

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT

PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

Date of report (Date of earliest event reported): November 6, 2007

Tegal Corporation

(Exact name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction
of incorporation)

000-26824
(Commission
File Number)

68-0370244
(I.R.S. Employer
Identification No.)

2201 South McDowell Boulevard
Petaluma, California 94954
(Address of Principal Executive Offices)

(707) 763-5600
(Registrant's telephone number, including area code)

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
 - o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
 - o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
 - o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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Item 2.02. Results of Operations and Financial Condition

On November 6, 2007, Tegal Corporation (the "Company") announced its financial results for the quarter and six months ended September 30, 2007, a copy of which is furnished as Exhibit 99.1 to this Form 8-K and incorporated by reference herein. On November 6, 2007 the Company held a conference call announcing its financial results for the quarter and six months ended September 30, 2007. The transcript of this conference call is furnished as Exhibit 99.2 to this Form 8-K and is incorporated by reference herein.

Item 9.01 Financial Statements and Exhibits

(c) Exhibits.

Exhibit No. Description

99.1 Press Release dated November 6, 2007.

99.2 Transcript of Tegal Corporation's earnings conference call held on November 6, 2007.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Date: November 6, 2007 TEGAL CORPORATION

By: /s/ Christine T. Hergenrother

Name: Christine T. Hergenrother

Title: Chief Financial Officer

EXHIBIT INDEX

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Exhibit 99.1

Exhibit 99.2

**TEGAL CORPORATION REPORTS PROFIT IN
SECOND QUARTER OF FISCAL 2008**

Revenues Increase 111% Year-Over-Year, Quarterly Net Income of \$0.10 per share

San Jose, Calif., November 6, 2007 — Tegal Corporation (Nasdaq:TGAL), a leading designer and manufacturer of plasma etch and deposition systems used in the production of integrated circuits and nanotechnology devices, today announced financial results for the Second Quarter Fiscal Year 2008, which ended September 30, 2007. Senior management will conduct an investor conference call to discuss these results and the company's financial outlook in more detail today at 2pm Pacific Time, Tuesday, November 6, 2007. More information about the conference call is provided below.

Second Quarter Highlights

- Net income of \$693 thousand or \$0.10 per share compared to a net loss of (\$3.3) million in the same period last year and (\$639) thousand in the prior quarter.
- Operating income reached \$1.1 million during the quarter excluding non-cash charges of \$0.6 million.
- Shipments during the quarter included 3 advanced etch systems for high volume manufacturing of integrated active-passive devices in Europe and an advanced PVD system to a leading European analog and power device manufacturer.
- The Company announced new orders for 900 and 980 etch systems and upgrades from a leading hard disk drive manufacturer and a leading Japan-based sensor and control systems maker.

“We are pleased to report our first quarterly profit since December 2000, a very significant milestone,” said Thomas Mika, President and CEO of Tegal Corporation. “We have made substantial progress in the strategic re-engineering of our business, improving our overall cost structure and delivering sales growth, while continuing to work towards driving new product introductions. This quarter we remained focused on manufacturing and also field support for the many advanced systems that we have recently delivered. We are also making good progress in our efforts to complete and place tools with customers for our new products, including the AMS PVD tool for Aluminum Nitride applications, our innovative NLD product, and the porting of our etch technology onto our new Compact platform. We are very pleased with our accomplishments so far, but feel we can still drive more improvements in our business and continue to deliver improved operating results.”

Financial Results

Revenues for the second quarter of fiscal 2008 were \$10.8 million, an increase of 111% from the \$5.1 million in the same period last year. Tegal reported net income of \$0.7 million, or \$0.10 per share, for the quarter, compared to a net loss of (\$3.3) million, or (\$0.47) per share in the same period last year, and a net loss of (\$0.6) million, or (\$0.09) per share in the prior quarter.

Gross profits for the second quarter of fiscal 2008 were 39.3% compared to 46.9% in the same period last year, but up from the 35.3% in the prior quarter.

Operating income for the second quarter was \$0.5 million, including approximately \$0.6 million of non-cash charges. This was an improvement over the \$3.1 million operating loss in the same period last year and the \$1.4 million operating loss in the prior quarter, which included \$0.5 million and \$0.6 million of non-cash charges, respectively.

