u></u>

Note 13. Subsequent Event

Increase in Common Stock Repurchase Program

In October 2007, the Company's Board of Directors expanded its existing common stock repurchase program, authorizing the repurchase of up to an additional \$30 million of the Company's shares of common stock through open-market purchases or private transactions. The size and timing of the repurchases will depend on the Company's share price.

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

This quarterly report on Form 10-Q contains forward-looking statements, which are subject to the Safe Harbor provisions created by the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and beliefs, including estimates and projections about our industry. Our forward-looking statements may include statements that relate to our future revenue, customer demand, market share, competitiveness, margins, product development plans and levels of research and development (R&D activity), outsourcing plans and operating expenses, tax expenses, the expected effects, cost and timing of restructurings and consolidation of operations and facilities, economic conditions in general and in our industry and the sufficiency of our financial resources to support future operations and capital expenditures. Forward-looking statements typically are identified by use of terms such as "anticipates," "expects," "intends," "plans," "seeks," "estimates," "believes" and similar expressions, although some forward-looking statements are expressed differently. These statements are not guarantees of future performance and are subject to numerous risks, uncertainties and assumptions that are difficult to predict. Such risks and uncertainties include those set forth in Part II, Item 1A under "Risk Factors" and Item 2 under "Management's Discussion and Analysis of Financial Condition and Results of Operations." Our actual results could differ materially from those anticipated by these forward-looking statements. The forward-looking statements in this report speak only as of the time they are made and do not necessarily reflect our outlook at any other point in time. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or for any other reason.

Documents to Review In Connection With Management's Analysis of Financial Condition and Results of Operations

This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes presented in this Form 10-Q and the consolidated financial statements and notes in our last filed Annual Report on Form 10-K, for the year ended December 31, 2006.

Overview

In 2006, we were the leading supplier of dry strip equipment and the second largest supplier of rapid thermal processing (RTP) equipment in the global semiconductor industry, according to estimates by Gartner Dataquest, an independent research firm. Our manufacturing equipment is used for transistor level, or front-end-of-line manufacturing, and also in specialized applications for processing the interconnect layer, or back-end-of-line processing. Our manufacturing equipment utilizes innovative technology to deliver advanced processing capabilities and high productivity for the fabrication of current and next-generation integrated circuits (ICs). Our tools, technologies and expertise are enablers in the semiconductor industry's transition to larger 300 millimeter wafers, sub-90 nanometer design rules and the use of new materials, such as copper, low capacitance (low-k) dielectrics and barrier metals.

Our business depends upon capital expenditures by manufacturers of semiconductor devices. The level of capital expenditures by these manufacturers depends upon the current and anticipated market demand for such devices. Because the demand for semiconductor devices is highly cyclical, the demand for wafer processing equipment is also highly cyclical. The cyclicality and uncertainties regarding overall market conditions continue to present significant challenges to us and impair our ability to forecast near-term revenue. Given that many of our costs are fixed in the short-term, our ability to quickly modify our operations in response to changes in market conditions is limited. Part of our strategy is to outsource selected non-critical functions in manufacturing, spare parts logistics, subsystem design and other areas to third parties specializing in these areas. This allows us to concentrate our resources on our core technologies in strip and RTP, reduce our cost structure and achieve greater flexibility to expand and contract manufacturing capacity as market conditions require.

Going forward, the success of our business will be dependent on numerous factors, including, but not limited to, the market demand for semiconductors and semiconductor wafer processing equipment and our ability to (a) significantly grow the Company, either organically or through acquisitions, in order to enhance our competitiveness and profitability, (b) develop and bring to market new products that address our customers' needs, (c) grow customer loyalty through collaboration with and support of our customers, (d) maintain a cost structure that will enable us to operate effectively and profitably throughout changing industry cycles and (e) generate the gross margins necessary to enable us to make the necessary investments in our business.

