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 Quarter Ended: July 31, 2003

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

For the Transition Period from ______ to ______

Commission file number 0-26714

ADE CORPORATION

(Exact Name of Registrant as Specified in its Charter)

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

80 Wilson Way, Westwood, Massachusetts 02090

(Address of Principal Executive Offices, Including Zip Code)

(781) 467-3500

(Registrant s Telephone Number, Including Area Code)

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

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

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

Common Stock, par value $.01 per share	13,875,952 shares
Class	**Outstanding at September 12, 2003**

Table of Contents

ADE CORPORATION

INDEX

Table of Contents

PART I.

FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (unaudited):

ADE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEET

(in thousands, unaudited)

	July 31, 2003	April 30, 2003
Assets		
Current assets:		
Cash and cash equivalents	$ 32,982	$ 21,476
Marketable securities	1,706	1,060
Accounts receivable, net	11,661	13,385
Inventories	29,283	29,349
Prepaid expenses and other current assets	1,198	1,046
Total current assets	76,830	66,316
Fixed assets, net	12,033	20,923
Investments	500	3,724
Assets held for sale	4,515	4,709
Intangible assets, net	795	833
Goodwill	1,318	1,318
Restricted cash	1,054	3,157
Other assets	133	136
Total assets	$ 97,178	$ 101,116
Liabilities and stockholders equity		
Current liabilities:		
Current portion of long-term debt	$ 161	$ 672
Accounts payable	3,726	4,527
Accrued expenses and other current liabilities	9,938	8,779
Deferred income on sales to affiliate		2,259
Total current liabilities	13,825	16,237
Deferred gain on sale-leaseback	1,694	
Long-term debt	3,735	10,082
Stockholders equity:		
Common stock	138	138

Capital in excess of par value	104,623	103,943
Accumulated deficit	(28,043)	(29,844)
Accumulated other comprehensive income	1,206	560
Total stockholders equity	77,924	74,797
Total liabilities and stockholders equity	$ 97,178	$ 101,116

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

Table of Contents

ADE CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(in thousands, except per share data, unaudited)

	Three months ended July 31,	
	2003	**2002**
Net Revenue:		
Systems and parts	$ 16,866	$ 12,875
Service	2,200	1,865
Total revenue	19,066	14,740
Cost of revenue:		
Systems and parts	8,109	6,591
Service	2,423	2,351
Total cost of revenue	10,532	8,942
Gross profit	8,534	5,798
Operating expenses:		
Research and development	3,697	4,844
Marketing and sales	2,005	2,800
General and administrative	2,165	2,853
Restructuring charges	393	877
Total operating expenses	8,260	11,374
Income (loss) from operations	274	(5,576)
Gain on sale of long-term investment	1,729	
Interest and other income (expense), net	(162)	(119)
Income (loss) before provision for income taxes and equity in net earnings (loss) of affiliated companies	1,841	(5,695)
Provision for income taxes	88	22
Income (loss) before equity in net earnings (loss) of affiliated companies	1,753	(5,717)
Equity in net earnings (loss) of affiliated companies	48	(64)
Net income (loss)	$ 1,801	$ (5,781)
Basic earnings (loss) per share	$ 0.13	$ (0.42)
Diluted earnings (loss) per share	$ 0.13	$ (0.42)
Weighted average shares outstanding - basic	13,768	13,679
Weighted average shares outstanding - diluted	13,827	13,679

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

Table of Contents

ADE CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(in thousands, unaudited)

