AXCELIS TECHNOLOGIES INC
Form 10-Q
November 08, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

or

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

For the transition period from to

Commission file number 000-30941

AXCELIS TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**34-1818596**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

108 Cherry Hill Drive

Beverly, Massachusetts 01915

(Address of principal executive offices, including zip code)

(978) 787-4000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

As of November 3, 2006 there were 101,297,394 shares of the registrant s common stock outstanding.

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PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements.

Axcelis Technologies, Inc.

Consolidated Statements of Income

(In thousands, except per share amounts)

(Unaudited)

	Three months ended September 30, 2006	2005	Nine months ended September 30, 2006	2005
Revenue				
Systems	$ 78,546	$ 47,083	$ 198,684	$ 155,723
Services	42,062	39,280	133,006	116,724
Royalties, primarily from SEN	2,209	1,019	6,688	7,149
	122,817	87,382	338,378	279,596
Cost of revenue	69,551	51,679	198,128	163,156
Gross profit	53,266	35,703	140,250	116,440
Operating expenses				
Research & development	17,597	17,755	54,000	51,165
Selling	11,743	10,691	33,919	34,565
General & administrative	11,986	11,994	34,258	34,996
Amortization of intangible assets	656	612	1,895	1,836
Restructuring charges	53	1,545	147	5,427
	42,035	42,597	124,219	127,989
Income (loss) from operations	11,231	(6,894)	16,031	(11,549)
Other income (expense)				
Equity income of SEN	2,372	1,395	10,734	11,360
Interest income	2,250	1,505	5,816	3,799
Interest expense	(2,570)	(1,661)	(6,657)	(4,971)
Other net	153	435	837	(2)
	2,205	1,674	10,730	10,186
Income (loss) before income taxes	13,436	(5,220)	26,761	(1,363)
Income taxes (credit)	916	(53)	1,552	1,157
Net income (loss)	$ 12,520	$ (5,167)	$ 25,209	$ (2,520)
Net income (loss) per share				
Basic	$ 0.12	$ (0.05)	$ 0.25	$ (0.03)
Diluted	0.12	(0.05)	0.25	(0.03)
Shares used in computing basic and diluted income (loss) per share				
Basic	101,165	100,428	101,003	100,256
Diluted	101,612	100,428	101,205	100,256

See accompanying Notes to Consolidated Financial Statements

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Axcelis Technologies, Inc.

Consolidated Balance Sheets

(In thousands)

(Unaudited)

	September 30, 2006	December 31, 2005
ASSETS		
Current assets		
Cash and cash equivalents	$ 90,452	$ 71,417
Marketable securities	91,539	93,797
Restricted cash	9,164	8,037
Accounts receivable, net	98,163	79,379
Inventories, net	146,255	109,972
Prepaid expenses and other current assets	37,644	32,767
Total current assets	473,217	395,369
Property, plant & equipment, net	66,534	71,443
Investment in SEN	119,163	108,815
Goodwill	46,773	46,773
Intangible assets	14,205	16,100
Restricted cash, long-term portion	2,694	3,195
Other assets	23,866	19,748
	$ 746,452	$ 661,443
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	$ 39,627	$ 25,556
Accrued compensation	21,177	18,437
Warranty	6,569	5,739
Income taxes	2,043	3,021
Deferred revenue	40,420	30,140
Other current liabilities	11,587	11,333
Current portion of long-term debt	74,217	
Total current liabilities	195,640	94,226
Long-term debt	76,165	125,000
Long-term deferred revenue	9,468	11,177
Other long-term liabilities	4,601	4,999
Stockholders equity		
Preferred stock		
Common stock	101	101
Additional paid-in capital	468,779	466,454
Deferred compensation		(5,385)
Treasury stock	(1,218)	(1,218)
Accumulated deficit	(5,978)	(31,187)
Accumulated other comprehensive loss	(1,106)	(2,724)
	460,578	426,041
	$ 746,452	$ 661,443

