FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1999-09-10** | Period of Report: **1999-07-31**
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FILER

CREDENCE SYSTEMS CORP
CIK:**893162**| IRS No.: **942878499** | State of Incorp.:**DE** | Fiscal Year End: **1031**
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SIC: **3825** Instruments for meas & testing of electricity & elec signals

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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 July 31, 1999

OR

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

For the transition period from to

Commission file number 0-22366

CREDENCE SYSTEMS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	94-2878499
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
215 Fourier Ave., Fremont, California	94539
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (510) 657-7400

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

At September 8, 1999, there were 21,722,791 shares of the Registrant's common stock, $0.001 par value per share, outstanding.

CREDENCE SYSTEMS CORPORATION

INDEX

PART I - FINANCIAL INFORMATION

Item I - Financial Statements

CREDENCE SYSTEMS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

<TABLE>
<CAPTION>

	July 31, 1999	October 31, 1998a
<S>	<C>	<C>
ASSETS	(unaudited)	
Current assets:		
Cash and cash equivalents................	$ 66,066	$ 48,391
Restricted cash..........................	-	2,400
Short-term investments...................	52,810	62,777
Accounts receivable, net.................	47,091	33,901
Inventories..............................	35,822	37,406
Other current assets.....................	27,115	40,676
Total current assets...................	228,904	225,551
Long-term investments......................	26,381	20,357
Property and equipment, net................	42,396	41,764
Other assets...............................	16,055	18,517
Total assets...........................	$313,736	$306,189
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable.........................	$ 20,616	$ 8,090
Accrued liabilities......................	24,495	26,978
Income taxes payable.....................	5,291	5,877
Total current liabilities..............	50,402	40,945
Convertible Subordinated Notes.............	96,610	115,000
Minority interest..........................	175	227
Stockholders' equity.......................	166,549	150,017
Total liabilities and stockholders' equity...	$313,736	$306,189

</TABLE>

See accompanying notes.

a) Derived from the audited consolidated balance sheet included in the Company's Form 10-K for the year ended October 31, 1998.

CREDENCE SYSTEMS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

<TABLE>
<CAPTION>

	Three Months Ended July 31,		Nine Months Ended July 31,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
Net sales	$ 52,378	$ 37,322	$ 116,968	$ 194,357
Cost of goods sold	24,826	16,901	59,103	84,003
Cost of goods sold - restructure and other	--	20,952	--	20,952
Gross margin	27,552	(531)	57,865	89,402
Operating expenses:				
Research and development	9,631	11,569	27,780	37,293
Selling, general and administrative	14,184	13,987	40,287	52,226
Special charges	--	23,224	6,231	23,224
Total operating expenses	23,815	48,780	74,298	112,743
Operating income (loss)	3,737	(49,311)	(16,433)	(23,341)

Interest and other income (expenses), net	(6)	(7)	(67)	1,151
Income (loss) before income tax provision (benefit)	3,731	(49,318)	(16,500)	(22,190)
Income tax provision (benefit)	1,352	(15,682)	(5,948)	(6,458)
Minority interest (benefit)	15	(50)	(31)	(124)
Net income (loss) before extraordinary items	2,364	(33,586)	(10,521)	(15,608)
Gain on extinguishment of debt (net of taxes of $275 & $926)	488	--	1,646	--
Net income (loss)	$ 2,852	$ (33,586)	$ (8,875)	$ (15,608)
Net income (loss) per share				
Basic (before extraordinary items)	$ 0.11	$ (1.55)	$ (0.51)	$ (0.72)
Basic (extraordinary items)	$ 0.02	--	$ 0.08	--
Basic	$ 0.13	$ (1.55)	$ (0.43)	$ (0.72)
Diluted (before extraordinary items)	$ 0.11	$ (1.55)	$ (0.51)	$ (0.72)
Diluted (extraordinary items)	$ 0.02	--	$ 0.08	--
Diluted	$ 0.13	$ (1.55)	$ (0.43)	$ (0.72)
Number of shares used in computing per share amount				
Basic	21,257	21,674	20,874	21,726
Diluted	22,116	21,674	20,874	21,726

</TABLE>

See accompanying notes.

CREDENCE SYSTEMS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Increase (decrease) in cash and cash equivalents
(in thousands)
(unaudited)

<TABLE>
<CAPTION>

<S>	Nine Months Ended July 31, 1999 <C>	1998 <C>
Cash flows from operating activities:		
Net (loss)	$ (8,875)	$ (15,608)
Adjustments to reconcile net (loss) to net cash provided by operating activities:		
Depreciation and amortization	15,248	12,838
Special charges	6,231	44,177
Loss on disposal of property and equipment	333	149
Deferred income taxes	--	(11,512)
Gain on extinguishment of debt	(2,572)	--
Minority interest	(31)	124
Changes in operating assets and liabilities:		
Restricted cash, accounts receivable, inventories and other current assets	1,701	(23,503)
Accounts payable, accrued liabilities and income taxes payable	9,362	4,157
Net cash provided by operating activities	21,397	10,822
Cash flows from investing activities:		
Purchases of available-for-sale securities	(69,114)	(135,080)
Maturities of available-for-sale short-term securities	17,489	63,644
Sales of available-for-sale securities	55,568	11,977
Acquisition of property and equipment	(13,939)	(8,319)
Other assets	(1,734)	(10,498)
Net cash (used in) investing activities	(11,730)	(78,276)
Cash flows from financing activities:		
Issuance of common stock	6,977	3,109
Other	(21)	--
Issuance (purchase) of treasury stock	1,052	(12,795)
Net cash provided by (used in) financing activities	8,008	(9,686)
Net increase (decrease) in cash and cash equivalents	17,675	(77,140)
Cash and cash equivalents at beginning of period	48,391	132,761
Cash and cash equivalents at end of period	$ 66,066	$ 55,621

Supplemental disclosures of cash flow information:		
Interest paid	$ 3,018	$ 3,103
Income taxes refunded	$ 19,357	$ --
Income taxes paid	$ --	$ 12,492
Non-cash investing activities:		
Net transfers of inventory to property and equipment	$ 2,654	$ 7,427
Non-cash financing activities:		
Income tax benefit from stock option exercises	$ 1,923	$ 970
Issuance of treasury stock for convertible subordinated notes	$ 15,433	$ --
Exchange of convertible subordinated notes for common stock plus issuance costs	$ (18,005)	$ --

</TABLE>

See accompanying notes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Quarterly Financial Statements

The condensed consolidated financial statements and related notes for the periods ended July 31, 1999 and 1998 are unaudited but include all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations of the Company for the interim periods. The results of operations for the periods ended July 31, 1999 and 1998 are not necessarily indicative of the operating results to be expected for the full fiscal year. The information included in this report should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the fiscal year ended October 31, 1998 included in the Company's most recent Annual Report on Form 10-K and the additional risk factors contained herein and therein, including, without limitation, risks relating to fluctuations in our quarterly net sales and operating results, limited systems sales, backlog, cyclicality of the semiconductor industry, management of fluctuations in our operating results, expansion of our product lines, limited sources of supply, reliance on our subcontractors, highly competitive industry, rapid technological change, importance of timely product introduction, customer concentration, lengthy sales cycle, risks associated with acquisitions, changes in financial accounting standards and accounting estimates, dependence on key personnel, transition in our executive management, international sales, proprietary rights, future capital needs, leverage, year 2000 readiness disclosure, and volatility of our stock price and effects of certain anti-takeover provisions, as set forth in this Report. Any party interested in reviewing a free copy of the Form 10-K or the Company's other publicly available documents should write to the Chief Financial Officer of the Company.

Use of Estimates - The preparation of the accompanying unaudited consolidated condensed financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates.

2. Inventories

Inventories are stated at the lower of standard cost (which approximates first-in, first-out cost) or market. Inventories consist of the following (in thousands):

	July 31, 1999	October 31, 1998
	(unaudited)	
Raw materials	$ 11,205	$ 9,860
Work-in-process	19,095	21,609
Finished goods	5,522	5,937
	$ 35,822	$37,406

3. Net Income (Loss) Per Share

Net income (loss) per basic share is based upon the weighted average number of common shares outstanding during the period. Net income (loss) per diluted share is based upon the weighted average number of common and dilutive potential common shares outstanding during the period. The Company's Convertible

Subordinated Notes are not dilutive potential common shares and, accordingly, were excluded from the calculation of net income (loss) per diluted share. Options to purchase approximately 2,568,705 shares at an average price of $22.72 per share were outstanding at July 31, 1999. Options are not included in the computation of diluted net loss per share because options are antidilutive in periods when the Company incurs a net loss.

3. Net Income (Loss) Per Share (continued)

<TABLE>
<CAPTION>

	Three Months Ended July 31,		Nine Months Ended July 31,	
	1999	1998	1999	1998
<S>	<C>	<C>	<C>	<C>
	(in thousands, except per share amounts)			
Numerator:				
Numerator for basic and diluted net income (loss) per share-net income (loss)	$ 2,852	$ (33,586)	$ (8,875)	$ (15,608)
Denominator:				
Denominator for basic net income (loss) per share-weighted-average shares	21,257	21,674	20,874	21,726
Effect of dilutive securities-employee stock options	859	-	-	-
Denominator for diluted earnings per share-adjusted weighted-average shares and assumed conversions	22,116	21,674	20,874	21,726
Basic net income (loss) per share$	0.13	$ (1.55)	$ (0.43)	$ (0.72)
Diluted net income (loss) per share	$ 0.13	$ (1.55)	$ (0.43)	$ (0.72)

</TABLE>

4. Changes in Accounting Standards

As of November 1, 1998 the Company adopted Statement of Financial Accounting Standards No. 130 "Reporting Comprehensive Income" ("SFAS 130"). SFAS 130 established new rules for the reporting and display of comprehensive income (loss) and its components including unrealized gains or losses on the Company's available-for-sale securities and foreign currency translation adjustments. For the periods ended July 31, 1999 and 1998, total comprehensive income (loss) amounted to:
<TABLE>
<CAPTION>

	Three Months Ended July 31,		Nine Months Ended July 31,	
	1999	1998	1999	1998
	(in thousands)			
<S>	<C>	<C>	<C>	<C>
Net income (loss)	$ 2,852	$ (33,586)	$ (8,875)	$ (15,608)
Other comprehensive income, net of tax:				
Foreign currency translation adjustment	1	(18)	47	(98)
Unrealized gain (loss) on available-for-sale securities	(799)	(131)	(369)	70
Other comprehensive income (loss)	(798)	(149)	(322)	(28)
Total comprehensive income (loss)	$ 2,054	$ (33,735)	$ (9,197)	$ (15,636)

</TABLE>

5. Contingencies

The Company is involved in various claims arising in the ordinary course of business, none of which, in the opinion of management, if determined adversely against the Company, will have a material adverse effect on the Company's business, financial condition or results of operations.

6. Extraordinary Item and Special Charges

During the third fiscal quarter of 1999, the Company recorded an extraordinary gain of $ 488,000, net of tax of $275,000 on the exchange of 275,000 shares of the Company's common stock held in treasury for an aggregate of $9,350,000 of its 5 1/4% Convertible Subordinated Notes due 2002 (the "Notes"). For the nine month period ended July 31, 1999, the Company recorded an extraordinary gain of $1,646,000, net of tax of $926,000 on the exchange of 603,000 shares of the Company's common stock held in treasury for an aggregate of $18.4 of its Notes. The Company may engage in similar transactions in the future.

For the nine month period ended July 31, 1999, the Company recorded special charges of $6.2 million. These charges were primarily from costs relating to the disposal of excess facilities and severance. As of July 31, 1999, approximately $2.4 million in accrued liabilities related to special charges recorded in 1998 and 1999 remained on the Company's balance sheet, representing rent and settlement costs on excess facilities. These amounts will be paid out over the next six months.