	Three months ended July 31,	
	2003	**2002**
Cash flows from operating activities:		
Net income (loss)	$ 1,801	$ (5,781)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	896	1,217
Long-lived asset impairment	200	
Equity in net earnings of affiliate, net of dividends received	952	125
Gain on sale of long-term investment	(1,729)	
Changes in assets and liabilities:		
Accounts receivable, net	1,724	(1,163)
Inventories	66	(364)
Prepaid expenses and other current assets	(152)	204
Accounts payable	(801)	674
Accrued expenses and other current liabilities	1,159	(1,909)
Deferred income on sales to affiliate	(2,259)	218
Net cash provided by (used in) operating activities	1,857	(6,779)
Cash flows from investing activities:		
Purchases of fixed assets	(32)	(398)
Change in restricted cash	2,103	50
Proceeds from sale of building, net	9,753	
Proceeds from sale of long-term investment	4,000	
Decrease in other assets	3	3
Net cash provided by (used in) investing activities	15,827	(345)
Cash flows from financing activities:		
Repayment of long-term debt	(6,858)	(151)
Proceeds from issuance of common stock	680	104
Net cash used in financing activities	(6,178)	(47)
Net increase (decrease) in cash and cash equivalents	11,506	(7,171)
Cash and cash equivalents, beginning of period	21,476	26,108
Cash and cash equivalents, end of period	$ 32,982	$ 18,937

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

Table of Contents

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 in the United States of America for complete financial statements. Accordingly, these statements should be read in conjunction with the financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended April 30, 2003.

2. Comprehensive Income (Loss)

Comprehensive income (loss) was as follows:

	(in thousands)	
	Three months ended	
	July 31, 2003	July 31, 2002
	(unaudited)	
Net income (loss)	$ 1,801	$ (5,781)
Other comprehensive income (loss):		
Unrealized income (loss) on marketable securities, net of $0 tax	646	(1,280)
Other comprehensive income (loss):	646	(1,280)
Comprehensive income (loss)	$ 2,447	$ (7,061)

3. Inventories

Inventories consist of the following:

	(in thousands)	
	July 31, 2003	**April 30, 2003**
	(unaudited)	
Raw materials and purchased parts	$ 14,737	$ 14,149
Work-in-process	13,166	12,618
Finished goods	1,380	2,582
	$ 29,283	$ 29,349

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

4. Investments

On July 10, 2003, the Company received a $1.0 million dividend payment from Japan ADE, Ltd (JAL). On July 24, 2003, the Company entered into an agreement to sell the majority of its 50% ownership in JAL to Kanematsu Electronics, Ltd., the other 50% owner of JAL. The Company received proceeds of $4.0 million and realized a gain of $1.7 million from this transaction. The Company retained a 9% ownership interest in JAL. Prior to the transaction, the Company accounted for its investment in JAL under the equity method. As a result of the decrease in both ownership and influence over the affairs of JAL, the Company will account for its remaining 9% interest under the cost method.

Prior to July 24, 2003, when the Company was accounting for its investment in JAL under the equity method, the revenue from sales to JAL, which had not in turn been sold by JAL to unrelated third parties, was eliminated and the related profit on such sales was recorded as deferred income on sales to affiliate. As a result of the reduction of the Company s 50% investment in JAL to 9% and the change in accounting method for the remaining investment to the cost method, the Company recognized approximately $6.4 million of revenue and $3.9 million of profit that otherwise may have been deferred as of July 31, 2003.

5. Intangible Assets

The Company has capitalized license fees for software included in the Company s products. These license fees are amortized at the greater of 1) the ratio that current gross revenue for the related products 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. The carrying amount and accumulated amortization for the Company s intangible assets are as follows:

	(in thousands)	
	July 31, 2003	**April 30, 2003**
	(unaudited)	
License fees at cost	$ 1,400	$ 1,400
Accumulated amortization	(605)	(567)
Net carrying value	$ 795	$ 833

Amortization expense for the three months ended July 31, 2003 and 2002 was $38,000 and $113,000, respectively. Estimated amortization is $150,000 for the fiscal years ended April 30, 2004, 2005 and 2006 and $50,000 for the fiscal year ended April 30, 2007.