See accompanying Notes to Consolidated Financial Statements

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Axcelis Technologies, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine months ended September 30, 2006	2005
Operating activities		
Net income (loss)	$ 25,209	$ (2,520)
Adjustments required to reconcile net income to net cash used for operating activities		
Depreciation and amortization	13,138	15,835
Amortization of intangible assets	1,895	1,836
Accretion of premium on long-term debt	1,165	
Stock compensation expense	4,466	593
Impairment of fixed assets		725
Undistributed income of SEN	(10,734)	(11,360)
Changes in operating assets & liabilities		
Accounts receivable	(18,165)	16,719
Inventories	(34,618)	5,981
Other current assets	(4,964)	(24,506)
Accounts payable & other current liabilities	17,817	(11,663)
Deferred revenue	8,571	902
Income taxes	(984)	(1,818)
Other assets and liabilities	(8,700)	3,035
Net cash used for operating activities	(5,904)	(6,241)
Investing activities		
Purchases of marketable securities	(70,329)	(86,297)
Sales and maturities of marketable securities	73,263	77,115
Expenditures for property, plant & equipment	(3,947)	(6,329)
Increase in restricted cash	(627)	(4,372)
Net cash used for investing activities	(1,640)	(19,883)
Financing activities		
Proceeds from issuance of convertible debt	24,217	
Proceeds from the exercise of stock options	1,362	1,142
Proceeds from employee stock purchase plan	1,578	2,150
Net cash provided by financing activities	27,157	3,292
Effect of exchange rate changes on cash	(578)	343
Net increase (decrease) in cash and cash equivalents	19,035	(22,489)
Cash and cash equivalents at beginning of period	71,417	108,295
Cash and cash equivalents at end of period	$ 90,452	$ 85,806

See accompanying Notes to Consolidated Financial Statements

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Axcelis Technologies, Inc.

Notes To Consolidated Financial Statements (Unaudited)

(All tabular amounts in thousands, except per share amounts)

Note 1. Nature of Business and Basis of Presentation

Axcelis Technologies, Inc. (Axcelis or the Company), is a worldwide producer of ion implantation, dry strip, thermal processing and curing equipment used in the fabrication of semiconductors in the United States, Europe and Asia. In addition, the Company provides extensive aftermarket service and support, including spare parts, equipment upgrades, and maintenance services. The Company owns 50% of the equity of a joint venture with Sumitomo Heavy Industries, Ltd. in Japan. This joint venture, SEN Corporation, an SHI and Axcelis Company (SEN), licenses technology from the Company relating to the manufacture of ion implantation products and has exclusive rights to manufacture and sell these products in the territory of Japan. SEN is the leading producer of ion implantation equipment in Japan.

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management all adjustments, which are of a normal recurring nature, considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for other interim periods or for the year as a whole.

The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in Axcelis Technologies, Inc. s annual report on Form 10-K for the year ended December 31, 2005 and the amendment to the annual report on Form 10-K/A filed on June 29, 2006.

Note 2. Stock-Based Compensation

Adoption of SFAS No. 123R

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) Share-Based Payment (SFAS No. 123R). SFAS No. 123R replaces SFAS No. 123 Accounting for Stock-Based Compensation (SFAS No. 123), supersedes Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB No. 25), and amends SFAS No. 95 Statement of Cash Flows . SFAS No. 123R requires entities to recognize compensation expense for all share-based payments to employees and directors, including grants of employee stock options, based on the grant-date fair value of those share-based payments (with limited exceptions), adjusted for expected forfeitures. In April 2005, the Securities and Exchange Commission (SEC) issued a final ruling that extended the compliance date for SFAS No. 123R to the first interim or annual reporting period of the registrants first fiscal year that begins on or after June 15, 2005.

The Company adopted SFAS No. 123R, effective January 1, 2006 using the modified prospective transition method. Under that transition method, stock-based compensation expense recognized during the three and nine months ended September 30, 2006 includes: (a) stock options, restricted stock and restricted stock units granted prior to, but not yet vested, as of December 31, 2005, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) shares issued in offerings under the Employee Stock Purchase Plan with offering periods commencing January 1, 2006 and stock options, restricted stock and restricted stock units granted subsequent to December 31, 2005, based on the grant-date fair value estimated using the Black-Scholes valuation model in accordance with the provisions of SFAS No. 123R. Expense is recognized ratably over the requisite service period. Under the modified prospective transition method, results for prior periods are not restated.

Under SFAS No. 123R the Company recognized stock-based compensation expense of $1.6 million and $4.5 million for the three and nine months ended September 30, 2006, respectively. Adoption of SFAS No. 123R reduced income before income taxes and net income by approximately $0.7 million and $2.7 million ($0.01 per basic and diluted share and $0.03 per basic and diluted share) for the three and nine months ended September 30, 2006, respectively, as the Company would have recognized $0.9 million and $1.8 million of stock-based compensation expense for the three and nine months ended September 30, 2006, respectively, related to its outstanding and additional issuances of restricted stock and restricted stock units prior to the adoption of SFAS No. 123R.