Results of Operations

The following table sets forth our condensed consolidated results of operations for the periods indicated, along with amounts expressed as a percentage of net sales, and comparative information regarding the absolute and percentage changes in these amounts:

	Three Months Ended					
	September 30, 2007		October 1, 2006		Increase (Decrease)	
	(thousands)	%	(thousands)	%	(thousands)	%
Net sales.....	\$ 58,480	100.0	\$ 76,460	100.0	\$ (17,980)	(23.5)
Cost of sales.....	32,800	56.1	50,193	65.6	(17,393)	(34.7)
Gross profit	25,680	43.9	26,267	34.4	(587)	(2.2)
Operating expenses:						
Research, development and engineering	8,099	13.8	7,265	9.5	834	11.5
Selling, general and administrative.....	15,924	27.2	15,936	20.8	(12)	(0.1)
Amortization of intangibles	128	0.2	172	0.2	(44)	(25.6)
Gain on disposition of Wet business.....	-	-	(572)	(0.7)	572	(100.0)
Total operating expenses.....	24,151	41.3	22,801	29.8	1,350	5.9
Income from operations	1,529	2.6	3,466	4.6	(1,937)	(55.9)
Interest income.....	1,984	3.4	1,480	1.9	504	34.1
Interest expense.....	(30)	(0.1)	(71)	(0.1)	41	(57.7)
Other income (expense), net.....	(285)	(0.5)	164	0.2	(449)	n/m ⁽¹⁾
Income before income taxes.....	3,198	5.5	5,039	6.6	(1,841)	(36.5)
Provision for (benefit from) income taxes.....	(374)	(0.6)	452	0.6	(826)	n/m ⁽¹⁾
Net income.....	\$ 3,572	6.1	\$ 4,587	6.0	\$ (1,015)	(22.1)

	Nine Months Ended					
	September 30, 2007		October 1, 2006		Increase (Decrease)	
	(thousands)	%	(thousands)	%	(thousands)	%
Net sales.....	\$ 214,965	100.0	\$ 198,177	100.0	\$ 16,788	8.5
Cost of sales.....	116,422	54.2	121,473	61.3	(5,051)	(4.2)
Gross profit	98,543	45.8	76,704	38.7	21,839	28.5
Operating expenses:						
Research, development and engineering	26,103	12.1	20,563	10.4	5,540	26.9
Selling, general and administrative.....	48,993	22.8	45,760	23.1	3,233	7.1
Amortization of intangibles	383	0.2	516	0.2	(133)	(25.8)
Gain on disposition of Wet business.....	-	-	(572)	(0.3)	572	(100.0)
Total operating expenses.....	75,479	35.1	66,267	33.4	9,212	13.9
Income from operations	23,064	10.7	10,437	5.3	12,627	121.0
Interest income.....	5,354	2.5	3,946	2.0	1,408	35.7
Interest expense.....	(74)	(0.1)	(156)	(0.1)	82	(52.6)
Other income (expense), net.....	1,014	0.5	441	0.2	573	129.9
Income before income taxes.....	29,358	13.7	14,668	7.4	14,690	100.1
Provision for (benefit from) income taxes.....	6,588	3.1	1,236	0.6	5,352	433.0
Net income.....	\$ 22,770	10.6	\$ 13,432	6.8	\$ 9,338	69.5

(1) not meaningful

Net Sales and Deferred Revenue

Net sales for the three months ended September 30, 2007 decreased from the same period of 2006, primarily due to a decrease in system sales of \$22.0 million and a decrease in royalty revenues from DNS of \$1.4 million, partially offset by an increase of \$5.4 million due to net recognition of previously deferred systems revenue.

Net sales for the nine months ended September 30, 2007 increased from the same period of 2006, primarily due to an increase in system sales of \$4.8 million, an increase of \$9.5 million due to net recognition of deferred systems revenue, an increase in sales of service and spare parts of \$0.4 million and an increase in royalty revenues from DNS of \$2.1 million. Net sales for the first nine months of 2007 and 2006 included royalty income from DNS of \$8.6 million and \$6.5 million, respectively.

International sales as a percentage of total net sales are set forth in the table below. We anticipate that international sales, predominantly to customers based in Europe and the Pacific Rim, including China, Japan, Korea, Singapore and Taiwan, will continue to account for a significant portion of our sales.

