ADE CORP
Form 10-Q
September 16, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-Q

(Mark One)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For Quarter Ended: July 31, 2002 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 0-26714

ADE CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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

80 Wilson Way, Westwood, Massachusetts 02090
(Address of Principal Executive Offices, Including Zip Code)

(781) 467-3500
(Registrant's Telephone Number, Including Area Code)

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

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

Common Stock, par value $.01 per share	13,687,400 shares
Class	Outstanding at September 13, 2002

ADE CORPORATION

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PART I.
FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (unaudited):

ADE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands, unaudited)

	July 31, 2002	April 30, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 18,937	$ 26,108
Marketable securities	1,291	2,571
Accounts receivable, net	12,888	11,725
Inventories	33,065	32,701
Prepaid expenses and other current assets	1,074	1,278

	July 31, 2002	April 30, 2002
Total current assets	67,255	74,383
Fixed assets, net	29,952	30,658
Investments	3,485	3,610
Intangible assets, net	1,170	1,283
Goodwill, net	1,318	1,318
Restricted cash	3,302	3,352
Other assets	144	147
Total assets	$ 106,626	$ 114,751
Liabilities and stockholders' equity		
Current liabilities:		
Current portion of long-term debt	$ 652	$ 646
Accounts payable	7,268	6,594
Accrued expenses and other current liabilities	10,095	12,004
Deferred income on sales to affiliates	1,688	1,470
Total current liabilities	19,703	20,714
Long-term debt	10,558	10,715
Stockholders' equity:		
Common stock	137	137
Capital in excess of par value	103,657	103,553
Accumulated deficit	(28,220)	(22,439)
Accumulated other comprehensive income	791	2,071
Total stockholders' equity	76,365	83,322
Total liabilities and stockholders' equity	$ 106,626	$ 114,751

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

ADE CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share data, unaudited)

	Three months ended July 31,	
	2002	**2001**

	Three months ended July 31,	
Net Revenue:		
Systems and parts	$ 12,875	$ 23,092
Service	1,865	2,279
Total revenue	14,740	25,371
Cost of revenue:		
Systems and parts	6,591	12,069
Service	2,351	2,850
Total cost of revenue	8,942	14,919
Gross profit	5,798	10,452
Operating expenses:		
Research and development	4,844	6,115
Marketing and sales	2,800	3,588
General and administrative	2,853	2,312
Restructuring charges	877	
Total operating expenses	11,374	12,015
Loss from operations	(5,576)	(1,563)
Interest and other income (expense), net	(119)	311
Loss before provision for income taxes and equity in net earnings (loss) of affiliated companies	(5,695)	(1,252)
Provision for income taxes	22	7
Loss before equity in net earnings (loss) of affiliated companies	(5,717)	(1,259)
Equity in net earnings (loss) of affiliated companies	(64)	68
Net loss	$ (5,781)	$ (1,191)
Basic loss per share	$ (0.42)	$ (0.09)
Diluted loss per share	$ (0.42)	$ (0.09)
Weighted average shares outstanding basic	13,679	13,567
Weighted average shares outstanding diluted	13,679	13,567

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

ADE CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands, unaudited)

	Three months ended July 31, 2002	Three months ended July 31, 2001
Cash flows from operating activities:		
Net loss	$ (5,781)	$ (1,191)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,217	1,489
Equity in net (earnings) loss of affiliated companies, net of dividends received	125	41
Changes in assets and liabilities:		
Accounts receivable, net	(1,163)	7,226
Inventories	(364)	1,219
Prepaid expenses and other current assets	204	261
Accounts payable	674	(2,189)
Accrued expenses and other current liabilities	(1,909)	(4,588)
Deferred income on sales to affiliate	218	(72)
Net cash provided by (used in) operating activities	(6,779)	2,196
Cash flows from investing activities:		
Purchases of fixed assets	(398)	(941)
Change in restricted cash	50	50
Decrease in other assets	3	88
Net cash used in investing activities	(345)	(803)
Cash flows from financing activities:		
Repayment of long-term debt	(151)	(149)
Proceeds from issuance of common stock	104	472
Net cash provided by (used in) financing activities	(47)	323
Net increase (decrease) in cash and cash equivalents	(7,171)	1,716
Cash and cash equivalents, beginning of period	26,108	29,220
Cash and cash equivalents, end of period	$ 18,937	$ 30,936

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

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Preparation

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

Pursuant to accounting requirements of the Securities and Exchange Commission applicable to quarterly reports on Form 10-Q, the accompanying unaudited condensed consolidated financial statements and these notes do not include all disclosures required by generally accepted accounting principles for complete financial statements. Accordingly, these statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2002.