Backlog was \$8.9M at the end of the quarter.

\$18.5 million remains in a Litigation Suspense liability account, pending resolution of the company's dispute with its attorneys over the amount payable under the settlement agreement. The \$1 million reduction in the account reflects a settlement of \$995 thousand with one of the attorneys representing Sputtered Films, Inc.

Cash at the end of the fiscal second quarter of 2008 was \$20.3 million, a \$5.4 million decrease from the end of the March quarter. Over the same 6 month period, inventories increased by \$5.5 million to \$11.1 million, while accounts payable increased by \$1.9 million to \$3.4 million, both reflecting the investment required to fulfill orders coming in during the quarter.

Investor Conference Call

Tegal Corporation will discuss these results and further details of its second quarter of fiscal 2008 during a conference call today, November 6, 2007, at 5:00 p.m. EST / 2:00 p.m. PST. The call is open to all interested investors. The call-in numbers are (866) 578-5771 or (617) 213-8055. For either dial-in number, Investors should reference passcode: 98159631. A digital recording will be made available two hours after the completion of the conference call, and it will be accessible through midnight on Tuesday, November 13, 2007. To access, investors should dial (888) 286-8010 or (617) 801-6888 and enter passcode: 31764338. The

conference call also will be available online via the Investor Section of the Company's website at: www.tegal.com. An online replay of the teleconference, along with a copy of the Company's earnings release, will also be available on the Company's website.

Safe Harbor Statement

Except for historical information, matters discussed in this news release contain forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. Forward-looking statements, which are based on assumptions and describe our future plans, strategies and expectations, are generally identifiable by the use of the words "anticipate," "believe," "estimate," "expect," "intend," "project" or similar expressions. These forward-looking statements are subject to risks, uncertainties and assumptions about the Company including, but not limited to industry conditions, economic conditions, acceptance of new technologies and market acceptance of the Company's products and services. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements in this paragraph. For a further discussion of these risks and uncertainties, please refer to the Company's periodic filings with the Securities and Exchange Commission.

About Tegal

Tegal provides process and equipment solutions to leading edge suppliers of advanced semiconductor and nanotechnology devices. Incorporating unique, patented etch and deposition technologies, Tegal's system solutions are backed by over 35 years of advanced development and over 100 patents. Some examples of devices enabled by Tegal technology are energy efficient memories found in portable computers, cellphones, PDAs and RFID applications; megapixel imaging chips used in digital and cellphone cameras; power amplifiers for portable handsets and wireless networking gear; and MEMS devices like accelerometers for automotive airbags, microfluidic control devices for ink jet printers; and laboratory-on-a-chip medical test kits.

More information is available on the Internet at: www.tegal.com.

Contact:

Tegal Corporation
Christine Hergenrother (VP and CFO), 707/763-5600
or
The Blue Shirt Group
Rakesh Mehta or Chris Danne, 415/217-7722

TEGAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except share data)

	<u>Sept 30</u> <u>2007</u>	<u>March 31</u> <u>2007</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 20,348	\$ 25,776
Accounts receivable, net of allowances for sales returns and doubtful accounts of \$230 and \$413 at September 30, 2007 and March 31, 2007, respectively	8,056	6,634
Inventories, net	11,178	5,567
Prepaid expenses and other current assets	1,497	991
Total current assets	<u>41,079</u>	<u>38,968</u>
Property and equipment, net	1,318	1,351
Intangible assets, net	1,026	1,161
Other assets	107	176
Total assets	<u>\$ 43,530</u>	<u>\$ 41,656</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and bank lines of credit	\$ —	\$ 10
Accounts payable	3,863	1,974
Accrued product warranty	1,435	1,101
Deferred revenue	1,162	1,064
Litigation suspense	18,505	19,500
Accrued expenses and other current liabilities	3,228	3,590
Total current liabilities	<u>28,193</u>	<u>27,239</u>
Total long term liabilities	<u>—</u>	<u>—</u>
Total liabilities	<u>28,193</u>	<u>27,239</u>
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock; \$0.01 par value; 5,000,000 shares authorized; none issued and outstanding	—	—
Common stock; \$0.01 par value; 50,000,000 shares authorized; 7,126,912 and 7,106,867 shares issued and outstanding at September 30, 2007 and March 31, 2007, respectively	71	71
Additional paid-in capital	123,281	122,473
Accumulated other comprehensive income (loss)	297	240
Accumulated deficit	(108,312)	(108,367)
Total stockholders' equity	<u>15,337</u>	<u>14,417</u>
Total liabilities and stockholders' equity	<u>\$ 43,530</u>	<u>\$ 41,656</u>

TEGAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	September 30,		September 30,	
	2007	2006	2007	2006
Revenue	\$ 10,800	\$ 5,113	\$ 15,398	\$ 11,689
Cost of sales	6,560	2,713	9,537	6,791
Gross profit	4,240	2,400	5,861	4,898
Operating expenses:				
Research and development expenses	1,057	1,066	1,835	2,062
Sales and marketing expenses	1,279	964	2,285	2,008
General and administrative expenses	1,448	3,485	2,651	5,787
Total operating expenses	3,784	5,515	6,771	9,857
Operating loss	456	(3,115)	(910)	(4,959)
Other income (expense), net	237	(166)	964	(124)
Net loss	\$ 693	\$ (3,281)	\$ 54	\$ (5,083)
Net loss per share, basic and diluted	\$ 0.10	\$ (0.47)	\$ 0.01	\$ (0.72)
Shares used in per share computation:				
Basic	7,119	7,045	7,111	7,029
Diluted	7,276	7,045	7,217	7,029

Note: Shares used in per share computation for Basic and Diluted reflect a 1 to12 reverse stock split effected by the Company on July 25, 2006



Nov. 06. 2007 / 5:00 PM EST, TGAL - Q2 2008 Tegal Corporation Earnings Conference Call

CORPORATE PARTICIPANTS

Christine Hergenrother

Tegal Corporation - CFO

Tom Mika

Tegal Corporation - President, CEO

CONFERENCE CALL PARTICIPANTS

Glenn Mattson

GTK Capital Partners - Analyst

Steve Sullivan

Horizon Financial Group - Analyst

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the third quarter 2008 Tegal Corporation earnings conference call. My name is Shaun and I will be your coordinator for today. At this time all participants are in a listen-only mode. We will be facilitating a question-and-answer session towards the end of this conference. (OPERATOR INSTRUCTIONS) I would now like to turn the presentation over to your host for today's call, Ms. Christine Hergenrother, Chief Financial Officer. Please proceed.

Christine Hergenrother - Tegal Corporation - CFO

Thank you. Good afternoon and welcome to Tegal's investor conference call for the second quarter of fiscal 2008, which ended September 30, 2007. Before I review the financial results for the quarter and the year, I have two housekeeping items. The first is a reminder that a digital recording of this conference call will be available two hours after the completion of the call, and it will be available through midnight on Tuesday, November 13, 2007. To access, investors should dial 888-286-8010 or 617-801-6888 and enter pass code 31764338. An online replay of the call along with a copy of the Company's earnings release will be available on the Company's website as well.

The second housekeeping item is a reminder about the all-important Safe Harbor statement that should be taken into consideration when listening to comments that will be made on this call. Except for historical information, matters discussed on this call are forward-looking

statements. Such forward-looking statements are subject to certain risks and uncertainties, including but not limited to industry conditions, economic conditions, acceptance of new technology, the growth of target markets as well as other risks. Actual operations and financial results may differ materially from Tegal's expectations as a result of these factors or unanticipated events. Specifically, we refer you to the risks and uncertainties as set forth in the Company's periodic filings with the Securities and Exchange Commission.

Following my review of the financial performance for the quarter, I will introduce Tom Mika, President and Chief Executive Officer of Tegal, who will have some additional comments. After that, we will entertain questions from the dial-in audience.

Revenues for the fiscal second quarter were \$10.8 million, a sequential increase of 135% from \$4.6 million in the fiscal first quarter of 2007 and an increase of 111% from the \$5.1 million recorded for the same quarter one year ago.

