



# **FORM 10-Q**

**CYMER INC - CYMI**

**Filed: November 03, 2008 (period: September 30, 2008)**

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

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

**FORM 10-Q**

(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, 2008

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 0-21321

**CYMER, INC.**

(Exact name of registrant as specified in its charter)

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

**33-0175463**  
(IRS Employer Identification No.)

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

**92127**  
(Zip Code)

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

**N/A**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller  
reporting company)

Smaller reporting  
company

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

The total number of shares of Common Stock, with \$0.001 par value, outstanding on October 31, 2008 was 29,606,731.

CYMER, INC.

FORM 10-Q

For the Quarterly Period Ended September 30, 2008

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ITEM 1. Financial Statements

CYMER, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share data)

	September 30, 2008	December 31, 2007
<b>ASSETS:</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 222,754	\$ 305,707
Short-term investments	37,485	22,355
Accounts receivable—net	78,539	91,875
Accounts receivable—related party	644	1,112
Inventories	184,359	129,757
Deferred income taxes	42,590	42,147
Income taxes receivable	13,377	—
Prepaid expenses and other assets	12,172	8,930
Total current assets	591,920	601,883
PROPERTY AND EQUIPMENT—NET	116,276	116,725
LONG-TERM INVESTMENTS	16,567	29,443
DEFERRED INCOME TAXES	20,896	19,272
GOODWILL	8,833	8,833
INTANGIBLE ASSETS—NET	10,661	12,951
OTHER ASSETS	6,310	5,045
TOTAL ASSETS	\$ 771,463	\$ 794,152
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 20,361	\$ 23,980
Accounts payable—related party	1,356	4,428
Accrued warranty	25,585	24,350
Accrued payroll and benefits	14,426	24,406
Accrued patents, royalties and other fees	4,087	3,303
Convertible subordinated notes	140,722	—
Income taxes payable	—	13,468
Deferred revenue	15,994	4,974
Other current liabilities	2,616	4,569
Total current liabilities	225,147	103,478
CONVERTIBLE SUBORDINATED NOTES	—	140,722
INCOME TAXES PAYABLE	22,054	17,755
DEFERRED REVENUE	—	5,562
OTHER LIABILITIES	14,395	17,401
Total liabilities	261,596	284,918
MINORITY INTEREST	5,671	5,711
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock—\$.001 par value; authorized 5,000,000 shares; no shares issued or outstanding	—	—
Common stock—authorized 100,000,000 shares; \$.001 par value, 42,426,000 shares issued and 29,574,000 shares outstanding at September 30, 2008; 42,339,000 shares issued and 30,290,000 shares outstanding at December 31, 2007	42	42
Additional paid-in capital	585,053	579,711
Treasury stock at cost (12,852,000 and 12,049,000 common shares) at September 30, 2008 and December 31, 2007 respectively	(473,580)	(450,704)
Accumulated other comprehensive income (loss)	(14,539)	214
Retained earnings	407,220	374,260
Total stockholders' equity	504,196	503,523
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 771,463	\$ 794,152

See Notes to Unaudited Condensed Consolidated Financial Statements.

## CYMER, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In thousands, except per share data)

	For the three months ended September 30,		For the nine months ended September 30,	
	2008	2007	2008	2007
<b>REVENUES:</b>				
Product and service sales	\$ 110,943	\$ 130,371	\$ 357,536	\$ 378,684
Product sales—related party	450	1,754	1,800	3,090
Total revenues	111,393	132,125	359,336	381,774
<b>COST OF REVENUES</b>	58,855	65,899	186,272	187,684
<b>GROSS PROFIT</b>	52,538	66,226	173,064	194,090
<b>OPERATING EXPENSES:</b>				
Research and development	24,334	21,367	71,272	60,760
Sales and marketing	5,853	6,845	18,366	19,595
General and administrative	8,030	9,934	27,123	28,473
Total operating expenses	38,217	38,146	116,761	108,828
<b>OPERATING INCOME</b>	14,321	28,080	56,303	85,262
<b>OTHER INCOME (EXPENSE):</b>				
Foreign currency exchange gain (loss)	(6,359)	1,527	(6,428)	1,956
Write-down of investments	(270)	—	(5,103)	—
Interest and other income	2,014	4,027	7,722	16,250
Interest and other expense	(1,625)	(1,704)	(4,923)	(4,807)
Total other income (expense)—net	(6,240)	3,850	(8,732)	13,399
<b>INCOME BEFORE INCOME TAX PROVISION AND MINORITY INTEREST</b>	8,081	31,930	47,571	98,661
<b>INCOME TAX PROVISION</b>	2,829	11,010	16,650	34,099
<b>MINORITY INTEREST</b>	483	750	2,039	2,363
<b>NET INCOME</b>	\$ 5,735	\$ 21,670	\$ 32,960	\$ 66,925
<b>EARNINGS PER SHARE:</b>				
Basic earnings per share	\$ 0.19	\$ 0.69	\$ 1.10	\$ 1.94
Weighted average common shares outstanding—basic	29,665	31,395	30,034	34,573
Diluted earnings per share	\$ 0.19	\$ 0.65	\$ 1.08	\$ 1.84
Weighted average common shares outstanding—diluted	29,779	34,588	32,952	37,852

See Notes to Unaudited Condensed Consolidated Financial Statements.

## CYMER, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

	For the nine months ended September 30,	
	2008	2007
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 32,960	\$ 66,925
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,198	19,016
Non-cash stock-based compensation	4,525	4,363
Minority interest	(2,039)	(2,363)
Provision for deferred income taxes	(2,643)	13,162
(Gain) loss on disposal and impairment of property and equipment	(11)	298
Write-down of investments	5,103	—
Change in assets and liabilities:		
Accounts receivable—net	12,973	8,133
Accounts receivable—related party	468	(922)
Income taxes receivable	(13,741)	(5,228)
Inventories	(56,090)	(19,137)
Prepaid expenses and other assets	(5,231)	(2,068)
Accounts payable	(3,718)	10
Accounts payable—related party	(3,072)	(2,334)
Accrued expenses and other liabilities	(13,058)	(936)
Deferred revenue	5,309	7,555
Income taxes payable	(9,104)	(1,589)
Net cash provided by (used in) operating activities	<u>(27,171)</u>	<u>84,885</u>
<b>INVESTING ACTIVITIES:</b>		
Acquisition of property and equipment	(19,174)	(13,491)
Purchases of investments	(90,309)	(76,044)
Proceeds from sold or matured investments	81,184	210,565
Acquisition of patents	—	(121)
Net cash provided by (used in) investing activities	<u>(28,299)</u>	<u>120,909</u>
<b>FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	1,752	12,803
Cash investment in joint venture received from minority shareholder	2,000	—
Tax windfall (shortfall) from stock option exercises	(935)	1,876
Repurchase of common stock into treasury	(22,876)	(287,960)
Net cash used in financing activities	<u>(20,059)</u>	<u>(273,281)</u>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<u>(7,424)</u>	<u>3,288</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<u>(82,953)</u>	<u>(64,199)</u>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD</b>	<u>305,707</u>	<u>302,098</u>
<b>CASH AND CASH EQUIVALENTS AT END OF THE PERIOD</b>	<u>\$ 222,754</u>	<u>\$ 237,899</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Interest paid	\$ 5,357	\$ 5,252
Income taxes paid, net	<u>\$ 42,162</u>	<u>\$ 25,801</u>

See Notes to Unaudited Condensed Consolidated Financial Statements.

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Nine Months Ended September 30, 2008

(Unaudited)

**1. BASIS OF PRESENTATION**

*Unaudited Interim Financial Statements*—The accompanying unaudited condensed consolidated financial information has been prepared by Cymer, Inc., and its wholly-owned subsidiaries and majority-owned joint venture, TCZ, Pte. Ltd. ("TCZ") (collectively, "Cymer"), without audit, in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. The unaudited condensed consolidated balance sheet at December 31, 2007 was derived from the audited financial statements at that date; however it does not include all disclosures required by accounting principles generally accepted in the United States.

In the opinion of management, the unaudited condensed consolidated financial statements for the interim period presented reflect all material adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial position and results of operations as of and for such periods indicated. These unaudited condensed consolidated financial statements and notes hereto should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007. Results for the interim periods presented herein are not necessarily indicative of results that may be reported for any other interim period or for the fiscal year ending December 31, 2008.

*Principles of Consolidation*—The accompanying unaudited condensed consolidated financial statements include the accounts of Cymer, Inc. and the accounts of our wholly-owned subsidiaries. We also consolidate the financial position and results of operations of TCZ and reflect the minority interest in the joint venture in our unaudited condensed consolidated financial statements. Earnings or losses of TCZ are distributed in accordance with the respective percentage interests of the joint owners. All significant intercompany balances and transactions have been eliminated in consolidation.

*Use of Estimates*—The unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Applying these principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the unaudited condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results may differ from those estimates.

*Accounting Pronouncements Adopted*

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value using generally accepted accounting principles, and expands disclosures related to fair value measurements. This Statement applies to other accounting pronouncements that require or permit fair value measurements. Accordingly, SFAS No. 157 does not require any new fair value measurements. However, for some entities, the application of this Statement changes current practice. This Statement became effective for us on January 1, 2008. Subsequent to the issuance of SFAS No. 157, the FASB issued FASB Staff Position 157-2 ("FSP 157-2"). FSP 157-2 delays the effective date of the application of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. We adopted all of the provisions of SFAS No. 157 on January 1, 2008 with the exception of the application

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

**1. BASIS OF PRESENTATION (Continued)**

of the Statement to non-recurring nonfinancial assets and nonfinancial liabilities. Although SFAS No. 157 increases the level of disclosures required for us for certain of our financial assets and liabilities, it did not have a material impact on our unaudited condensed consolidated financial statements. See Note 9, "Fair Value Measurements" for our SFAS No. 157 disclosures for the nine months ended September 30, 2008.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). This Statement permits companies to choose to measure many financial assets and liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in net income. This Statement also establishes presentation and disclosure requirements to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 became effective for fiscal years beginning after November 15, 2007. This Statement became effective for us on January 1, 2008. Based upon our analysis and implementation of SFAS No. 159 as it relates to our balance sheet accounts, we did not elect the fair value option permitted in SFAS No. 159 for any of our eligible financial assets or liabilities. Therefore, SFAS No. 159 did not have any impact on our unaudited condensed consolidated financial statements.

*Reclassifications*—Certain prior year amounts in the unaudited condensed consolidated financial statements have been reclassified to conform to the 2008 presentation.

**2. STOCKHOLDERS' EQUITY**

**Equity Awards**

We grant equity awards from our 2005 Equity Incentive Plan (the "Incentive Plan"), which provides for the issuance of incentive stock options, non-statutory stock options, stock appreciation rights, stock bonus awards, stock purchase awards, stock unit awards and other stock awards to our employees, non-employee directors and consultants. Stock options issued under the Incentive Plan expire ten years after the options are granted and generally vest and become exercisable ratably over a four-year period following the date of grant. Stock unit awards issued under the Incentive Plan generally vest one to four years from the date granted.

**2007 Long-Term Incentive Plan**—In April 2007, the compensation committee of our board of directors adopted the Long-Term Incentive Bonus Plan ("2007 LTIP") for 2007. Per the provisions of the 2007 LTIP, any bonuses accrued for performance in 2007 are paid 50% in cash and 50% in the form of restricted stock unit awards and both are ultimately earned or awarded based on the achievement of certain financial and performance criteria as set forth in the 2007 LTIP. The number of shares subject to the target restricted stock unit awards for 2007 was determined by dividing the cash value of the award by \$44.57, the closing price of our common stock as reported on the Nasdaq Global Select Market on April 16, 2007, the grant date.

In March 2008, the compensation committee approved the 2007 LTIP payments based on the achievement of the performance conditions for 2007 and issued 66,000 restricted stock units from our Incentive Plan. The restricted stock units will vest in three equal annual installments beginning January 1, 2009.

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

2. STOCKHOLDERS' EQUITY (Continued)

**Long-Term Incentive Bonus Program**—In October 2007, the compensation committee of our board of directors approved the Long Term Incentive Bonus Program ("LTIP") which became effective January 1, 2008 for our executive officers and certain key employees. Any potential equity based bonuses awarded under the LTIP are calculated based on a target dollar amount. This target amount is divided into two equity award components to be granted from our Incentive Plan: 50% of the target amount in time-based vesting stock options and 50% in performance-based restricted stock units ("RSUs"). In January 2008, we granted stock options to purchase 434,000 shares under the LTIP and they will vest over our standard four-year schedule. The shares subject to the RSU awards will vest and become issuable following a three-year performance period that commences on the grant date only if our relative performance compared to specified peer companies over the three-year period meets or exceeds certain performance measures. Vesting of the RSU awards is subject to downward adjustment if the participant fails to meet 100% of his or her individual management-by-objective goals during the three-year performance period. During the nine months ended September 30, 2008, 159,000 RSU's were granted at 100% of the target number of shares under the LTIP.

We value the stock unit awards which are issued to our non-employee directors and key employees using an intrinsic calculation based on the price of our stock on the date that the stock unit award is granted. Compensation expense related to these stock unit awards is recognized straight line over the service period. For those stock unit awards that have performance-based conditions such as those granted under our long term incentive programs, we adjust the compensation expense over the service period based upon the expected achievement of the performance conditions under our programs. The fair value of stock-based options granted, less expected forfeitures, is recognized to expense over the requisite service period.

**Share-Based Compensation**—The components of share-based compensation expense for employees, non-employee directors and non-employees for the three and nine months ended September 30, 2008 and 2007 are as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Stock options—employees and non-employee directors	\$ 904	\$ 917	\$ 2,671	\$ 3,147
Stock options—non-employees or change in status	4	14	32	123
Restricted stock unit awards—employees	173	213	500	567
Restricted stock units—non-employee directors	175	175	554	526
Performance restricted stock unit awards—employees	63	—	768	—
Total share-based compensation	\$ 1,319	\$ 1,319	\$ 4,525	\$ 4,363

For the nine months ended September 30, 2008, we realized a tax shortfall for share-based compensation of approximately \$935,000. The tax windfall realized for share-based compensation for the nine months ended September 30, 2007 totaled approximately \$1.9 million.