SFAS No. 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow. Because the Company does not recognize the benefit of tax deductions in

excess of recognized compensation cost due to its cumulative net operating loss position, this change had no impact on the Company s consolidated statement of cash flows as of and for the three and nine months ended September 30, 2006. For 2006, the Company used restricted stock units in its annual share-based payment program for employees, while continuing to use stock options for new hire grants. As a result, restricted stock units comprised the majority of equity grants in 2006.

Accounting Prior to Adoption of SFAS No. 123R

Prior to January 1, 2006, as permitted under SFAS No. 123, as amended by SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure, Axcelis elected to follow the provisions of APB No. 25 to account for stock-based awards to employees. Under APB No. 25, compensation expense with respect to such awards is not recognized if on the date the awards were granted the exercise price was equal to or greater than the market value of the underlying common shares. Historically, all stock options have been granted with an exercise price equal to the fair market value of the common stock on the date of grant. Accordingly, no compensation expense was recognized from option grants to employees and directors. The fair value of restricted stock unit and restricted stock awards was charged to deferred compensation at the time of issuance and amortized to expense over the vesting period on a straight-line basis.

On October 24, 2005, the Compensation Committee of the Board of Directors resolved to accelerate the vesting of certain unvested and out-of-the-money stock options with exercise prices equal to or greater than $10.00 per share. These options were previously awarded to its employees and other eligible participants, including executive officers, under the Company s 2000 Stock Plan. Of the approximately 1.5 million accelerated options, 309,474 options, or 21.2%, were held by executive officers. The acceleration of vesting was effective for stock options outstanding as of December 15, 2005, at which date the closing price of the Company s common stock was $4.70 per share. The weighted average exercise price of the options subject to the acceleration was $11.52 per share. The acceleration of the vesting of these options did not result in compensation expense based on generally accepted accounting principles. For pro forma disclosure requirements under SFAS No. 123, the Company recognized an incremental $7.1 million of stock-based compensation expense for all options whose vesting was accelerated. As a result of this action the Company is not recognizing compensation expense of approximately the same amount associated with these options in operating results upon effectiveness of the application of SFAS No. 123R.

The modified prospective transition method of SFAS No. 123R requires the presentation of pro forma information, for periods presented prior to the adoption of SFAS No. 123R, regarding net income (loss) and net income (loss) per share as if the Company had accounted for its stock plans under the fair value method of SFAS No. 123.

For pro forma purposes, the fair value of stock options was estimated using the Black-Scholes option valuation model and amortized on a graded attribution approach using the following assumptions for the three and nine months ended September 30, 2005:

	Three months ended September 30, 2005			**Nine months ended September 30, 2005**		
Risk-free interest rate	3.74	4.05	%	2.92	4.05	%
Expected stock price volatility	69.3		%	69.3		%
Weighted average expected term (in years)	4.0			4.0		
Expected dividend yield	0.0		%	0.0		%

The weighted average grant date fair value (determined using the Black-Scholes option pricing model) for options granted during the three and nine months ended September 30, 2005 was $3.75 and $3.71, respectively.

The following table illustrates the effect on net loss and net loss per share for the three and nine months ended September 30, 2005 if the Company had accounted for its stock plans using the fair value method of accounting provided under SFAS No. 123:

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		Three months ended September 30, 2005	Nine months ended September 30, 2005
Net loss, as reported (Under APB No. 25)		$ (5,167)	$ (2,520)
Add:	Stock-based employee compensation expense included in reported net loss	549	593
Deduct:	Total stock-based employee compensation expense determined under fair value based method for all awards	(3,615)	(11,842)
Pro forma net loss		$ (8,233)	$ (13,769)
Net loss per share as reported			
Basic		$ (0.05)	$ (0.03)
Diluted		$ (0.05)	$ (0.03)
Pro forma net loss per share			
Basic		$ (0.08)	$ (0.14)
Diluted		$ (0.08)	$ (0.14)

2000 Stock Plan

The Company maintains the Axcelis Technologies, Inc. 2000 Stock Plan (the 2000 Plan), a stock award and incentive plan which permits the issuance of options, stock appreciation rights, restricted stock, restricted stock units, and performance awards to selected employees, directors and consultants of the Company. The 2000 Plan originally reserved 18.5 million shares of common stock for future grant, which amount was subsequently increased to 33.2 million shares of common stock. The 2000 Plan expires in 2012. At September 30, 2006 there were 17.4 million shares of common stock available for future grant. At September 30, 2006, stock awards outstanding under the 2000 Plan included stock options, restricted stock, and restricted stock units.