In the third quarter of fiscal 1998, the Company recorded restructure and other costs totaling $39.4 million. These charges were the result of the Company's response to a major downturn in the business outlook for the ATE and related semiconductor and semiconductor equipment industries which took place during the period. Also in the third capital fiscal quarter of 1998, the Company recognized approximately $4.8 million of acquired in-process research and development expense related to the acquisition of certain assets and assumed liabilities of Heuristic Physics Laboratories, Inc.

As of July 31, 1999, approximately $2.4 million in accrued liabilities related to special charges recorded in 1998 and 1999 remained on the Company's balance sheet, representing rent and settlement costs on excess facilities. These amounts will be paid out over the next six months.

7. Subsequent Event - Acquisition of Opmaxx, Inc.

On July 20, 1999 the Company announced that it would be exercising its right to acquire Opmaxx, Inc. Opmaxx provides solutions for integrating design, test and manufacturing of analog/mixed signal systems. The acquisition will be accounted for in the fourth fiscal quarter of 1999 under the purchase method of accounting. The acquisition was closed in September 1999 for approximately $8.0 million in cash and assumed liabilities.

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

The following discussion may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties. While this discussion represents the Company's current judgment on the future direction of the business, such risks and uncertainties could cause actual results to differ materially from any future performance suggested herein. Factors that could cause actual results to differ are identified throughout the discussion below, as well as in the section entitled "Risk Factors" below, and elsewhere in this Report. The Company undertakes no obligation to publicly revise any forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

The following table sets forth items from the Condensed Consolidated Statements of Operations as a percentage of net sales for the periods indicated:

<TABLE>
<CAPTION>

	Three Months Ended July 31,		Nine Months Ended July 31,	
	1999	1998	1999	1998

<S>	unaudited <C>	<C>	unaudited <C>	<C>
Net sales..	100.0%	100.0%	100.0%	100.0%
Cost of goods sold..................................	47.4%	45.3%	50.5%	43.2%
Cost of goods sold - restructure and other.........	-	56.1%	-	10.8%
Gross margin...	52.6%	(1.4%)	49.5%	46.0%
Operating expenses				
Research and development...........................	18.4%	31.0%	23.8%	19.2%
Selling, general, and administrative...............	27.1%	37.5%	34.4%	26.9%
Special charges....................................	-	62.3%	5.3%	11.9%
Total operating expenses........................	45.5%	130.8%	63.5%	58.0%
Operating income (loss)..............................	7.1%	(132.2%)	(14.1%)	(12.0%)
Interest and other income (expenses), net............	(0.0)%	0.0%	(0.0%)	0.6%
Income (loss) before income taxes....................	7.1 %	(132.2%)	(14.1%)	(11.4%)
Income taxes provision (benefit).....................	2.6%	(42.2%)	(5.1 %)	(3.3%)
Minority interest....................................	0.0%	(0.0%)	(0.0%) %)	(0.1%)
Net income (loss) before extraordinary items..........	4.5%	(90.0%)	(9.0%)	(8.0%)
Gain on extinguishment of debt.......................	0.9%	-	1.4%	-
Net income (loss)....................................	5.4%	(90.0%)	(7.6%)	(8.0%)

</TABLE>

RESULTS OF OPERATIONS

NET SALES

Net sales consist of revenues from systems sales, spare parts, maintenance contracts and software products principally in the semiconductor automatic test equipment market ("ATE"). Net sales were $52.4 million for the third quarter of fiscal 1999, representing an increase of 40.0% from the net sales of $37.3 million in the comparable period of fiscal 1998. The increase was due primarily to an improvement in the overall health of the semiconductor industry and the backend capital equipment sector specifically. The Company experienced improved overall demand from integrated device manufacturers as well as contract test house customers. Net sales were $117 million for the nine month period ended July 31, 1999 compared to $194.4 million for the comparable period of fiscal 1998. The decline in net sales of $77.4 million, or 40% for the nine month period, was due primarily to higher demands for ATE in the first and second quarters of fiscal 1998. International net sales accounted for approximately 63.7% and 69.5% of the total net sales for the third quarter and nine months of fiscal 1999, compared to approximately 61% and 72% for the comparable periods in 1998. The Company's international net sales are denominated primarily in United States dollars.

GROSS MARGIN

The Company's gross margin has been and will continue to be affected by a variety of factors, including manufacturing efficiencies, pricing by competitors and suppliers, new product introductions, product sales mix, production volume, customization and reconfiguration requirements, international and domestic sales mix and field service margins. The gross margin was 52.6% and 49.5% for the third quarter and nine month periods of fiscal 1999, compared with 54.7% and 56.8% (without the restructuring charge) for the comparable periods of fiscal 1998. The decrease in gross margin as a percent of sales was due to lower average selling prices, changes in the mix of products sold, and product development delays which the Company believes will continue to adversely affect gross margins through at least the end of the current fiscal year.

RESEARCH AND DEVELOPMENT

Research and development ("R&D") expenses were $9.6 million in the third quarter of fiscal 1999, a decrease of $2.0 million or 17.0% from $11.6 million in the same period of fiscal 1998. R&D expenses were $27.8 million in the first nine months of fiscal 1999, a decrease of $9.5 million or 25% from the same period in fiscal 1998. R&D expenses decreased due to lower headcount and related expenses, outside services and project related expenses. The Company currently intends to continue to invest significant resources in the development of derivative products and enhancements for the foreseeable future. Accordingly, the Company expects these expenses to increase in absolute dollars for the remainder of fiscal 1999.

SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses ("SG&A") were $14.2 million in the third quarter of fiscal 1999 compared to $14.0 million in the third quarter of fiscal 1998. SG&A expenses increased due to commission expenses associated with higher revenues offset in part by lower headcount and related expenses. As a percentage of net sales, SG&A expenses were 27.1% for the third quarter of fiscal 1999, compared with 37.5% for the corresponding period in fiscal 1998. SG&A expenses were $40.3 million in the first nine months of fiscal 1999, a decrease of $11.9 million or 23% from the same period in fiscal 1998. The Company expects SG&A expenses for the remainder of fiscal 1999 to increase in absolute dollars. Increases expected in the remainder of fiscal 1999 include, but are not necessarily limited to, the costs of installing a new MIS system, increases in salaries of current employees and the costs of moving the Company's primary Oregon operations into a new facility.

SPECIAL CHARGES AND EXTRAORDINARY ITEM

During the third fiscal quarter of 1999, the Company recorded an extraordinary gain of $ 488,000, net of tax of $275,000 on the exchange of 275,000 shares of the Company's common stock held in treasury for an aggregate of $9,350,000 of its Notes. For the nine month period ended July 31, 1999, the Company recorded an extraordinary gain of $1,646,000, net of tax of $926,000 on the exchange of 603,000 shares of the Company's common stock held in treasury for an aggregate of $18.4 of its Notes. The Company may engage in similar transactions in the future.

For the nine month period ended July 31, 1999, the Company recorded special charges of $6.2 million. These charges were primarily from costs relating to the disposal of excess facilities and severance. As of July 31, 1999, approximately $2.4 million in accrued liabilities related to special charges recorded in 1998 and 1999 remained on the Company's balance sheet, representing rent and settlement costs on excess facilities. These amounts will be paid out over the next six months.

In the third quarter of fiscal 1998, the Company recorded restructure and other costs totaling $39.4 million. These charges were the result of the Company's reaction to a major downturn in the business outlook for the ATE and related semiconductor and semiconductor equipment industries which took place during the period. Also in the third fiscal quarter of 1998, the Company recognized approximately $4.8 million of acquired in-process research and development expense related to the acquisition of certain assets and assumed liabilities of Heuristic Physics Laboratories, Inc.

As of July 31, 1999, approximately $2.4 million in accrued liabilities related to special charges recorded in 1998 and 1999 remained on the Company's balance sheet, representing rent and settlement costs on excess facilities. These amounts will be paid out over the next six months.

INTEREST AND OTHER INCOME EXPENSES, NET

Net interest and other expenses for the third fiscal quarter of 1999 was at $6,000, down from $7,000 as of the third fiscal quarter of 1998. For the nine month periods ended July 31, 1999 and 1998, the net interest and other expenses were $67,000 and income of $1.2 million, respectively. Overall expenses are attributable to the disposal of fixed assets.

INCOME TAXES The Company's income tax benefit is based on a projected effective tax rate.

The projected effective tax rate for the first nine months of fiscal 1999 was 36% compared to 29% for the first nine months of fiscal 1998. Excluding the impact of in-process research and development, the Company's effective tax rate for the first nine months of fiscal 1998 was 34%.

Realization of a portion of the net deferred tax assets at July 31, 1999 is dependent on the Company's ability to generate approximately $42,000,000 of future taxable income. Management believes that it is more likely than not that the assets may be realized based on current profitability. However, there can be no assurance that the Company will meet its expectations of future income. Management evaluates the realizability of the deferred tax assets quarterly and assesses the need for additional valuation allowances.

Year 2000 Readiness disclosure

The "Year 2000" issue results from the use in computer hardware and software of two digits rather than four digits to define the applicable year. When computer systems must process dates both before and after January 1, 2000, two-digit year "fields" may create processing ambiguities that can cause errors and system failures. The results of these errors may range from minor undetected errors to complete shutdown of an affected system. These errors or failures may have limited effects, or the effects may be widespread, depending on the computer chip, system or software, and its location and function. The effects of the Year 2000 problem are exacerbated because of the interdependence of computer and telecommunications systems in the United States and throughout the world. Because of this interdependence, the failure of one system may lead to the failure of many other systems even though the other systems are themselves "Year 2000 compliant."

Our Board of Directors has reviewed the Year 2000 issue generally and as it may affect our business activity specifically. We are implementing a Year 2000 Plan (the "Plan") which is designed to cover all of our activities and which is monitored by the Board of Directors. We will modify the Plan as circumstances change. Under the Plan, we are using a five-phase methodology for addressing the issue. The phases are Awareness, Assessment, Renovation, Validation and Implementation.

The Awareness phase consisted of defining the Year 2000 problem and gaining executive level support and sponsorship for addressing it. We established a Year 2000 program team and created an overall strategy. During the Assessment phase, we inventoried all internal systems, products and supply chain partners and prioritized each for renovation. We believe we have completed a majority of the Awareness and Assessment phases; however, we will continue to work in these areas as we complete our assessment of existing supply chain partners and enter into new supply chain relationships in the ordinary course of business. Renovation consists of converting, replacing, upgrading or eliminating systems that have Year 2000 problems. We have begun Renovation on mission-critical systems and have completed all but two systems as of July 31, 1999. The remaining mission-critical systems are now scheduled for completion of renovation by October 1999. Validation involves ensuring that hardware and software fixes will work properly in 1999 and beyond and can occur both before and after implementation. We began the Validation phase in late 1998 and will continue through October, 1999 to allow for thorough testing before the Year 2000. Implementation is the installation of Year 2000 ready hardware and software components in a live environment.

The impact of Year 2000 issues on our business will depend not only on corrective actions that we take, but also on the way Year 2000 issues are addressed by governmental agencies, businesses and other third parties that provide us with services or data or receive services or data from us, or whose financial condition or operational capability is important to us. To reduce this exposure, we have an ongoing process of identifying and contacting mission-critical third party vendors and other significant third parties to determine their Year 2000 plans and target dates. Risks associated with any such third parties located outside the United States may be higher insofar as it is generally believed that non-U.S. businesses may not be addressing their Year 2000 issues on as timely a basis as U.S. businesses. Notwithstanding our efforts, we cannot be certain that we, mission-critical third party vendors or other significant third parties will adequately address their Year 2000 issues.