Our recorded net income for the second quarter is \$693,000 or \$0.10 per share compared to a net loss of \$3.3 million or \$0.47 per share in the comparable quarter one year ago. Last quarter, Tegal reported a loss of \$638,000 or \$0.09 per share.

Gross profits for the second quarter came in at 39.3% compared to 38% in the comparable quarter one year ago and 35.3% in Q1 of this fiscal year. The improvement in gross profits was mainly attributable to a favorable product mix and increased revenue during the quarter.

Overall operating expenses for the second quarter were \$3.8 million, a decrease of about \$1.8 million from the same quarter last year and an increase of \$800,000 compared to last quarter.

Sales and marketing expense increased from last quarter by approximately \$300,000, largely due to sales commissions on the increased revenue. Overall R&D spending was flat from the same quarter last year, coming in at just over \$1 million for the quarter and an increase of \$200,000 from the previous quarter. The previous quarter included payments from customers for non-reoccurring development work. The increase of \$300,000 in G&A expense from last quarter was largely due to an executive compensation study conducted during the quarter and legal fees related to our recent arbitration.

Nonoperating expenses netted out to a gain for the quarter of \$237,000, including net interest income of \$263,000, offset by other expense of \$26,000. The resulting operating income for the second quarter was \$456,000 compared to a loss of \$3.1 million in the same quarter one year ago and a negative \$1.4 million in the first quarter of this fiscal year.

Included in operating income were non-cash charges of approximately \$600,000, which included \$400,000 of stock compensation expense for options vesting during the quarter. The remaining non-cash expenses were depreciation, amortization and warrant expenses. Excluding these non-cash charges, operating income for the second quarter was \$1.1 million.

Now moving to the balance sheet. Cash at the end of the second quarter was \$20.3 million, a decrease of \$3 million from last quarter. The cash decrease was due primarily to changes in working capital and a cash settlement payment to Gonzalez & Leigh, one of our former litigation attorneys.

Accounts receivable increased by \$1.2 million from last quarter, coming in at \$8.1 million. Inventories increased by \$2.5 million from \$8.6 million to \$11.1 million. PP&E, intangibles and other assets increased a combined \$91,000, mainly consisting of other current assets.

Total current liabilities decreased by \$417,000 over the last quarter, resulting from increases in accounts payable and product warranty, and offset by the \$995,000 payment made in the settlement of Gonzalez & Leigh. The company had no long-term liabilities at the end of the quarter.

Regarding the dispute with our other litigation attorneys on the remaining fees owed for the settlement of a litigation with AMS, Agilent and Avago, we plead our case with the Bar Association of San Francisco in a nonbinding arbitration proceeding on September 10th and 11th. We expect to receive their ruling any day now.

The company's book to bill ratio was less than 1 during the quarter and the backlog as of today stands at \$10.3 million. Total shares outstanding as of September 30, 2007, were 7,126,912.

I would now like to introduce Tom Mika, our President and Chief Executive Officer.

Tom Mika - Tegal Corporation - President, CEO

Thanks, Christine. We are very pleased with our second quarter results. We reached our first quarterly profit since December 2000 and our margin reached 39.3%, which is very close to our corporate target of 40%, and as Christine mentioned, our operating income, excluding non-cash charges, was a solid \$1.1 million.

We believe this quarter's results demonstrate our hard work and success in the strategic restructuring of our business over the last several years. However, while we are encouraged by our accomplishments, we believe that we can still drive more improvements in our business and continue to deliver improved operating results.

I thought it would be useful today to review our progress over the past couple of years, to give you some insight as to where we are currently and perhaps to set the stage for what might lie ahead.

In 2004, when I was CFO, we began in earnest to make some changes in the management of the company and began to review the structure of the company and the new technologies that we had acquired in 2002 and 2003. I became CEO in mid-2005 and at this time we set out some goals for a turnaround, which we stated at the time would take two years to achieve. But we thought some goals would come earlier, as they have.

The goals were threefold. To achieve cash breakeven. Second, to achieve significant increases in revenues. And third, change the business model in order to turn the company into a profitable growing technology company. I'm very pleased that we have delivered on each of these objectives.

Our success was driven by our focus on four main areas; management, existing product strategies, new products, and infrastructure. I'd like to review each of these areas as I did two years ago, with updates on what we are doing today to drive continued success.