Expiration of non-qualified stock options or stock appreciation rights is based on award agreements. Non-qualified stock options typically expire ten years from date of grant, but, if approved by the Board of Directors, may have a stated term in excess of ten years. Incentive stock option awards expire ten years from the date of grant. Generally, options granted to employees terminate upon termination of employment (or 90 days thereafter). Under the terms of the 2000 Plan, the exercise price, determined by the Board of Directors, may not be less than the fair market value of a share of the Company s common stock on the date of grant. Stock options granted to employees generally vest over a period of four years while stock options granted to non-employee members of the Company s Board of Directors generally vest over a period of 6 months and, once vested, are not affected by the director s termination of service to the Company. The Company settles stock option exercises with newly issued common shares.

Generally, unvested restricted stock and restricted stock unit awards expire upon termination of service to the Company (or 90 days thereafter). Restricted stock or restricted stock unit awards granted to employees generally vest over a period of four years while restricted stock or restricted stock units granted to members of the Company s Board of Directors generally vest over a period of six months.

Under the 2000 Plan, fair market value is defined as the closing price of a share of the common stock on the Nasdaq National Market System (now the Nasdaq Global Market), as of any applicable date, as long as the Company s shares are traded on such system

Stock Options

The Company estimates the fair value of stock options using the Black-Scholes valuation model, consistent with the provisions of SFAS No. 123R, SEC SAB No. 107 and the Company s prior period pro forma disclosures of net earnings, including stock-based compensation (determined under a fair value method as prescribed by SFAS No. 123).

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option valuation model and a straight line attribution approach using the following assumptions for the three and nine months ended September 30, 2006:

	Three months ended September 30, 2006		Nine months ended September 30, 2006	
Risk-free interest rate	4.75 5.12	%	4.29 5.12	%
Expected stock price volatility	57.0	%	56.9 59.0	%
Weighted average expected term (in years)	4.2		4.2	
Expected dividend yield	0.0	%	0.0	%

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The risk-free interest rate is based on U.S. Treasury interest rates for a term consistent with the expected life of the stock options.

The expected stock price volatility assumption was derived using a combination of historical and implied volatility. The Company determined that a blended volatility is more reflective of market conditions and a better indicator of expected volatility than historical volatility alone. Prior to the adoption of SFAS No. 123R, the Company used historical volatility as the basis for its expected volatility assumption.

Weighted average expected term was calculated using a forward looking lattice model of the Company s stock price incorporating a suboptimal exercise factor and a projected post-vest forfeiture rate. Prior to the adoption of SFAS No. 123R, the Company used the estimated option life (typically four years) as the basis for its expected term assumption.

Expected dividend yield was not considered in the option pricing formula since the Company does not pay dividends and has no current plans to do so in the future.

The forfeiture rate used was based upon historical experience. As required by SFAS No. 123R, the Company will adjust the estimated forfeiture rate based upon actual experience.

The weighted average grant date fair value per option (determined using the Black-Scholes option pricing model) for options granted during the three and nine months ended September 30, 2006 was $2.92 and $2.47, respectively.

The following table summarizes the stock option activity for the nine months ended September 30, 2006:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	13,464	$ 11.81		
Granted	604	4.98		
Exercised	(225)	6.05		
Canceled	(193)	6.51		
Expired	(788)	11.75		
Outstanding at September 30, 2006	12,862	$ 11.68	5.5	$ 3,856
Exercisable at September 30, 2006	11,394	$ 12.36	5.1	$ 2,504

The total intrinsic value of options exercised during the three and nine months ended September 30, 2006 was nil and $0.2 million, respectively. The total fair value of stock options vested during the three and nine months ended September 30, 2006 was $1.0 million and $3.4 million, respectively. As of September 30, 2006, there was $3.8 million of total forfeiture adjusted unrecognized compensation cost related to non-vested stock options granted under the 2000 Plan. That cost is expected to be recognized over a weighted-average period of 2.1 years. Cash received from stock option exercises was $0.1 and $1.4 million during the three and nine months ended September 30, 2006, respectively.