We are developing contingency plans in the event that we, mission-critical third party vendors or other significant third parties fail to adequately address Year 2000 issues. Such plans principally involve identifying alternative vendors or internal remediation. We cannot ensure that any such plans will fully mitigate any such failures or problems. Furthermore, there may be certain mission-critical third parties, such as utilities, telecommunication companies, or material vendors for which alternative arrangements or sources are limited or unavailable.

Although it is difficult for us to estimate the total costs of implementing the Plan, our current estimate is that such costs will be approximately $2.5 million through October 1999 and beyond. However, although we believe that our estimates are reasonable, we cannot be certain, for the reasons stated in the next paragraph, that the actual costs of implementing the Plan will not differ materially from the estimated costs. We have incurred costs of approximately $1.6 million through July 31, 1999 in connection with the Plan. A significant portion of total Year 2000 project expenses is represented by existing staff that have been redeployed to this project. We do not believe that the redeployment of existing staff will have a material adverse effect on our business, results of operations or financial position. Nor do we expect incremental expenses related to the Year 2000 project to materially impact operating results in any one period.

For a number of reasons, we cannot predict or quantify the extent and magnitude of the Year 2000 problem as it will affect our business, either before or for some period after January 1, 2000. Among the most important reasons are:

- lack of control over systems used by third parties critical to our operation;
- dependence on third party software vendors to deliver Year 2000 upgrades in a timely manner;
- complexity of testing inter-connected networks and applications that depend on third party networks; and
- the uncertainty surrounding how others will deal with liability issues raised by Year 2000 related failures.

For example, we cannot be certain that systems used by third parties will be Year 2000 ready by January 1, 2000, or by some earlier date, so as not to create a material disruption to our business. Moreover, the estimated costs of implementing the Plan do not take into account the costs, if any, that might be incurred as a result of Year 2000-related failures that occur despite our implementation of the Plan.

Although we are not aware of any material operational issues associated with preparing our internal systems for the Year 2000 or of material issues with respect to the adequacy of mission-critical third party systems, we cannot ensure that we will not experience material unanticipated negative consequences and/or material costs caused by undetected errors or defects in such systems or by our failure to adequately prepare for the results of such errors or defects, including the costs of related litigation, if any. The impact of such consequences could have a material adverse effect on our business, financial condition or results of operations.

INTRODUCTION OF THE EURO

To date the introduction and the use of the Euro has not had nor does the Company expect it to have a material adverse effect on our business, financial condition or results of operations principally because the Company's international revenues are denominated primarily in United States dollars.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was $21.4 million for the nine months ended July 31, 1999. This cash flow from operating activities was primarily attributable to net income before depreciation and amortization and special charges of approximately $12.6 million, income tax refunds of $19.4 million, offset by cash used for net changes in the remaining operating assets and liabilities.

Net cash used in investing activities was $11.7 million for the nine months ended July 31, 1999. Cash flow used in investing activities was primarily attributable to purchases of property and equipment of approximately $13.9 million, and net maturities and sales of available-for-sale securities of approximately $3.9 million.

Net cash provided by financing activities was $8.0 million for the nine months ended July 31, 1999. The cash provided by financing activities was primarily attributable to treasury stock and common stock issued in accordance with the Company's employee stock option and stock purchase plans.

The Company recorded non-cash transactions during the nine month period ended July 31, 1999 for the exchange of 603,000 shares of the Company's Common Stock held in treasury for an aggregate of $18.4 million of its Notes. These transactions resulted in extraordinary gains of $1.6 million, net of tax of $0.9 million, as well as an increase in paid-in capital of $15.4 million.

As of July 31, 1999, the Company had working capital of approximately $179 million including cash and short-term investments of $119 million, $47.1 million of accounts receivable and $35.8 million of inventories. The Company expects its accounts receivable to continue to represent a significant portion of working capital. The Company believes that because of the relatively long manufacturing cycles of many of its testers and the new products it has and plans to continue to introduce, investments in inventories will also continue to represent a significant portion of working capital. Significant investments in accounts receivable and inventories will continue to subject the Company to increased risks which could materially adversely affect the Company's business, financial condition and results of operations. Total current liabilities of $40.9 million as of October 31, 1998 increased to $50.4 million for the nine months ending July 31, 1999.

The Company's principal sources of liquidity as of July 31, 1999 consisted of approximately $ 66.1 million of cash and cash equivalents, short-term investments of $52.8 million and $20 million available under the Company's unsecured working capital line of credit expiring July 22, 2000. In addition, the Company has $26.4 million of available for sale securities classified as long-term. As of July 31, 1999, no amounts were outstanding under the unsecured line of credit. Additionally, as of July 31, 1999, the Company had operating lease commitments for facilities and test and other equipment totaling approximately $ 42.3 million.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's investment portfolio and long-term debt obligations. The Company maintains a strict investment policy which ensures the safety and preservation of its invested funds by limiting default risk, market risk, and reinvestment risk. The Company's investments consists primarily of commercial paper, medium term notes, asset backed securities, US. Treasury notes and obligations of U.S. Government agencies, bank certificates of deposit, auction rate preferred securities, corporate bonds and municipal bonds. The table below presents notional amounts and related weighted-average interest rates by year of maturity for the Company's investment portfolio and long-term debt obligations (in thousands, expect percent amounts):

<TABLE>
<CAPTION>

	1999	2000	2001	2002	2003	Thereafter
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Cash Equivalents						
Fixed rate	$ 66,066	-	-	-	-	-
Average rate	4.85%	-	-	-	-	-
Short term investments						
Fixed rate	$ 52,810	-	-	-	-	-
Average rate	5.58%	-	-	-	-	-
Long term investments						
Fixed rate	$ -	$ 16,354	$ 10,027	-	-	-
Average rate	-	5.36%	5.32%	-	-	-
Total investment securities	$ 118,876	$ 16,354	10,027	-	-	-
Average rate	5.19%	5.36%	5.32%	-	-	-
Long term debt						
Fixed rate	-	-	-	$ 96,610	-	-
Average rate	-	-	-	5.25%	-	-

</TABLE>

The Company attempts to mitigate default risk by attempting to invest in high credit quality securities and by constantly positioning its portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity and maintain a prudent amount of diversification.

The Company has no current cash flow exposure due to rate changes for its $96.6 million Convertible Subordinated Notes. The Company has a $20 million line of credit under which it can borrow either at the bank's prime rate or the LIBOR rate. As of July 31, 1999, the Company had no borrowings under its line of credit.

RISK FACTORS

Fluctuations in Our Quarterly Net Sales and Operating Results

<TABLE>
<CAPTION>

	1996				1997				1998				1999		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Net Sales	61.00	66.40	67.20	44.20	40.30	43.40	51.08	69.39	82.40	74.60	37.30	22.40	26.5	38.1	54.2
Net Income (loss)	10.50	11.50	11.60	4.30	1.05	3.28	-0.90	7.25	9.20	8.80	-33.60	-10.70	-6.6	-5.2	3.5

</TABLE>

A variety of factors affect our net sales and results of operations. The above graph illustrates that our quarterly net sales and operating results have fluctuated significantly. We believe they will continue to fluctuate for a number of reasons, including:

- economic conditions in the semiconductor industry in general and capital equipment industry specifically;

- timing of new product announcements and new product releases by us or our competitors;

- market acceptance of our new products and enhanced versions of existing products;

- manufacturing inefficiencies associated with the start-up of our new products, changes in our pricing or payment terms and cycles, and those of our competitors, customers and suppliers;

- manufacturing capacity and ability to volume produce systems and meet customer requirements;

- write-offs of excess and obsolete inventories, and uncollectible receivables;

- patterns of capital spending by our customers, delays, cancellations or rescheduling of customer orders due to customer financial difficulties or otherwise;

- changes in overhead absorption levels due to changes in the number of systems manufactured, the timing and shipment of orders, availability of components including custom integrated circuits ("IC's"), subassemblies and services, customization and reconfiguration of systems and product reliability;

- expenses associated with acquisitions and alliances;

- operating expense reductions, including costs relating to facilities consolidations, excess facilities and related expenses;

- the proportion of our direct sales and sales through third parties, including distributors and original equipment manufacturers ("OEM"), the mix of products sold, the length of manufacturing and sales cycles, and product discounts; and

- natural disasters, political and economic instability, regulatory changes and outbreaks of hostilities.

We presently are introducing and will continue to introduce many new products and product enhancements in the future, the timing and success of which will affect our business, financial condition and results of operations. Our gross margins on system sales have varied significantly, and will continue to vary significantly based on a variety of factors, including:

- manufacturing inefficiencies;

- pricing concessions by us and our competitors and pricing by our suppliers;

- hardware and software product sales mix;

- inventory write-downs;

- production volume;

- new product introductions;

- product reliability;

- absorption levels and the rate of capacity utilization;

- customization and reconfiguration of systems;

- international and domestic sales mix and field service margins;

- facility relocations and consolidations.

New and enhanced products typically have lower gross margins in the early stages of commercial introduction and production. Although we have recorded and continue to record provisions for estimated sales returns, uncollectible accounts, and product warranty costs, we cannot be certain that our estimates will be adequate. We may be required to record charges in future quarters to reflect, in part, the cost of additional facilities consolidation, as it occurs.

We cannot forecast with any certainty the impact of these and other factors on our sales and operating results in any future period. In addition, our need for continued significant expenditures for research and development, marketing and other expenses for new products, capital equipment purchases and worldwide training and customer service and support, among other factors, will make it difficult for us to reduce our significant fixed expenses in a particular period if we don't meet our net sales goals for that period. As a result, we cannot be certain that we will continue to be profitable or that we will not sustain losses in the future. As a result, the price of our common stock may continue to be materially adversely affected.

Limited Systems Sales; Backlog

We derive a substantial portion of our net sales from the sale of a relatively small number of systems that typically range in price from $350,000 to $3.6 million, other than certain memory products and software products, for which the price range is typically below $50,000. As a result, our net sales and operating results for a particular period could be significantly impacted by the timing of recognition of revenue from a single transaction. Our net sales and operating results for a particular period could also be materially adversely affected if an anticipated order from even one customer is not received in time to permit shipment during that period. Backlog at the beginning of a quarter typically does not include all orders necessary to achieve our sales objectives for that quarter. In addition, orders in backlog are subject to cancellation, delay, deferral or rescheduling by customers with limited or no penalties. Consequently, our quarterly net sales and operating results have in the past and will in the future depend upon our obtaining orders for systems to be shipped in the same quarter that the order is received.

Furthermore, we ship certain products generating most of our net sales near the end of each quarter. Accordingly, our failure to receive an anticipated order or a delay or rescheduling in a shipment near the end of a particular period may cause net sales in a particular period to fall significantly below expectations, which could have a material adverse effect on our business, financial condition or results of operations. The relatively long manufacturing cycle of many testers has caused and could continue to cause future shipments of testers to be delayed from one quarter to the next, which could materially adversely affect our business, financial condition or results of operations. Furthermore, as we and our competitors announce new products and technologies, customers may defer or cancel purchases of our existing systems, which could have a material adverse effect on our business, financial condition or results of operations. We cannot forecast the impact of these and other factors on sales and operating results.

Cyclicality of Semiconductor Industry

Our business and results of operations depend largely upon the capital expenditures of manufacturers of semiconductors and companies that specialize in contract packaging and/or testing of semiconductors, including manufacturers and contractors that are opening new or expanding existing fabrication facilities or upgrading existing equipment, which in turn depend upon the current and anticipated market demand for semiconductors and products incorporating semiconductors. The semiconductor industry has been highly cyclical with recurring periods of oversupply, which often have had a severe effect on the semiconductor industry's demand for test equipment, including the systems we manufacture and market. We believe that the markets for newer generations of semiconductors will also be subject to similar fluctuations.