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following:

	(in thousands)	
	July 31, 2003	April 30, 2003
	(unaudited)	
Accrued salaries, wages and vacation pay	$ 1,662	$ 1,716
Accrued commissions	637	1,146
Accrued warranty costs	1,057	1,041
Accrued restructuring	367	165
Deferred revenue	3,114	1,947
Other	3,101	2,764
	$ 9,938	$ 8,779

7. Stock-based Compensation

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

	(In thousands, except per share data) Three months ended July 31,	
	2003	2002
Net income (loss), as reported	$ 1,801	$ (5,781)

Deduct: Total stock-based employee compensation expense determined under fair value based method, net of related income taxes		309		446
Pro forma net income (loss)	$	1,492	$	(6,227)
Net earnings (loss) per share:				
Basic - as reported	$	0.13	$	(0.42)
Basic - pro forma	$	0.11	$	(0.46)
Diluted - as reported	$	0.13	$	(0.42)
Diluted - pro forma	$	0.11	$	(0.46)

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

8. Restructuring

During the first quarter of fiscal 2004, as a result of continued cost cutting initiatives, the Company recorded a restructuring charge of $393,000, which consisted primarily of severance expenses for 20 terminated employees. The employees were terminated from various functional areas within the Company s Semiconductor Systems and ADE Technologies business segments. The majority of all the severance payments from the first quarter restructuring will be made by the end of fiscal year 2004. In connection with the first quarter restructuring, the Company did not renew its lease at its Bethel, Connecticut facility, which expired in August 2003. Prior to the end of the first quarter, the operations of the Bethel facility were relocated to the Westwood, Massachusetts and Tucson, Arizona facilities.

Below is a table summarizing the activity related to the restructuring accrual for the three months ended July 31, 2003:

	(in thousands)		
	Severance	Office Closures	Total
Balance at April 30, 2003	$ 120	$ 45	$ 165
Restructuring accrual	393		393
Cash payments	(191)		(191)
Balance at July 31, 2003	$ 322	$ 45	$ 367

9. Sale-leaseback

On July 29, 2003, the Company entered into an agreement to sell and leaseback its headquarters site in Westwood, Massachusetts, which resulted in a deferred gain of $1.7 million. The Company used $3.8 million of the approximately $10.1 million in proceeds, less transaction costs, from the transaction to retire its 1996 Industrial Development Bond and eliminated the related letter of credit. On July 31, 2003, the Company used approximately $3.0 million of the proceeds to retire its 1997 Industrial Development Bond, which resulted in $2.7 million of restricted cash becoming available for general corporate purposes. As part of this transaction, the Company entered into a lease agreement with a 15 year term and annual rent payments increasing from approximately $1.0 million at the beginning of the lease term to approximately $1.3 million by the end of the lease term. The lease has been classified as an operating lease and the gain of $1.7 million on the transaction has been deferred and will be amortized as a reduction of rent expense on a straight-line basis over the term of the lease.

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

10. 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, 2003 and 2002, respectively, 941,515 and 645,971 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, basic and diluted loss per share is the same due to the antidilutive effect of potential common shares outstanding.

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

	(in thousands) Three months ended July 31,	
	2003	**2002**
Shares used in computation:		
Weighted average common stock outstanding used in computation of basic earnings (loss) per share	13,768	13,679
Dilutive effect of stock options outstanding	59	
Shares used in computation of diluted earnings (loss) per share	13,827	13,679

11. 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 were reflected in segment revenue during the period they were shipped by the respective segment, which can differ from the period the revenue was recognized for consolidated financial reporting purposes. As a result of the transaction discussed in Note 4, as of July 24, 2003, all sales to JAL are reflected in both segment and consolidated revenue in the same period. For the reportable segments, intersegment sales are recorded at 60% of the domestic list price of the respective product.

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

11. Segment Reporting (Continued)

	(in thousands)			
	SSG	PST	ATI	Total
For the quarter ended July 31, 2003				
Revenue from external customers	$ 12,790	$ 4,531	$ 1,546	$ 18,867
Intersegment revenue	19		12	31
Income (loss) from operations	(157)	941	(543)	241
Depreciation and amortization expense	756	114	26	896
Long-lived asset impairment	200			200
Capital expenditures	32			32
For the quarter ended July 31, 2002				
Revenue from external customers	$ 10,332	$ 2,833	$ 1,544	$ 14,709
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