	Three Months Ended		Nine Months Ended	
	September 30, 2007	October 1, 2006	September 30, 2007	October 1, 2006
International sales.....	92%	92%	93%	89%
Sales to the Pacific Rim.....	71%	81%	79%	82%

Deferred revenue at September 30, 2007 decreased to \$11.9 million from \$16.8 million at December 31, 2006, primarily due to a \$4.2 million decrease in deferred revenue for system shipments which were fully deferred in accordance with our revenue recognition policy at December 31, 2006, and were recognized in 2007; a \$5.6 million net decrease in deferred revenue for the recognition of a portion of system shipments in accordance with our revenue recognition policy and a \$0.1 million decrease in deferred service contract revenue, partially offset by an increase in deferred revenue related to a royalty license agreement of \$5.0 million.

Gross Profit and Gross Profit Margin

Gross profit for the three months ended September 30, 2007 decreased by \$0.6 million compared to the same period of 2006, primarily due to lower gross profit of \$4.5 million from systems sales, a \$1.4 million decrease in royalty revenue from DNS and lower gross profit of \$0.1 million from service and spare parts sales, partially offset by an increase of \$5.4 million due to net recognition of previously deferred systems revenue.

Gross profit margin for the three months ended September 30, 2007 increased by 9.5 percentage points compared to the same period of 2006, primarily due to higher gross profit margin from net recognition of previously deferred systems revenue of 8.2 percentage points, higher gross profit margin from system sales of 1.1 percentage points and higher gross margin from service and spare parts sales of 2.0 percentage points, partially offset by lower gross profit margin from DNS royalty revenue of 1.8 percentage points.

Gross profit for the nine months ended September 30, 2007 increased by \$21.8 million compared to the same period of 2006, primarily due to higher gross profit of \$10.2 million from systems sales, an increase of \$9.5 million due to net recognition of previously deferred systems revenue and a \$2.1 million increase in royalty revenue from DNS.

Gross profit margin for the nine months ended September 30, 2007 increased by 7.1 percentage points compared to the same period of 2006, primarily due to higher gross profit margin from system sales of 2.5 percentage points, higher gross profit margin from net recognition of previously deferred systems revenue of 4.6 percentage points and higher gross profit margin from DNS royalty revenue of 0.7 percentage points, partially offset by lower gross margin from service and spare parts sales of 0.7 percentage points.

Due to intense competition, we continue to face pricing pressure that can affect our gross profit margin. Our gross profit margin has varied over the years and will continue to be affected by many factors, including competitive pressures, product mix, economies of scale, material costs and other costs, overhead absorption levels and our revenue recognition requirements.

Research, Development and Engineering

Research, development and engineering expenses increased in amount for three and nine months ended September 30, 2007 compared to the same period of 2006, primarily due to activities in 2007 to expand our product portfolio to accommodate sub-65 nanometer design rules.

Selling, General and Administrative

Selling, general and administrative (SG&A) expenses for the three months ended September 30, 2007 were level with the same period of 2006. As a percentage of net sales, our SG&A expenses increased in the three months ended September 30, 2007 compared to the same period of 2006 because of the decrease in net sales in 2007.

Selling, general and administrative (SG&A) expenses for the nine months ended September 30, 2007 increased compared to the same period of 2006, primarily as the result of a \$4.7 million increase in employee compensation which related to higher levels of business activity, a \$1.1 million increase in stock-based compensation as determined in accordance with SFAS No. 123(R) and a net increase in other miscellaneous expenses of \$0.4 million; which were partially offset by a \$1.6 million decrease which related to the release of amounts previously accrued as we completed all remaining obligations under a foreign government-funded capital development project and a \$1.4 million decrease related to the release of previously reserved accounts receivable that were collected during the period. As a percentage of net sales, our SG&A expenses decreased in the nine months ended September 30, 2007 compared to the same period of 2006 because of the increase in net sales in 2007.

Amortization of Intangibles

Amortization of intangibles for the three and nine months ended September 30, 2007 decreased compared to the same period of 2006 due to the writeoff of the remaining net book value of Radiant technology of \$2.6 million in the fourth quarter of 2006. The Radiant technology was acquired in our acquisition of Vortek Technology, Ltd. in October 2004.