We have experienced shipment delays, delays in commitments and purchase order restructurings by several customers and we expect delays and restructurings may continue. Accordingly, we cannot be certain that we will be able to achieve or maintain our current or prior level of sales or rate of growth. We anticipate that a significant portion of new orders may depend upon demand from semiconductor device manufacturers building or expanding fabrication facilities and new device testing requirements that are not addressable by currently installed test equipment, and there can be no assurance that such demand will develop to a significant degree, or at all. In addition, our business, financial condition or results of operations may be adversely affected by any factor adversely affecting the semiconductor industry in general or particular segments within the semiconductor industry. The recent Asian financial crisis has contributed to a widespread uncertainty and a slowdown in the semiconductor industry. This slowdown in the semiconductor industry has resulted in reduced spending for semiconductor capital equipment, including automatic test equipment ("ATE") which the Company sells. This industry slowdown has had and may continue to have a material adverse effect on product backlog, balance sheet and results of operations. Therefore, there can be no assurance that the operating results will not continue to be materially adversely affected if downturns or slowdowns in the semiconductor industry continue or occur again in the future.

Management of Fluctuations in Our Operating Results

We have over the last several years experienced significant fluctuations in our operating results. In fiscal 1998, we generated net sales of $82.4 million for the first quarter and $22.4 million for the fourth quarter, a decrease of 73% in our net sales within one fiscal year. For the third quarter of fiscal 1999, the net sales were $52.4 million. Since 1993, except for cost-cutting efforts during the past two years, we have overall significantly increased the scale of our operations in general to support periods of increased sales levels and expanded product offerings and have expanded operations to address critical infrastructure and other requirements, including the hiring of additional personnel, significant investments in R&D to support product development, our establishment of a joint venture with Innotech Corporation and numerous acquisitions. However, in the past, and particularly in the three quarters ended October 31, 1998 and to some extent this fiscal year as discussed above, we have experienced significant revenue declines and reductions in our operations. These fluctuations in our sales and operations have placed a considerable strain on our management, financial, manufacturing and other resources. In order to effectively deal with the changes brought on by the cyclical nature of the industry, we have been required to implement and improve a variety of highly flexible operating, financial and other systems, procedures and controls capable of expanding or contracting consistent with our business. However, we cannot be certain that any existing or new systems, procedures or controls will be adequate to support fluctuations in our operations or that our systems, procedures and controls will be cost-effective or timely. Any failure to implement, improve and expand or contract such systems, procedures and controls efficiently and at a pace consistent with our business could have a material adverse effect on our business, financial condition and our results of operations.

Expansion of Our Product Lines

We are currently devoting and intend to continue to devote significant resources to the development of new products and technologies. During fiscal 1999, we intend to continue to evaluate these new products and to invest significant resources in plant and equipment, leased facilities, inventory, personnel and other costs, to begin or prepare to increase production of these products and to provide the marketing, administration and after-sales service and support, if any, required to service and support these new hardware and software products. Accordingly, we cannot be certain that gross profit margin and inventory levels will not continue to be adversely impacted by continued delays in new product introductions or start-up costs associated with the initial production and installation of these new product lines. These start-up costs include additional manufacturing overhead, additional inventory and warranty reserve requirements and the enhancement of after-sales service and support organizations. In addition, the increases in inventory on hand for new hardware and software product development and customer support requirements have increased and will continue to increase the risk of inventory write-offs. We cannot be certain that operating expenses will not increase, relative to sales, as a result of adding additional marketing and administrative personnel, among other costs, to support our additional products. If we are unable to achieve significantly increased net sales or if sales fall below expectations, our operating results will continue to be materially adversely affected. We cannot be certain that our net sales will increase or remain at recent levels or that any new products will be successfully commercialized or contribute to revenue growth.

Limited Sources of Supply; Reliance on Our Subcontractors

We obtain certain components, subassemblies and services necessary for the manufacture of our testers from a limited group of suppliers. We do not maintain long-term supply agreements with most of our vendors and we purchase most of our components and subassemblies through individual purchase orders. The manufacture of certain of our components and subassemblies is an extremely complex process. We also rely on outside vendors to manufacture certain components and subassemblies and to provide certain services. We have recently experienced and continue to experience significant reliability, quality and timeliness problems with several critical components including certain custom integrated circuits. In addition, we and certain of our subcontractors periodically experience significant shortages and delays in delivery of various components and subassemblies. We cannot be certain that these or other problems will not continue to occur in the future with our suppliers or outside subcontractors. Our reliance on a limited group of suppliers and on outside subcontractors involves several risks, including an inability to obtain an adequate supply of required components, subassemblies and services and reduced control over the price, timely delivery, reliability and quality of components, subassemblies and services. Shortages, delays, disruptions or terminations of the sources for these components and subassemblies have delayed and could continue to delay shipments of our systems and new products and could continue to have a material adverse effect on our business, financial condition or results of operations.

Our continuing inability to obtain adequate yields or timely deliveries or any other circumstance that would require us to seek alternative sources of supply or to manufacture such components internally could also have a material adverse effect on our business, financial condition or results of operations. Such delays, shortages and disruptions would also damage relationships with current and prospective customers and have and could continue to allow competitors to penetrate such customer accounts. We cannot be certain that our internal manufacturing capacity or that of our suppliers and subcontractors will be sufficient to meet customer requirements.

Highly Competitive Industry

The ATE industry is intensely competitive. Because of the substantial investment required to develop test application software and interfaces, we believe that once a semiconductor manufacturer has selected a particular ATE vendor's tester, the manufacturer is likely to use that tester for a majority of its testing requirements for the market life of that semiconductor and, to the extent possible, subsequent generations of similar products. As a result, once an ATE customer chooses a system for the testing of a particular device, it is difficult for competing vendors to achieve significant ATE sales to such customer for similar use. Our inability to penetrate any large ATE customer or achieve significant sales to any ATE customer could have a material adverse effect on our business, financial condition or results of operations.

We face substantial competition throughout the world, primarily from ATE manufacturers located in the United States, Europe and Japan, as well as several of our customers. Many competitors have substantially greater financial and other resources with which to pursue engineering, manufacturing, marketing and distribution of their products. Certain competitors have recently introduced or announced new products with certain performance or price characteristics equal or superior to certain products we currently offer. These competitors have recently introduced products that compete directly against our products. We believe that if the ATE industry continues to consolidate through strategic alliances or acquisitions, we will continue to face significant additional competition from larger competitors that may offer product lines and services more complete than ours. Our competitors are continuing to improve the performance of their current products and to introduce new products, enhancements and new technologies that provide improved cost of ownership and performance characteristics. New product introductions by our competitors could cause a decline in our sales or loss of market acceptance of our existing products.

Moreover, our business, financial condition or results of operations could continue to be materially adversely affected by increased competitive pressure and continued intense price-based competition. We have experienced and continue to experience significant price competition in the sale of our testers. In addition, pricing pressures typically become more intense at the end of a product's life cycle and as competitors introduce more technologically advanced products. We believe that to be competitive, we must continue to expend significant financial resources in order to, among other things, invest in new product development and enhancements and to maintain customer service and support centers worldwide. We cannot be certain that we will be able to compete successfully in the future.

Rapid Technological Change; Importance of Timely Product Introduction

The ATE market is subject to rapid technological change. Our ability to compete in this market depends upon our ability to successfully develop and introduce new hardware and software products and enhancements and related software tools with greater features on a timely and cost-effective basis, including products under development internally as well as products obtained in acquisitions. Our customers require testers and software products with additional features and higher performance and other capabilities. We are therefore required to enhance the performance and other capabilities of our existing systems and software products and related software tools. Any success we may have in developing new and enhanced systems and software products and new features to our existing systems and software products will depend upon a variety of factors, including:

- product selection;
- timely and efficient completion of product design;
- implementation of manufacturing and assembly processes;
- successful coding and debugging of software;

- product performance;
- reliability in the field; and
- effective sales and marketing.

Because we must make new product development commitments well in advance of sales, new product decisions must anticipate both future demand and the availability of technology to satisfy that demand. We cannot be certain that we will be successful in selecting, developing, manufacturing and marketing new hardware and software products or enhancements and related software tools. Our inability to introduce new products and related software tools that contribute significantly to net sales, gross margins and net income would have a material adverse effect on our business, financial condition and results of operations. New product or technology introductions by our competitors could cause a decline in sales or loss of market acceptance of our existing products. In addition, if we introduce new products, existing customers may curtail purchases of the older products and delay new product purchases. Any unanticipated decline in demand for our hardware or software products could have a materially adverse affect on our business, financial condition or results of operations.

Significant delays can occur between the time we introduce a system and the time we are able to produce that system in volume. We have in the past experienced significant delays in the introduction, volume production and sales of our new systems and related feature enhancements and are currently experiencing significant delays in the introduction of our VS2000, Quartet and Kalos series testers as well as certain enhancements to our existing SC and DUO series testers. These delays have been primarily related to our inability to successfully complete product hardware and software engineering within the time frame originally anticipated, including design errors and redesigns of ICs. As a result, certain customers have experienced significant delays in receiving and using certain of our testers in production. We cannot be certain that these or additional difficulties will not continue to arise or that such delays will not continue to materially adversely affect customer relationships and future sales. Moreover, we cannot be certain that we will not encounter these or other difficulties that could delay future introductions or volume production or sales of our systems or enhancements and related software tools. We have incurred and may continue to incur substantial unanticipated costs to ensure the functionality and reliability of our testers and to increase feature sets. If our systems continue to have reliability, quality or other problems, or the market perceives certain of our products to be feature deficient, we may suffer reduced orders, higher manufacturing costs, delays in collecting accounts receivable and higher service, support and warranty expenses, or inventory write-offs, among other effects. Our failure to have a competitive tester and related software tools available when required by a semiconductor manufacturer could make it substantially more difficult for us to sell testers to that manufacturer for a number of years. We believe that the continued acceptance, volume production, timely delivery and customer satisfaction of our newer digital, mixed signal and non-volatile memory testers are of critical importance to our future financial results. As a result, our inability to correct any technical, reliability, parts shortages or other difficulties associated with our systems or to manufacture and ship the systems on a timely basis to meet customer requirements could damage our relationships with current and prospective customers and would continue to materially adversely affect our business, financial condition and results of operations.

Customer Concentration; Lengthy Sales Cycle

One customer, Spirox Corporation (a distributor in Taiwan), accounted for 42%, 34%, 30% and 25% of our net sales in the first nine months of fiscal 1999 and fiscal years 1998, 1997, and 1996, respectively. Consequently, our business, financial condition and results of operations could be materially adversely affected by the loss of or any reduction in orders by this or any other significant customer, including losses or reductions due to continuing or other technical, manufacturing or reliability problems with our products or continued slow-downs in the semiconductor industry or in other industries that manufacture products utilizing semiconductors. Our ability to maintain or increase sales levels will depend upon:

- our ability to obtain orders from existing and new customers;
- our ability to manufacture systems on a timely and cost-effective basis;
- our ability to complete the development of our new hardware and software products;
- our customers' financial condition and success;
- general economic conditions; and
- our ability to meet increasingly stringent customer performance and other requirements and shipment delivery dates.

Sales of our systems depend in part upon the decision of semiconductor manufacturers to develop and manufacture new semiconductor devices or to increase manufacturing capacity. As a result, sales of our testers are subject to a variety of factors we cannot control. In addition, the decision to purchase a tester generally involves a significant commitment of capital, with the attendant delays frequently associated with significant capital expenditures. For these and other reasons, our systems have lengthy sales cycles during which we may expend substantial funds and management effort to secure a sale, subjecting us to a number of significant risks. We cannot be certain that we will be able to maintain or increase net sales in the future or that we will be able to retain existing customers or attract new ones.