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,	
	2003	2002
Total external revenue for reportable segments	$ 18,867	$ 14,709
Net impact of revenue recognition on sales to affiliate	199	31
Total consolidated revenue	$ 19,066	$ 14,740
Total operating income (loss) for reportable segments	$ 241	(5,605)
Net impact of intercompany gross profit eliminations and deferred profit on sales to affiliate	33	29
Total consolidated operating income (loss)	$ 274	$ (5,576)

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

12. New Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 150 (SFAS 150), Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The Company believes that the adoption of SFAS 150 will not have a material impact on its current financial position and results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51. FIN 46 requires certain variable interest entities, or VIEs, to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all VIEs created or acquired after January 31, 2003. For VIEs created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. The Company believes that the adoption of FIN 46 will not have a significant impact on its consolidated financial statements.

In November 2002, the Emerging Issues Task Force issued No. 00-21 (EITF 00-21), Accounting for Revenue Arrangements with Multiple Deliverables. EITF 00-21 addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. EITF 00-21 establishes three principles: revenue arrangements with multiple deliverables should be divided into separate units of accounting, arrangement consideration should be allocated among the separate units of accounting based on their relative fair values and revenue recognition criteria should be considered separately for separate units of accounting. EITF 00-21 is effective for all revenue arrangements entered into in fiscal periods beginning after June 15, 2003, with early adoption permitted. The Company does not expect the adoption of EITF 00-21 to have a material impact on the Company s consolidated financial statements.

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

13. Commitments and Contingencies

Pending Litigation

On October 12, 2000, the Company filed a patent infringement lawsuit against KLA-Tencor (KLA), a competitor, in the United States 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 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. On March 13, 2003, the District Court issued a ruling upholding KLA s principal arguments with respect to ADE s claims of infringement. The District Court has not yet ruled on KLA s counterclaims. Once all rulings have been issued by the District Court, the Company will consider whether or not to appeal the rulings to the United States Court of Appeals for the Federal Circuit. Accordingly, at this time, the Company cannot predict the outcome or the amount of gain or loss, if any, from this lawsuit.

On October 18, 2002, a former employee of the Company filed a civil action against the Company in Massachusetts Superior Court, Suffolk County, alleging that the Company breached his employment contract with the Company and seeking damages of approximately $500,000. The Company has filed an answer to the former employee s complaint denying his allegations, and believes that the former employee s claim lacks merit. The Company has also filed counterclaims against the employee. On July 15, 2003, the former employee amended his complaint to add related allegations and to add Dr. Koliopoulos and Mr. James as individual defendants. The Company and the individual defendants plan to defend the civil action charges vigorously. Since the matters are at a preliminary stage, the Company is unable to predict the outcome or amount of the related expense, or loss, if any, associated with this litigation. However, the Company believes that any related expense or loss will be fully covered under the Company s insurance policies.

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

Guarantor agreements

Under the Company s by-laws, the Company must indemnify its officers and directors against all liabilities incurred or threatened by reason of serving in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements in unlimited; however, the Company has a Director and Officer insurance policy that limits its exposure and enables the Company to recover a portion of any future amounts paid. As a result of the Company s insurance policy coverage, it believes the estimated fair value of these indemnification arrangements is minimal. All of these indemnification arrangements were grandfathered under the provisions of FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, as they were in effect prior to December 31, 2002. Accordingly, no liabilities have been recorded for these arrangements as of July 31, 2003.

The Company has an agreement with a vendor whereby it guarantees the expenses incurred by certain of the Company s employees. The term of the agreement is from execution until cancellation and payment of any outstanding amounts. The Company would be required to pay any unsettled employee expenses upon notification from the vendor. The maximum potential amount of future payments the Company could be required to make under this agreement is not significant. As a result, the Company believes the estimated fair value of these agreements is minimal. Accordingly, no liabilities have been recorded for this guaranty as of July 31, 2003.