Area one, management. Over the past two years we have made several new hires in senior positions and promoted several individuals internally to key positions. For the most part, these appointments have worked out very well and I believe that we have a strong cohesive team of experienced managers.

While we are pleased with the results, we are now working on two important new efforts to further improve our management structure. The first is to upgrade our Human Resources program and policies through the revision of job descriptions, benchmarking and performance appraisals and all the other efforts that should be expected of a leading company.

The second, which is more of a continuous program, is to improve the communication and cohesiveness among all our employees and Management in order to achieve our agreed upon goals and objectives.

Secondary is in existing product strategies. The essence and the success of our existing product strategy lies in the etching and deposition of so-called new materials. We do not serve mainstream device markets with the old materials such as silicon, silicon dioxide, silicon nitride, aluminum and copper are commonly used. Old materials are common, elemental, inexpensive and relatively easy to deposit and etch. They are used in microprocessors, ICs, Flash memory and DRAM. These are markets where Moore's Law applies and in which competitors who are vastly larger than we are compete.

Instead, we have focused on new materials where Moore's Law generally doesn't apply and where the markets are today considerably smaller, but growing rapidly. Included in our list of new materials are four categories of materials, including high-K materials, such as PZT, hafnium oxides, zirconium oxide and BST; noble metals that include platinum, iridium, ruthenium and gold; piezoelectrics -- aluminum nitride, PZT, zirconium oxide; and compound semiconductors or 3-5 materials, generally known by their substrates, which are gallium arsenide, indium phosphide, gallium nitride and silicon carbide.

These materials are uncommon compound materials which are expensive and difficult to deposit and etch. I often use the term difficult to etch and deposit without really defining it, since it is very technical. Basically, it has to do with how the chemistries, energies and surfaces within the reactors affect and are affected by the new materials. In addition, it has to do with the active control of [SSO] morphology and measures of cost of ownership, such as throughput repeatability and time to clean the reactors. In other words, the difficult task has to be done over and over again in a production environment economically.

Despite the challenges, new materials have uses in some of the most sought after applications in the market today, such as advanced nonvolatile memories, systems on chips, tunable capacitors, power management devices, high-speed computing, LEDs, acoustic filters, MEMS, sensors and actuators. Such devices are behind the higher functionality and smaller size of your wireless devices, portability of laptops and other electronic appliances, the force feedback of the gaming console, sensors on your cars, and the power management devices on everything from your iPod to your Prius hybrid car.

We understood years ago that despite the challenges of working with new materials, we needed to develop solutions focused on these growing end markets. We knew that competing successfully in these markets required a willingness to make significant investments and accept risk, both on the part of Tegal and on the part of our customers. The risks and investments we have made have paid off, as these end markets are now flourishing and our existing product line is positioned extremely well. This has led to recent new order momentum and our improved financial performance.

Now with our financial turnaround, stronger balance sheet and the competence and skill of our engineering process development and field support teams, we are all working to further improve our competitive positions and continue our recent new order momentum.

On the topic of new orders, I was very pleased to be able to announce today a new order by Skyworks Solutions of an additional advanced etch system to this very prominent and extremely successful innovator of high-performance analog and mixed signal semiconductors, enabling mobile connectivity. Skyworks' power amplifiers, front-end modules and direct conversion radios are at the heart of many of today's leading edge multimedia handsets.

The system will be shipped to Skyworks' fab in Southern California, where it will be used to etch silicon nitride and other critical thin films on gallium arsenide substrates, supporting Skyworks business expansion in the multimode and multimedia handset market.

The compound semiconductor market is one to which we are firmly committed and we are striving to offer new cost-effective processes and system solutions to companies in this market.

The third area is new products. While we have been focused on improving our results through our current product offering, we have also remained focused on introducing new products in order to continue growing in the future. We have also learned that this process takes patience. Two years ago, I confessed our mistake of talking in conference calls about an expected short timeline for delivering our Nano-Layer Deposition product, while it was still very much under development. I have tried to readjust the timeline and lower expectations about early revenues from this project and continue to in subsequent calls to talk only about beta systems.