Risks Associated with Acquisitions

We have developed in significant part through mergers and acquisitions of other companies and businesses. We intend in the future to pursue additional acquisitions of complementary product lines, technologies and businesses. We may have to issue debt or equity securities to pay for future acquisitions, which could be dilutive. We have also incurred and may continue to incur certain liabilities or other expenses in connection with acquisitions, which have and could continue to materially adversely affect our business, financial condition and results of operations. Although we believe we have accounted for our acquisitions properly, the U.S. Securities and Exchange Commission (the "SEC") has been reviewing more closely the accounting for acquisitions by companies, particularly in the area of "in-process" research and development costs. If we are required by the SEC to restate any charge that we recognized in an acquisition so far, that could result in a lesser charge to income and increased amortization expense, which could also have a material adverse effect on our business, financial condition and results of operations.

In addition, acquisitions involve numerous other risks, including:

- difficulties assimilating the operations, personnel, technologies and products of the acquired companies;
- diversion of our management's attention from other business concerns;
- risks of entering markets in which we have no or limited experience; and
- the potential loss of key employees of the acquired companies.

For these reasons, we cannot be certain what effect future acquisitions may have on our business, financial condition and results of operations.

Changes in Financial Accounting Standards and Accounting Estimates

We prepare our financial statements to conform with generally accepted accounting principles ("GAAP"). GAAP are subject to interpretation by the American Institute of Certified Public Accountants, the SEC and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results, and may even affect our reporting of transactions completed before a change is announced. Accounting policies affecting many other aspects of our business, including rules relating to purchase and pooling-of-interests accounting for business combinations, employee stock purchase plans and stock options grants, have recently been revised or are under review. Changes to those rules or the questioning of current practices may have a material adverse effect on our reported financial results or on the way we conduct our business.

In addition, our preparation of financial statements in accordance with GAAP requires that we make estimates and assumptions that affect the recorded amounts of assets and liabilities, disclosure of those assets and liabilities at the date of the financial statements and the recorded amounts of expenses during the reporting period. A change in the facts and circumstances surrounding those estimates could result in a change to our estimates and could impact our future operating results.

Dependence on Key Personnel

Our future operating results depend substantially upon the continued service of our executive officers and key personnel, none of whom are bound by an employment or non-competition agreement. Our future operating results also depend in significant part upon our ability to attract and retain qualified management, manufacturing, technical, engineering, marketing, sales and support personnel. Competition for such personnel is intense, and we cannot ensure success in attracting or retaining such personnel. There may be only a limited number of persons with the requisite skills to serve in these positions and it may be increasingly difficult for us to hire such personnel over time. Our business, financial condition and results of operations could be materially adversely affected by the loss of any of our key employees, by the failure of any key employee to perform in his or her current position, or by our inability to attract and retain skilled employees.

Transition in Our Executive Management

On July 31, 1999 the Company announced the appointment of Graham J. Siddall as the new President and Chief Executive Officer of Credence Systems Corporation. Mr. Siddall joins the Company from KLA-Tencor where he was Executive Vice President of the Wafer Inspection Group. The Company has experienced several transitions in executive management in recent years. In conjunction with the departure in December 1998 of our former chairman and chief executive officer, our Board of Directors appointed David A. Ranhoff, executive vice president, and Dennis P. Wolf, executive vice president, chief financial officer and secretary, jointly to the office of the president. The Board also named a new chairman, Dr. William Howard, Jr., and began the search for a new chief executive officer which culminated in the appointment of Mr. Siddall. These transitions have placed significant demands on our operational, administrative and financial staff and we anticipate that these demands will continue in the near term. We cannot be certain that such transitions will not have a material adverse effect on our business, financial condition and results of operations, or on the way we are perceived by the market or on the price of our common stock.

International Sales

International sales accounted for approximately 64%, 70%, 69%, 70% and 67% of our total net sales for the third quarter and first nine months of fiscal 1999 and fiscal years 1998, 1997 and 1996, respectively. As a result, we anticipate that international sales will continue to account for a significant portion of our total net sales in the foreseeable future. These international sales will continue to be subject to certain risks, including:

- changes in regulatory requirements;
- tariffs and other barriers;
- political and economic instability;
- an outbreak of hostilities;
- integration of foreign operations of acquired businesses;
- foreign currency exchange rate fluctuations;
- difficulties with distributors, joint venture partners, original equipment manufacturers, foreign subsidiaries and branch operations;
- potentially adverse tax consequences; and
- the possibility of difficulty in accounts receivable collection.

We are also subject to the risks associated with the imposition of domestic and foreign legislation and regulations relating to the import or export of semiconductor equipment. We cannot predict whether the import and export of our products will be subject to quotas, duties, taxes or other charges or restrictions imposed by the United States or any other country in the future. Any of these factors or the adoption of restrictive policies could have a material adverse effect on our business, financial condition or results of operations. Net sales to the Asia Pacific region accounted for approximately 62%, 60%, 66% and 58% of our total net sales for the first nine months of fiscal 1999 and for the fiscal years 1998, 1997 and 1996, and thus demand for our products is subject to the risk of economic instability in that region and could continue to be materially adversely affected. Countries in the Asia Pacific

region, including Korea and Japan, have recently experienced weaknesses in their currency, banking and equity markets. These weaknesses could continue to adversely affect demand for our products, the availability and supply of our product components, and our consolidated results of operations. The current Asian financial crisis has contributed to a widespread uncertainty and a slowdown in the semiconductor industry. This slowdown has resulted in reduced spending on semiconductor capital equipment, including ATE, and has had, and may continue to have, a material adverse effect on our product backlog, balance sheet and results of operations.

We do not expect that the introduction and the use of the Euro will have a material adverse effect on our business, financial condition or results of operations.

Proprietary Rights

We attempt to protect our intellectual property rights through patents, copyrights, trademarks, maintenance of trade secrets and other measures, including entering into confidentiality agreements. However, we cannot be certain that others will not independently develop substantially equivalent intellectual property or that we can meaningfully protect our intellectual property. Nor can we be certain that our patents will not be invalidated, deemed unenforceable, circumvented or challenged, or that the rights granted thereunder will provide us with competitive advantages, or that any of our pending or future patent applications will be issued with claims of the scope we seek, if at all. Furthermore, we cannot be certain that others will not develop similar products, duplicate our products or design around our patents, or that foreign intellectual property laws or agreements into which we've entered will protect our intellectual property rights. Inability or failure to protect our intellectual property rights could have a material adverse effect upon our business, financial condition and results of operations. We have been involved in extensive, expensive and time-consuming reviews of, and litigation concerning, patent infringement claims. In addition, we have at times been notified that we may be infringing intellectual property rights of third parties and we expect to continue to receive notice of such claims in the future.

In July, 1998, inTEST IP Corporation ("inTEST") alleged in writing that one of our products is purportedly infringing a patent held by inTEST. We may also be obligated to other third parties relating to this allegation. We have completed initial investigation into the allegation. Based in part on the opinion of outside counsel, we believe we have meritorious defenses to the claims. However, we cannot be certain of success in defending this patent infringement claim or claims for indemnification resulting from infringement claims.

Certain of our customers have received notices from Mr. Jerome Lemelson alleging that the manufacture of semiconductor products and/or the equipment used to manufacture semiconductor products infringes certain patents issued to Mr. Lemelson. We were notified by a customer in 1990 and by a different customer in late 1994 that we may be obligated to defend or settle claims that our products infringe Mr. Lemelson's patents, and that if it is determined that the customer infringes Mr. Lemelson's patents, such customer intends to seek indemnification from us for damages and other related expenses. We have not received further communications from such customers regarding these matters.

We cannot be certain of success in defending current or future patent infringement claims or claims for indemnification resulting from infringement claims. Our business, financial condition and results of operations could be materially adversely affected if we must pay damages to a third party or suffer injunction or if we expend significant amounts in defending any such action, regardless of the outcome. With respect to any claims, we may seek to obtain a license under the third party's intellectual property rights. We cannot be certain, however, that the third party will grant us a license on reasonable terms or at all. We could decide, in the alternative, to litigate such claims. Litigation on such matters may be extremely expensive and time consuming, and could materially adversely affect our business, financial condition or results of operations, regardless of the outcome.

Future Capital Needs; Leverage

Developing and manufacturing new ATE systems and enhancements is highly capital intensive. In order to be competitive, we must make significant investments in capital equipment, expansion of operations, systems, procedures and controls, research and development and worldwide training, customer service and support, among many other items. We may be unable to obtain additional financing in the future on acceptable terms, or at all. In connection with our issuance in September 1997 of convertible promissory notes (the "Notes"), we currently have outstanding $96.6 million of such Notes which resulted in a ratio

of long-term debt to total long-term capitalization at July 31, 1999 of approximately 37%. As a result, our principal and interest obligations are substantial. The degree to which we are leveraged could materially adversely affect our ability to obtain financing for working capital, acquisitions or other purposes and could make our business more vulnerable to industry downturns and competitive pressures. Our ability to meet debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control. If we raise additional funds by issuing equity securities, our stockholders could be significantly diluted. We may exchange Notes for shares of our common stock or may refinance or exchange the Notes, which may also dilute our stockholders and may make it difficult for us to obtain additional future financing, if needed.

If we are unable to obtain adequate funds, we may be required to restructure or refinance our debt or to delay, scale back or eliminate certain of our research and development, acquisition or manufacturing programs. We may also need to obtain funds through arrangements with partners or others and we may be required to relinquish rights to certain of our technologies or potential products or other assets.

Year 2000 Readiness Disclosure

The "Year 2000" issue results from the use in computer hardware and software of two digits rather than four digits to define the applicable year. When computer systems must process dates both before and after January 1, 2000, two-digit year "fields" may create processing ambiguities that can cause errors and system failures. The results of these errors may range from minor undetected errors to complete shutdown of an affected system. These errors or failures may have limited effects, or the effects may be widespread, depending on the computer chip, system or software, and its location and function. The effects of the Year 2000 problem are exacerbated because of the interdependence of computer and telecommunications systems in the United States and throughout the world. Because of this interdependence, the failure of one system may lead to the failure of many other systems even though the other systems are themselves "Year 2000 compliant."

Our Board of Directors has reviewed the Year 2000 issue generally and as it may affect our business activity specifically. We are implementing a Year 2000 plan (the "Plan") which is designed to cover all of our activities and which is monitored by the Board of Directors. We will modify the Plan as circumstances change. Under the Plan, we are using a five-phase methodology for addressing the issue. The phases are Awareness, Assessment, Renovation, Validation and Implementation.

The Awareness phase consisted of defining the Year 2000 problem and gaining executive level support and sponsorship for addressing it. We established a Year 2000 program team and created an overall strategy. During the Assessment phase, we inventoried all internal systems, products and supply chain partners and prioritized each for renovation. We believe we have completed a majority of the Awareness and Assessment phases; however, we will continue to work in these areas as we complete our assessment of existing supply chain partners and enter into new supply chain relationships in the ordinary course of business. Renovation consists of converting, replacing, upgrading or eliminating systems that have Year 2000 problems. We have begun renovation on mission-critical systems and have completed all but two systems by July 31, 1999. The remaining two mission-critical systems are now scheduled for completion of renovation by October 1999. Validation involves ensuring that hardware and software fixes will work properly in 1999 and beyond and can occur both before and after implementation. We began the Validation phase in late 1998 and will continue through June 1999 to allow for thorough testing before the Year 2000. Implementation is the installation of Year 2000 ready hardware and software components in a live environment.

