UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended: October 31, 2005

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

For the Transition Period from _________ to _________

Commission file number 0-26714

ADE CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Massachusetts	**04-2441829**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

80 Wilson Way, Westwood, Massachusetts 02090

(Address of Principal Executive Offices, Including Zip Code)

(781) 467-3500

(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 x NO ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common Stock, par value $.01 per share	14,388,537 shares
Class	Outstanding at December 8, 2005

Table of Contents

ADE CORPORATION

INDEX

Table of Contents

PART I.

FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (unaudited):

ADE CORPORATION

CONSOLIDATED BALANCE SHEET

(in thousands, except share and per share information, unaudited)

	October 31, 2005	April 30, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 81,231	$ 72,841
Marketable securities	833	836
Accounts receivable, net	17,826	18,499
Inventories	34,039	30,764
Prepaid expenses and other current assets	1,268	1,373
Deferred income taxes	10,627	10,601
Total current assets	145,824	134,914
Fixed assets, net	8,665	9,241
Deferred income taxes	4,102	6,616
Investments	499	499
Intangible assets, net	402	533
Goodwill	1,318	1,318
Other assets	113	105
Total assets	$ 160,923	$ 153,226
Liabilities and stockholders equity		
Current liabilities:		
Current portion of long-term debt	$ 182	$ 177
Accounts payable	6,849	6,027
Accrued expenses and other current liabilities	11,271	12,069
Total current liabilities	18,302	18,273
Deferred gain on sale-leaseback	1,440	1,496
Long-term debt, net of current portion	3,338	3,431
Total liabilities	23,080	23,200

Commitments and contingencies (Note 9)

Stockholders equity:		
Preferred stock, $1.00 par value; 1,000,000 shares authorized; none issued or outstanding		
Common stock, $.01 par value: 25,000,000 shares authorized: 14,387,787 and 14,260,773 issued and outstanding at October 31, 2005 and April 30, 2005, respectively	143	143
Capital in excess of par value	111,650	109,597
Retained earnings	25,671	19,870
Accumulated other comprehensive income	379	416
Total stockholders equity	137,843	130,026
Total liabilities and stockholders equity	$ 160,923	$ 153,226

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

Table of Contents

ADE CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share data, unaudited)

	Three months ended October 31,		Six months ended October 31,	
	2005	**2004**	**2005**	**2004**
Net Revenue:				
Systems and parts	$ 20,788	$ 25,922	$ 42,509	$ 51,250
Service	2,826	3,367	5,417	6,351
Total revenue	23,614	29,289	47,926	57,601
Cost of revenue:				
Systems and parts	8,073	10,948	16,431	22,164
Service	2,323	2,595	4,668	4,770
Total cost of revenue	10,396	13,543	21,099	26,934
Gross profit	13,218	15,746	26,827	30,667
Operating expenses:				
Research and development	3,819	3,657	7,630	7,283
Marketing and sales	2,940	2,815	6,450	6,285
General and administrative	2,424	2,864	5,182	5,527
Total operating expenses	9,183	9,336	19,262	19,095
Income from operations	4,035	6,410	7,565	11,572
Interest income	589	134	1,071	197
Interest expense	(71)	(82)	(120)	(134)
Other income	3	19	56	52
Income before provision for income taxes	4,556	6,481	8,572	11,687
Provision for income taxes	1,640	178	2,771	326
Net income	$ 2,916	$ 6,303	$ 5,801	$ 11,361
Basic earnings per share	$ 0.20	$ 0.45	$ 0.40	$ 0.81
Diluted earnings per share	$ 0.20	$ 0.44	$ 0.40	$ 0.80
Weighted average shares outstanding - basic	14,376	14,042	14,347	14,024
Weighted average shares outstanding - diluted	14,605	14,257	14,610	14,271

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

Table of Contents

ADE CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands, unaudited)