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

2. STOCKHOLDERS' EQUITY (Continued)

Comprehensive Income (Loss)

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income	\$ 5,735	\$ 21,670	\$ 32,960	\$ 66,925
Foreign currency translation adjustments(1)	(5,566)	2,174	(14,301)	3,288
Unrealized gains (losses) on available-for-sale investments, net of tax	(314)	211	(302)	311
Unrealized losses on foreign currency exchange contracts, net of tax	(69)	(20)	(176)	(54)
Unrealized pension gains (losses), net of taxes	16	2	26	(1)
Comprehensive income (loss)	\$ (198)	\$ 24,037	\$ 18,207	\$ 70,469

The components of accumulated other comprehensive income (loss) are as follows (in thousands):

	September 30, 2008	December 31, 2007
Foreign currency translation adjustments(1)	\$ (14,264)	\$ 37
Unrealized gains (losses) on available for sale investments, net of tax	(73)	229
Unrealized gains (losses) on foreign currency forward exchange contracts, net of tax	(86)	90
Unrealized pension losses, net of taxes	(116)	(142)
Accumulated other comprehensive income (loss)	\$ (14,539)	\$ 214

(1) Since the beginning of 2008 and most notably in the third quarter of 2008, several of the foreign currencies in which our subsidiary offices operate have weakened significantly against the U.S. Dollar which impacts the comprehensive income (loss) on our unaudited condensed consolidated balance sheets. The most volatile of these currencies during the nine month period ended September 30, 2008 was the Korean Won and to a lesser extent the Euro. For the first nine months of 2007, and the year ended December 31, 2007 several of the foreign currencies in which we conduct business, primarily the Japanese Yen, the Korean Won and the Euro, strengthened or remained stable against the U.S. dollar.

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

2. STOCKHOLDERS' EQUITY (Continued)

Stock Repurchase Program

In April 2008, our board of directors authorized us to repurchase up to \$100 million of our common stock in the open market or in privately negotiated transactions. The program does not have a fixed expiration date and may be discontinued at any time. Through September 30, 2008, we purchased 803,500 shares for \$22.9 million under this program.

3. EARNINGS PER SHARE

Basic and diluted earnings per share are presented in accordance with SFAS No. 128, "Earnings Per Share". Basic earnings per share ("EPS") is computed by dividing net income or loss attributable to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock (convertible subordinated notes using the "if-converted" method, and common stock options, restricted stock units, and employee stock purchase plan ("ESPP") shares using the treasury stock method) were exercised or converted into common stock. Potential dilutive securities are excluded from the diluted EPS computation in loss periods as their effect would be anti-dilutive.

The following table sets forth the basic and diluted EPS (in thousands, except per share information):

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>NET INCOME:</b>				
Net income, as reported	\$ 5,735	\$ 21,670	\$ 32,960	\$ 66,925
Interest expense on convertible subordinated notes, net of taxes	—	919	2,692	2,710
Net earnings available to common shareholders, diluted	\$ 5,735	\$ 22,589	\$ 35,652	\$ 69,635
<b>WEIGHTED AVERAGE SHARES:</b>				
Basic weighted average common shares outstanding	29,665	31,395	30,034	34,573
Effect of dilutive securities:				
Options, stock units and ESPP	114	379	104	465
Assumed conversion of subordinated notes	—	2,814	2,814	2,814
Diluted weighted average common shares outstanding	29,779	34,588	32,952	37,852
<b>Earnings per share:</b>				
Basic	\$ 0.19	\$ 0.69	\$ 1.10	\$ 1.94
Diluted	\$ 0.19	\$ 0.65	\$ 1.08	\$ 1.84

For the three months ended September 30, 2008 and 2007, weighted average options to purchase shares of common stock totaling approximately 2.7 million shares and 794,000 shares, respectively, were not included in the computation of diluted earnings per share as their effect was anti-dilutive. For the

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

3. EARNINGS PER SHARE (Continued)

nine months ended September 30, 2008 and 2007, weighted average options to purchase shares of common stock totaling approximately 2.7 million shares and 752,000 shares were not included in the computation of diluted earnings per share as their effect was anti-dilutive. For the three months ended September 30, 2008, weighted average common stock attributable to convertible subordinated notes consisting of 2.8 million shares were not included in the computation of diluted earnings per share as their effect was anti-dilutive. Additionally, for the three and nine months ended September 30, 2008, weighted average restricted stock units totaling approximately 139,000 shares and 138,000 shares, respectively, were not included in the computation of diluted earnings per share as their effect was anti-dilutive. There were no anti-dilutive shares related to restricted stock units for the three or nine month period ended September 30, 2007.

4. INVENTORIES

Inventories are written down to the lower of cost or estimated market value, which is defined as the lower of the current replacement cost or net realizable value as defined by Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, if the market value is less than cost. This value approximates the first-in, first-out method. Inventories consisted of the following (in thousands):

	September 30, 2008	December 31, 2007
<b>INVENTORIES:</b>		
Raw materials	\$ 43,673	\$ 43,238
Work-in-progress	29,095	21,610
Finished goods	111,591	64,909
<b>Total</b>	<b>\$ 184,359</b>	<b>\$ 129,757</b>

The increase in inventories for the nine months ended September 30, 2008 was due primarily to increases in our field replacement parts inventory to support the increased utilization of our light sources, to provide for faster replacement parts availability to support new XLR light source system installations and to support our OnPulse® service agreements. The increase in inventory also includes Extreme Ultraviolet ("EUV") systems that are currently being built in support of planned production demand.

5. INCOME TAXES

The tax provision of \$16.7 million for the nine months ended September 30, 2008 reflects an annual effective rate of 36.5% without the recently reinstated federal research and development credit included. The rate for both the three and nine months ended September 30, 2008 of 35% is lower than the forecasted annual effective rate due to the impact of discrete items recorded in the third quarter of 2008. Our forecasted annual effective tax rate depends on various factors, such as tax legislation and credits and the geographic compositions of our pre-tax income. On October 3, 2008, the currently expired federal research and development tax credit was signed into law and reinstated retroactively to

**CYMER, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Nine Months Ended September 30, 2008**

**(Unaudited)**

**5. INCOME TAXES (Continued)**

January 1, 2008. As it was signed into law subsequent to September 30, 2008, there was no benefit associated with it taken in our third quarter or year-to-date tax provision. The annual effective rate with the federal research and development credit included is expected to be approximately 33%.

As of September 30, 2008, the balance of our net FASB Interpretation No. 48 ("FIN 48") liability was \$22.1 million. The balance is \$1.1 million higher than the balance at June 30, 2008. This increase is due to additional interest accrued on our FIN 48 reserve and the impact of certain temporary items that were trued up when the 2007 U.S. income tax return was filed in the third quarter of 2008. There was no material net impact to the 2008 tax provision for the quarter or the year as a result of these items.

We are currently under an IRS audit for the 2003 through 2006 tax years. Though the estimated completion date of the audit is not known, it is unlikely that the audit will be completed or that the progress of the audit will cause us to reassess our tax reserves for these years within the next twelve months. The completion of this audit could require a material change to our gross unrecognized tax benefits. However, based on the status of this audit and the protocol for finalizing such audits, it is not possible to estimate the impact of this audit on previously recorded uncertain tax positions. We do not foresee material changes to the state or foreign uncertain tax positions within the next twelve months.

**6. GUARANTEES AND WARRANTIES**

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

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

**CYMER, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Nine Months Ended September 30, 2008**

**(Unaudited)**

**6. GUARANTEES AND WARRANTIES (Continued)**

The following table summarizes information related to our warranty provision (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Beginning balance	\$ 26,410	\$ 28,975	\$ 24,350	\$ 29,450
Liabilities accrued for warranties issued, net of adjustments and expirations	3,163	3,251	15,288	11,143
Warranty expenditures incurred during the period	(3,988)	(5,741)	(14,053)	(14,108)
Balance as of September 30	\$ 25,585	\$ 26,485	\$ 25,585	\$ 26,485

We agree to indemnify our customers, and the general purchase agreements with our three lithography tool manufacturer customers, ASML, Canon and Nikon, as well as certain of our development and supply agreements, generally include intellectual property indemnification provisions that provide we defend these parties against certain infringement claims directed against our products. Under the indemnification provisions, we would pay court-ordered damages attributable to any proven infringement, including attorney's fees associated with settlements or litigation in respect of such claims, provided that the party involved used the tool or made the component or subsystem in accordance with our recommendations and did not modify the tool or incorporate technology or features that were not of our design, and provided further that the party involved follows specific procedures for notifying us of such claims and allows us to manage the defense and settlement proceedings. As of September 30, 2008, we were not subject to any pending intellectual property-related litigation. We have not received any requests for nor have we been required to make any payments under these indemnification provisions.

**7. RELATED PARTY TRANSACTIONS**

*Carl Zeiss SMT AG and Carl Zeiss Laser Optics Beteiligungsgesellschaft mbH ("Zeiss").* As a result of the formation of our TCZ joint venture in July 2005 and under the terms of the joint venture agreement which was amended in September 2006, Zeiss is a related party. In addition to transactions that occur among us, Zeiss and TCZ related to the joint venture, we also purchase certain optical parts directly from Zeiss and periodically sell our light source system products to Zeiss. We recorded revenue associated with these related party transactions of \$450,000 and \$1.8 million for the three months ended September 30, 2008 and 2007, respectively, and \$1.8 million and \$3.1 million for the nine months ended September 30, 2008 and 2007, respectively. As of September 30, 2008 and December 31, 2007, we had an accounts receivable balance of \$644,000 and \$1.1 million, respectively, and an accounts payable balance of \$1.4 million and \$4.4 million, respectively, all of which were associated with these related party transactions with Zeiss.

During the third quarter of 2008, we and Zeiss agreed to make an additional \$5.0 million cash contribution to TCZ. This additional contribution was split following the terms of the Joint Venture

**CYMER, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Nine Months Ended September 30, 2008**

**(Unaudited)**

**7. RELATED PARTY TRANSACTIONS (Continued)**

Agreement or 60% from us and 40% from Zeiss. Both parties made their portion of this contribution to TCZ prior to September 30, 2008.

**8. CONTINGENCIES AND COMMITMENTS**

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

**9. FAIR VALUE MEASUREMENTS**

We adopted SFAS No. 157, "Fair Value Measurements" as of January 1, 2008, with the exception of the application of the statement to our non-recurring nonfinancial assets and nonfinancial liabilities. Non-recurring nonfinancial assets and nonfinancial liabilities for which we have not applied the fair value provisions of SFAS No. 157 currently include those measured within goodwill, intangible and long-lived assets impairment testing.

SFAS No. 157 currently applies to all financial assets and liabilities that are being measured and reported on at fair value on a recurring basis. This includes certain items we currently report in cash equivalents and available-for-sale securities within our cash and cash equivalents, short term and long term investments on the accompanying unaudited condensed consolidated balance sheets. In addition, our derivatives, which consisted of foreign currency forward exchange contracts, are reported at fair value and are included in the scope of SFAS No. 157.

SFAS No. 157 stipulates that fair value is defined as the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, willing parties. Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied. These valuation techniques include unobservable inputs and involve some level of estimation and judgment on the part of the reporting entity, the degree of which is dependent on the price transparency for the instruments or market and the instruments' complexity.

Upon our adoption of SFAS No. 157, assets and liabilities recorded at fair value in our unaudited condensed consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. The levels as defined by the fair value hierarchy in SFAS No. 157 are as follows:

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

## 9. FAIR VALUE MEASUREMENTS (Continued)

Level 1—	Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.
Level 2—	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly at the measurement date.
Level 3—	Inputs are unobservable for the asset or liability and usually reflect the reporting entity's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The majority of our available-for-sale securities and our foreign currency forward exchange contracts are priced via independent providers. In obtaining such valuation information from third parties, we have evaluated the valuation methodologies used to develop the fair values in order to determine whether such valuations are representative of an exit price in our principal markets.

*Available-for-Sale Securities.* The fair values of our available-for-sale securities are determined by a matrix pricing which is a mathematical technique widely used to value securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark-quoted securities. Such assets are classified as Level 2 inputs in the fair value hierarchy and typically include our commercial paper and government and corporate fixed income securities which are included in our investment portfolio. As a result of the continued crisis in the credit market and the recent weakening of the U.S. economy, we have considered whether or not these Level 2 inputs are appropriate and are still reflective of fair value for our available-for-sale securities. Based on the types of holdings which are included in our investment portfolio, we determined that these Level 2 inputs were reflective of fair value for our available-for-sale securities as of September 30, 2008.