The following table summarizes information with respect to stock options outstanding and exercisable at September 30, 2006:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding**	**Weighted-Average Remaining Contractual Life (years)**	**Weighted-Average Exercise Price**	**Number Exercisable**	**Weighted-Average Exercise Price**
$4.36 -$6.38	2,588	6.9	$ 5.60	1,884	$ 5.74
$6.77 - $10.00	2,902	4.9	$ 8.06	2,138	$ 8.28
$10.28 - $15.38	5,064	5.6	$ 12.20	5,064	$ 12.20
$15.63 - $22.00	2,307	3.6	$ 21.87	2,307	$ 21.87
$24.13	1	3.8	$ 24.13	1	$ 24.13
Total	12,862	5.5	$ 11.68	11,394	$ 12.36

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Restricted Stock And Restricted Stock Units

During 2005, the Compensation Committee of the Board of Directors approved the issuance of 854,000 restricted stock units (RSUs) to selected employees, including 365,000 to executive officers, and the issuance of 44,000 shares of restricted stock to Directors under the 2000 Plan. RSUs represent the Company s unfunded and unsecured promise to issue shares of the common stock at a future date, subject to the terms of the RSU Award Agreement and the 2000 Plan. The purpose of these awards is to assist in attracting and retaining highly competent employees and directors and to act as an incentive in motivating selected employees and directors to achieve long-term corporate objectives. These 2005 RSU awards vest over four years for employees and executive officers. The 2005 restricted stock awards to directors vested on January 1, 2006. The fair value of restricted stock unit and restricted stock awards is charged to expense ratably over the requisite service period.

In accordance with an approval by the Compensation Committee of the Board of Directors under the 2000 Plan, in July 2006 the Company issued 862,000 RSUs to selected employees, including 417,000 to executive officers, and 50,000 shares of restricted stock to directors. In September 2006, the Company issued an additional 5,600 RSUs to selected employees under the 2000 Plan, as approved by the Compensation Committee fo the Board of Directors. The 2006 awards vest over four years for non-executive officers. The 2006 awards for executive officers vest 50% on July 3, 2009 and 50% on July 3, 2010, subject to acceleration if the Company meets certain market capitalization targets, but not earlier than July 3, 2008. The 2006 restricted stock awards to directors will vest on January 2, 2007. The fair value of restricted stock unit and restricted stock awards is charged to expense ratably over the requisite service period.

Changes in the Company s non-vested restricted stock and restricted stock units for the nine months ended September 30, 2006 follow:

	Shares/units
Outstanding at December 31, 2005	1,063
Granted	917
Vested	(137)
Forfeited	(8)
Outstanding at September 30, 2006	1,835

The fair value of the Company s restricted stock and restricted stock units was calculated based upon the fair market value of the Company s stock at the date of grant. As of September 30, 2006, there was $9.4 million of total forfeiture adjusted unrecognized compensation cost related to nonvested restricted stock and restricted stock units, which is expected to be amortized over a weighted average amortization period of 3.2 years.

Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the Purchase Plan) provides effectively all Axcelis employees the opportunity to purchase common stock of the Company at less than market prices. Purchases are made through payroll deductions of up to 10% of the employee s salary, subject to certain caps set forth in the Purchase Plan. Historically, employees could purchase Axcelis common stock at 85% of the market value of the Company s common stock on the first trading day of each offering period or on the day the stock is purchased, whichever was lower. Effective January 1, 2006, employees may only purchase Axcelis common stock at 85% of the market value of the Company s common stock on the day the stock is purchased. The purchase price may be adjusted by a committee of the Board of Directors.

Compensation expense was not recognized through December 31, 2005 because the Purchase Plan was a non-compensatory plan under Section 423 of the Internal Revenue Code. Under SFAS No. 123R, the Purchase Plan is now considered compensatory and as such, compensation expense is recognized beginning January 1, 2006. Compensation expense is computed as the benefit of discounted stock price, amortized to compensation expense straight-line over each offering period of six months. Compensation expense for the three and nine months ended September 30, 2006 was $0.1 million and $0.3 million, respectively.

As of September 30, 2006, there were a total of 4.3 million shares reserved for issuance and available for purchase under the Purchase Plan. There were 0.2 million shares purchased under the Purchase Plan during the three months ended September 30, 2006 and 0.5 million shares purchased under the Purchase Plan during the nine months ended September 30, 2006.