The impact of Year 2000 issues on our business will depend not only on corrective actions that we take, but also on the way Year 2000 issues are addressed by governmental agencies, businesses and other third parties that provide us with services or data or receive services or data from us, or whose financial condition or operational capability is important to us. To reduce this exposure, we have an ongoing process of identifying and contacting mission-critical third party vendors and other significant third parties to determine their Year 2000 plans and target dates. Risks associated with any such third parties located outside the United States may be higher insofar as it is generally believed that non-U.S. businesses may not be addressing their Year 2000 issues on as timely a basis as U.S. businesses. Notwithstanding our efforts, we cannot be certain that we, mission-critical third party vendors or other significant third parties will adequately address their Year 2000 issues.

We are developing contingency plans in the event that we, mission-critical third party vendors or other significant third parties fail to adequately address Year 2000 issues. Such plans principally involve identifying alternative vendors or internal remediation. We cannot ensure that any such plans will fully mitigate any such failures or problems. Furthermore, there may be certain mission-critical third parties, such as utilities, telecommunication companies, or material vendors for which alternative arrangements or sources are limited or unavailable.

Although it is difficult for us to estimate the total costs of implementing the Plan, our current estimate is that such costs will be approximately $2.5 million through October 1999 and beyond. However, although we believe that our estimates are reasonable, we cannot be certain, for the reasons stated in the next paragraph, that the actual costs of implementing the Plan will not differ materially from the estimated costs. We have incurred costs of approximately $1.6 million through July 31, 1999 in connection with the Plan. A significant portion of total Year 2000 project expenses is represented by existing staff that have been redeployed to this project. We do not believe that the redeployment of existing staff will have a material adverse effect on our business, results of operations or financial position. Nor do we expect incremental expenses related to the Year 2000 project to materially impact operating results in any one period.

For a number of reasons, we cannot predict or quantify the extent and magnitude of the Year 2000 problem as it will affect our business, either before or for some period after January 1, 2000. Among the most important reasons are:

- lack of control over systems used by third parties critical to our operation;

- dependence on third party software vendors to deliver Year 2000 upgrades in a timely manner;

- complexity of testing inter-connected networks and applications that depend on third party networks; and

- the uncertainty surrounding how others will deal with liability issues raised by Year 2000 related failures.

For example, we cannot be certain that systems used by third parties will be Year 2000 ready by January 1, 2000, or by some earlier date, so as not to create a material disruption to our business. Moreover, the estimated costs of implementing the Plan do not take into account the costs, if any, that might be incurred as a result of Year 2000-related failures that occur despite our implementation of the Plan.

Although we are not aware of any material operational issues associated with preparing our internal systems for the Year 2000 or of material issues with respect to the adequacy of mission-critical third party systems, we cannot ensure that we will not experience material unanticipated negative consequences and/or material costs caused by undetected errors or defects in such systems or by our failure to adequately prepare for the results of such errors or defects, including the costs of related litigation, if any. The impact of such consequences could have a material adverse effect on our business, financial condition or results of operations.

Volatility of Our Stock Price

We believe that factors such as announcements of developments related to our business, fluctuations in our financial results, general conditions or developments in the semiconductor and capital equipment industry and the general economy, sales or purchases of our common stock in the marketplace, announcements of our technological innovations or new products or enhancements or those of our competitors, developments in patents or other intellectual property rights, developments in our relationships with customers and suppliers, or a shortfall or changes in revenue, gross margins or earnings or other financial results from analysts' expectations or an outbreak of hostilities or natural disasters, could continue to cause the price of our common stock to fluctuate, perhaps substantially. In recent years the stock market in general, and the market for shares of small capitalization companies in particular, including ours, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. For example, in fiscal 1997, the price of our common stock ranged from a high of $55.00 to a low of $13.75. In fiscal 1998, the price of our common stock ranged from a high of $35.25 to a low of $9.31 and during the first nine months of fiscal 1999, the price of our common stock ranged from a high of $42.44 to a low of $13.69. The market price of our common stock is likely to continue to fluctuate significantly in the future, including fluctuations unrelated to our performance.

Effects of Certain Anti-Takeover Provisions

Certain provisions of our Amended and Restated Certificate of Incorporation, shareholders rights plan, equity incentive plans, Bylaws and of Delaware law may discourage certain transactions involving a change in corporate control. In addition to the foregoing, our classified board of directors, the shareholdings of our officers, directors and persons or entities that may be deemed affiliates, the adoption of a shareholder rights plan and the ability of our Board of Directors to issue "blank check" preferred stock without further stockholder approval could have the effect of delaying, deferring or preventing a third party to acquire us and may adversely affect the voting and other rights of holders of our common stock.

PART II. - OTHER INFORMATION

Item 1. Legal Proceedings
None

Item 2. Changes in Securities
None

Item 3. Defaults upon Senior Securities
None

Item 4. Submission of Matters to a Vote of Securityholders
None

Item 5. Other Information

(a) The acquisition of Opmaxx, Inc. was closed in September 1999 for approximately $8.0 million in cash and assumed liabilities. The acquisition will be accounted for in the fourth fiscal quarter of 1999 under the purchase method of accounting.

(b) On July 31, 1999 the Company announced the appointment of Graham J. Siddall as the new President and Chief Executive Officer of Credence Systems Corporation. Mr. Siddall joins the Company from KLA-Tencor where he was Executive Vice President of the Wafer Inspection Group.

Item 6. Exhibits and Reports on Form 8-K

(a) See Exhibit Index on page 28.

(b) The Company filed a report on Form 8-K on August 26, 1999 reporting its financial results for the third quarter of fiscal year 1999.

(c) The Company filed a report on Form 8-K on July 22, 1999 reporting the planned acquisition of Opmaxx, Inc.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

CREDENCE SYSTEMS CORPORATION

(Registrant)

Sept. 10, 1999	/S/ DENNIS P. WOLF
Date	Dennis P. Wolf Dennis P. Wolf, Executive Vice President, Chief Financial Officer and Secretary

EXHIBIT INDEX

Exhibit Number	
10.4	Amendment to Loan Agreement dated July 23, 1999 between Silicon Valley Bank and Credence Systems Corporation.
10.5	Employment Agreement by and between the Company and Graham J. Siddall
27.2	EDGAR Financial Data Schedule

AMENDMENT
TO
LOAN AGREEMENT

This Amendment to Loan Agreement is entered into as of July 23, 1999 (the "Amendment") by and between SILICON VALLEY BANK ("Agent" or "Bank") and CREDENCE SYSTEMS CORPORATION, a Delaware corporation ("Credence" or "Borrower").

RECITALS

Borrower, Credence Korea, Credence Systems K.K., Bank and Bank of Hawaii are parties to that certain Loan Agreement dated as of July 26, 1996, as amended by an Amendment to Loan Agreement dated as of July 25, 1997, an Amendment to Loan Agreement dated as of July 24, 1998, and an Amendment to Loan Agreement dated as of February 5, 1999. Bank of Hawaii, Credence Korea and Credence Systems K.K. have elected not to continue to be parties to the Agreement. Bank and Borrower desire to amend the Agreement to reflect such withdrawals and to reflect certain other changes, all in accordance with the terms of this Amendment.

NOW, THEREFORE, the parties agree as follows:

1. Bank of Hawaii, Credence Korea and Credence Systems, K.K. shall cease to be parties to the Agreement. All references to such entities in the Agreement are deleted.

2. The following definitions in Section 1.1 are amended and replaced in their entirety to read as follows:

a. "Collateral" means the property of each Borrower described on Exhibit D attached hereto.

b. "Committed Line" means Twenty Million Dollars ($20,000,000)

c. "Maturity Date" means July 22, 2000.

3. The defined terms "Optional Currency", "Optional Currency Rate Advance", "Optional Currency Rate" and "Optional Currency Rate Instruments" are deleted from the Agreement.

4. The first paragraph of Section 2.1 (a) is amended to read as follows:

"Subject to the terms and conditions of this Agreement, Bank will make Advances to Borrower in United States Dollars in an amount that does not exceed the Committed Line minus the face amount of all outstanding Letters of Credit (including undrawn and drawn but unreimbursed Letters of Credit) minus the reserve, if any, taken under Section 2.1.1(d). Notwithstanding the foregoing, if the aggregate amount of outstanding Advances plus Letters of Credit plus the reserve, if any, taken under Section 2.1.1(d) exceed Fifteen Million Dollars ($15,000,000), then Bank will make Advances to Borrower in an aggregate amount not to exceed the lesser of (i) the Committed Line or (ii) the Borrowing Base plus one hundred percent (100%) of Accounts that are supported by one or more letters of credit in an amount and of a tenor, and issued by a financial institution, acceptable to Bank. Subject to the terms and conditions of this Agreement, amounts borrowed pursuant to this Section 2.1 may be repaid and reborrowed at any time during the term of this Agreement."

5. Section 2.1(c) is deleted. All references to Optional Currency, Optional Currency Rate Advance, Optional Currency Rate and Optional Currency Rate Instrument are deleted. All Advances shall be made only in United States Dollars.

6. The reference in Section 2.1(c) to " 150 basis points" is amended to read "200 basis points".

7. The first sentence in Section 2.1.1(c) is amended to read as follows: "The maximum aggregate obligation at any one time for undrawn and drawn but unreimbursed Letters of Credit shall be Fifteen Million Dollars ($15,000,000).

8. The reference in the last paragraph of Section 5.3 to "Twenty Million Dollars ($20,000,000)" is amended to read "Fifteen Million Dollars ($15,000,000)".

9. Section 5.8 is deleted in its entirety.

10. Section 5.9 is deleted in its entirety and replaced with the following:

> "5.9 Tangible Net Worth. Maintain, on a consolidated basis, as of the last day of each fiscal quarter, a Tangible Net Worth, excluding Subordinated Debt, of not less than One Hundred Twenty Five Million Dollars ($125,000,000)."

11. Section 5.10 is deleted in its entirety and replaced with the following:

> "5.10 Profitability. Beginning the fiscal quarter ending July 31, 1999, on a consolidated basis, have a minimum net profit of at least One Dollar ($1.00) for the four-quarter period beginning the fiscal quarter ending July 31, 1999. Borrower may suffer losses in up to two quarters, provided that Borrower may suffer a loss from continuing operations in only one quarter."

12. Article 11 is deleted in its entirety and replaced with the following:

> "11. Springing Lien. Borrower grants Bank a continuing security interest in all currently existing and hereafter acquired or arising Collateral in order to secure Prompt repayment of all Obligations and in order to secure prompt performance by Borrower of its covenants and duties under the Loan Documents. Except as set forth in the Schedule, such security interest constitutes a valid, first priority security interest in the Collateral. Borrower shall from time to time execute and deliver to Bank, at the request of Bank, all financing statements and other documents that Bank may reasonably request, in form satisfactory to Bank, to perfect and continue perfected Bank's security interest in the Collateral. Notwithstanding any provision of this Section 11 to the contrary, the grant of security interest hereunder shall not be effective unless at any time the balance of Borrower's unrestricted cash and marketable securities is below Ninety Million Dollars ($90,000,000), at which time such grant shall automatically be effective and Bank shall have the right to file with the California Secretary of State or such other appropriate government office, the financing statements on Form UCC-1 delivered in connection with this Amendment. Bank shall otherwise retain such financing statements in its offices."

13. The attached Exhibit C is hereby added and incorporated by reference into the Agreement.

14. As a condition to the effectiveness of this Amendment, Bank shall receive a fee of Seventy-Five Thousand Dollars ($75,000), payable upon the date hereof, plus all Bank Expenses incurred in connection with the preparation of this Amendment.

15. As a condition to the effectiveness of this Amendment, Bank shall have received, in form and substance satisfactory to Bank, the following:

a. resolutions by Borrower authorizing the execution and delivery of this Amendment;

b. executed financing statement on Form UCC-1; and

c. such other documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate.

16. Unless otherwise defined, all capitalized terms in this Amendment shall be as defined in the Agreement. Except as amended, the Agreement remains in full force and effect.

17. Borrower represents and warrants that the Representations and Warranties contained in the Agreement are true and correct as of the date of this Amendment, and that no Event of Default has occurred and is continuing.