*Auction Rate Securities.* We currently hold one auction rate security ("ARS") within our investment portfolio which is classified as an available-for-sale-security and has a par value of \$5.6 million. Under normal market conditions, we would determine the fair value of this ARS based on observable market prices for identical or similar instruments. However, due to the continuing crisis in the credit markets and the fact that this ARS has failed in multiple auctions since being purchased by us in October 2007, we have been unable to obtain such market data on which to base our valuation thus far in 2008. Therefore, we have been calculating the fair value of this ARS at the end of each reporting period utilizing a discounted cash flow model which is a Level 3 input in the fair value hierarchy. This model assumes that we will enter into a credit default swap to protect the par value of the ARS and that it will settle in 40 years. Other inputs to this discounted cash flow calculation include a coupon rate and a default swap risk rate over the 40 year period. As a result of utilizing this model, we determined that the fair value of this ARS was \$497,000 at September 30, 2008 which resulted in an impairment to date of \$5.1 million or approximately 91% of its par value during the nine month period ended September 30, 2008. In addition to this ARS having multiple failed auctions since it was purchased, the company that insures the ARS and the ARS itself were significantly downgraded during the first half of 2008. As a result of the failed auctions associated with this ARS, the magnitude of the impairment, the downgrading of the ARS itself and the company that insures it, and the continuing

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

9. FAIR VALUE MEASUREMENTS (Continued)

credit market crisis, we determined that the \$5.1 million impairment to date was other-than-temporary. Since we determined that this was an other-than-temporary impairment, we recorded this as a write-down of investments in other income (expense), net in the accompanying unaudited condensed consolidated statements of income. Of this \$5.1 million impairment, \$270,000 was identified and recorded in the three months ended September 30, 2008. This additional impairment in the third quarter of 2008 was primarily due to the increase in the interest rates associated with credit default swaps, one of the inputs included in our model to determine the fair value of the ARS at the end of the period. It is uncertain that we will be able to liquidate this ARS in the near term and the likelihood is high that we will hold this ARS in excess of 12 months. Therefore, we have classified the \$497,000 fair value of this ARS as a long-term investment on our unaudited condensed consolidated balance sheet at September 30, 2008.

*Derivative Instruments.* Our foreign currency forward exchange contracts are valued using an income approach which includes observable Level 2 market inputs at the measurement date and uses a standard valuation technique to convert future foreign currency amounts to a single discounted present amount assuming participants are motivated, but not compelled to transact. Level 2 inputs are limited to quoted prices for similar assets or liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability. Key inputs in this discounted calculation include spot currency exchange rates at the measurement date, interest rates, and credit default swap rates at standard quoted intervals. Credit default derivatives are not available to us; therefore, we use the spread over LIBOR for the current yield on our convertible note. The principal market in which we execute our foreign currency forward exchange contracts is the retail market. Mid-market pricing is used as a practical expedient for fair value measurements. Since significant inputs in the valuation of our foreign currency forward exchange contracts are observable in the active market, they are classified as Level 2 in the fair value hierarchy. As a result of the continued crisis in the credit market and the recent weakening of the U.S. economy, we have considered whether or not these Level 2 inputs are appropriate and are still reflective of fair value for our derivative instruments. Based upon our review of our derivative instruments and the credit worthiness of the parties associated with them, we determined that the Level 2 inputs currently being used were reflective of the fair value of our derivative instruments as of September 30, 2008.

**CYMER, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Nine Months Ended September 30, 2008**

**(Unaudited)**

**9. FAIR VALUE MEASUREMENTS (Continued)**

Our financial assets and financial liabilities measured at fair value on a recurring basis which are subject to the disclosure requirements of SFAS No. 157 at September 30, 2008 are as follows (in thousands):

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Assets:</b>				
Cash and cash equivalents	\$ 165,208	\$ 57,546	\$ —	\$ 222,754
Auction rate securities	—	—	497	497
Other available-for-sale securities	—	53,555	—	53,555
<b>Total Assets</b>	<b>\$ 165,208</b>	<b>\$ 111,101</b>	<b>\$ 497</b>	<b>\$ 276,806</b>
<b>Liabilities:</b>				
Foreign currency forward exchange contracts	\$ —	\$ 592	\$ —	\$ 592
<b>Total Liabilities</b>	<b>\$ —</b>	<b>\$ 592</b>	<b>\$ —</b>	<b>\$ 592</b>

The following table summarizes the change in balance sheet carrying value associated with the ARS which was the only Level 3 financial instrument carried at fair value at September 30, 2008 (in thousands):

Balance at January 1, 2008	\$ —
Transfers in and out of Level 3	5,600
Total realized and unrealized gains (losses) included in earnings	(5,103)
Included in other comprehensive income	—
Purchases, sales, issuances and settlements	—
Balance at September 30, 2008	<u>\$ 497</u>

We currently have convertible subordinated notes which are outstanding and these notes are recorded at face value on our unaudited condensed consolidated balance sheets. Per the guidance in SFAS No. 107 "Disclosures about Fair Value of Financial Instruments", we are required to disclose the fair value of such notes at the end of each reporting period. The principal amount of the notes outstanding at September 30, 2008 was \$140.7 million and the fair value of such debt based on Bloomberg quoted market prices at September 30, 2008 was \$139.3 million. As there are quoted prices for our convertible subordinated notes in active markets, our disclosure is based on a Level 1 input per the SFAS No. 157 fair value hierarchy.

CYMER, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine Months Ended September 30, 2008

(Unaudited)

10. SEGMENT OPERATIONS

Our primary business is to design, manufacture and sell excimer light source systems and installed base products and services for use in photolithography systems used in the manufacture of semiconductors. We are also a 60% majority-owner of TCZ, which is developing a process tool for use in the manufacture of flat panel displays. These two businesses constitute separate reporting segments per the requirements of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS No. 131") as they each serve a different customer base, one in the semiconductor capital equipment industry and the other in the flat panel display industry. Prior to the third quarter of 2008, the TCZ segment did not exceed the quantitative thresholds included in SFAS No. 131. As such, we did not provide segment disclosures prior to the third quarter of 2008. Information related to our Cymer and TCZ segments is as follows (in thousands):

	<u>Cymer</u>	<u>TCZ</u>	<u>Total</u>
<b>REVENUE AND NET INCOME</b>			
<b>Three months ended September 30, 2008(1)</b>			
Revenue	\$ 111,393	\$ —	\$ 111,393
Net income (loss)	\$ 6,391	\$ (656)	\$ 5,735
<b>Three months ended September 30, 2007(1)</b>			
Revenue	\$ 132,125	\$ —	\$ 132,125
Net income (loss)	\$ 22,760	\$ (1,090)	\$ 21,670
<b>Nine months ended September 30, 2008(1)</b>			
Revenue	\$ 359,336	\$ —	\$ 359,336
Net income (loss)	\$ 35,848	\$ (2,888)	\$ 32,960
<b>Nine months ended September 30, 2007(1)</b>			
Revenue	\$ 381,774	\$ —	\$ 381,774
Net income (loss)	\$ 70,288	\$ (3,363)	\$ 66,925
<b>ASSETS</b>			
<b>September 30, 2008(2)</b>			
Total assets	\$ 756,280	\$ 15,183	\$ 771,463
<b>December 31, 2007(2)</b>			
Total assets	\$ 777,823	\$ 16,329	\$ 794,152

(1) TCZ net loss is presented net of intercompany eliminations and minority interest.

(2) TCZ total assets are presented net of intercompany eliminations

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

*The following discussion of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and notes thereto included in "Item 1. Financial Statements" of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto and the section titled "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007, filed with the Securities Exchange Commission on February 27, 2008.*

### Forward-Looking Statements

Statements in this Quarterly Report on Form 10-Q that are not strictly historical in nature are "forward-looking statements", within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements include, but are not limited to, references to the outlook for the semiconductor industry and us; expected domestic and international product sales and development; our planned research and development activities and expenditures; adequacy of our capital resources and investments; effects of business cycles in the semiconductor business; our competitive position; and our relationships with customers and third-party manufacturers of our products, and may contain words such as "believes," "anticipates," "expects," "plans," "intends" and words of similar meaning. These statements are predictions based on current information and our expectations and involve a number of risks and uncertainties. The underlying information and our expectations are likely to change over time. Actual events or results may differ materially from those projected in the forward-looking statements due to various factors, including, but not limited to, those contained under the caption "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q. Forward-looking statements herein speak only as of the date of this Quarterly Report on Form 10-Q. Unless required by law, we undertake no obligation to update or revise any forward-looking statements to reflect new information or future events or developments. Thus, you should not assume that our silence over time means that actual events are bearing out as expressed or implied in such forward-looking statements.

### Overview

We provide state-of-the-art lithographic light sources designed to help enable the performance of leading edge wafer steppers and scanners built by the three lithography tool manufacturers, and we provide installed base products and services ("IBPS") to support chipmakers that use these light sources in the production of advanced wafer patterning applications. We currently supply deep ultraviolet ("DUV") light sources to each of the lithography tool manufacturers, ASML, Canon, and Nikon, who in turn supply their wafer steppers and scanners to chipmakers. In addition, we sell IBPS, which include replacement parts, various service offerings and upgrades to lithography tool manufacturers as well as directly to chipmakers. We provide worldwide service and support through certified field service engineers, and we have replacement parts depots located close to many of our customers throughout the world. Our light source systems currently constitute many of the excimer light sources incorporated in lithography wafer stepper and scanner tools at chipmakers worldwide. As the leading supplier of lithography light sources, many of the consumer electronic devices manufactured in the last several years contain a semiconductor manufactured using our light sources.

We currently operate within two reportable segments, Cymer and TCZ. The Cymer segment of our business consists of products including photolithography light sources and IBPS. The TCZ segment is targeting the growing market for low-temperature poly-silicon ("LTPS") processing used in the manufacture of flat panel displays. No sales or revenues have been earned or recorded to date for our TCZ segment. Additional information regarding our reporting segment is contained in Note 10 to our unaudited condensed consolidated financial statements and in this Item 2. under Results of

Since we derive a substantial portion of our revenues from lithography tool manufacturers, we are subject to the volatile and unpredictable cyclical nature of the semiconductor equipment industry. The semiconductor equipment industry historically has experienced periodic ups and downs, some of them more pronounced than others.

The most recent growth year for the semiconductor equipment industry was 2006, during which we achieved record revenue and net income levels. We and many of the companies in our industry initially expected 2007 to be another growth year but as the year progressed, some chipmakers reduced capital equipment purchases in conjunction with delays in their planned build-outs of new fabs. In the first three quarters of 2008, global economic conditions continued to worsen, negatively effecting consumer spending on electronics. As a result, chipmakers have further reduced their capital spending and are delaying deliveries of capacity equipment. This has resulted in lithography tool manufacturers reducing their demand for our light sources in the first three quarters of 2008 compared to the same period in the prior year.

Our light source system shipments have historically tracked with the semiconductor-equipment cycle while our IBPS business scales with light source system utilization and installed base growth. As a result, our IBPS revenue has grown in the first three quarters of 2008 compared to the first three quarters of 2007. However, our total revenue declined approximately six percent in the first nine months of 2008 as compared to the same period in 2007.

Demand for our most advanced XL Series argon fluoride ("ArF") light sources remained strong in the first nine months of 2008. We shipped 39 ArF light sources for immersion applications in the first three quarters of 2008. Our XLR Series of light sources have accounted for the majority of these shipments with the XLR500i being selected by chipmakers in the Memory, Foundry and Logic sectors. During the third quarter of 2008, we introduced—and received multiple orders for—the newest member of the XLR Series, the XLR 500d, designed for dry ArF applications at the 32nm node. We believe that we are also well-positioned to support double patterning at the 32nm node with the XLR 600i, the industry's first 90W ArF light source designed for use in immersion double patterning applications. We received additional orders for multiple XLR 600i systems in the third quarter of 2008, while multiple units of the XLR500d and XLR600i are scheduled for shipment in late 2008. With product demand heavily weighted toward these high productivity ArF light sources; our currency adjusted average selling price ("ASP") continued to rise, reaching \$1.6 million during the third quarter of 2008.

We entered into a number of new OnPulse™ contracts with our customers during the third quarter of 2008. OnPulse contributes to our IBPS revenue and we now have more than 950 production light sources under such coverage at 23 different chipmakers and 51 fabs. However, we saw utilization at foundry and memory customers slow in the third quarter of 2008, driving a reduction in pulse usage. Though subject to variations in installed base utilization, we believe that our IBPS provide us with a foundation that will help weather a very difficult capital equipment environment. Given the challenges facing our customers, we view this time period as an opportunity for our IBPS to help chipmakers maximize their tool productivity and reduce their cost of operations.

In the third quarter of 2008, we continued to make progress on our laser produced plasma EUV source development. In late September 2008, at the EUVL Symposium, we announced that we had achieved a new industry milestone by producing one megajoule of EUV energy within a 24 hour run-time. One megajoule is enough EUV energy to process 250 300mm wafers. We also demonstrated further improvement in our industry leading debris mitigation technology, keeping the collector clean while measuring stable, uninterrupted transmitted power continuously for eight hours on a fully integrated system. Our first two commercial EUV sources are being assembled in the EUV

manufacturing area of our facility in San Diego, California. We expect to ship the first EUV source late this year, and anticipate shipping additional sources during 2009. Additionally, we are making progress in TCZ, our joint venture with Zeiss that is developing a production tool for the flat panel display industry. TCZ is currently building multiple production tools, and anticipates delivering its first prototype tool in late 2008 or early 2009.

The semiconductor and semiconductor capital equipment industries are currently operating in a rapidly changing business environment. Lower consumer spending, tighter credit markets, and rising unemployment are reducing consumer demand for electronics, resulting in an overall slowdown in semiconductor capital spending, including lithography. Visibility into customers' investment plans has been reduced and the timing for capacity orders is uncertain. We expect fourth quarter 2008 light source system and IBPS demand to be lower than in the third quarter of 2008. We anticipate that customer demand will continue to be largely driven by orders for leading edge immersion light sources, and that the recent pattern of investment by logic chipmakers will continue. We also believe that lithography demand will continue to exceed demand for overall semiconductor capital equipment, driven by increasing need for advanced immersion and double patterning applications over the next several years.

We are focused on winning each light source selection by providing customers with increased performance, productivity and lower cost of operations. We continue to review our overall cost structure, and we will take additional actions based on changing business conditions. We will continue to strengthen our leadership position by investing responsibly in research and development, delivering new XLR features and capabilities and successfully commercializing our EUV source product. We are also focused on increasing efficiencies within manufacturing and the field, driving continuous improvement in quality and reliability, and we are working to optimize our field inventory levels.