	Six months ended October 31,	
	2005	**2004**
Cash flows from operating activities:		
Net income	$ 5,801	$ 11,361
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	970	1,164
Deferred income taxes	2,488	
Non-cash compensation	10	15
Amortization of gain from sale-leaseback	(56)	(56)
Changes in assets and liabilities:		
Accounts receivable, net	673	(8,440)
Inventories	(3,275)	713
Prepaid expenses and other current assets	105	(67)
Other assets	(8)	7
Accounts payable	822	(115)
Accrued expenses and other current liabilities	(798)	3,721
Net cash provided by operating activities	6,732	8,303
Cash flows from investing activities:		
Purchases of fixed assets	(264)	(151)
Change in restricted cash		6
Net cash used in investing activities	(264)	(145)
Cash flows from financing activities:		
Repayment of long-term debt	(88)	(82)
Proceeds from issuance of common stock	2,043	549
Net cash provided by financing activities	1,955	467
Effect of exchange rate changes on cash and cash equivalents	(33)	(7)
Net increase in cash and cash equivalents	8,390	8,618
Cash and cash equivalents, beginning of period	72,841	41,560
Cash and cash equivalents, end of period	$ 81,231	$ 50,178

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

5

Table of Contents

1. Basis of Preparation

The accompanying unaudited consolidated financial statements of ADE Corporation (the Company) include, in the opinion of management, all adjustments (consisting only of normal and recurring adjustments) necessary for a fair statement of the Company s financial position, results of operations and cash flows at the dates and for the periods indicated. Results of operations for interim periods are not necessarily indicative of those to be achieved for full fiscal years.

Pursuant to accounting requirements of the Securities and Exchange Commission (SEC) applicable to quarterly reports on Form 10-Q, the accompanying unaudited consolidated financial statements and these notes do not include all disclosures required by generally accepted accounting principles (GAAP) in the United States of America for complete financial statements. Accordingly, these statements should be read in conjunction with the financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended April 30, 2005. The Company maintains a website where copies of its reports filed with SEC may be accessed, as well as other information concerning the Company s business, products and news releases. The address of the Company s website is www.ade.com. The Company s website is included as a textual reference only and the information on the Company s website is not incorporated by reference into this Quarterly Report on Form 10-Q.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingencies in the Company s unaudited consolidated financial statements. Areas particularly subject to estimation include the allowance for doubtful accounts, the valuation for potential excess and obsolete inventory, the carrying value of the Company s intangible assets and the valuation allowance on deferred tax assets. Actual results could differ from those estimates.

2. Comprehensive Income

Comprehensive income was as follows:

	(in thousands) Three months ended		(in thousands) Six months ended	
	October 31, 2005	October 31, 2004	October 31, 2005	October 31, 2004
	(unaudited)		(unaudited)	
Net income	$ 2,916	$ 6,303	$ 5,801	$ 11,361
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities, net of tax	(16)	62	(3)	(191)
Currency translation adjustments	(22)	(7)	(33)	(7)
Other comprehensive income (loss)	(38)	55	(36)	(198)
Comprehensive income	$ 2,878	$ 6,358	$ 5,765	$ 11,163

6

Table of Contents

3. Inventories

Inventories consist of the following:

	(in thousands)	
	October 31, 2005	April 30, 2005
	(unaudited)	
Raw materials and purchased parts	$ 18,182	$ 16,820
Work-in-process	14,401	13,084
Finished goods	1,456	860
	$ 34,039	$ 30,764

4. Intangible Assets

The Company has capitalized license fees for software included in the Company s products. These license fees are amortized at the greater of 1) the ratio that current gross revenue for the related products bears to the total current and anticipated future gross revenue for those products or 2) on a straight-line basis over the estimated useful life of the related products. The carrying amount and accumulated amortization for the Company s intangible assets are as follows:

	(in thousands)	
	October 31, 2005	April 30, 2005
	(unaudited)	
License fees at cost	$ 1,400	$ 1,400
Accumulated amortization	(998)	(867)
Net carrying value	$ 402	$ 533

Amortization expense was $79,000 and $38,000 for the three months ended October 31, 2005 and 2004, respectively, and $131,000 and $75,000 for the six months ended October 31, 2005 and 2004, respectively. Estimated annual amortization is $289,000, $216,000 and $28,000 for the fiscal years ending April 30, 2006, 2007 and 2008, respectively.