2. Comprehensive Loss

Comprehensive loss was as follows:

	Three months ended	
	July 31, 2002	**July 31, 2001**
	(in thousands)	
Net loss	$ (5,781)	$ (1,191)
Other comprehensive income (loss):		
Unrealized gain (loss) on marketable securities, net of $0 tax	(1,280)	28
Other comprehensive income (loss)	(1,280)	28
Comprehensive loss	$ (7,061)	$ (1,163)

3. Inventories

Inventories consist of the following:

	July 31, 2002	**April 30, 2002**
	(unaudited)	
	(in thousands)	
Raw materials and purchased parts	$ 17,199	$ 16,228
Work-in-process	14,530	15,104
Finished goods	1,336	1,369
	$ 33,065	$ 32,701

4. Goodwill and Intangible Assets

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Other Intangible Assets," which was effective for the Company on May 1, 2002. SFAS 142 requires, among other things, the discontinuance of goodwill amortization and includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, and reclassification of certain intangibles out of previously reported goodwill. In accordance with this statement, the Company discontinued the amortization of its net goodwill of $1.3 million. In addition, under SFAS 142 the Company is required to test all existing goodwill for impairment as of May 1, 2002, on a reporting unit basis. The Company will complete this transitional impairment test during the second quarter of fiscal 2003. Had SFAS 142 been in effect during the three months ended July 31, 2001, the Company's net loss and net loss per share would have been as follows:

	Three months ended	
	July 31, 2002	July 31, 2001
	(in thousands, except per share data, unaudited)	
Reported net loss	$ (5,781)	$ (1,191)
Add back of goodwill amortization		59
Adjusted net loss	(5,781)	$ (1,132)
Reported basic and diluted net loss per share	$ (0.42)	$ (0.09)
Add back of goodwill amortization		0.01
Adjusted basic and diluted loss per share	$ (0.42)	$ (0.08)

The Company has $2.9 million in capitalized license fees for software included in the Company's products, which are still being amortized and have accumulated amortization of $1.7 million and $1.6 million at July 31, 2002 and April 30, 2002, respectively. These license fees are amortized at the greater of 1) the ratio that current gross revenue for the related products bear to the total current and anticipated future gross revenue for those products or 2) on a straight-line basis over the estimated useful life of the related products. For the quarter ended July 31, 2002, the Company amortized $113,000 of the license fees to the cost of revenue. Estimated amortization is $450,000 for the fiscal year ended April 30, 2003, $150,000 for each of the fiscal years ended April 30, 2004, 2005 and 2006, and $50,000 for the fiscal year ended April 30, 2007.

5. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

	July 31, 2002	April 30, 2002
	(unaudited)	
	(in thousands)	
Accrued salaries, wages and vacation pay	$ 1,674	$ 2,223
Accrued commissions	786	1,191
Accrued warranty costs	930	1,146
Accrued restructuring	495	
Deferred revenue	3,527	4,537
Other	2,683	2,907
	$ 10,095	$ 12,004

6. Restructuring

During the first quarter of fiscal 2003, the Company implemented selective headcount reductions and closed three satellite offices in response to the prolonged downturn in the semiconductor industry. The Company recorded a restructuring charge of $877,000, which consisted of $679,000 in employee severance expenses for the 39 terminated employees spread across all functional areas of the Company and $198,000 related to the closing of the satellite offices, which primarily represents future lease obligations on the vacated offices. When applicable, anticipated future sublease income relating to vacated offices was offset against the charge for the remaining lease payments. The sublease income was based on estimates and will be monitored going forward and is subject to change. The Company expects that all severance payments will be made by the end of fiscal year 2003. Below is a table summarizing the activity related to the restructuring accrual for the quarter ended July 31, 2002:

	Severance	Office Closures	Total
Restructuring accrual	$ 679	$ 198	$ 877
Cash payments	(338)	(44)	(382)
Balance at July 31, 2002	$ 341	$ 154	$ 495

7. Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing income (loss) available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed using the weighted average number of common shares outstanding and gives effect to all dilutive potential common shares outstanding during the period. For the three months ended July 31, 2002 and 2001, respectively, 645,971 and 241,695 common shares issuable upon the exercise of stock options have been excluded from the computation of diluted earnings per share, as their effect would have been antidilutive. For the three months ended July 31, 2002 and 2001, basic and diluted loss per share is the same due to the antidilutive effect of potential common shares outstanding.