We maintain a website at [www.cymer.com](http://www.cymer.com) to which we regularly post copies of our press releases as well as additional information about us. Our filings with the SEC are available free of charge through our website as soon as reasonably practicable after being electronically filed with or furnished to the SEC. Interested persons can subscribe on our website to email alerts that are sent automatically when we issue press releases, file our reports with the SEC or post certain other information to our website. Information contained in our website does not constitute a part of this report.

### **Critical Accounting Policies and Estimates**

#### *General*

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

We believe that revenue recognition, inventory valuation, refurbished inventories, warranty obligations, stock-based compensation, and income taxes require more significant judgments and estimates in the preparation of our unaudited condensed consolidated financial statements than do other of our accounting estimates and judgments.

#### *Revenue Recognition*

Our revenues consist of product sales, which primarily include sales of light source systems, replacement parts, and to a lesser extent, training, service, upgrades, and refurbishments of our light source systems.

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

Revenue from replacement parts is recognized at the point that legal title passes to the customer, which is generally upon shipment from our facility. For a significant portion of our parts sales, our customers return the consumed assembly to us as part of the sale of the new part. We reuse some of the material within these core assemblies, mainly metal components, for the future build of core assemblies. As a result, our revenue consists of both cash and the value of the reusable parts received from our customers as consideration for these replacement part sales. Revenue associated with our customers' return of core assemblies is recognized upon receipt of the returned core assembly. The amount of the revenue is determined based upon the fair value of the reusable parts that we expect to yield from the returned core assembly which is based on historical experience. Revenue associated with our OnPulse® pulse utilization contracts is recognized based on actual pulse usage of the replacement parts in each light source system covered under the contract.

Service and training revenue is recognized as the services are rendered. For our service contracts, including OnPulse®, revenue is generally recognized straight line over the term of the contract or based on pulse usage.

Revenue from the sale of upgrades is recognized when the upgrade has been successfully installed by us and accepted by the customer.

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

On a limited basis, certain of our product sales transactions are accounted for as multiple-element arrangements in accordance with EITF 00-21. A multiple-element arrangement is a transaction which may involve the delivery or performance of multiple products, or services, and performance may occur at different points in time or over different periods of time. We allocate consideration to multiple element transactions based on the relative fair values of each separate element which we determine based on prices charged for such items when sold on a stand alone basis. In cases where there is objective and reliable evidence of the fair value of the undelivered item(s) in an arrangement but no such evidence for the delivered item(s), we use the residual method to allocate the arrangement consideration. If there is no objective and reliable evidence of the fair value of the undelivered item, we account for the transaction as a single unit of accounting per the requirements of EITF 00-21. Our sales arrangements do not include general rights of return.

Deferred revenue represents payments received from our customers in advance of the delivery of products and/or services, or before the satisfaction of all revenue recognition requirements as described above.

#### *Inventory Valuation*

Our inventories are written down to the lower of cost or estimated market value, which is defined as the lower of the current replacement cost or net realizable value as defined by Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, if the market value is less than cost. This value approximates the first-in, first-out method. We evaluate the need to record adjustments for impairment of our inventory on a quarterly basis and our policy is to assess the valuation of all inventories, including raw materials, work-in-process, finished goods, replacement parts and reusable parts that we use for our refurbishment activities. Obsolete inventory or inventory for which we either do not have expected usage based on our forecasted demand for the next 12 months or that we do not expect to have a high likelihood of use beyond 12 months is written down to its estimated market value, if less than its cost. When we perform our quarterly analysis of obsolete and excess inventory, we take into consideration certain assumptions related to market conditions and future demands for our products, including changes to product mix, new product introductions, and/or product discontinuances, which may result in excess or obsolete inventory. As part of this analysis, we also determine whether there are potential amounts owed to vendors as a result of cancelled or modified raw material orders. We estimate and record a separate liability, which is included in accrued and other liabilities in the accompanying balance sheets for such amounts owed.

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

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

Based upon our experience, we believe that the estimates we use to calculate the value of our inventories are reasonable and properly reflect the risk of excess and obsolete inventory. If actual demand or the usage periods for our inventory are substantially different from our estimates, such differences may have a material adverse effect on our financial condition and results of operations.

#### *Refurbished Inventories*

As part of our regular business activities, we conduct significant parts refurbishment and material reclaim activities related to some of our core assemblies, particularly our chamber assemblies. These activities involve arrangements with our customers where we sell a new part to the customer at a reduced sales price if the customer returns the consumed assembly that the new part replaces. These returned core assemblies contain a certain amount of material, primarily metal components, that may be reused by us in the manufacture of future core assemblies. Upon receipt of these consumed core assemblies from our customers, we record an entry to recognize the estimated fair value of the reusable components either 1) as revenue if the return of the core assembly relates to the sale of a replacement part or 2) as a reduction in cost of revenues if the return of the core assembly is related to a part being replaced under our warranty or per the terms of an active service contract with our customer. The value of the reusable parts contained within the consumed assembly is determined based upon historical data on the value of the reusable parts that we typically yield from that consumed assembly.

#### *Warranty Obligations*

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

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

We adopted the provisions of Statement of Financial Accounting Standards No. 123R ("SFAS No. 123R"), "Share-Based Payment", on January 1, 2006. SFAS No. 123R requires companies to estimate the fair value of stock-based compensation awards on the date of grant using an option-pricing model and amortize the resulting expense over the requisite service period of the award, which is generally the vesting period. Upon adoption of SFAS No. 123R, we elected to use the Black-Scholes option pricing model to estimate the fair value of stock options that we grant under our equity incentive plans. In order to determine the fair value of stock option grants under the Black-Scholes option pricing model, we must use subjective assumptions including the expected term of the stock options and our expected stock price volatility over the expected term of the stock options. SFAS No. 123R also requires that a forfeiture rate be estimated and included in the calculation of stock-based compensation expense at the time that the stock option or other stock awards such as our restricted stock unit awards are granted and revised if necessary in subsequent periods if actual forfeiture rates differ from those estimates.

We use a combination of historical and implied volatility ("blended volatility") to determine the expected stock volatility that we include in the Black-Scholes option pricing model to value our stock options. Historical volatility is based on a period commensurate with the expected term of the options. Implied volatility is derived based on six-month traded options of our common stock. The expected term of our stock options represents the period of time options are expected to be outstanding and is based on observed historical exercise patterns for our company which we believe are indicative of future exercise behavior. We estimate forfeiture rates based on the historical activity for our company which we believe are indicative of future forfeiture rates.

If we change any of the key assumptions that we use in the Black-Scholes option pricing model as described above, or if we decide to use a different valuation model in the future or change our forfeiture rate, the compensation expense that we record under SFAS No. 123R may differ significantly in the future from what we have recorded in the current period and could materially impact our financial condition and operating results.

During the first quarter of 2008, we granted performance restricted stock units ("PRsUs") to our executive officers and certain key employees under our new Long-Term Incentive Program which became effective on January 1, 2008. PRsUs are a form of share-based award in which the number of shares ultimately received will be determined based on our relative performance compared to a specified group of peer companies over a three-year performance period and eligible individual's management by objectives ("MBO") achievement during the same three year performance period. The value of each PRsU is determined on the grant date, based on our stock price, and assumes that performance targets will be achieved. During each quarter over the three-year performance period, we will calculate and record the stock-based compensation expense for the PRsUs using the following estimates: 1) our expected performance (both revenue growth and net income growth) as compared to the specified peer group companies as defined by the plan over the three year period and 2) the expected average percentage achievement of each of the participant's individual MBO goals over the three year period. The results of these two estimates will be used to calculate the expected PRsUs which will vest at the end of the three year period and the resulting quarterly stock-based compensation expense. At each reporting period, we will reassess these estimates and the probability of meeting these goals and adjust our estimated stock-based compensation expense accordingly. If actual results are not consistent with our initial assumptions and judgments used in estimating the forecasted metrics, we may be required to increase or decrease compensation expense, which could materially impact our financial condition and operating results.

Income taxes are accounted for in accordance with SFAS No. 109 ("SFAS No. 109"), "Accounting for Income Taxes", which requires deferred tax assets and liabilities to be recognized using enacted tax rates for the effect of temporary differences between the financial statement and tax bases of recorded assets and liabilities. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. We have determined that our future taxable income will be sufficient to recover our deferred tax assets. If in the future we determine that a change has occurred which will not allow this recovery, we will record a valuation allowance against our deferred tax assets. This will result in a charge against our income tax provision.

The calculation of our effective tax rate is dependant upon the geographic composition of our world wide earnings, tax regulations governing each region and the availability of tax credits. In addition, the calculation of our tax liabilities involves uncertainties in the application of complex tax laws and regulations. We recognize these uncertainties based on FIN 48, "Accounting for Uncertainty in Income Taxes". The final payment of the amounts regarding these uncertainties may ultimately prove to be less than or greater than our estimate. If this occurs there will be either a benefit or a charge to our income tax provision.

## RESULTS OF OPERATIONS

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

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Revenues:				
Product and service sales	99.6%	98.7%	99.5%	99.2%
Product sales—related party	0.4%	1.3%	0.5%	0.8%
Total revenues	100.0%	100.0%	100.0%	100.0%
Cost of Revenues	52.8%	49.9%	51.8%	49.2%
Gross Profit	47.2%	50.1%	48.2%	50.8%
Operating expenses:				
Research and development	21.8%	16.2%	19.8%	15.9%
Sales and marketing	5.3%	5.2%	5.1%	5.1%
General and administrative	7.2%	7.5%	7.6%	7.5%
Total operating expenses	34.3%	28.9%	32.5%	28.5%
Operating income	12.9%	21.2%	15.7%	22.3%
Total other income (expense)—net	(5.6)%	2.9%	(2.4)%	3.5%
Income before income tax provision and minority interest	7.3%	24.1%	13.3%	25.8%
Income tax provision	2.5%	8.3%	4.6%	8.9%
Minority interest	0.4%	0.6%	0.6%	0.6%
Net income	5.1%	16.4%	9.3%	17.5%

We currently operate within two reportable segments, Cymer and TCZ. The Cymer segment of our business consists of products including photolithography light sources and IBPS. The TCZ segment is targeting the growing market for LTPS processing used in the manufacture of flat panel displays. No sales or revenues were earned or recorded for the three or nine months ended September 30, 2008 and 2007 for the TCZ segment. As a result, no cost of revenue was recorded for these same periods. The discussion which follows for operating expenses and other income and expenses includes our consolidated expenses and identifies expenses associated with the TCZ segment for the three and nine months ended September 30, 2008 and 2007. Additional information regarding our reporting segments is contained in Note 10 to our unaudited condensed consolidated financial statements.

**Three Months Ended September 30, 2008 and 2007**

*Revenues.* The types of revenue that we generate and how we recognize revenue for each is explained above under the heading "Critical Accounting Policies and Estimates". The following table summarizes the components of our revenue and provides comparisons from period to period (in thousands, except units sold and percentage change):

	For the three months ended September 30,		2008 vs. 2007	
	2008	2007	Increase (Decrease)	% Change
Light source systems:				
Revenue	\$ 34,118	\$ 64,079	\$ (29,961)	-47%
Units sold	21	47	(26)	-55%
Average selling price(1)	\$ 1,620	\$ 1,376	\$ 244	18%
IBPS revenue	\$ 77,222	\$ 67,967	\$ 9,255	14%
Other revenue	\$ 53	\$ 79	\$ (26)	-33%
Total revenue	\$ 111,393	\$ 132,125	\$ (20,732)	-16%

(1)

The calculation of average selling price excludes \$97,000 and includes \$591,000 of deferred light source system revenue for the three months ended September 30, 2008 and 2007, respectively.

Total revenue decreased 16% for the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily due to a 47% decline in light source system revenues which was partially offset by a 14% increase in IBPS revenue from period to period. The decrease in light source revenues is primarily due to the number of light source systems that we sold as a result of the slowing in the semiconductor capital equipment industry. A total of 21 light source systems were sold at an average selling price of \$1.6 million in the three months ended September 30, 2008 compared to 47 light sources systems at an average selling price of \$1.4 million in the three months ended September 30, 2007. The average selling price of our light source systems increased 18% period over period due to a higher concentration of sales of our most advanced ArF light sources for high volume immersion production applications which include our XLR series light source. Our IBPS revenue growth from period to period was driven by high pulse utilizations of our light sources, our growing installed base of light sources and strong adoption of OnPulse® contracts. There were no sales recorded or revenues earned associated with our TCZ segment for the three months ended September 30, 2008 or 2007. We expect our revenue to decline in the fourth quarter of 2008 as compared to the third quarter of 2008 due to the continued slowing in the semiconductor capital equipment industry and the overall decline in the global economy.

Our DUV backlog includes only those orders for which we have received a completed purchase order from a customer, and that will be delivered to a customer within the following twelve months. In addition, our DUV backlog does not include services which will be provided to our customers in the future or under service contracts. For the period ended September 30, 2008, our DUV backlog totaled \$50.4 million and total DUV bookings were \$111.6 million which yielded a book-to-bill ratio of 1.0 compared to the period ended September 30, 2007, where our DUV backlog totaled \$110.9 million and total DUV bookings were \$151.1 million which yielded a book-to-bill ratio of 1.14. The decline in our DUV backlog and book to bill ratio period over period primarily reflects the slowing in the semiconductor capital equipment industry and a corresponding decline in the demand for our light source systems. Although the decline in the DUV bookings period over period reflects the slowdown in the semiconductor industry and the decline in light source system demand, the DUV bookings from period to period was positively impacted by an increase in the demand for our IBPS.

We installed 23 light sources at chipmakers and other end-users for the three months ended September 30, 2008 as compared to 55 light sources installed during the three months ended September 30, 2007.