Table of Contents

5. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

	(in thousands)	
	October 31, 2005	April 30, 2005
	(unaudited)	
Accrued salaries, wages, vacation pay and incentive compensation	$ 2,150	$ 3,335
Accrued commissions	2,158	1,512
Accrued warranty costs	1,199	1,482
Deferred revenue	2,338	2,316
Other	3,426	3,424
	$ 11,271	$ 12,069

6. Stock-based Compensation

Stock-based compensation awards to employees under the Company s stock plans are accounted for using the intrinsic value method prescribed in Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, and related interpretations. The Company has adopted the disclosures required by Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation (SFAS 123) and SFAS No. 148, Accounting for Stock-based Compensation. Had compensation cost for the stock-based compensation been determined based on the fair value at the grant dates of awards consistent with the provisions of SFAS 123, the Company s net income and earnings per share would have been reduced to the pro forma amounts as follows:

	(In thousands, except per share data)		(In thousands, except per share data)	
	Three months ended October 31,		Six months ended October 31,	
	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Net income, as reported	$ 2,916	$ 6,303	$ 5,801	$ 11,361
Add back: Stock-based compensation included in net income, as reported, net of taxes	3	5	6	15
Deduct: Total stock-based employee compensation expense determined under fair value based method, net of related income taxes	273	393	506	755
Pro forma net income	$ 2,646	$ 5,915	$ 5,301	$ 10,621

Net earnings per share:								
Basic - as reported	$	0.20	$	0.45	$	0.40	$	0.81
Basic - pro forma	$	0.18	$	0.42	$	0.37	$	0.76
Diluted - as reported	$	0.20	$	0.44	$	0.40	$	0.80
Diluted - pro forma	$	0.18	$	0.41	$	0.36	$	0.74

8

Table of Contents

7. Earnings Per Share

Earnings per share are presented in accordance with SFAS No. 128, Earnings Per Share, which requires the presentation of basic earnings per share and diluted earnings per share. Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding and gives effect to all potential dilutive common shares outstanding during the period. Potential dilutive common shares include shares issuable upon the assumed exercise of dilutive stock options. For the three months ended October 31, 2005 and 2004, respectively, 24,250 and 349,935 common shares issuable upon the exercise of stock options have been excluded from the computation of diluted earnings per share, as their effect would have been antidilutive because the exercise price of the options was greater than the average market value of the Company s common stock during the respective periods. For the six months ended October 31, 2005 and 2004, respectively, 24,250 and 331,660 common shares issuable upon the exercise of stock options have been excluded from the computation of diluted earnings per share, as their effect would have been antidilutive because the exercise price of the options was greater than the average market value of the Company s common stock during the respective periods.

The following is a reconciliation of the shares used in calculating basic and diluted earnings per share:

	(in thousands)		(in thousands)	
	Three months ended October 31,		Six months ended October 31,	
	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Shares used in computation:				
Weighted average common stock outstanding used in computation of basic earnings per share	14,376	14,042	14,347	14,024
Dilutive effect of stock options outstanding	229	215	263	247
Shares used in computation of diluted earnings per share	14,605	14,257	14,610	14,271

8. Segment Reporting

The Company has three reportable segments: ADE Semiconductor Systems Group (SSG), ADE Phase Shift (PST) and ADE Technologies (ATI). SSG manufactures and markets metrology and inspection systems to the semiconductor wafer and device manufacturing industries that are used to improve yield and capital productivity. Sales of the Company s stand-alone software products are also included in the SSG segment. PST manufactures and markets high performance, non-contact surface metrology equipment using advanced interferometric technology that provides enhanced yield management to the data storage, semiconductor wafer and device manufacturing and optics industries. ATI manufactures and markets high precision magnetic characterization and non-contact dimensional metrology gauging systems primarily to the data storage industry.