Interest and Other Income (Expense), Net

Interest income increased in the three and nine months ended September 30, 2007 compared with the same period of 2006, primarily due to higher average cash balances. Other income, net for the three months ended September 30, 2007 included foreign currency exchange rate related losses of \$0.4 million due to impact of the decline in the U.S. dollar on our foreign assets and liabilities, partially offset by other miscellaneous income of \$0.1 million.

Other income, net for the nine months ended September 30, 2007 included \$1.1 million of income from certain payments and legal settlements related to two previous lines of business, as well as realized and unrealized foreign currency exchange gains of \$0.1 million and a realized foreign exchange gain of \$0.2 million on forward foreign exchange contracts settled in 2007, which was partially offset by other miscellaneous expenses of \$0.4 million.

Provision for Income Taxes

The provision for income taxes in the nine months ended September 30, 2007 included a normalized provision of \$3.4 million for Federal and state income taxes and a \$0.9 million provision for foreign taxes. In the second quarter, we also recorded \$3.8 million in income tax expense related to a ruling on the applicability of tax law in one of our foreign locations. Additionally, in the third quarter, we recorded a benefit of \$0.3 million for Federal taxes and \$1.2 million for foreign taxes based on a change in management's estimate of future tax benefits. We reduced our current tax liability by \$1.3 million through the utilization of certain acquired tax assets, largely consisting of net operating loss carryforwards resulting from the acquisition of STEAG in 2001. The Federal and state tax provision for the nine months ended September 30, 2007, however, does not reflect a benefit for the utilization of these net operating losses, as it was used to reduce the goodwill originally recorded in the acquisition. The provision for income taxes for the nine months ended October 1, 2006 was \$1.2 million, which primarily consisted of a \$0.8

million provision for foreign taxes. On a quarterly basis, we evaluate our expected income tax expense or benefit based on our year to date operations and record an adjustment in the current quarter. The net tax provision is the result of the mix of profits earned by us and our subsidiaries in tax jurisdictions with a broad range of income tax rates.

Our valuation allowance at September 30, 2007 is primarily attributable to Federal and state deferred tax assets, as well as certain foreign deferred tax assets. We believe that sufficient uncertainty exists with regard to the realizability of these tax assets such that a valuation allowance is necessary. Factors considered in providing a valuation allowance include the lack of a significant history of consistent profits and the lack of carry-back capacity to realize these assets. Based on the absence of objective evidence, we are unable to assert that it is more likely than not that we will generate sufficient taxable income to realize these remaining net deferred tax assets.

Critical Accounting Policies

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses 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 management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. On an on-going basis, management evaluates its estimates and judgments, including those related to reserves for excess and obsolete inventory, warranty obligations, bad debts, intangible assets, income taxes, restructuring costs, contingencies and litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. These form the basis for making judgment about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Consistent with the previous year, we consider certain accounting policies for the following areas as critical to our business operations and an understanding of our results of operations:

- Inventories and Inventory Valuation
- Goodwill and Other Intangible Assets
- Impairment of Long-Lived Assets
- Warranty
- Stock-based Compensation
- Income Taxes
- Revenue Recognition

Except for income taxes, there have been no material changes from the methodology applied by management for critical accounting estimates previously disclosed in our most recent Annual Report on Form 10-K. The methodology applied to management's estimate for income taxes has changed due to the implementation of a new accounting pronouncement as described below.

Income Taxes. In June 2006, the FASB issued FASB Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 became effective for Mattson beginning in 2007, and addressed the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The impact of our reassessment of our tax positions in accordance with FIN 48 resulted in a cumulative effect of adoption of \$0.7 million, which was recorded as an increase in our accumulated deficit in the first quarter of 2007.

For additional information regarding the adoption of FIN 48, see Note 10 to the accompanying condensed consolidated financial statements. For further discussion of our critical accounting estimates related to income taxes, see our 2006 Annual Report on Form 10-K.

Liquidity and Capital Resources

Our cash, cash equivalents and short-term investments were \$166.2 million at September 30, 2007, an increase of \$27.3 million from \$138.9 million as of December 31, 2006. Stockholders' equity at September 30, 2007 was \$250.3 million. We believe that these balances, including interest to be earned thereon, and anticipated cash flows from operating activities will be sufficient to fund our working and other capital requirements over the course of the next twelve months and for the foreseeable future. In the normal course of business, we evaluate the merits of acquiring technology or businesses, or establishing strategic relationships with or investing in these businesses. We may use available cash, cash equivalents and marketable security investments to fund such activities in the future. In the event additional needs for cash arise, we may raise additional funds from a combination of sources, including the potential issuance of debt or equity securities.