Our sales are generated primarily by shipments to customers in the United States, Japan, Korea and Europe and, to a lesser extent, other Asian countries. Approximately 82% and 86% of our sales for the three months ended September 30, 2008 and 2007, respectively, were derived from customers outside the U.S. We maintain a wholly owned Japanese subsidiary, Cymer Japan, which sells to our Japanese customers. Revenues from Japanese customers, generated primarily by Cymer Japan, accounted for 21% and 26% of total revenues for the three months ended September 30, 2008 and 2007, respectively. The activities of Cymer Japan are limited to sales and service of products purchased by Cymer Japan from Cymer San Diego as the parent corporation. We anticipate that international sales will continue to account for a significant portion of our sales.

*Cost of Revenues.* Cost of revenues includes direct material and labor, warranty expenses, license fees, manufacturing and service overhead. Cost of revenues also includes foreign exchange gains and losses on foreign currency forward exchange contracts ("forward contracts") associated with purchases of our products by Cymer Japan for resale under firm third-party sales commitments. Shipping costs associated with our product sales are also included in cost of revenues. We do not charge our customers for shipping fees. The cost of revenues decreased 11% to \$58.9 million for the three months ended September 30, 2008 from \$65.9 million for the three months ended September 30, 2007. This decrease was primarily due to lower costs associated with our reduced light source system sales from period to period, which was partially offset by higher costs associated with sales of our IBPS. There were no cost of revenues recorded associated with the TCZ segment for the three months ended September 30, 2008 or 2007.

Gross profit decreased to \$52.5 million with a 47.2% gross margin for the three months ended September 30, 2008 from \$66.2 million with a 50.1% gross margin for the three months ended September 30, 2007. The decline from period to period is primarily due to the increasing percentage of sales attributable to our IBPS which typically generate lower margins. We anticipate that gross margin will remain at or below the third quarter 2008 level in the fourth quarter of 2008 due to lower overall sales and the continued shift in our sales mix to our IBPS.

*Research and Development.* Research and development expenses include costs of internally-funded projects as well as continuing product development support expenses, which consist primarily of employee and material costs, depreciation of equipment and other engineering related costs. Research and development expenses increased 13.9% to \$24.3 million for the three months ended September 30, 2008 from \$21.4 million for the three months ended September 30, 2007 due primarily to costs associated with our EUV source development and to a lesser extent, costs for our LTPS product development efforts associated with the TCZ joint venture and ongoing DUV product development

efforts. The increase in research and development costs were offset by decreases in variable compensation costs from period to period of \$1.7 million associated with our incentive programs, some of which we do not expect to fund in 2008. As a percentage of total revenues, research and development expenses increased to 21.8% for the three months ended September 30, 2008 from 16.2% for the three months ended September 30, 2007. We expect that our investment in research and development will continue and we anticipate that research and development expenses will remain relatively flat in the fourth quarter of 2008.

Research and development expenses for the TCZ segment associated with their LTPS product development efforts decreased 23% to \$1.0 million for the three months ended September 30, 2008 from \$1.3 million for the three months ended September 30, 2007 due primarily to a reduction of depreciation expense associated with certain demonstration equipment.

*Sales and Marketing.* Sales and marketing expenses include sales, marketing and customer support staff expenses and other marketing expenses. Sales and marketing expenses decreased 14.5% to \$5.9 million for the three months ended September 30, 2008 from \$6.8 million for the three months ended September 30, 2007. The decrease in sales and marketing expenses from period to period primarily reflects a \$549,000 decrease in variable compensation costs associated with our incentive bonus programs, some of which we do not expect to fund in 2008, and decreases in professional fees and travel related expenses. These decreases in sales and marketing expenses were partially offset by increases in employee related salaries and benefits. As a percentage of total revenues, sales and marketing expenses increased slightly to 5.3% for the three months ended September 30, 2008 compared to 5.2% for the three months ended September 30, 2007. We anticipate that sales and marketing expenses will remain relatively flat in the fourth quarter of 2008 as compared to the third quarter of 2008 levels.

Sales and marketing expenses associated with the TCZ segment increased 105% to \$517,000 for the three months ended September 30, 2008 from \$253,000 for the three months ended September 30, 2007 due primarily to increases in employee compensation and benefits related expenses

*General and Administrative.* General and administrative expenses consist primarily of management and administrative personnel costs, professional services, including external audit and consultant fees, and administrative operating costs. General and administrative expenses decreased 19% to \$8.0 million for the three months ended September 30, 2008 from \$9.9 million for the three months ended September 30, 2007 primarily due to a \$1.5 million decrease in variable compensation costs associated with our incentive bonus programs, some of which we do not expect to fund in 2008. In addition, general and administrative expenses decreased from period to period due to a \$715,000 decrease in professional fees and recruiting fees. These decreased expenses from period to period were partially offset by a \$363,000 increase in employee compensation and benefits and travel expenses. As a percentage of total revenues, general and administrative expenses decreased to 7.2% for the three months ended September 30, 2008 compared to 7.5% for the three months ended September 30, 2007. We anticipate that general and administrative expenses will remain relatively flat in the fourth quarter of 2008 as compared to the third quarter of 2008 levels.

General and administrative expenses associated with the TCZ segment decreased 124% to a negative expense of \$66,000 for the three months ended September 30, 2008 from \$277,000 for the three months ended September 30, 2007 due primarily to a decrease in variable costs associated with the TCZ incentive program. This reduction was due to amounts recorded in the prior year which we reversed in the third quarter of 2008 due to changes in TCZ's expected results which were identified in the third quarter of 2008.

*Total Other Income (Expense)—Net.* Net other income (expense) consists primarily of interest income earned on our investment and cash portfolio, interest expense incurred on our convertible subordinated notes, foreign currency exchange gains or losses associated with fluctuations in the value of the functional currencies of our foreign subsidiaries against the U.S. Dollar and other items that may be specific to a reporting period. Other expense, net totaled \$6.2 million for the three months ended September 30, 2008 compared to other income, net of \$3.9 million for the three months ended September 30, 2007. The change from net other income to net other expense from period to period was primarily due to foreign currency exchange losses of \$6.4 million which we recorded during the three months ended September 30, 2008 as compared to foreign currency gains of \$1.5 million which we recorded during the three months ended September 30, 2007. This change from foreign currency exchange gains to losses from period to period was primarily due to the volatility of the foreign currencies in which our subsidiary offices conduct business as measured against the U.S. Dollar. In the third quarter of 2007, several of these currencies strengthened against the U.S. Dollar, whereas in the third quarter of 2008, their value, particularly that of the Korean Won and the Euro, significantly declined against the U.S. Dollar. To mitigate the risk of future foreign currency exchange exposure, we are expanding our foreign currency hedging program and transitioning other currency related business practices to be more U.S. Dollar centric.

This change from net other income to net other expense was also caused by a reduction in interest income from period to period as a result of lower overall cash and investment balances and lower interest rate yields. We also recorded an additional \$270,000 write-down of our sole auction rate security that is included in our investment portfolio and has a par value of \$5.6 million. Based on the continued crisis in the credit market and changes to one of the key inputs we use to value the auction rate security, we recorded an additional impairment at September 30, 2008 which we determined was other-than-temporary.

Total other income (expense), net associated with the TCZ segment reflects other expense, net of \$176,000 for the three months ended September 30, 2008 compared to net other income of \$140,000 for the three months ended September 30, 2007. This change primarily reflects foreign currency exchange losses recorded during the three months ended September 30, 2008 compared to foreign currency exchange gains recorded during the same period in 2007.

*Income Tax Provision.* The tax provision of \$2.8 million and \$11.0 million for the three months ended September 30, 2008 and 2007, respectively, reflects a tax rate for the quarter of 35.0% and 34.6%, respectively. The increase in the quarterly tax rate from 2007 to 2008 is primarily attributable to the expiration of the federal research and development credit on December 31, 2007. Our annual effective tax rate depends on various factors, such as tax legislation and credits and the geographic compositions of our pre-tax income. On October 3, 2008, the currently expired federal research and development tax credit was signed into law and reinstated retroactively to January 1, 2008. The reinstatement of this credit in the fourth quarter of 2008 will benefit our annual effective tax rate and lower it from 36.5% to approximately 33%.

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

	For the nine months ended September 30,		2008 vs. 2007	
	2008	2007	Increase (Decrease)	% Change
Light source systems:				
Revenue	\$ 120,466	\$ 180,987	\$ (60,521)	-33%
Units sold	81	147	(66)	-45%
Average selling price(1)	\$ 1,486	\$ 1,235	\$ 251	20%
IBPS	\$ 238,588	\$ 200,249	\$ 38,339	19%
Other revenue	\$ 282	\$ 538	\$ (256)	-48%
Total revenue	\$ 359,336	\$ 381,774	\$ (22,438)	-6%

(1)

The calculation of average selling price excludes \$67,000 and includes \$591,000 of deferred light source system revenue for the nine months ended September 30, 2008 and 2007, respectively.

Total revenue decreased 6% for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 due to a decline of 33% in light source system sales which was partially offset by an increase in our IBPS revenue. The decrease in light source revenues is primarily due to the lower number of light source systems that we sold which was driven by reduced semiconductor capital equipment spending. In the nine months ended September 30, 2008, we sold 81 light source systems compared to 147 in the nine months ended September 30, 2007. The average selling price of our lasers increased 20% from period to period to \$1.5 million in the nine months ended September 30, 2008 from \$1.2 million in the nine months ended September 30, 2007. This increase in the average selling price is due to the continued adoption of our most advanced ArF light sources for high volume immersion production applications which include our XLR series light source. On a foreign currency adjusted basis, the average selling price increased 21% period over period, due to the continued shift in the product mix to our higher priced ArF light source systems. ArF light source systems accounted for 91% of light source systems revenue for the nine months ended September 30, 2008 as compared to 82% of light source system revenue for the nine months ended September 30, 2007. The continued growth in our IBPS revenue has been driven by increasing pulse utilization of our existing light source systems by chipmaker customers, our growing installed base of light sources, the strong adoption of our OnPulse® service product and the sales of other productivity enhancements such as GLX. There were no sales recorded or revenues earned associated with the TCZ segment for the nine months ended September 30, 2008 or 2007.

Sales to our three lithography tool manufacturing customers, ASML, Canon, and Nikon, amounted to 24%, 4% and 18%, respectively, of total revenue for the nine months ended September 30, 2008, and 35%, 4% and 18%, respectively, of total revenue for the nine months ended September 30, 2007. Sales of IBPS made directly to chipmakers accounted for 54% of total revenue for the nine months ended September 30, 2008 and 43% of total revenue for the nine months ended September 30, 2007.

Approximately 84% and 86% of our sales for both the nine months ended September 30, 2008 and 2007, respectively, were derived from customers outside the United States.

Cost of Revenues. The cost of revenues decreased 1% to \$186.3 million for the nine months ended September 30, 2008 from \$187.7 million for the nine months ended September 30, 2007. This

decrease was primarily due to lower costs associated with the decrease in sales of our light source systems from period to period. This decrease was offset by higher costs associated with our IBPS, higher overall warranty costs and higher manufacturing rework costs from period to period. There was no cost of revenues recorded associated with the TCZ segment for the nine months ended September 30, 2008 or 2007.

Gross profit decreased to \$173.1 million with a 48.2% gross margin for the nine months ended September 30, 2008 from \$194.1 million with a 50.8% gross margin for the nine months ended September 30, 2007. This decrease in gross profit and gross margin from period over period is primarily due to a higher overall warranty expense and the increasing percentage of our revenues from IBPS which typically generate lower margins.

*Research and Development.* Research and development expenses increased 17.3% to \$71.3 million for the nine months ended September 30, 2008 from \$60.8 million for the nine months ended September 30, 2007 due primarily to increases in costs associated with our EUV source development and, to a lesser extent, costs for our LTPS product development efforts associated with our TCZ joint venture and ongoing DUV product development efforts. These increases in research and development expenses were partially offset by a \$3.7 million decrease from period to period in variable compensation costs associated with our incentive bonus programs, some of which we were able to fund in 2007 but do not expect to fund in 2008. As a percentage of total revenues, research and development expenses increased to 19.8% for the nine months ended September 30, 2008 from 15.9% for the nine months ended September 30, 2007.

Research and development expenses associated with the TCZ segment increased 19% to \$3.5 million for the nine months ended September 30, 2008 from \$2.9 million for the nine months ended September 30, 2007 due to increases in employee compensation and benefits expenses, consulting and outside services expenses.

*Sales and Marketing.* Sales and marketing expenses decreased 6.3% to \$18.4 million for the nine months ended September 30, 2008 from \$19.6 million for the nine months ended September 30, 2007. The decrease in sales and marketing expenses from period to period was primarily due to a \$1.6 million decrease in variable compensation costs associated with our incentive bonus programs, some of which we were able to fund in 2007, but do not expect to fund in 2008. This decrease in expense was partially offset by increases in employee compensation and benefits, public relations and travel expenses. As a percentage of total revenues, sales and marketing expenses were 5.1% for the nine months ended September 30, 2008 and September 30, 2007.

Sales and marketing expenses associated with the TCZ segment decreased 36% to \$1.2 million for the nine months ended September 30, 2008 from \$1.8 million for the nine months ended September 30, 2007 due primarily to a decrease in employee compensation and benefits and travel and entertainment expenses.

*General and Administrative.* General and administrative expenses decreased 4.7% to \$27.1 million for the nine months ended September 30, 2008 from \$28.5 million for the nine months ended September 30, 2007. The decrease in general and administrative expenses from period to period was primarily due to a \$2.0 million decrease in variable compensation costs associated with our incentive bonus programs, some of which we were able to fund in 2007, but which we do not expect to fund in 2008. In addition, professional fees decreased from period to period primarily due to a \$1.7 million decline in advisory fees which reflects costs incurred for the adoption and implementation of FIN 48 during the nine months ended September 30, 2007. This decrease in expense was offset by a \$1.3 million increase in employee compensation and benefits and travel expenses from period to period. As a percentage of total revenues, general and administrative expenses increased slightly to 7.6% for the nine months ended September 30, 2008 from 7.5% for the nine months ended September 30, 2007.