Table of Contents

ADE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

Pursuant to one of the provisions in the Company s standard terms and conditions of sale, the Company agrees, subject to certain limitations and conditions, to defend any suit or proceeding brought against a customer based on a claim that the Company s equipment, standing alone, infringes a United States patent or copyright or misappropriates a trade secret protected under United States law. Actions arising under such provision may only be brought by customers within two years after the cause of action arises. The maximum potential amount of payments the Company may be required to make under such provision is limited to the total purchase price of the Company s equipment sold under the particular contract. The Company has never incurred costs to defend lawsuits or settle claims related to these customer contract provisions. As a result, the Company believes the estimated fair value of these provisions is minimal. Accordingly, the Company has no liabilities recorded for these provisions as of July 31, 2003.

The Company warrants that its products will perform in all material respects in accordance with its standard published specifications. The term of the Company s standard warranty is 12 months. The Company accrues 2% or 3% of product revenues to provide for estimated warranty costs, based on which business unit made the sale. The following is a reconciliation of the activity in the Company s warranty liability for the three months ended July 31, 2003.

	(in thousands)
Balance at April 30, 2003	$ 1,041
Accruals for warranties issued	101
Warranty settlements made	(85)
Balance at July 31, 2003	$ 1,057

Table of Contents

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 magnetic 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 Company s markets are cyclical. Beginning in the second quarter of fiscal year 2002, the Company had experienced decreased demand for its products in its SSG and ATI business segments as a result of the downturn in the semiconductor wafer and device manufacturing industries as well as the magnetic data storage industry. Consequently, the Company experienced reduced order levels and revenues. In response to the industry downturn, the Company underwent cost reduction measures, including headcount reductions, while maintaining its investment in research and development to position the Company for the next wave of capital spending in the semiconductor wafer and device manufacturing industries as well as the magnetic data storage industry. Recently, the Company has seen signs of increased capital spending in the semiconductor wafer and device manufacturing and magnetic data storage industries and has experienced increased order levels, revenue and profits, however, no assurances can be made that this trend will continue.

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, 2003.

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 magnetic data storage markets, wafer pricing and wafer demand, the results of product development efforts, the success of the Company s product offerings in meeting customer needs within the timeframes required by customers in these markets, further increases in backlog, the Company s visibility and its predictions of future financial outcomes. Further information on potential factors that could affect the Company s business is described in Other Risk Factors and Trends appearing at the end of this Management s Discussion and Analysis of Financial Condition and Results of Operations and in the Company s reports on file with the Securities and Exchange Commission, including its Form 10-K for the fiscal year ended April 30, 2003.

Table of Contents

Restructuring

During the first quarter of fiscal 2004, as a result of continued cost cutting initiatives, the Company recorded a restructuring charge of $393,000, which consisted primarily of severance expenses for 20 terminated employees. The employees were terminated from various functional areas within the Company s Semiconductor Systems and ADE Technologies business segments. The majority of all the severance payments from the first quarter restructuring will be made by the end of fiscal year 2004. In connection with the first quarter restructuring, the Company did not renew its lease at its Bethel, Connecticut facility, which expired in August 2003. The operations of the Bethel facility were relocated to the Westwood, Massachusetts and Tucson, Arizona facilities.

Below is a table summarizing the activity related to the restructuring accrual for the three months ended July 31, 2003:

	(in thousands)		
	Severance	Office Closures	Total
Balance at April 30, 2003	$ 120	$ 45	$ 165
Restructuring accrual	393		393
Cash payments	(191)		(191)
Balance at July 31, 2003	$ 322	$ 45	$ 367

Sale of Long-term Investment

On July 24, 2003, the Company entered into an agreement to sell the majority of its 50% ownership in Japan ADE Ltd. (JAL), to Kanematsu Electronics, Ltd., the other 50% owner of JAL. The Company received proceeds of $4.0 million and realized a gain of $1.7 million from this transaction. The Company will retain a 9% ownership interest in JAL. Prior to the transaction, the Company accounted for its investment in JAL under the equity method. As a result of the decrease in both ownership and influence over the affairs of JAL, the Company will account for its remaining 9% interest under the cost method.

Prior to July 24, 2003, when the Company was accounting for its investment in JAL under the equity method, the revenue from sales to JAL, which had not in turn been sold by JAL to unrelated third parties, was eliminated and the related profit on such sales was recorded as deferred income on sales to affiliate. As a result of the reduction of the Company s 50% investment in JAL to 9% and the change in accounting method for the remaining investment to the cost method, the Company recognized approximately $6.4 million of revenue and $3.9 million of profit that otherwise may have been deferred as of July 31, 2003.