Cash Flows from Operating Activities

Net cash provided by operations during the nine months ended September 30, 2007 was \$47.1 million, primarily due to net income of \$22.8 million, decreases in accounts receivable and advanced billings of \$19.2 million, decreases in inventories and inventories – delivered systems of \$4.7 million, a \$4.8 million increase in other liabilities, depreciation of \$4.7 million and stock-based compensation of \$2.9 million, partially offset by a \$6.6 million decrease in accrued liabilities, a \$4.9 million decrease in deferred revenue and a reduction in allowance for doubtful accounts of \$1.4 million.

Net cash provided by operations during the nine months ended October 1, 2006 was \$7.1 million, primarily due to net income of \$13.4 million, an increase in accrued liabilities of \$8.3 million, an increase in accounts payable of \$6.3 million, depreciation and amortization of \$4.9 million, a decrease in prepaid expenses and other current assets of \$3.3 million, a decrease in advanced billings of \$1.9 million, a decrease in inventories-delivered systems of \$2.5 million, inventory valuation charges of \$1.7 million, and non-cash stock-based compensation of \$1.6 million which was included in net income, partially offset by an increase in inventories of \$14.4 million and an increase in accounts receivable of \$22.3 million. The increase in accounts receivable was primarily due to an increase in revenues. The increase in inventories and accounts payable is primarily due to the increase in system sales in 2006.

We expect that cash provided by operating activities may fluctuate in future periods as a result of a number of factors including fluctuations in our net sales and operating results, amount of revenue deferred, collection of accounts receivable and timing of payments.

Cash Flows from Investing Activities

Net cash provided by investing activities during the nine months ended September 30, 2007 was \$0.7 million, due to proceeds of \$42.6 million from sales and maturities of available-for-sale investments and proceeds of \$0.5 million from sales of property and equipment, partially offset by purchases of available-for-sale investments of \$35.9 million and capital spending of \$6.5 million.

Net cash used in investing activities during the nine months ended October 1, 2006 was \$44.6 million, primarily due to purchases of \$48.3 million of available-for-sale investments and capital spending of \$9.3 million, partially offset by proceeds of \$12.7 million from sales and maturities of available-for-sale investments.

Cash Flows from Financing Activities

Net cash used in financing activities during the nine months ended September 30, 2007 was \$17.6 million, attributable to purchases of treasury stock of \$20.0 million, which was partially offset by net proceeds of \$2.4 million from stock plans.

Net cash provided by financing activities during the nine months ended October 1, 2006 was \$2.9 million, attributable to net proceeds of \$2.9 million from stock plans.

Off-Balance-Sheet Arrangements

As of September 30, 2007, we did not have any significant "off-balance-sheet" arrangements, as defined in Item 303 (a)(4)(ii) of Regulation S-K.

Contractual Obligations

Under accounting principles generally accepted in the United States of America, certain obligations and commitments are not required to be included in our consolidated balance sheets. These obligations and commitments, while entered into in the normal course of business, may have a material impact on our liquidity. For further discussion of our contractual obligations, see our 2006 Annual Report on Form 10-K.

Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS No. 159), which permits entities to elect to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. This election is irrevocable. SFAS No. 159 will be effective for us on January 1, 2008. We are currently assessing the potential impact that the adoption of SFAS No. 159 will have on our financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for us beginning January 1, 2008. We are currently assessing the potential impact that the adoption of SFAS No. 157 will have on our financial statements.

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) conclusion on Issue No. 06-02, *Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, 'Accounting for Compensated Absences'* (EITF No. 06-02). The EITF concluded that companies should accrue for employee sabbatical leave over the service period in which employees earn the right to sabbatical leave. We adopted EITF No. 06-02 on January 1, 2007 as a change in accounting principle, and we have recorded the cumulative effect of adoption of approximately \$0.4 million as an increase in our accumulated deficit in the first quarter of 2007, as permitted by the transition provisions of EITF No. 06-02.