General and administrative expenses associated with the TCZ segment decreased 47% to \$591,000 for the nine months ended September 30, 2008 from \$1.1 million for the nine months ended September 30, 2007 due primarily to a decrease in variable costs associated with the TCZ incentive program. This reduction was due to amounts recorded in the prior year which we reversed in the third quarter of 2008 due to changes in TCZ's expected results which were identified in the third quarter of 2008. These decreases were partially offset by an increase in outside services expense.

*Total Other Income (Expense)—Net.* Other expense, net totaled \$8.7 million for the nine months ended September 30, 2008 compared to other income, net of \$13.4 million for the nine months ended September 30, 2007. The loss from net other income to net other expense from period to period was primarily due to foreign currency exchange losses of \$6.4 million which we recorded during the nine months ended September 30, 2008 as compared to foreign currency gains of \$2.0 million which we recorded during the nine months ended September 30, 2007. This change from foreign currency exchange gains to losses from period to period is primarily due to the volatility of the foreign currencies in which our subsidiary offices conduct business as measured against the U.S. Dollar. In the third quarter of 2007, several of these currencies strengthened against the U.S. Dollar, whereas in the third quarter of 2008, their value, particularly that of the Korean Won and the Euro significantly declined against the U.S. Dollar. To mitigate the risk of future foreign currency exchange exposure, we are expanding our foreign currency hedging program and transitioning other currency related business practices to be more U.S. Dollar centric.

This change from net other income to net other expense was also caused by a significant reduction in interest income from period to period as a result of lower overall cash and investment balances and lower interest rate yields. Additionally, we recorded a \$5.1 million write-down of our investments for the nine months ended September 30, 2008 related to the sole auction rate security that is included in our investment portfolio and has a par value of \$5.6 million. Based on the continued crisis in the credit market, the significant downgrading of this auction rate security in 2008, and an update to one of the key inputs used by us to calculate its value, our evaluation of its fair value at September 30, 2008 resulted in an other-than-temporary impairment totaling \$5.1 million.

Total other income (expense), net associated with the TCZ segment reflects other expense, net of \$145,000 for the nine months ended September 30, 2008 compared to net other income of \$415,000 for the nine months ended September 30, 2007. This change primarily reflects foreign currency exchange losses recorded during the three months ended September 30, 2008 compared to foreign currency exchange gains recorded during the same period in 2007. In addition, TCZ had lower interest income from period to period as a result of lower overall cash and investment balances in 2008 as compared to 2007.

*Income Tax Provision.* The tax provision of \$16.7 million and \$34.1 million for the nine months ended September 30, 2008 and 2007, respectively, reflects a tax rate for the year of 35.0% and 34.6%, respectively. The tax rate for the nine months ended September 30, 2008 is lower than the annual effective tax rate of 36.5%, as estimated without the recently reinstated federal research and development tax credit included, due to the impact of certain discrete items which were recorded in the third quarter of 2008. Our future annual effective tax rate depends on various factors, such as tax legislation and credits and the geographic compositions of our pre-tax income. On October 3, 2008, the currently expired federal research and development tax credit was signed into law and reinstated retroactively to January 1, 2008. The reinstatement of this credit in the fourth quarter of 2008 will benefit our annual effective tax rate and lower it from 36.5% to approximately 33%.

## LIQUIDITY AND CAPITAL RESOURCES

Historically we have funded our operations primarily from cash generated from operations, the proceeds of note offerings, and the proceeds from employee stock option exercises. We have also from time to time utilized cash to repurchase shares of our common stock and to repurchase principal on our convertible subordinated notes. As of September 30, 2008, we had approximately \$222.8 million in cash and cash equivalents, \$37.5 million in short-term investments, \$16.6 million in long-term investments, and \$366.8 million in working capital.

*Operating Activities.* Net cash used in operating activities was \$27.2 million for the nine months ended September 30, 2008 compared to net cash provided by operating activities of \$84.9 million for the nine months ended September 30, 2007. Net cash used in operating activities for the nine months ended September 30, 2008 primarily reflects lower net income for the period, significant increases in inventory, decreases in accrued expenses and other liabilities and changes in the balances of income taxes payable and receivable during the period. This use of cash was partially offset by a decrease in accounts receivable during the period. The increase in inventory is due primarily to increases in our field inventory to support the increased utilization of our light sources, to provide for faster replacement parts availability and optimize field inventory to support the new XLR light source system installations and to support our OnPulse® usage agreements. The increase in inventory also includes EUV systems that are currently being built in support of planned production demand. The decrease in accounts receivable was due to ongoing collection efforts, and the changes in the income tax accounts were primarily due to significant tax payments that were made during the nine month period ended September 30, 2008.

Net cash provided by operating activities for the nine months ended September 30, 2007 primarily reflects high net income for the period, decreases in accounts receivable balances and increases in deferred revenue which were partially offset by increases in inventories, decreases in accounts payable and decreases in accrued and other liabilities. The decrease in accounts receivable was primarily due to increased collection efforts during the period, and the increase in inventories was primarily due to an increase in our field inventory to support chipmaker pulse utilization rates and customer service contracts. The increase in deferred revenue was primarily due to prepayments received from ASML during the third quarter of 2007 for purchase orders we received from them under our multi-year EUV supply agreement.

*Investing Activities.* Net cash used in investing activities was \$28.3 million for the nine months ended September 30, 2008 compared to net cash provided by investing activities of \$120.9 million for the nine months ended September 30, 2007. Net cash used in investing activities for the nine months ended September 30, 2008 was due primarily due to the timing of short-term and long-term investments that matured and were reinvested during the period and the acquisition of \$19.2 million of property and equipment, a significant portion of which relates to building improvement costs and engineering equipment associated with our EUV research, development and productization efforts.

Net cash provided by investing activities during the nine months ended September 30, 2007 reflects the timing of short-term and long-term investments that matured and were reinvested during the period, the acquisition of \$13.5 million of property and equipment and a \$121,000 payment to acquire certain patent license rights. The majority of the proceeds from sold and matured investments during the nine months ended September 30, 2007 were used to fund the purchase of 7,194,000 shares of common stock for \$288.0 million during the second and third quarters of 2007 under a \$300 million board approved stock repurchase program.

*Financing Activities.* Net cash used in financing activities was \$20.1 million and \$273.3 million for the nine months ended September 30, 2008 and 2007, respectively. Net cash used in financing activities for the nine months ended September 30, 2008 reflects the purchase of shares of our common stock

totaling \$22.9 million and a tax shortfall for the period from stock option exercises totaling \$935,000. These were partially offset by an additional cash investment received from Zeiss, the TCZ minority shareholder, in the amount of \$2.0 million and the exercise of employee stock options during the period totaling \$1.8 million.

Net cash used in financing activities for the nine months ended September 30, 2007 primarily reflects the purchase of shares of our common stock totaling \$288.0 million. This cash used in financing activities was partially offset by proceeds received from the exercise of employee stock options totaling \$12.8 million and a tax windfall for the period from stock options exercises totaling \$1.9 million.

*Effect of Exchange Rate Changes.* The net effect of exchange rate changes on cash and cash equivalents, when expressed in U.S. Dollar terms, was a decrease in cash of \$7.4 million for the nine months ended September 30, 2008 compared to an increase in cash of \$3.3 million for the nine months ended September 30, 2007. Most of our foreign subsidiary offices operate in currencies other than the U.S. Dollar and the majority of their cash balances are denominated in these foreign currencies. As a result, our cash and cash equivalent balances are subject to the effects of the fluctuations in these currencies against the U.S. Dollar at the end of each reporting period. Since the beginning of 2008 and most notably in the third quarter of 2008, several of the foreign currencies in which our subsidiary offices operate have weakened significantly against the U.S. Dollar. The most volatile of these currencies during the nine month period ended September 30, 2008 were the Korean Won, and to a lesser extent, the Euro. Not only did the Korean Won weaken dramatically against the U.S. Dollar in the third quarter of 2008, but we had significant cash balances denominated in Korean Won as of September 30, 2008. As a result, cash and cash equivalents were negatively impacted by \$7.4 million as of September 30, 2008. For the first nine months of 2007, several of the foreign currencies in which we conduct business, primarily the Japanese Yen, the Korean Won and the Euro, strengthened against the U.S. Dollar. As a result, cash was positively impacted by \$3.3 million for the subsidiary office balances denominated in these currencies at September 30, 2007.

Our primary near term potential cash commitment is in February 2009 when the \$140.7 million in principal amount of our 3.5% convertible subordinated notes that are currently outstanding will mature. These notes are convertible into shares of our common stock at a conversion rate of 20 shares per \$1,000 principal or an effective conversion price of \$50.00 per share and are redeemable by us if the price of our common stock reaches certain levels. We anticipate that we will use our existing cash and cash equivalents to repay our convertible notes when they mature in February 2009.

We require substantial working capital to fund our business, particularly to finance inventories, including purchase orders with our vendors, accounts receivable, and for capital expenditures. Our future capital requirements depend on many factors, including our manufacturing activity, the timing and extent of spending to support product development efforts, expansion of sales and marketing and field service and support, competitive labor market compensation requirements, the timing of introductions of new products and enhancements to existing products, and the market acceptance of our products. We believe that after repaying the convertible notes in February 2009, cash generated from operations along with the liquidity provided by our remaining cash balances and short-term investments will be sufficient to sustain our operations, fund our ongoing technology leadership and potential future growth and provide for any potential future expansion of our business for at least the next 12 months.

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

As of September 30, 2008, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance, variable interest, or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we did not engage

in trading activities involving non-exchange traded contracts. As a result, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships. We do not have relationships and transactions with persons and entities that derive benefits from their non-independent relationship with us or our related parties except as disclosed herein.

There have been no material changes to our contractual obligations from the information provided in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations", included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

## RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value using generally accepted accounting principles, and expands disclosures related to fair value measurements. Subsequent to the issuance of SFAS No. 157, the FASB issued FASB Staff Position 157-2 ("FSP 157-2"). FSP 157-2 delays the effective date of the application of SFAS No. 157 to fiscal years beginning after November 15, 2008 for all nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. We adopted all of the provisions of SFAS No. 157 on January 1, 2008 with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. We will adopt FSP 157-2 as of January 1, 2009 and are currently evaluating the impact of this pronouncement on our unaudited condensed consolidated financial statements.

In September 2006, FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—An Amendment of FASB Statements No. 87, 88, 106, and 132(R)" ("SFAS No. 158"). We adopted all provisions of SFAS No. 158 in December 2006 except for the provision which will require us to measure the funded status of our pension plans as of the date of our year-end statement of financial position. This provision will be effective for us for the fiscal year ending December 31, 2008. SFAS No. 158 provides two approaches that a company can follow to transition to a fiscal year-end measurement date. We plan on utilizing the second approach which allows a company to continue using the measurements determined for the prior fiscal year-end reporting to estimate the effects of the SFAS No. 158 change at December 31, 2008. We do not expect its adoption to have a material impact on our unaudited condensed consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141R"), which replaces FASB Statement No. 141. SFAS No. 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date. The Statement also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. We will apply SFAS No. 141R to any acquisitions that we might commence subsequent to January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—amendments of ARB No. 51" ("SFAS No. 160"). SFAS No. 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement is effective for fiscal years beginning after December 15, 2008. We will adopt SFAS No. 160 as of January 1, 2009 and are currently evaluating the impact of this pronouncement on our unaudited condensed consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an Amendment of FASB Statement 133" ("SFAS No. 161"). SFAS No. 161 requires companies with derivative instruments to disclose information that should enable financial statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" and how derivative instruments and related hedged items affect a company's financial position, financial performance and cash. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. We will adopt SFAS No. 161 as of January 1, 2009 and are currently evaluating the impact of this pronouncement on our unaudited condensed consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS No. 162"). This statement identifies the sources of accounting principles and framework for selecting the principles to be used in the preparation of financial statements of non-governmental entities that are presented in conformity with generally accepted accounting principles in the United States. SFAS No. 162 is effective November 15, 2008 and we will adopt it as of such date. We do not expect that the adoption of this pronouncement will have a material impact on our unaudited condensed consolidated financial statements.

In May 2008, the FASB issued FASB Staff Position APB 14-1 ("FSP APB 14-1"), "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)", which applies to all convertible debt instruments that have a "net settlement feature", which means that such convertible debt instruments, by their terms, may be settled either wholly or partially in cash upon conversion. FSP APB 14-1 requires issuers of convertible debt instruments that may be settled wholly or partially in cash upon conversion to separately account for the liability and equity components in a manner reflective of the issuers' nonconvertible debt borrowing rate. FSP APB 14-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Early adoption is not permitted and retroactive application to all periods presented is required. We will adopt FSP APB 14-1 as of January 1, 2009 and are currently evaluating the impact that its adoption will have on our unaudited condensed consolidated financial statements.

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

#### **Foreign Currency Risk**

We conduct business in several international currencies through our global operations. Until the beginning of 2008, our Japanese subsidiary posed our greatest foreign currency risk due to the large volume of business that we conduct in Japan and the volatility of the Japanese Yen. In 2008, our exposure to foreign currency risks associated with our other international subsidiary offices has increased, and most notably in Korea and the Netherlands due to the increase in intercompany activities and the volatility of Korean Won and the Euro against the U.S. Dollar. These foreign currency exposures primarily relate to the U.S. Dollar intercompany accounts payable balances recorded at these offices which have grown significantly in 2008 as we have increased our investment in field inventory at these locations in support of world class customer parts availability. In the third quarter of 2008, these higher intercompany balances combined with the significant decline in the value of the Korean Won and the Euro against the U.S. Dollar resulted in significant foreign currency losses for the period.