The Company s reportable segments are determined based upon information used to evaluate the business by the chief operating decision maker, which includes the nature of the products, the external customers and customer industries and the sales and distribution methods used to market the products. The Company s chief operating decision maker is the President and Chief Executive Officer. The Company evaluates performance based upon profit or loss from operations. The Company does not measure the assets allocated to the segments. Management fees representing certain services provided by corporate offices have been allocated to each of the reportable segments based upon the usage of those services by each segment. For the reportable segments, intersegment sales are recorded at cost plus 20% and are eliminated in consolidation.

Table of Contents

8. Segment Reporting (Continued)

	(in thousands, unaudited)			
	SSG	**PST**	**ATI**	**Total**
For the quarter ended October 31, 2005				
Revenue from external customers	$ 12,554	$ 7,594	$ 3,466	$ 23,614
Intersegment revenue	36	119	140	295
Income from operations	595	2,376	1,097	4,068
Depreciation and amortization expense	394	111	6	511
Capital expenditures	9			9
For the quarter ended October 31, 2004				
Revenue from external customers	$ 18,815	$ 7,615	$ 2,859	$ 29,289
Intersegment revenue		122	128	250
Income from operations	4,379	1,850	194	6,423
Depreciation and amortization expense	433	130	4	567
Capital expenditures	18		13	31

	(in thousands, unaudited)			
	SSG	**PST**	**ATI**	**Total**
For the six months ended October 31, 2005				
Revenue from external customers	$ 23,560	$ 17,838	$ 6,528	$ 47,926
Intersegment revenue	36	202	436	674
Income (loss) from operations	(224)	6,053	1,772	7,601
Depreciation and amortization expense	746	211	13	970
Capital expenditures	192	118		310
For the six months ended October 31, 2004				
Revenue from external customers	$ 38,514	$ 13,368	$ 5,719	$ 57,601
Intersegment revenue	46	194	220	460
Income from operations	8,029	3,289	280	11,598
Depreciation and amortization expense	887	267	10	1,164
Capital expenditures	134		17	151

Table of Contents

8. Segment Reporting (Continued)

The following is a reconciliation for the above items where aggregate reportable segment amounts differ from amounts contained in the Company s consolidated financial statements.

	Three months ended October 31,		Six months ended October 31,	
	2005	2004	2005	2004
	(unaudited)		(unaudited)	
Total operating income for reportable segments	$ 4,068	$ 6,423	$ 7,601	$ 11,598
Net impact of intercompany gross profit eliminations	(33)	(13)	(36)	(26)
Total consolidated operating income	$ 4,035	$ 6,410	$ 7,565	$ 11,572

9. Commitments and Contingencies

Litigation

From time to time the Company is subject to legal proceedings and claims in the ordinary course of business. In the opinion of management, the amount of ultimate expense with respect to any current legal proceedings and claims will not have a material adverse effect on the Company s financial position or results of operations.

Guarantor agreements

The Company has an agreement with a vendor whereby it guarantees the expenses incurred by certain of the Company s employees. The term of the agreement is from execution until cancellation and payment of any outstanding amounts. The Company would be required to pay any unsettled employee expenses upon notification from the vendor. The maximum potential amount of future payments the Company could be required to make under this agreement is not significant. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, no liabilities have been recorded for this guaranty as of October 31, 2005.

Pursuant to one of the provisions in the Company s standard terms and conditions of sale, the Company agrees, subject to certain limitations and conditions, to defend any suit or proceeding brought against a customer based on a claim that the Company s equipment, standing alone, infringes a United States patent or copyright or misappropriates a trade secret protected under United States law. Actions arising under this provision may only be brought by customers within two years after the cause of action arises. The maximum potential amount of payments the Company may be required to make under this provision is limited to the total purchase price of the Company s equipment sold under the particular contract. The Company has never incurred costs to defend lawsuits or settle claims related to this customer contract provision. As a result, the Company believes the estimated exposure of this provision is minimal. Accordingly, the Company has no liabilities recorded for this provision as of October 31, 2005.