In June 2006, the FASB issued FASB Interpretation (FIN) 48, *Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. This interpretation defines the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. We adopted FIN 48 on January 1, 2007 as a change in accounting principle, and we have recorded the cumulative effect of adoption of \$0.7 million as an increase in our accumulated deficit in the first quarter of 2007, as permitted by the transition provisions of FIN 48. See Note 10 to the accompanying condensed consolidated financial statements.

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

Interest Rate Risk

We are exposed to financial market risks, including changes in foreign currency exchange rates and interest rates. Historically, much of our revenues and capital spending have been transacted in U.S. dollars.

Our exposure to market risk for changes in interest rates relates to our investment portfolio. We do not currently use derivative financial instruments in our investment portfolio, or hedge for these interest rate exposures. We place our investments with high credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

Our interest rate risk relates primarily to our investment portfolio, which consisted of \$124.9 million in cash equivalents and \$41.3 million in short-term marketable securities as of September 30, 2007. An immediate sharp increase in interest rates could have a material adverse affect on the fair value of our investment portfolio. Conversely, immediate sharp declines in interest rates could seriously harm interest earnings of our investment portfolio. By policy, we limit our exposure to longer-term investments.

Foreign Currency Risk

The functional currency of our foreign subsidiaries is their local currencies. Accordingly, all assets and liabilities of these foreign operations are translated using exchange rates in effect at the end of the period, and revenues and costs are translated using average exchange rates for the period. Gains or losses from translation of foreign operations where the local currencies are the functional currency are included as a component of accumulated other comprehensive income. Foreign currency transaction gains and losses are recognized in the consolidated income statements as they are incurred. Because much of our revenues and capital spending are transacted in U.S. dollars, we believe that foreign currency exchange rates should not materially adversely affect our overall financial position, results of operations or cash flows.

During January 2007, we settled one forward foreign exchange contract outstanding as of December 31, 2006 for the purchase in total of US\$23.7 million in exchange for 2.8 billion Japanese Yen (weighted average contract rate of 118 Yen to US\$1.00) upon maturity and realized a total foreign exchange gain of \$0.6 million, which was recorded in the first quarter of 2007 under other income, net. In total, for the nine months ended September 30, 2007, we recorded a net gain of \$0.2 million in other income (expense), net. We did not have any hedging activities for the three months ended September 30, 2007, or for the three and nine months ended October 1, 2006. There were no forward foreign exchange contracts outstanding as of September 30, 2007.

Item 4. *Controls and Procedures*

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the quarterly period covered by this report. Our disclosure controls and procedures are intended to ensure that the information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as the principal executive and financial officers, respectively, to allow final decisions regarding required disclosures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

Quarterly Evaluation of Changes in Internal Control over Financial Reporting

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any change occurred during the third quarter of 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Based on that evaluation, our management concluded that there was no such change during that quarter.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

In the ordinary course of business, we are subject to claims and litigation, including claims that we infringe third party patents, trademarks and other intellectual property rights. Although we believe that it is unlikely that any current claims or actions will have a material adverse impact on our operating results or our financial position, given the uncertainty of litigation, we cannot be certain of this. Moreover, the defense of claims or actions against us, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Our involvement in any patent dispute, other intellectual property dispute or action to protect trade secrets and know-how could result in a material adverse effect on our business. Adverse determinations in current litigation or any other litigation in which we may become involved could subject us to significant liabilities to third parties, require us to grant licenses to or seek licenses from third parties and prevent us from manufacturing and selling our products. Any of these situations could have a material adverse effect on our business.

Item 1A. *Risk Factors*

Other Items in this Quarterly Report on Form 10-Q describe risks and uncertainties associated with our business, including risks and uncertainties that could cause actual results to differ materially from the results expressed or implied by forward-looking statements contained in this Quarterly Report and in other statements we make publicly. A more complete description of a number of primary risk factors associated with our business, and which could cause our results to differ materially from the results expressed or implied by our forward-looking statements contained in this Quarterly Report on Form 10-Q or elsewhere, is set forth in our Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC on March 2, 2007.