Our risk management strategy to date has included the use of derivative financial instruments, principally forward contracts associated with our Japanese subsidiary, to manage our foreign currency risk exposure. We enter into forward contracts in order to reduce the impact of currency fluctuations related to purchases of our inventories by Cymer Japan in U.S. Dollars for resale under firm

third-party sales commitments denominated in Japanese Yen, as well as other foreign currency exposures including exposures related to intercompany debt. Our objective is to offset gains or losses resulting from these exposures with gains and losses on forward contracts, thereby reducing volatility of our earnings. We do not enter into forward contracts for speculative purposes.

As a result of the additional foreign currency exposures we have experienced in 2008, we will be expanding our foreign currency hedging program and the use of forward contracts in certain of our subsidiary offices and will be transitioning other foreign currency related business practices to be more U.S. Dollar centric where we deem appropriate. Although we currently enter into forward contracts and will be expanding their use in the near term, they may not be adequate to eliminate the impact of our exchange rate exposure. Failure to sufficiently hedge or otherwise manage such foreign currency risks properly could have a material adverse effect on our financial condition and results of operations.

As of September 30, 2008, we had outstanding forward contracts to buy U.S. \$42.5 million for 4.5 billion Yen under foreign currency exchange facilities with contract rates ranging from 102.25 Yen to 108.73 Yen per U.S. Dollar. These contracts expire on various dates through April 2009.

Our forward contracts generally qualify for hedge accounting treatment per the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". As a result, we defer changes in the fair value for the effective portion of these hedges and record the amount in accumulated other comprehensive income (loss). Subsequently, we reclassify the gain or loss to cost of revenues in the same period that the related sale is made to the third party. The fair value of all of our forward contracts and the deferred loss, net of tax, for those that qualify for hedge accounting treatment totaled to a liability of \$592,000 and \$86,000, respectively, as of September 30, 2008. For the nine months ended September 30, 2008, we recorded foreign currency exchange losses which totaled \$6.4 million whereas for the nine months ended September 30, 2007, we recorded foreign currency exchange gains which totaled \$2.0 million. The foreign currency loss for the nine months ended September 30, 2008 is primarily attributable to a significant decline in the Korean Won against the U.S. Dollar. The foreign currency gain for the nine months ended September 30, 2007 primarily reflects strengthening of the Korean Won, the Japanese Yen and the Euro against the U.S. Dollar during the period. These foreign currency gains and losses are primarily associated with our intercompany balances and are included in other income (expense), net on the accompanying unaudited condensed consolidated statements of income.

A 10% adverse change in the exchange rate of the Japanese Yen against the U.S. Dollar would decrease the fair value of these forward contracts by \$4.7 million. However, if this occurred, the fair value of the underlying exposures hedged by the contracts would increase by a similar amount. Accordingly, we believe that a 10% change in the foreign exchange rate of the Japanese Yen against the U.S. Dollar would have an immaterial impact on the consolidated results of operations.

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

We maintain an investment portfolio consisting primarily of government and corporate fixed income securities, certificates of deposit and commercial paper. While it is our general intent to hold such securities until maturity, we will occasionally sell certain securities for cash flow purposes. Therefore, our investments are classified as available-for-sale and are carried on the balance sheet at fair value. A change in market interest rates of 10% would have impacted our net income from these investments by approximately \$498,000 for the nine months ended September 30, 2008.

We also currently hold one auction rate security within our investment portfolio which was purchased according to our investment policy in October 2007 at a par value of \$5.6 million. Although this auction rate security is insured, the company that insures it was significantly downgraded in the first and second quarters of 2008. As a result of the downgrading of the company that insures this auction rate security, the auction rate security itself has also been downgraded. This auction rate

security has gone to auction every 28 days since November 2007 and has failed at every auction. As a result of these failed auctions, the downgrading of the auction rate security and the company that insures it, and the current credit market crisis, we have recorded impairment charges on this investment totaling \$5.1 million to properly reflect its fair value at September 30, 2008. Of this impairment, \$3.8 million was identified and recorded in the three months ended March 31, 2008, \$1.0 million was identified and recorded in the three months ended June 30, 2008 and \$270,000 was identified and recorded in the three months ended September 30, 2008. The impairment charges recorded in the first and second quarters of 2008 were primarily due to the downgrading of the auction rate security itself and the company that insures it, whereas the impairment charge recorded in the third quarter of 2008 was due to the increase in the interest rates associated with credit default swaps, one of the key inputs used by us to calculate the fair value of the auction rate security. Since we determined that these were all other-than-temporary impairments, we recorded these as a write-down of investments in other income (expense), net in the accompanying unaudited condensed consolidated statements of income. It is uncertain that we will be able to liquidate this auction rate security in the near term and the likelihood is high that we will hold this auction rate security in excess of twelve months. Therefore, we have classified the \$497,000 fair value of this auction rate security as a long-term investment on our unaudited condensed consolidated balance sheet at September 30, 2008. Since this auction rate security is immaterial to our overall cash and investment balances, we do not anticipate that our inability to liquidate it at its current fair value in the near term or long term will have an affect on our liquidity.

In February 2002, we issued \$250.0 million principal amount of unsecured fixed rate 3.50% convertible subordinated notes due February 15, 2009. Interest on these notes is payable on February 15 and August 15 of each year. The notes are convertible into shares of our common stock at a conversion rate of 20 shares per \$1,000 principal amount subject to adjustment under certain conditions. Because the interest rate is fixed, we believe there is no risk of increased expense. To date, we have repurchased, at a discount to par, \$109.2 million of these notes. The principal amount outstanding at September 30, 2008 was \$140.7 million and the fair value of such debt based on quoted market prices on September 30, 2008 was \$139.3 million. Per the fair value hierarchy defined in SFAS No. 157, "Fair Value Measurements", which we adopted effective January 1, 2008, this fair value qualifies as a level 1 input since it is based on observable prices which we obtain from Bloomberg at the end of each quarterly reporting period.

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

*Evaluation of disclosure controls and procedures.* For the third quarter of 2008, our chief executive officer and our chief financial officer evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") as of September 30, 2008, and concluded that as of such date, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the rules and forms of the Securities and Exchange Commission.

*Changes in internal control over financial reporting.* There has been no change in our internal control over financial reporting during the quarter ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

None.

### ITEM 1A. Risk Factors

*The risks described below may not be the only risks we face. Additional risks that we do not currently think are material may also impair our business operations. The risk factors set forth below with an asterisk (\*) next to the title contain changes to the description of the risk factors associated with our business as previously disclosed in Item 1A to our Annual Report on Form 10-K for the fiscal year ended December 31, 2007. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.*

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

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

- global demand for semiconductors in general and, in particular, for leading edge devices with smaller circuit geometries;
- cyclicalities in the market for semiconductor manufacturing equipment;
- rates at which our chipmaker customers take delivery of photolithography tools from our lithography tool manufacturer customers;
- rates at which lithography tool manufacturer customers take delivery of light source systems from us;
- timing and size of orders from our customers;
- our ability to manage customer satisfaction, product reliability, and direct field service and support effectiveness;
- increases or decreases in market penetration by our competitor;
- demand for reduced product lead time from our customers;
- the mix of light source models, and the level of installed base products and service revenues in our total revenues;
- changes in the price and profitability of our products;
- our ability to develop and implement new technologies and introduce new products that meet our customers' needs;
- utilization rates of light sources by our chipmaker customers, sales of IBPS and pulse usage;
- our ability to manage our manufacturing requirements;
- foreign currency exchange rate fluctuations in the countries in which we do business;
- our investments in marketable securities;
- changes in our effective tax rate;
- worldwide political instability;
- changing global economic conditions, including rising energy prices, inflation, unemployment, turmoil in the credit markets and financial services industry and credit availability; and

• intellectual property protection.

We have historically derived the majority of our quarterly and annual revenues from selling light source systems and IBPS used in semiconductor manufacturing. In recent years, light source sales have accounted for approximately half of our revenue in a given period. Because we sell a limited number of light source system products, the precise time that we recognize revenue from an order may have a significant impact on our total revenue for a particular period. As is the practice in our industry, our customers may cancel or reschedule orders with little or no penalty. Orders expected in one quarter could shift to another period due to changes in the anticipated timing of our customers' purchase decisions or rescheduled delivery dates requested by our customers. Our operating results for a particular quarter or year may be adversely affected if our customers cancel or reschedule orders, or if we cannot fill orders in time due to unexpected delays in manufacturing, testing, shipping, or product acceptance. In addition, our light source systems used in a production environment generate product revenues based on system usage. As our installed base of light source systems continues to grow, the product revenues generated by the operation of these light sources have a significant impact on our business operations. Our operating results for a particular period may be adversely affected if our customers reduce usage rates or change their buying patterns.

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

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

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

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

Downturns in the semiconductor industry often result in decreases in demand for semiconductor manufacturing equipment, including the photolithography tools that our OEM customers produce. Downturns in the semiconductor industry have generally had severe effects on the demand for semiconductor manufacturing equipment and to a lesser extent, the associated IBPS. Fluctuating levels

of investment by chipmakers and resulting pricing volatility will continue to materially affect our aggregate bookings, revenues and operating results. Even during periods of reduced revenues we believe we must continue to invest in research and development and to maintain extensive ongoing worldwide customer service and support capabilities to meet our customers' needs and to remain competitive. Continued spending in furtherance of these objectives may temporarily harm our financial results. Semiconductor industry downturns and slowdowns will likely continue to adversely affect our business, financial condition and operating results from time to time, and our operating results may fall below the expectations of public market analysts or investors in future quarters. Any failure to meet such expectations could materially adversely affect the price of our common stock.

Our OEM customers try to manage their inventories and production requirements to appropriate levels that reflect their expected sales to chipmakers. Market conditions in the semiconductor industry and our OEM customers' production efficiency can cause them to expand or reduce their orders for new light source systems as they try to manage their inventories and production requirements. We continue to work closely with our OEM customers to better understand these issues. However, we cannot guarantee that we will be successful in understanding our OEM customers' inventory management or production requirements or that our OEM customers will not build up an excess inventory of light source systems. If our OEM customers retain an excess inventory of light source systems, our revenue could be reduced in future periods as the excess inventory is utilized, which could adversely affect our operating results, financial condition and cash flows. If our OEM customers demand shorter product lead times to improve their inventory and cash positions, our inventory management and cash position may be negatively impacted, which may adversely affect our operating results, financial condition and cash flows.

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

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

	Nine months ended	
	<u>September 30,</u>	
	<u>2008</u>	<u>2007</u>
ASML	24%	35%
Nikon	18%	18%
Canon	4%	4%
Total	<u>46%</u>	<u>57%</u>

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

	<u>September</u>	<u>December</u>
	<u>30, 2008</u>	<u>31, 2007</u>
ASML	20%	31%
Nikon	25%	25%
Canon	2%	3%
Total	<u>47%</u>	<u>59%</u>

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

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

At varying degrees, the loss of any significant business from or production problems for any one of these customers would harm our business and financial condition.

**\*Our revenue is derived from the sale of a limited number of models of our light source systems, and products and services in support of the installed base of light source systems being used in production.**

We sell excimer light source systems, including KrF and ArF systems, and IBPS. We expect these light source systems and the related support products to continue to account for a substantial majority of our revenues in the near term. Continued market acceptance of our light source system products is, therefore, critical to our future success. Our excimer light sources are used in DUV photolithography equipment for the manufacture of semiconductor devices with features of and smaller than 250 nm. The demand for our products depends in part on the rate at which chipmakers further adopt excimer light sources as the chosen light source for their photolithography tools and the rate at which they continue to manufacture devices with progressively smaller features.

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

- performance of new ArF immersion-specific resists;
- potential shortages of specialized materials used in DUV optics;
- the productivity of double-patterning ArF lithography tools; and
- consolidation of chipmakers.

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

- a decline in demand for our customers' DUV photolithography tools;
- a failure to achieve continued market acceptance of our products;
- a failure to manage customer satisfaction, product reliability, or maintain the effectiveness of direct field service and support;
- the introduction of one or more improved versions of products by a competitor in the market in which we participate;
- technological changes that we are unable to address with our products;
- a failure to release new enhanced versions of our products on a timely basis; and
- a decline in chipmaker light source utilization rates or retirement of light sources in our installed base.

**\*The uncertainty of the current economic and political conditions could harm our revenues and operating results.**

Current domestic and global economic conditions are uncertain. The recent turmoil in the economic environment in many parts of the world may continue to put pressure on global economic conditions.

Our projected revenues and operating results are based on assumptions concerning certain levels of consumer and corporate spending. A general weakening of, or declining corporate or consumer confidence in, the global and domestic economy, or a reduction in corporate or consumer spending, could delay or decrease purchases of our products by our customers, which are driven in part because of indirect consumer demand for the end-market applications which incorporate our products.

Our revenues and operating results may also be affected by uncertain or changing economic and market conditions, including the recent crisis in the credit markets and financial services industry. If global economic and market conditions, or economic conditions in the United States or other key markets, remain uncertain or persist, spread, or deteriorate further, we may experience material impacts on our business, operating results, and financial condition.

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

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

At this time, chipmakers are continuing to expand their manufacturing capacity at 65 nm, and a growing number of manufacturers of certain types of memory chips are in production at 55 nm and below. Some advanced logic chips are now in production at 45 nm, while some memory manufacturers have recently commenced production at about the 45 nm node. Additionally, other types of chipmakers have a significant level of development underway at this node. These efforts, along with expanding use of ArF immersion lithography in production among certain memory manufacturers, are driving demand for our most advanced ArF light sources. At the same time, chipmakers also need tools for the less critical layers on wafers, which drive demand for our KrF light source products for DUV photolithography systems as well. After our chipmaker customers have built their capacity to levels appropriate to meet existing demand, their demand for our light source products will depend, in part, on their sales forecasts and their estimates regarding the duration and magnitude of the current industry cycle and whether their projected manufacturing process yields will enable ongoing investments at a suitable level of capacity.