The Company warrants that its products will perform in all material respects in accordance with its standard published specifications. The term of the Company s standard warranty is 12 months. The Company currently accrues 2% of product revenues, based on history, to provide for estimated warranty costs. The following is a reconciliation of the quarterly activity in the Company s warranty liability for the six months ended October 31, 2005 and 2004.

11

Table of Contents

9. Commitments and Contingencies (Continued)

	(in thousands) Six months ended October 31,	
	2005	2004
	(unaudited)	
Accrued warranty, beginning balance	$ 1,482	$ 1,257
Accruals for warranties issued	735	717
Warranty settlements made	(1,018)	(469)
Accrued warranty, ending balance	$ 1,199	$ 1,505

10. New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 151, Inventory Costs (SFAS 151). SFAS 151 amends the guidance in Accounting Review Board No. 43, Chapter 4, Inventory Pricing, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). SFAS 151 is effective for fiscal years beginning after June 15, 2005. The adoption of SFAS 151 is not expected to have a material impact on the Company s financial position and results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R). SFAS 123R requires that the cost resulting from all share-based payment transactions be measured using a fair-value method and be recognized in the financial statements. SFAS 123R is effective as of the beginning of the first interim or annual reporting period of the first fiscal year that begins on or after June 15, 2005. SFAS 123R is effective for the Company s first quarter of fiscal 2007 beginning May 1, 2006. SFAS 123R permits public companies to adopt its requirements using one of two methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date.

2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures for either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company has not yet determined whether it will adopt SFAS 123R using the modified prospective method or the modified retrospective method. Management is currently evaluating the impact that the adoption of SFAS 123R will have on the Company s financial position and results of operations.

11. Income Taxes

For the three months ended October 31, 2005, the Company earned income before taxes of $4.6 million and recorded a tax provision of $1.6 million. The Company s effective tax rate in the second quarter of fiscal 2006 was approximately 36% compared to approximately 3% in the second quarter of fiscal 2005. For the six months ended October 31, 2005, the Company earned income before taxes of $8.6 million and recorded a tax provision of $2.8 million. The Company s effective tax rate in the six months ended October 31, 2005 was approximately 32% compared to approximately 3% in the second quarter of fiscal 2005. The effective tax rate for the six months ended October 31, 2005 includes an adjustment to the estimated benefit of prior year research and development credits. The provision for income taxes in the three and six months ended October 31, 2004 consisted only of federal and state alternative minimum taxes and foreign income taxes because at that time, the Company had a full valuation allowance against its deferred tax assets.

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

Introduction and Business Outlook

ADE Corporation (the Company) designs, manufactures, markets and services highly precise, automated measurement, defect detection and handling equipment with current applications in the production of semiconductor wafers, semiconductor devices and magnetic computer disks. The Company operates three major business segments, the Semiconductor Systems Group (SSG), ADE Phase Shift (PST) and ADE Technologies (ATI). SSG manufactures multifunctional semiconductor metrology and automation systems and optical wafer defect inspection equipment used to detect particles and other defects on silicon wafer surfaces primarily for the semiconductor wafer and device manufacturing industries. PST manufactures high-performance, non-contact surface metrology equipment using advanced interferometric technology that provides enhanced yield management to the data storage, semiconductor and optics industries. ATI manufactures high precision magnetic characterization and non-contact dimensional metrology gauging systems primarily for the data storage industry.

Historically, the semiconductor wafer and device industries and the magnetic data storage industry have been highly cyclical and have experienced both rapid periods of growth and rapid downturns that can be abrupt and result in significant changes in revenue and profits. During the four most recent quarters, there has been evidence of a slight downturn in the semiconductor industry. As a result, prior to the second quarter of fiscal 2006, the Company had experienced four consecutive quarters of decreased bookings and, consequently, decreased revenues in the last two quarters. However, during the second quarter of fiscal 2006, the Company experienced a slight increase in bookings. This fact, combined with an increase in quoting activity, suggests that the semiconductor industry may be entering a period of expansion. However, due to limited industry visibility, the Company cannot determine if this recent increase in order activity will continue and if so, for how long. Contrary to previous industry downturns, the Company has maintained its profitability during those quarters of decreased order activity, albeit at a reduced level. The Company makes no assurances that current order, revenue, backlog, and profit levels can be sustained in future periods. The Company expects that order levels will increase later in fiscal 2006 as the industry strengthens and the Company s new products gain acceptance.