Note 3. Net Income (Loss) Per Share

SFAS No. 128, Earnings Per Share, requires two presentations of earnings per share, basic and diluted. Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders (the numerator) by the weighted-average number of common shares outstanding (the denominator) for the period. The computation of diluted earnings (loss) per

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share is similar to basic earnings (loss) per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

For purposes of computing diluted earnings per share, weighted average common shares outstanding do not include stock options with an exercise price inclusive of unrecognized compensation expense which exceeded the average fair market value of the Company s common stock for the period, as the effect would be anti-dilutive. As such, the Company has excluded from the computation 12.1 million and 12.2 million (for the three and nine months ended September 30, 2006, respectively) and 11.5 million and 10.9 million (for the three and nine months ended September 30, 2005, respectively) outstanding stock options. In addition, 7.5 million shares and 6.9 million shares of common stock for the assumed conversion of the Company s convertible debt for the three and nine months ended September 30, 2006, respectively, and 6.3 million shares of common stock for the assumed conversion of the Company s convertible debt for the three and nine months ended September 30, 2005, computed using the if converted method, were excluded from the computation of diluted earnings per share as the effect of conversion would be anti-dilutive. These stock options and conversions could, however, become dilutive in future periods.

A reconciliation of net income (loss) and shares used in computing basic and diluted earnings (loss) per share follows:

	Three months ended September 30,		**Nine months ended September 30,**	
	2006	**2005**	**2006**	**2005**
	(in thousands, except per share data)			
Income (loss) available to common stockholders	$ 12,520	$ (5,167)	$ 25,209	$ (2,520)
Weighted average common shares outstanding used in computing basic net income (loss) per share	101,165	100,428	101,003	100,256
Incremental shares	447		202	
Weighted average common shares outstanding used in computing diluted net income (loss) per share	101,612	100,428	101,205	100,256
Net income (loss) per share				
Basic	$ 0.12	$ (0.05)	$ 0.25	$ (0.03)
Diluted	0.12	(0.05)	0.25	(0.03)

Note 4. Comprehensive Income (Loss)

The components of comprehensive income (loss) follow:

	Three months ended September 30,		**Nine months ended September 30,**	
	2006	**2005**	**2006**	**2005**
	(in thousands)			
Net income (loss)	$ 12,520	$ (5,167)	$ 25,209	$ (2,520)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(4,315)	(3,276)	1,582	(13,797)
Unrealized gain (loss) on marketable securities	28	(16)	36	(31)
Comprehensive income (loss)	$ 8,233	$ (8,459)	$ 26,827	$ (16,348)

Note 5. Inventories

The Company adopted Statement of Financial Accounting Standards No. 151 (SFAS No. 151) Inventory Costs, an amendment of ARB 43, Chapter 4 effective January 1, 2006. SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, Inventory Pricing to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 requires that idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current period charges. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. Adopting SFAS No. 151 did not have a material impact on the Company s consolidated financial statements.

The components of inventories follow:

	September 30, 2006 (in thousands)	December 31, 2005
Raw materials	$ 88,839	$ 78,230
Work-in-process	41,773	22,073
Finished goods (completed systems)	15,643	9,669
	$ 146,255	$ 109,972

Note 6. Restructuring

The Company recorded restructuring charges of $0.1 million for both the three and nine months ended September 30, 2006. The charge recorded during the three months ended September 30, 2006 represents a reevaluation of the assumptions used in determining the fair value of certain lease obligations related to facilities abandoned in a previous restructuring. The revised assumptions, including lower estimates of expected sub-rental income over the remainder of the lease terms and expected lease termination costs associated with exiting a portion of the facilities, are based on management s evaluation of the commercial rental market. For the nine months ended September 30, 2006, the above mentioned charges are net of a credit of $0.3 million to previously recognized restructuring charges relating primarily to the adjustment for severance and other one-time termination benefits associated with reduction in force actions and the consolidation of the Company s Rockville, Maryland operations into its headquarters and manufacturing facility located in Beverly, Massachusetts. In addition to the amounts reported as restructuring charges, $0.4 million of relocation and other incremental expenses related to the consolidation of the Rockville, Maryland operations are included in general and administrative expense for the nine months ended September 30, 2006.

In total, the Company expects to incur approximately $13.1 million in restructuring and general and administrative expenses related to these actions, of which $12.9 million has been recognized in the statement of income since the fourth quarter of 2004. The Company expects to incur approximately $0.2 million in additional expense through December 31, 2006. Of the total cost related to these actions, approximately $12.4 million is expected to result in cash expenditures, of which $11.3 million has been paid through September 30, 2006. Leases are expected to be paid over the remaining lease periods extending to 2007.