8. Segment Reporting

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

The Company's reportable segments are determined based upon the nature of the products, the external customers and customer industries and the sales and distribution methods used to market the products. The Company evaluates performance based upon profit or loss from operations. The Company does not measure the assets allocated to the segments. Management fees representing certain services provided by corporate offices have been allocated to each of the reportable segments based upon the usage of those services by each segment. Additionally, other income (loss), the provision for

(benefit from) income taxes and the equity in net earnings (loss) of affiliated companies are not included in segment profitability.

Some sales to JAL, ADE's 50% affiliate, are reflected in segment revenue during the period they are shipped by the respective segment, which can differ from the period the revenue is recognized for consolidated financial reporting purposes. For the reportable segments, intercompany sales are recorded at 60% of the domestic list price of the respective product.

	SSG	PST	ATI	Total
		(in thousands)		
For the quarter ended July 31, 2002				
Revenue from external customers	$ 10,332	$ 2,833	$ 1,544	$ 14,709

	SSG	PST	ATI	Total
Intersegment revenue			226	226
Income (loss) from operations	(5,442)	112	(275)	(5,605)
Depreciation and amortization expense	1,066	99	52	1,217
Capital expenditures	313	85		398
For the quarter ended July 31, 2001				
Revenue from external customers	$ 19,557	$ 1,154	$ 1,735	$ 22,446
Intersegment revenue	198		303	501
Loss from operations	(1,536)	(1,282)	(316)	(3,134)
Depreciation and amortization expense	1,337	96	56	1,489
Capital expenditures	821	50	70	941

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

	Three months ended July 31,	
	2002	2001
Total external revenue for reportable segments	$ 14,709	$ 22,446
Net impact of revenue recognition on sales to affiliate	31	2,925
Total consolidated revenue	$ 14,740	$ 25,371
Total operating loss for reportable segments	$ (5,605)	$ (3,134)
Net impact of intercompany gross profit eliminations and deferred profit on sales to affiliate	29	1,571
Total consolidated operating loss	$ (5,576)	$ (1,563)

9. New Accounting Pronouncements

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 requires one method of accounting for long-lived assets disposed of by sale. SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001. The adoption of SFAS 144 by the Company during the quarter ended July 31, 2002 did not have a material impact on its current financial position and results of operations.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections." For most companies, SFAS 145 will require gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under SFAS 4. Extraordinary treatment will be required for certain extinguishments as provided in APB Opinion No. 30. The statement also amended SFAS 13 for certain sales-leaseback transactions and sublease accounting. The Company is required to adopt the provisions of SFAS 145 effective May 1, 2003. The Company does not expect the adoption of SFAS 145 to have a material effect on the Company's financial condition or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)" and must be applied beginning January 1, 2003. SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than when the exit or disposal plan is approved. The Company will adopt the provisions of SFAS 146 for exit and disposal activities that are initiated after December 31, 2002 as required by the standard.

10. Pending Litigation

On October 12, 2000, the Company filed a patent infringement lawsuit against KLA-Tencor (KLA), a competitor, in the U.S. District Court in Delaware. The Company seeks damages and a permanent injunction against further infringement of United States Patent Number 6,118,525, entitled "Wafer Inspection System for Distinguishing Pits and Particles." On November 22, 2000, KLA filed a counterclaim in the United States District Court in Delaware alleging that the Company has infringed three patents owned by KLA. KLA is seeking damages for the alleged patent infringement and a permanent injunction against future infringement. In addition, KLA has asked the District Court for a declaration that United States Patent Number 6,118,525, owned by the Company, is invalid and not infringed by KLA. At this time, the Company cannot predict the outcome or the amount of gain or loss, if any.

11. Subsequent Events

In August 2002, an agreement was entered into between the Company and its former Chief Executive Officer, Robert C. Abbe. Under the terms of the agreement, Mr. Abbe will receive a total of $1.1 million over a three-year period, beginning in September 2002, for severance and consulting services.

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

Introduction

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

The following information should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto included in this quarterly report and the audited consolidated financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2002.

Forward-Looking Statements

This quarterly report on Form 10-Q contains certain forward-looking statements that are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those expressed by such statements. Those statements that make reference to the Company's expectations, predictions and anticipations should be considered forward-looking statements. These statements include, but are not limited to, risks and uncertainties associated with the strength of the semiconductor and hard disk markets, wafer pricing and wafer demand, the results of its product development efforts, the success of ADE's product offerings in meeting customer needs within the timeframes required by customers in these markets, further increases in backlog, the Company's visibility and the it's predictions of future financial outcomes. Further information on potential factors that could affect the Company's business is described in "Other Risk Factors" appearing at the end of this Management's Discussion and Analysis of Financial Condition and Results of Operations and in the Company's reports on file with the Securities and Exchange Commission, including its Form 10-K for the fiscal year ended April 30, 2002.