18. This Amendment may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one instrument.

IN WITNESS WHEREOF, the undersigned have executed this Amendment as of the first date above written.

CREDENCE SYSTEMS CORPORATION

By:

Title:

SILICON VALLEY BANK

By:

Title:

PA\932979.1
1190989-901501

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EXHIBIT C
COMPLIANCE CERTIFICATE

TO: SILICON VALLEY BANK

FROM: CREDENCE SYSTEMS CORPORATION

The undersigned authorized officer of CREDENCE SYSTEMS CORPORATION hereby certifies that in accordance with the terms and conditions of the Loan and Security Agreement between Borrower and Bank (the "Agreement"), (i) Borrower is in complete compliance for the period ending with all required covenants except as noted below and (ii) all representations and warranties of Borrower stated in the Agreement are true and correct in all material respects as of the date hereof. Attached herewith are the required documents supporting the above certification. The Officer further certifies that these are prepared in accordance with Generally Accepted Accounting Principles (GAAP) and are consistently applied from one period to the next except as explained in an accompanying letter or footnotes.

Please indicate compliance status by circling Yes/No under "Complies" column.
<TABLE>
<CAPTION>

Reporting Covenant	Required	Complies	
<S>	<C>	<C>	<C>
Form 10-K	Annually within 5 days	Yes	No
Form 10-Q	Quarterly within 5 days	Yes	No
A/R & A/P Agings, BBC	Monthly within 20 days if outstanding Advances exceed $15,000,000	Yes	No

</TABLE>
<TABLE>
<CAPTION>

Financial Covenant	Required	Actual	Complies	
<S>	<C>	<C>	<C>	<C>
Maintain on a Quarterly Basis:				
Minimum Quick Ratio	2.0:1.0	:1.0	Yes	No
Tangible Net Worth, excluding Sub Debt	$125,000,000	$	Yes	No
Profitability	1	$	Yes	No

</TABLE>

1. Borrower, on a consolidated basis, to have a minimum net profit of at least $1.00 for the four-quarter period that begins with the fiscal quarter ending on July 31, 1999. Borrower may suffer losses in up to 2 quarters, provided only one such loss is from continuing operations.

Comments Regarding Exceptions: See Attached.

Sincerely,

SIGNATURE

TITLE

DATE

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1190989-901501

EXHIBIT D

The Collateral shall consist of all right, title and interest of Borrower in and to the following:

(a) All goods and equipment now owned or hereafter acquired, including, without limitation, all machinery, fixtures, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing, and all attachments, accessories, accessions, replacements, substitutions, additions, and improvements to any of the foregoing, wherever located;

(b) All inventory, now owned or hereafter acquired, including, without limitation, all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products including such inventory as is temporarily out of Borrower's custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and Borrower's Books relating to any of the foregoing;

(c) All contract rights and general intangibles now owned or hereafter acquired, including, without limitation, goodwill, trademarks, servicemarks, trade styles, trade names, patents, patent applications, leases, license agreements, franchise agreements, blueprints, drawings, purchase orders, customer lists, route lists, infringements, claims, computer programs, computer discs, computer tapes, literature, reports, catalogs, design rights, income tax refunds, payments of insurance and rights to payment of any kind;

(d) All now existing and hereafter arising accounts, contract rights, royalties, license rights and all other forms of obligations owing to Borrower arising out of the sale or lease of goods, the licensing of technology or the rendering of services by Borrower, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Borrower and Borrower's Books relating to any of the foregoing;

(e) All documents, cash, deposit accounts, securities, investment property, financial assets, securities entitlements, securities accounts, letters of credit, certificates of deposit, instruments and chattel paper now owned or hereafter acquired and Borrower's Books relating to the foregoing;

(f) All copyright rights, copyright applications, copyright registrations and like protections in each work of authorship and derivative work thereof, whether published or unpublished, now owned or hereafter acquired; all trade secret rights, including all rights to unpatented inventions, know-how, operating manuals, license rights and agreements and confidential information, now owned or hereafter acquired; all mask work or similar rights available for the protection of semiconductor chips, now owned or hereafter acquired; all claims for damages by way of any past, present and future infringement of any of the foregoing; and

Any and all claims, rights and interests in any of the above and all substitutions for, additions and accessions to and proceeds thereof.

Inclusion of any property in the description of Collateral in this Exhibit shall not imply any obligation to maintain any license or retain any property that would otherwise expire or be disposed of in the ordinary course of Borrower's business in compliance with the Loan Agreement.

CORPORATE RESOLUTIONS TO BORROW

Borrower: CREDENCE SYSTEMS CORPORATION

I, the undersigned Secretary or Assistant Secretary of Credence Systems Corporation (the "Corporation"), HEREBY CERTIFY that the Corporation is organized and existing under and by virtue of the laws of the State of Delaware.

I FURTHER CERTIFY that the Certificate of Incorporation and Bylaws previously delivered to Bank are in full force and effect and have not been amended, modified or restated.

I FURTHER CERTIFY that at a meeting of the Directors of the Corporation (or by other duly authorized corporate action in lieu of a meeting), duly called and held, at which a quorum was present and voting, the following resolutions were adopted.

BE IT RESOLVED, that any one (1) of the following named officers, employees, or agents of this Corporation, whose actual signatures are shown below:

NAMES	POSITION	ACTUAL SIGNATURES
Dennis P. Wolf	Office of the President EVP & CFO	/s/ Dennis P. Wolf
John Detwiler	VP Corporate Controller	/s/ John Detwiler

Suguna Vepa	Director of Treasury	/s/ Suguna Vepa

acting for an on behalf of this Corporation and as its act and deed be, and they hereby are, authorized and empowered:

Borrow Money. To borrow from time to time from Silicon Valley Bank ("Bank"), on such terms as may be agreed upon between the officers, employees, or agents and Bank, such sum or sums of money as in their judgment should be borrowed, without limitation, including such sums as are specified in that certain Loan Agreement dated as of July 26, 1996, as amended from time to time, including the Amendment to Loan Agreement dated as of July 23, 1999 (the "Loan Agreement").

Execute Loan Agreement. To execute and deliver to Bank the Loan Agreement, any amendment thereto, and one or more renewals, extensions, modifications, refinancing, consolidations, or substitutions for one or more of the notes, or any portion of the Loan Agreement.

Grant Security. To grant a security interest to Bank in the Collateral described in the Loan Agreement, which security interest shall secure all of the Corporation's Obligations, as described in the Loan Agreement.

Negotiate Items. To draw, endorse, and discount with Bank all drafts, trade acceptances, promissory notes, or other evidences of indebtedness payable to or belonging to the Corporation or in which the Corporation may have an interest, and either to receive cash for the same or to cause such proceeds to be credited to the account of the Corporation with Bank, or to cause such other disposition of the proceeds derived therefrom as they may deem advisable.

Letters of Credit. To execute letters of credit applications and other related documents pertaining to Bank's issuance of letters of credit.

Foreign Exchange Contracts. To request Bank to enter into foreign exchange contracts on its behalf.

Further Acts. In the case of lines of credit, to designate additional or alternate individuals as being authorized to request advances thereunder, and in all cases, to do and perform such other acts and things, to pay any and all fees and costs, and to execute and deliver such other documents and agreements as they may in their discretion deem reasonably necessary or proper in order to carry into effect the provisions of these Resolutions.

BE IT FURTHER RESOLVED, that any and all acts authorized pursuant to these resolutions and performed prior to the passage of these resolutions are hereby ratified and approved, that these Resolutions shall remain in full force and effect and Bank may rely on these Resolutions until written notice of their revocation shall have been delivered to and received by Bank. Any such notice shall not affect any of the Corporation's agreements or commitments in effect at the time notice is given.

I FURTHER CERTIFY that the officers, employees, and agents named above are duly elected, appointed, or employed by or for the Corporation, as the case may be, and occupy the positions set forth opposite their respective names; that the foregoing Resolutions now stand of record on the books of the Corporation; and that the Resolutions are in full force and effect and have not been modified or revoked in any manner whatsoever.

IN WITNESS WHEREOF, I have hereunto set my hand on August 12, 1999 and attest that the signatures set opposite the names listed above are their genuine signatures.

CERTIFIED AND ATTESTED BY:

X

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1190999-901501

FINANCING STATEMENT - FOLLOW INSTRUCTIONS CAREFULLY
This Financing Statement is presented for filing pursuant to the Uniform Commercial Code and will remain effective, with certain exceptions, for 5 years from date of filing.

A. NAME & TEL. # OF CONTACT AT FILER (optional)

B. FILING OFFICE ACCT. # (optional)

C. RETURN COPY TO: (Name and Mailing Address)

SILICON VALLEY BANK, ATTN: LOAN SERVICES
ADMINISTRATION
3003 TASMAN DRIVE
SANTA CLARA, CA 95054-1191

D. OPTIONAL DESIGNATION (if applicable): LESSOR/LESSEE CONSIGNOR/CONSIGNEE NON-UCC FILING

---

1. DEBTOR'S EXACT FULL LEGAL NAME - insert only one debtor name (1a or 1b)

1a. ENTITY'S NAME
Credence Systems Corp

1b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME	SUFFIX

1c. MAILING ADDRESS	CITY	STATE	COUNTRY	POSTAL CODE
215 FOURIER AVENUE	FREMONT	CA	USA	94539

1d. S.S. OR TAX I.D.# OPTIONAL ADD'NL INFO RE ENTITY DEBTOR

1e. TYPE OF ENTITY

1f. ENTITY'S STATE OR COUNTRY OR ORGANIZATION

1g. ENTITY'S ORGANIZATIONAL I.D.#, if any

---

2. ADDITIONAL DEBTOR'S EXACT FULL LEGAL NAME
insert only one debtor name (2a or 2b)

2a. ENTITY'S NAME

2b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME	SUFFIX

2c. MAILING ADDRESS	CITY	STATE	COUNTRY	POSTAL CODE

2d. S.S. OR TAX I.D.# OPTIONAL ADD'NL INFO RE ENTITY DEBTOR

2e. TYPE OF ENTITy

2f. ENTITY'S STATE OR COUNTRY OR ORGANIZATION

2g. ENTITY'S ORGANIZATIONAL I.D.#, if any

---

3. SECURED PARTY'S (ORIGINAL S/P or ITS TOTAL ASSIGNEE) EXACT FULL LEGAL NAME
insert only one secured party name (3a or 3b)

3a. ENTITY'S NAME
Silicon Valley Bank

3b. INDIVIDUAL'S LAST NAME	FIRST NAME	MIDDLE NAME	SUFFIX

3c. MAILING ADDRESS	CITY	STATE	COUNTRY	POSTAL CODE
3003 TASMAN DRIVE	SANTA CLARA	CA	USA	95054

4. This FINANCING STATEMENT covers the following types or items of property:
SEE EXHIBIT A ATTACHED HERETO FOR COLLATERAL DESCRIPTION.