Changes in the Company s restructuring liability are as follows:

	Severance (in thousands)	Retention	Leases	Total
Balance at December 31, 2005	$ 636	$ 120	$ 1,264	$ 2,020
Restructuring expense (credit)	(287)	(51)	485	147
Cash payments	(349)	(69)	(883)	(1,301)
Balance at September 30, 2006	$	$	$ 866	$ 866

Restructuring charges of $1.5 million and $5.4 million for the three and nine months ended September 30, 2005, respectively, consisted primarily of severance and other one-time termination benefits that were paid related to reduction in force actions and the consolidation of the Company s Rockville, Maryland operations into its headquarters and manufacturing facility located in Beverly, Massachusetts. In addition to the amounts reported as restructuring charges, $1.4 million and $4.2 million for the three and nine months ended September 30, 2005, respectively, of relocation and other incremental expenses related to the consolidation of the Rockville, Maryland operations are included in general and administrative expense.

Note 7. Product Warranty

The Company offers a one - to three - year warranty for all of its products, the terms and conditions of which vary depending upon the product sold. For all systems sold, the Company accrues a liability for the estimated cost of standard warranty at the time of system shipment and defers the portion of systems revenue attributable to the fair value of non-standard warranty. Costs for non-standard warranty are expensed as incurred. Factors that affect the Company s warranty liability include the number of installed units, historical and anticipated product failure rates, material usage and service labor costs. The Company periodically assesses the adequacy of its recorded liability and adjusts the amount as necessary.

Changes in the Company s product warranty liability are as follows:

	Nine months ended September 30, 2006 (in thousands)	2005
Balance at December 31	$ 7,166	$ 10,924
Warranties issued during the period	7,284	7,181
Settlements made during the period	(4,637)	(6,944)
Changes in liability for pre-existing warranties during the period	(2,406)	(1,152)
Balance at September 30	$ 7,407	$ 10,009
Amount classified as current	$ 6,569	$ 8,321
Amount classified as long-term	838	1,688
Balance at September 30	$ 7,407	$ 10,009

Note 8. Convertible Subordinated Debt

On May 2, 2006, the Company entered into an exchange and purchase agreement pursuant to which the holder of an aggregate of approximately $50.8 million of the Company s existing 4.25% Convertible Subordinated Notes due January 15, 2007 (the Old Notes), agreed to exchange its Old Notes for $50.8 million in aggregate principal amount of the Company s newly issued 4.25% Convertible Senior Subordinated Notes due January 15, 2009 (the New Notes), plus accrued and unpaid interest on the Old Notes through but excluding May 2, 2006, the closing date of the exchange. In addition, the Company issued an additional $24.2 million of New Notes, resulting in an aggregate of $75 million of New Notes outstanding.

The New Notes are unsecured senior indebtedness of the Company and bear interest at the rate of 4.25% per annum. Interest is payable on January 15 and July 15 of each year, commencing July 15, 2006. The New Notes mature on January 15, 2009. At maturity, the Company is required to repay the outstanding principal of the New Notes, plus a maturity premium of 11.125% of such principal, resulting in an effective annual yield to maturity of approximately 8.0%.

The principal amount of the New Notes, together with the accreted portion of the maturity premium, which increases over the term of the notes, as of the conversion date, are convertible at the option of the holder, at any time on or prior to maturity, into shares of the Company s common stock at a conversion price equal to $20.00 per share, which also is the conversion price of the Old Notes, subject to adjustment in certain circumstances.

In accordance with the Financial Accounting Standards Board s Emerging Issues Task Force Issue No. 96-19, Debtor s Accounting for a Modification or Exchange of Debt Instruments , the Company considered the terms of the New Notes to be substantially different from the terms of the Old Notes. As such, the Company wrote off approximately $0.2 million of debt issuance costs related to the Old Notes to interest expense during the three months ended June 30, 2006. In addition, debt issuance costs of approximately $0.3 million related to the New Notes are being amortized to interest expense over the term of the New Notes.

Note 9. Deferred Income Taxes

At December 31, 2005, the Company had $104.2 million of deferred tax assets relating to net operating loss carryforwards, tax credit carryforwards and other temporary differences (principally in the United States, Europe, and Asia), which are available to reduce income taxes in future years. SFAS No. 109 Accounting for Income Taxes requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence needs to be considered, including a company s performance, the market environment in which the company operates, length of carryback and carryforward periods, existing sales backlog, and projections of future operating results. Where there are cumulative losses in recent years, SFAS No. 109 creates a strong presumption that a valuation allowance is needed. This presumption can be overcome in very limited circumstances.