Restructuring

During the first quarter of fiscal 2003, the Company implemented selective headcount reductions and closed three satellite offices in response to the prolonged downturn in the semiconductor industry. The Company recorded a restructuring charge of $877,000, which consisted of $679,000 in employee severance expenses for the 39 terminated employees spread across all functional areas of the Company and $198,000 related to the closing of the satellite offices, which primarily represents future lease obligations on the vacated offices. When applicable, anticipated future sublease income relating to vacated offices was offset against the charge for the remaining lease payments. The sublease income was based on estimates and will be monitored going forward and is subject to change. Below is a table summarizing the activity related to the restructuring accrual for the quarter ended July 31, 2002:

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Critical Accounting Policies, Significant Judgments and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure at the date of our financial statements. On an on-going basis, management evaluates its estimates and judgments, including those related to bad debts, inventories, intangible assets, income taxes, and warranty obligations. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The Company considers certain accounting policies related to revenue recognition and allowance for doubtful accounts, inventory valuation, accounting for incomes taxes and valuation of long-lived assets to be critical policies due to the estimates and judgments involved in each. Except for the critical accounting policy regarding the valuation of long-lived assets, described below, our critical accounting policies have not changed since April 30, 2002.

Revenue Recognition and Allowance for Doubtful Accounts

The Company changed its revenue recognition policy effective May 1, 2000, based on guidance provided in SEC Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, our price is fixed or determinable and collectibility is reasonably assured. Our standard customer arrangement includes a signed purchase order, in which we offer payment terms of 30 to 90 days, no right of return of delivered products and a twelve month warranty. We assess whether the fee associated with our revenue transactions is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of the fee is due after our normal payment terms, 30 to 90 days, we determine that the fee is not fixed or determinable. In these cases, we recognize revenue as the fees become due. We assess collectibility based on the credit worthiness of the customer and past transaction history. We perform on-going credit evaluations of our customers and do not require collateral from our customers. For many of our international customers, we require an irrevocable letter of credit to be issued by the customer before the purchase order is accepted. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize the revenue at the time that collection becomes reasonably assured, which is generally upon the receipt of cash.

For some of the Company's sales transactions, a portion, usually 10%, of the fee is not due until installation occurs and the customer accepts the product. The other 90% of the fee is normally due 30 to 90 days after shipment. If the Company has met defined customer acceptance experience levels with a specific type of product, these transactions are accounted for as multiple-element arrangements with the deferral of the portion of the fee not due until installation is complete and customer acceptance

has occurred. Management of the Company must make a determination of what constitutes an appropriate experience level with a product. This determination is based on, but not limited to, the extent to which a product contains significantly new technology, the number of similarly configured products previously delivered and our experience with a particular customer. The portion of the fee related to the installation of the product and customer training is classified as service revenue. All other sales with customer acceptance provisions are recognized as revenue upon customer acceptance.

The Company's transactions frequently involve the sales of systems and services under multiple element arrangements. Revenue under multiple element arrangements is allocated to all elements except systems based upon the fair value of those elements. The amounts allocated to training are based upon the price charged when this element is sold separately and unaccompanied by the other elements. The amount allocated to installation revenue is based upon hourly rates and the estimated time to complete the service. The amount allocated to system and parts is done on a residual method basis. Under this method, the total arrangement value is allocated first to undelivered elements, based on their fair values, with the remainder being allocated to system revenue. Installation and training are not essential to the functionality of systems as these services do not alter the equipment's capabilities, are available from other vendors and the systems are standard products.

We accrue for anticipated warranty costs upon shipment. Service revenue is recognized as the services are performed provided collection of the related receivable is probable. Service contract revenue is recognized ratably over the contractual periods in which the services are provided. We do not provide the right to return products. Revenue from software licenses is recognized when an agreement has been executed, software has been delivered, fees are fixed or determinable and collection of the related receivable is probable. Revenue from software consulting services provided on a time and reimbursable expense basis is recognized as the services are provided.

Revenue from sales to Japan ADE Ltd, our 50% owned affiliate and a distributor of our products, by the SSG, ATI and PST segments are reflected in segment revenue during the period they are shipped by the respective segment, which can differ from the period the revenue is recognized for consolidated financial re