---

5. CHECK BOX (if applicable)

This FINANCING STATEMENT is signed by the Secured Party instead of the Debtor to perfect a security interest (a) in collateral already subject to a security interest in another jurisdiction when it was brought into this state, or when the debtor's location was changed to this state, or (b) in accordance with other statutory provisions (additional date may be required)

---

6. REQUIRED SIGNATURE (S)

---

7. If filed in Florida (check one)
Documentary stamp tax paid Documentary stamp tax not applicable

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8. This FINANCING STATEMENT is to be filed (for record) (or recorded) in the REAL ESTATE RECORDS
Attach Addendum (if applicable)

---

9. Check to REQUEST SEARCH CERTIFICATE(S) on Debtor(s)
[ADDITIONAL FEE]
(optional) All Debtors Debtor 1 Debtor 2

DEBTOR: CREDENCE SYSTEMS, INC.
SECURED PARTY: SILICON VALLEY BANK

EXHIBIT A

The Collateral shall consist of all right, title and interest of Borrower in and to the following:

(i) All goods and equipment now owned or hereafter acquired, including, without limitation, all machinery, fixtures, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing, and all attachments, accessories, accessions, replacements, substitutions, additions, and improvements to any of the foregoing, wherever located;

(ii) All inventory, now owned or hereafter acquired, including, without limitation, all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products including such inventory as is temporarily out of Borrower's custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above, and Borrower's Books relating to any of the foregoing;

(iii) All contract rights and general intangibles now owned or hereafter acquired, including, without limitation, goodwill, trademarks, servicemarks, trade styles, trade names, patents, patent applications, leases, license agreements, franchise agreements, blueprints, drawings, purchase orders, customer lists, route lists, infringements, claims, computer programs, computer discs, computer tapes, literature, reports, catalogs, design rights, income tax refunds, payments of insurance and rights to payment of any kind;

(iv) All now existing and hereafter arising accounts, contract rights, royalties, license rights and all other forms of obligations owing to Borrower arising out of the sale or lease of goods, the licensing of technology or the rendering of services by Borrower, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Borrower and Borrower's Books relating to any of the foregoing;

(v) All documents, cash, deposit accounts, securities, investment property, financial assets, securities entitlements, securities accounts, letters of credit, certificates of deposit, instruments and chattel paper now owned or hereafter acquired and Borrower's Books relating to the foregoing;

(vi) All copyright rights, copyright applications, copyright registrations and like protections in each work of authorship and derivative work thereof, whether published or unpublished, now owned or hereafter acquired; all trade secret rights, including all rights to unpatented inventions, know-how, operating manuals, license rights and agreements and confidential information, now owned or hereafter acquired; all mask work or similar rights available for the protection of semiconductor chips, now owned or hereafter acquired; all claims for damages by way of any past, present and future infringement of any of the foregoing; and

Any and all claims, rights and interests in any of the above and all substitutions for, additions and accessions to and proceeds thereof.

Inclusion of any property in the description of Collateral in this Exhibit shall not imply any obligation to maintain any license or retain any property that would otherwise expire or be disposed of in the ordinary course of Borrower's business in compliance with the Loan Agreement.

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Credence Systems
Corporation

215 Fourier Avenue
Fremont, CA 94539
(510) 657-7400
FAX (510) 623-2560

CREDENCE
SYSTEMS CORPORATION

July 29, 1999

Mr. Graham J. Siddall

Dear Graham,

On behalf of the Board of Directors of Credence Systems Corporation (the "Company"), I am pleased to extend to you an offer to become the President & Chief Executive Officer of the Company. Under your leadership, Credence has the opportunity to become the company that shapes the future of Semiconductor Test Equipment. Our offer consists of the following benefits, terms and conditions:

POSITION: Upon commencement of your employment with the Company, you will become the President and Chief Executive Officer of the Company, responsible for leading and managing the Company in all regards. You will also be appointed as a member of the Board of Directors of the Company and shall be nominated to serve on the Company's board as long as you serve as Chief Executive Officer. You will report directly to the Board of Directors of the Company.

SALARY: You will receive a base salary paid at the rate of $33,333.33 per month, an annualized rate of $400,000.00, which will be reviewed annually on or about your employment anniversary date. You will be paid semi-monthly, less payroll deductions and required withholdings, in accordance with the Company's regular payroll practices.

BONUS: Your annual target bonus for FY 2000 is up to $250,000.00. A prorated portion of your bonus will be guaranteed for nine (9) months and will be paid in three (3) equal quarterly installments of $62,500.00 each. This period includes the fourth quarter of FY 1999, ending October 31, 1999 and the first six (6) months of FY 2000, ending April 30, 2000. The balance of your bonus will also be paid quarterly based upon your achievement of relevant performance objectives that you will propose to the Board of Directors by December 31, 1999, subject to their approval.

Special Bonuses: Before December 31, 1999, you will design and submit performance objectives to the Board of Directors for the balance of FY 2000 for their approval. With extraordinary accomplishment, beyond a base plan, you have the opportunity to participate in an additional bonus of up to $100,000.00. This Special Bonus will be paid following the end of FY 2000 and before December 31,2000.

On September 9, 1999, the Company will pay you $125,000.00 as a sign-on bonus.

STOCK OPTIONS: Subject to approval by the Board of Directors, upon commencement of your employment with Credence Systems Corporation, which is expected to occur on or before July 29, 1999, you will be granted an incentive stock option, to the maximum extent permitted by law, to purchase five hundred thousand (500,000) shares of the Company's Common Stock at an option price set by the Board of Directors and reflecting current market price at that time. The Company intends to evaluate your performance at the end of each Fiscal Year for the purpose of additional stock option grants. Such grants will be subject to the sole approval of the Board of Directors of the Company.

VESTING: Your option will vest over a four (4) year period, with 1/48th vesting at the end of each continuous month of employment with the Company.

TERMINATION BENEFITS: Provided the parties enter into a mutual general release, mutual nondisparagement and nonsolicitation and confidentiality agreement, if you are involuntarily terminated by the Company (but not a successor) prior to a Change of Control without "Cause," or if you terminate your employment with the Company (but not a successor), prior to a Change of Control for "Good Reason" on or before June 30, 2000, the Company will provide you with your then effective base salary and target bonus in accordance with the Company's standard payroll policy until June 30, 2001 and the Company will immediately accelerate the vesting of all such unvested stock options as if you were a full-time employee as of June 30, 2001 and ceased employment on June 30, 2001, and will extend the final exercise date of your options as if you were employed at that date.

Provided the parties enter into a mutual general release, mutual nondisparagement and nonsolicitation and confidentiality agreement, if you are involuntarily terminated by the Company (but not a successor) prior to a Change of Control without "Cause" or if you terminate your employment with the Company (but not a successor) prior to a Change of Control for "Good Reason" after June 30, 2000, or if you die, the Company will provide you or your estate with your then effective base salary and target bonus in accordance with the Company's standard payroll policy, for a period of twelve (12) months after the date of such termination, and the Company will accelerate immediately the vesting of all such unvested stock options for an additional twelve (12) months after such date of termination and will extend the final exercise date of your options as if you were employed for such 12-month period.

In addition, regardless of the dates of termination referred to above, in the event of a termination without Cause or for Good Reason, if you choose to continue your health care pursuant to COBRA, the Company would pay your COBRA premiums during such period of severance referred to above.

For the purposes of this Offer, a termination for "Cause" will mean a termination initiated by the Company (or a successor) for any of the following reasons: (i) repeated failure to perform any essential duty of your position, other than for a medical reason documented by a physician, after being given written notice of such failure by the Board of Directors and thirty (30) days in which to cure your performance; (ii) an act committed by you which constitutes gross misconduct and which is injurious to the Company or any subsidiary or a successor; (iii) your being convicted of a crime; (iv) committing an act of fraud against, or the misappropriation of property belonging to, the Company or any subsidiary or a successor; (v) an act of dishonesty committed by you in connection with your responsibilities as an employee and intended to result in the personal enrichment of yourself, your family or others; or (vi) a material breach of any confidentiality or proprietary information or other material agreement between you and the Company or any subsidiary or any successor. If your employment is terminated by the Company (or a successor) for "Cause" or if you leave voluntarily without "Good Reason," you will be paid your base salary and all unused and unpaid vacation earned through your date of termination, but no other benefits. In such event, all stock vesting and benefits will cease on your date of termination.

"Good Reason" means (i) failure by the Company or any subsidiary or successor to comply with any material terms of this letter agreement or any other material agreement between you and the Company or any subsidiary or successor, (ii) a diminution in the nature or scope of your authority, title, function or duties, (iii) a reduction in your base salary or benefits (unless such reduction is part of an officer-wide program to reduce expenses) or (iv) relocation of your principal office to a location outside Silicon Valley.

CHANGE OF CONTROL: Provided the parties enter into a Mutual general release, mutual nondisparagement and nonsolicitation and confidentiality agreement, in the event of a (i) Change of Control (as defined in the Credence Systems Corporation Addendum to the Stock Option Agreement), and (ii) at any time after such Change of Control, the Company or its successor terminates you without Cause or you leave for Good Reason or you die, the Company or its successor shall pay you or your estate as soon as soon as practicable after such date of termination an amount equal to 200% of your then effective annual base salary and 200% of your target bonus and the Company shall immediately accelerate the vesting on all your unvested stock options through the twenty-four (24) month period following such termination date, and shall extend the final exercise date of your options as if you were employed for such 24-month period.

In the event that you become entitled to termination benefits within one year following a Change of Control, if any of the payments or benefits to which you are entitled will be subject to an excise tax under the Internal Revenue Code, the Company will "gross up" the amount of such payments and benefits so that on an after-tax basis you will receive the same amount of payments and benefits as you would have received absent the imposition of such excise tax.

In the event of a Change of Control and a subsequent termination without Cause or for Good Reason, other then as set forth in this section entitled Change of Control, you shall not be entitled to any other benefits or compensation from the Company or any successor. If, after a Change of Control, your employment is terminated by the Company or any successor for Cause or you leave voluntarily without a Good Reason, you will be paid your base salary and for all unused vacation earned through your date of termination but no other benefits. In such event, all stock vesting and benefits will cease on your date of termination.

MISCELLANEOUS: You will be entitled to participate in the Company's other benefit plans as a full-time employee to the extent set forth in such plans.

You shall have no duty to seek other employment or otherwise take action to mitigate payments the Company may be required to make in connection with any termination of your employment. If your termination from the Company or a successor would give rise to termination payments under this letter agreement, the Company or its successor shall enter into a mutual general release, mutual nondisparagement and nonsolicitation and confidentiality agreement on reasonable terms; the term of the nonsolicit shall be the same as the term for which base salary is paid if the termination is prior to a Change of Control and shall be 24 months if the termination is after a Change of Control.

The Company shall reimburse you for your reasonable attorneys fees incurred in connection with the review of this agreement.

The employment terms in this letter constitute the complete, final and exclusive embodiment of the entire agreement between you and Credence Systems Corporation with respect to the terms and conditions of your employment. These terms supercede any other agreements or promises made to you by anyone, whether oral or written. This agreement is governed by California law and, except as set forth herein, and shall be binding on the Company's successor and assigns.

California is an "at-will" employment state, and Credence Systems Corporation is an at-will employer. This means that either you or the Company or any successor has the right to terminate the employment relationship at any time, for any reason, with or without cause. This is the full and final agreement between you and the Company or any successor on these terms. Although your job duties, title, compensation and benefits, and the personnel policies and procedures may change from time-to-time, the at-will nature of your employment may only be changed in a document signed by you and the Chairman of the Board of Directors.

As required by law, this offer is subject to satisfactory proof of your right to work in the United States of America. You will also be required to sign the Company's standard proprietary assignment of information and inventions agreement.

Graham, we are very excited about your joining the Credence Systems team and look forward to a mutually rewarding relationship. We are convinced that your experience and commitment to develop a great company is an excellent match for both you and Credence Systems Corporation. We look forward to your positive acceptance of this offer.

This offer will remain open to you until Thursday, July 29, 1999. If you wish to accept employment at Credence Systems Corporation under the terms described above, please sign, date and return a copy of this letter to signify your approval.

START DATE: You will start full-time employment at Credence Systems Corporation on or before Thursday, July 29, 1999.

I look forward to your favorable reply and to a productive and enjoyable work relationship with you.

Sincerely,

Credence Systems Corporation,

William G. Howard, Jr.
Chairman

Accepted:

Graham J. Siddall July 29, 1999

cc: Board of Directors, Credence Systems Corporation
Michael V. Parsells

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