Sale-leaseback

On July 29, 2003, the Company entered into an agreement to sell and leaseback its headquarters site in Westwood, Massachusetts, which resulted in a deferred gain of $1.7 million. The Company used $3.8 million of the approximately $10.1 million in proceeds, less transaction costs, from the transaction to retire its 1996 Industrial Development Bond and eliminated the related letter of credit. On July 31, 2003, the Company used approximately $3.0 million of the proceeds to retire its 1997 Industrial Development Bond, which resulted in $2.7 million of restricted cash becoming available for general corporate purposes. As part of this transaction, the Company entered into a lease agreement with a 15 year term and annual rent payments increasing from approximately $1.0 million at the beginning of the lease term to approximately $1.3 million by the end of the lease term. The lease has been classified as an operating lease and the gain of $1.7 million on the transaction has been deferred and will be amortized as a reduction of rent expense on a straight-line basis over the term of the lease.

Critical Accounting Policies, Significant Judgments and Estimates

The discussion and analysis of the Company s financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure at the date of the Company s financial statements. On an 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 income taxes, valuation of goodwill and software and the accounting for leases to be critical policies due to the estimates and judgments involved in each.

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, the price is fixed or determinable and collectibility is reasonably assured. The Company s standard customer arrangement includes a signed purchase order, in which it offers payment terms of 30 to 90 days, no right of return of delivered products and a twelve month warranty. The Company assesses whether the fee associated with its revenue transactions is fixed or determinable based on the payment terms associated with the transaction. If a significant portion of the fee is due after the Company s normal payment terms, 30 to 90 days, it determines that the fee is not fixed or determinable. In these cases, the Company recognizes revenue as the fees become due. The Company assesses collectibility based on the credit worthiness of the customer and past transaction history. The Company performs on-going credit evaluations of its customers and does not require collateral from its customers. For many of the Company s international customers, it requires that an irrevocable letter of credit be issued by the customer before the purchase order is accepted. If the Company determines that collection of a fee is not reasonably assured, it defers the fee and recognizes the revenue at the time that collection becomes reasonably assured, which is generally upon the receipt of cash.

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

The Company accrues 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. 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 systems sales to JAL, the Company s previously 50% owned affiliate and a distributor of the Company s products, by the SSG, ATI and PST segments has been reflected in segment revenue during the period they were shipped by the respective segment, which could differ from the period the revenue was recognized for consolidated financial reporting purposes. Consolidated revenue on systems sales to JAL was recognized when the related product or software was shipped to and accepted by the end user of the product or software. As a result of the Company s decreased investment in JAL, beginning July 24, 2003, all sales to JAL are reflected in both segment and consolidated revenue in the same period.

The Company maintains an allowance for doubtful accounts based on a continuous review of customer accounts, payment patterns and specific collection issues. Where specific collection issues are identified, the Company records a specific allowance based on the amount that the Company believes will be collected. For accounts where specific collection issues are not identified, the Company will record a reserve based on the age of the receivable and historical collection patterns.

Inventory Valuation

Inventories are valued at the lower of cost or market, cost being determined on a first-in, first-out basis. Management evaluates the need to record adjustments for impairment of inventory on a monthly basis. The Company s policy is to assess the valuation of all inventories, including raw materials, work-in-process, finished goods and spare parts. Inventory that, in the judgment of management, is obsolete or in excess of the Company s estimated usage is written-down to its estimated market value, if less than its cost. Inherent in the estimates of market value are management s estimates related to current economic trends, future demand for the Company s products, and technological obsolescence. Significant management judgments must be made when establishing the reserve for obsolete and excess inventory. If the Company s judgments and estimates relating to obsolete and excess inventory prove to be inadequate, its financial results could be materially adversely affected in future periods. If the inventory value is written down to its net realizable value, and subsequently there is an increased demand for the inventory at a higher