In 2003, the Company entered a three-year cumulative loss position and revised its projections of the amount and timing of profitability in future periods. As a result, the Company increased its valuation allowance to reduce the carrying value of deferred tax assets to zero. The Company will maintain a valuation allowance on future tax benefits for entities in a three-year cumulative loss position until it can sustain an appropriate level of profitability. However, going forward should the Company s return to profitability provide sufficient evidence, in accordance with the provisions of SFAS No. 109, to support the ultimate realization of income tax benefits attributable to net operating losses, tax credit carryforwards, and other deductible temporary differences, a reduction in the valuation allowance may be recorded and the carrying value of

deferred tax assets may be restored, resulting in a non-cash credit to earnings.

Note 10. Significant Customers

In the three months ended September 30, 2006, one customer accounted for approximately 12% and three other customers each accounted for approximately 10% of revenue, respectively. In the nine months ended September 30, 2006, one customer accounted for approximately 11% of revenue. In the three months ended September 30, 2005, three customers accounted for approximately

13%, 11% and 10% of revenue, respectively. In the nine months ended September 30, 2005, one customer accounted for approximately 21% of revenue. For the three and nine months ended September 30, 2006 and 2005, no other customer accounted for more than 10% of revenue.

Note 11. Contingencies

Litigation

From time to time, the Company may be subject to legal proceedings and claims arising from the conduct of its business including litigation related to intellectual property matters, customer contract matters, employment claims and environmental matters. At September 30, 2006, the Company is not a party to any material legal proceedings.

Indemnifications

The Company s system sales agreements typically include provisions under which the Company agrees to take certain actions, provide certain remedies and defend its customers against third-party claims of intellectual property infringement under specified conditions and to indemnify customers against any damage and costs awarded in connection with such claims. The Company has not incurred any material costs as a result of such indemnifications and has not accrued any liabilities related to such obligations in the accompanying consolidated financial statements.

Note 12. Recent Accounting Pronouncements

SFAS 158

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans , which requires an employer to (a) recognize in its statement of financial position an asset for a plan s overfunded status or a liability for a plan s underfunded status, (b) measure a plan s assets and its obligations that determine its funded status as of the end of the employer s fiscal year, and (c) recogonize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer s fiscal year-end statement of financial position becomes effective for fiscal years ending after December 15, 2008. The Company is currently evaluating what impact, if any, this statement will have on its consolidated financial statements.

FIN 48

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes . It also prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and it provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective as of the beginning of the first fiscal year beginning after December 15, 2006. The Company does not believe adoption of FIN 48 will have a material impact on the Company s consolidated financial statements.

SFAS 154

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections , which changes the requirements for the accounting and reporting of a change in accounting principle. SFAS No. 154 applies to all voluntary changes in accounting principle as well as to changes required by an accounting pronouncement that does not include specific transition provisions. SFAS No. 154 requires that changes in accounting principle be retrospectively applied. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. SFAS No. 123R, however, allowed for a modified prospective approach of adoption. The adoption of this statement did not have any impact on the Company s consolidated financial statements.

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

Certain statements in Management s Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements that involve risks and uncertainties. Words such as may, will, should, would, anticipates, expects, intends, plans, believes, seeks, estimates and similar expressions identify such forward-looking statements. The forward-looking statements contained

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herein are based on current expectations and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in such forward-looking statements. Factors that might cause such a difference include, among other things, those set forth under Liquidity and Capital Resources and Risk Factors and those appearing elsewhere in this Form 10-Q. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management s analysis only as of the date hereof. We assume no obligation to update these forward-looking statements to reflect actual results or changes in factors or assumptions affecting forward-looking statements.

Overview

Axcelis Technologies, Inc. (Axcelis, we, us, or our), is a worldwide producer of ion implantation, dry strip, thermal processing and curing equipment used in the fabrication of semiconductors. In addition, we provide extensive aftermarket service and support, including spare parts, equipment upgrades, and maintenance services. We own 50% of the equity of a joint venture known as SEN Corporation, an SHI and Axcelis Company, or SEN with Sumitomo Heavy Industries, Ltd. in Japan. SEN licenses technology from us relating to the manufacture of specified ion implantation products and has exclusive rights to manufacture and sell these products in the territory of Japan. SEN is the leading producer of ion implantation equipment in Japan.