The following information should be read in conjunction with the unaudited consolidated financial statements and notes thereto included in this quarterly report and the audited consolidated financial statements and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in the Company s Annual Report on Form 10-K for the fiscal year ended April 30, 2005.

Forward-Looking Statements

This quarterly report on Form 10-Q contains statements which constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Federal securities laws. Statements that make reference to the Company s expectations, predictions, plans and anticipations are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed by such statements and should be considered forward-looking statements. These statements include, but are not limited to, expectations about the Company s performance in the third quarter and remainder of fiscal 2006, the success of the Company s new and existing products, orders and revenue associated with those products for the remainder of fiscal 2006, market demand, wafer starts, the Company s limited visibility with respect to its industry s long term trends, expectations about the impact of SFAS No. 123 (revised 2004), and the Company s predictions of future financial outcomes. These statements involve risks and uncertainties including those associated with the strength of the semiconductor and magnetic data storage markets, wafer pricing and wafer demand, the results of product development efforts, the success of the Company s product offerings in meeting customer needs within the timeframes required by customers in these markets, further increases in backlog, the Company s ability to maintain current gross profit levels, optimism based on the Company s book-to-bill ratio, the potential of rapidly slowing order flow and the potential impact of promulgations. Subject to applicable law, the Company disclaims any intent or obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise. Further information on potential factors that could affect the Company s business is described in Other Risk Factors and Trends appearing at the end of this

Management s Discussion and Analysis of Financial Condition and Results of Operations and in the Company s other reports on file with the SEC, including its Annual Report on Form 10-K for the fiscal year ended April 30, 2005.

Table of Contents

Critical Accounting Policies, Significant Judgments and Estimates

The discussion and analysis of the Company s financial condition and results of operations are based upon its 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 judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure at the date of the Company s financial statements. On an ongoing basis, management evaluates its estimates and judgments, including those related to bad debts, inventories, intangible assets, income taxes and warranty obligations. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments 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. The Company considers certain accounting policies related to revenue recognition and allowance for doubtful accounts, inventory valuation, accounting for income taxes and the valuation of goodwill and software to be critical policies due to the estimates and judgments involved in each.

Revenue Recognition and Allowance for Doubtful Accounts

The Company s revenue recognition policy complies with SEC Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements (SAB 104). The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectibility is reasonably assured. The Company s standard customer arrangement includes a signed purchase order, in which it offers payment terms of 30 to 90 days, no right of return of delivered products and a twelve month warranty. The Company assesses whether the fee associated with its revenue transactions is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of the fee is due after the Company s normal payment terms of 30 to 90 days, it determines that the fee is not fixed or determinable. In these cases, the Company recognizes revenue as the fees become due. The Company assesses collectibility based on the credit worthiness of the customer and past transaction history. The Company performs initial credit evaluations of its customers and does not require collateral from its customers. For many of the Company s international customers, it requires that an irrevocable letter of credit be issued by the customer before the purchase order is accepted. If the Company determines that collection of a fee is not reasonably assured, it defers the fee and recognizes the revenue at the time that collection becomes reasonably assured, which is generally upon the receipt of cash.

For some of the Company s sales transactions, a portion, usually 10%, of the fee is not due until installation occurs and the customer accepts the product. The other 90% of the fee is normally due 30 to 90 days after shipment. If the Company has met defined customer acceptance experience levels with a specific type of product, these transactions are accounted for as multiple-element arrangements with the deferral of the portion of the fee not due until installation is complete and customer acceptance has occurred. Management of the Company must make a determination of what constitutes an appropriate experience level with a product. This determination is based on, but not limited to, the extent to which a product contains significantly new technology, the number of similarly configured products previously delivered