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

Future technologies such as EUV, nano-imprint lithography, and certain maskless lithography techniques may render our KrF and ArF excimer light source products obsolete. We must manage product transitions, as introduction of new products could adversely affect our sales of existing

products. If new products are not introduced on time, or have reliability or quality problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products, and additional service and warranty expenses. We may not be able to develop and introduce new products or enhancements to our existing products and processes in a timely or cost effective manner that satisfies customer needs or achieves market acceptance. Failure to develop and introduce these new products and enhancements could materially adversely affect our operating results, financial condition and cash flows.

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

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

Our future performance depends, in part, upon our ability to continue to compete successfully worldwide. We currently have one competitor that sells light sources for DUV photolithography applications. This competitor, Gigaphoton, is a joint venture between two large companies, Komatsu and Ushio, and is headquartered in Japan. Over the past couple of years, Gigaphoton has been successful in gaining market penetration in the DUV light source industry and is continuing to aggressively try to gain additional market penetration. We know that our customers have purchased products from this competitor and that our customers have qualified this competitor's light sources for use with their products.

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

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

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

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

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

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

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

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

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

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

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

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

Operations at our two manufacturing facilities and at our subcontractors are subject to disruption for a variety of reasons, including work stoppages, terrorism, fire, earthquake, energy shortages, flooding or other natural disasters. Such disruptions could cause delays in shipments of our products to our customers. We provide no assurance that alternate production capacity would be available if a

major disruption were to occur or that, if it were available, it could be obtained on favorable terms, or at all. Such disruption could result in cancellation of orders or loss of customers, which would have a material adverse effect on our operating results, financial condition and cash flows.

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

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

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

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

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

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

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

We serve an increasingly global market. A large portion of our total revenues is derived from customers located outside of the U.S. We expect our international sales to continue to account for a very large portion of our total revenues. In order to support our foreign customers, we maintain a manufacturing and field service subsidiary in Korea as well as field service and support subsidiaries in Japan, the Netherlands, the People's Republic of China, Singapore and Taiwan.

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

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

- fluctuations in exchange rates and currency controls;
- unexpected changes in regulatory requirements;
- political and economic conditions and instability, including the recent turmoil in the economic environment in many parts of the world;

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

In addition to having a manufacturing plant located in Korea, many of our chipmaker customers are located in Asia. Economic problems and currency fluctuations affecting these regions in Asia could create a larger risk for us. Further, even though it has not been difficult for us to comply with U.S. export controls, these export rules could change in the future and make it more difficult or impossible for us to export our products to many countries. We self insure certain risks including earthquake risk. Any of these vulnerabilities could have a material adverse effect on our business, financial condition and results of operations.

One of our international subsidiary offices recently learned that some of its employees joined a labor union in October 2008. If these employees remain in the union, or if additional employees of this subsidiary decide to join the union, our cost of doing business could increase, and we could experience contract delays, difficulty in adapting to a changing regulatory and economic environment, cultural conflicts between unionized and non-unionized employees, strikes and work stoppages, any of which could have a material adverse effect on our business, financial condition and results of operations.

**\*We are exposed to foreign currency exchange rate fluctuations for all foreign currencies in which we do business and we may be adversely affected by these fluctuations or declining economic conditions in the countries in which we operate.**

We have international subsidiaries that operate in foreign currencies and sell our product to most of their customers in these foreign currencies. All of our international subsidiary offices purchase the products that they sell to their customers from our corporate office in the United States in U.S. Dollars. Although these subsidiary offices are located in various countries in Asia and Europe, and we are subject to foreign currency exchange risks associated with all of these countries, we currently only hedge these foreign currency exposures at our Japanese subsidiary since it accounts for the single largest portion of our foreign operations. When we sell products to our Japanese subsidiary, the sale is denominated in U.S. Dollars. When our Japanese subsidiary sells our products directly to customers in Japan, the sale is denominated in Japanese Yen. Thus, our results of operations may fluctuate based on the changing value of the Japanese Yen to the U.S. Dollar. We manage the exposure of our Japanese subsidiary to these fluctuations through forward contracts to hedge the subsidiary's purchase commitments. Although we enter into such forward contracts, they may not be adequate to eliminate the impact of our exchange rate exposure in Japan.

In addition to the foreign currency exchange risk that we have associated with our Japanese subsidiary, the foreign currency exchange exposure has increased significantly in our other international subsidiary offices in 2008, particularly those offices located in Korea and the Netherlands. Since the beginning of 2008 the value of both the Korean Won and the Euro have been very volatile against that of the U.S. Dollar. In the third quarter of 2008, both of these currencies declined significantly against

the U.S. Dollar, and as a result, we recorded significant foreign currency exchange losses during the period. As a result of the additional foreign currency exposures we have experienced in 2008, we will be expanding our foreign currency hedging program and the use of forward contracts to certain of our subsidiary offices and will be transitioning other foreign currency related business practices and processes to be more U.S. Dollar centric where we deem appropriate. Although we currently enter into forward contracts and will be expanding their use in the near term, they may not be adequate to eliminate the impact of our exchange rate exposure. Failure to sufficiently hedge or otherwise manage such foreign currency risks properly could have or continue to have a material adverse effect on our financial condition and results of operations.

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

We believe our success and ability to compete depend in part upon protecting our proprietary technology. We rely on a combination of patent, trade secret, copyright and trademark laws, nondisclosure and other contractual agreements and technical measures to protect our proprietary rights. We own and have numerous patents pending in the U.S. and various foreign countries covering certain aspects of technology related to light sources and piezo techniques. These patents will expire at various times through 2026.

Our pending patent applications and any future applications might not be approved. Our patents might not provide us with a competitive advantage and may be successfully challenged by third parties. In addition, third parties' patents might have an adverse effect on our ability to do business. Due to cost constraints, we do not seek international patent protection for all inventions that are covered by U.S. patents and patent applications. As a result we do not have foreign patent protection for some of our inventions. Additionally, laws of some foreign countries in which our products are or may be developed, manufactured or sold, including various countries in Asia, may not protect our products or intellectual property rights to the same extent as do the laws of the U.S. Thus, the likelihood of piracy of our technology and products is greater in these countries. Further, third parties might independently develop similar products, duplicate our products, or design around patents that are granted to us.

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

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

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

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

- independently develop substantially the same proprietary information or techniques;
- gain access to our trade secrets from unrelated third parties and/or without obligation of confidentiality; or
- disclose our technology following expiration of their confidentiality obligation.

**\*The parties to whom we have provided research and development services may dispute the ownership of the intellectual property that we developed while performing these services.**

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

**\*We may be subject to patent litigation to enforce patents issued to us or defend ourselves against claimed infringement by our competitor or any other third party.**

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

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

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

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

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

**\*Our investments in marketable securities are significant and are subject to market, interest and credit risk that may reduce their value.**

We maintain a significant portfolio of investments in marketable securities, particularly in corporate and government fixed income securities and commercial paper. Our earnings may be adversely affected by changes in the value of this portfolio. In particular, the value of our investments may be adversely affected by changes in interest rates, downgrades in the corporate bonds included in the portfolio, the recent turmoil in the credit markets and financial services industry and by other factors which may result in other than temporary declines in the value of our investments. Each of these events may cause us to record charges to reduce the carrying value of our investment portfolio which could have a material adverse effect on our results of operations.

**\*Changes in our effective tax rate may have an adverse effect on our results of operations.**

Our future effective tax rate may be adversely affected by a number of factors including:

- changes in available tax credits, particularly the federal research and development tax credit, which was reinstated in October 2008 for 2008 and 2009;
- the jurisdictions in which profits are determined to be earned and taxed;
- the resolution of issues arising from tax audits with various tax authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes;
- changes in tax laws or the interpretation of such tax laws, such as the Internal Revenue Service ("IRS") Code Section 199 manufacturing deduction which currently provides a tax benefit;
- changes in generally accepted accounting principles; and
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes.

Any significant increase in our future effective tax rates could adversely impact net income in future periods. In addition, the IRS Code Section 41 and other tax authorities regularly examine our income tax returns. Our financial condition and results of operations could be adversely impacted if any assessments resulting from the examination of our income tax returns by the IRS or other taxing authorities are not resolved in our favor.

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

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

- diversion of management's attention and resources to integrate the new company or new business opportunity;
- failure to retain key personnel;
- customer dissatisfaction or performance problems with the acquired company or new product in a new market;
- costs associated with acquisitions and joint ventures and the integration of acquired operations;

- costs associated with developing, marketing, introducing and supporting a new product in a new market;
- failure to commercialize purchased technologies;
- ability of the acquired companies, joint ventures or new markets to meet their financial projections;
- assumption of unknown liabilities or other unanticipated events or circumstances; and
- compliance with the Sarbanes-Oxley Act of 2002, new SEC regulations, NASDAQ Stock Market rules and new accounting pronouncements as they relate to the new company or joint venture.

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

**We may experience difficulties with our enterprise resource planning ("ERP") system or other critical information systems that we use for the daily operations of our business. System failure or malfunction or loss of data contained in these information systems may result in disruption of our operations and result in our inability to process transactions, and this could adversely affect our financial results.**

System failure or malfunction or loss of data which is housed in our critical information systems could disrupt our ability to timely and accurately process transactions and produce key financial reports, including information on our results of operations, financial position and cash flows. Any disruptions or difficulties that may occur in connection with our ERP system or other critical systems could also adversely affect our ability to complete important business processes such as the evaluation of our internal controls and attestation activities pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. If we encounter unforeseen problems with regard to our ERP system or other critical information systems, our business could be adversely affected.

**\*Compliance with changing regulations and standards for accounting, corporate governance and public disclosure may result in additional expenses.**

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, including accelerated SEC filing timelines and new Proxy rules, new NASDAQ Stock Market rules, new accounting pronouncements and the expected future requirement to transition to international financial reporting standards are creating uncertainty and additional complexities for companies such as ours. In particular, the Section 404 internal control evaluation requirements under the Sarbanes-Oxley Act have added complexity and costs to our business and require a significant investment of our time and resources to complete each year. We take these requirements seriously and expect to continue to make every effort to ensure that we receive clean attestations on our internal controls each year from our outside auditors, but there is no guarantee that our efforts to do so will be successful. To maintain high standards of corporate governance and public disclosure, we intend to invest all reasonably necessary resources to comply with all other evolving standards. These investments may result in increased general and administrative expenses and a diversion of management time and attention from strategic revenue generating and cost management activities.

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

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

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

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

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

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

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

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

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

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

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

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

We have registered a number of trademarks including "CYMER" and "INSIST ON CYMER" in the U.S. and in some other countries. We are also trying to register additional trademarks in the U.S. and in other countries. We use these trademarks and many other marks in our business and advertising materials, which are distributed throughout the world. We may be subject to trademark infringement actions for using these marks and other marks on a worldwide basis which would be costly to defend. If an adverse trademark infringement action were successful, we would have to stop using one or more of the marks and possibly pay damages.

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

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

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

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

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

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

(a) Not applicable

(b) Not applicable

(c) On April 21, 2008, we announced that our board of directors authorized us to repurchase up to \$100 million of our common stock. The purchases have been made from time to time in the open market or in privately negotiated transactions. The program does not have a fixed expiration date and may be discontinued at any time.

The following table provides information with respect to the shares of common stock repurchased by us during the three months ended September 30, 2008:

<u>Period</u>	<u>Total number of shares purchased</u>	<u>Average price paid per share</u>	<u>Total number of shares purchased as part of publicly announced plans or programs</u>	<u>Approximate dollar value of shares that may yet be purchased under the plans or programs</u>
July 1, 2008 to July 31, 2008	225,000	\$ 26.77	225,000	\$ 79.3 million
August 1, 2008 to August 31, 2008	82,600	26.77	82,600	\$ 77.1 million
September 1, 2008 to September 30, 2008	—	—	—	\$ 77.1 million
Total	<u>307,600</u>	<u>\$ 26.77</u>	<u>307,600</u>	

**ITEM 3. Defaults Upon Senior Securities**

None.

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

None.

**ITEM 5. Other Information**

(a) None.

(b) There were no material changes to the procedures by which security holders may recommend nominees to our board of directors.

**ITEM 6. Exhibits**

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act.

31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act.

32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act.

32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act.

**SIGNATURES**

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

**CYMER, INC.**

Date: November 3, 2008 By: /s/ NANCY J.  
BAKER

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

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## [SIGNATURES](#)

**CERTIFICATION**

I, Robert P. Akins, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2008 of Cymer, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2008

/s/ ROBERT P. AKINS

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Robert P. Akins  
*Chairman, Chief Executive Officer*

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[Exhibit 31.1](#)

**CERTIFICATION**

I, Nancy J. Baker, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the fiscal quarter ended September 30, 2008 of Cymer, Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2008

/s/ NANCY J. BAKER

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

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[Exhibit 31.2](#)  
[CERTIFICATION](#)

**CERTIFICATION**

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

1. The Registrant's quarterly report on Form 10-Q for the period ended September 30, 2008, to which this certification is attached as Exhibit 32.1 (the "Report"), fully complies with the requirements of Section 13(a) of the Exchange Act; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

**In Witness Whereof**, the undersigned has set his hand hereto as of the 3rd day of November, 2008.

/s/ ROBERT P. AKINS

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Robert P. Akins,  
*Chief Executive Officer*

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

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[CERTIFICATION](#)

**CERTIFICATION**

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

1. The Registrant's quarterly report on Form 10-Q for the period ended September 30, 2008, to which this certification is attached as Exhibit 32.2 (the "Report"), fully complies with the requirements of Section 13(a) of the Exchange Act; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

**In Witness Whereof**, the undersigned has set her hand hereto as of the 3rd day of November, 2008.

/s/ NANCY J. BAKER

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Nancy J. Baker,  
*Chief Financial Officer*

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

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[Exhibit 32.2](#)  
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