What I have learned is that you just can't make a baby in less than nine months and you can't launch a major new piece of capital equipment in less than about three to five years, period. Having said all that, given the substantial time and investment we have now spent, I believe we are making good progress and I am still very optimistic that I will have something positive to say about NLD soon, so please stay tuned.

The fourth area is infrastructure. This is an area in which we have made remarkable progress in a relatively short period of time. We have significantly improved our cost structure over the last two years through consolidation and other initiatives. We completed the integration of Sputtered Films and closed all of our operations in Santa Barbara. Over the course of the last year, we have revised our plan for San Jose, which currently houses our PVD operations, including process development and allows people in both PVD and etch who live in the area to work out of that office, rather than commuting to Petaluma.

We will eventually display our Compact NLD and Compact etch tools there, but we'll do limited demos and no manufacturing from that facility. We will continue to manufacture in Petaluma, which will remain our administrative location and our headquarters. The key to our position in the facilities area is low-cost and flexibility. We have reduced our overhead by several million dollars, cutting our burden rate by 50% and have not committed to any long-term leases.

We have not made much progress on outsourcing manufacturing and will not until we formally launch the Compact platform. We have however made substantial progress in our distribution infrastructure by recruiting reps in Singapore, Japan and Korea. We are still working on China.

In summary, Q2 '08 was a milestone event for Tegal. The first profitable quarter in seven years. We demonstrated good progress toward our stated objectives. Despite our success, we are increasing our intensity to drive further improvements into our business and deliver continued growth.

Looking forward to the remainder of the year, we believe that next quarter we will likely see a drop-off in some end sales from the very strong second quarter, but we should still demonstrate a good year-over-year growth. In addition, the fourth quarter should improve over Q3 and depending on our performance, we have good potential for it being profitable for the entire fiscal year.

Thanks for your attention and now I'll be happy to answer any questions that you may have.

Nov. 06. 2007 / 5:00 PM EST, TGAL - Q2 2008 Tegal Corporation Earnings Conference Call

QUESTION AND ANSWER

Operator

(OPERATOR INSTRUCTIONS) Glenn Mattson from GTK.

Glenn Mattson - *GTK Capital Partners - Analyst*

Congratulations on a great quarter. Just calling about the industry potential for the existing and future products, could you give me some information on that? Thank you.

Tom Mika - *Tegal Corporation - President, CEO*

As far as our market potential is concerned, as I said in previous calls, Tegal participates in kind of a broad set of niche markets, all of which are growing pretty rapidly, but tend to be markets in which multiple system sales are sometimes difficult to achieve and difficult to predict. When you get a wildly successful product like the IPAD from STMicroelectronics, then we have some predictability to our sales. We're working on a pretty broad front and we think it represents a lot of potential.

I think in general, in order to miniaturize devices and to increase functionality, companies are going to have to continue to adopt new materials. So I think in that respect our strategy is on target.

As far as future products are concerned, we're really staying within the new materials area. Our Nano-Layer Deposition product, our first applications are in the areas of depositing tinitride films, very thin films on highly conformal structures that are attempting to increase functionality or decrease size of devices. So we're staying with new materials in both our existing product lines and in our new product lines.

Glenn Mattson - *GTK Capital Partners - Analyst*

It sounds like, Tom, you have a good patent protection position as well?

Tom Mika - Tegal Corporation - President, CEO

Tegal has a lot of patents, as a matter of fact and we continue to add patents. We also continue, by the way, to lose patents, in the sense that we're not pursuing some patent protection in some markets for patents that we don't think are of extreme value. It turns out that the cost of administering our patents and filing in countries all over the world is extremely expensive, so we have to focus on those things that we think are key patents. But yes, virtually all of our technology is protected by patents one way or another.

Glenn Mattson - GTK Capital Partners - Analyst

Tom, the last question I have is on the backlog. You said it was up to 10.3 as of today. Is that net of sales you've made so far in the quarter as well? In other words, you started at 8.9 and then you've had some sales in this quarter as well and do I assume that this 10.3 is after the current sales in this quarter?

Tom Mika - Tegal Corporation - President, CEO

No, since we haven't reported any sales in this quarter yet, it is not net of that number.

Glenn Mattson - GTK Capital Partners - Analyst

Okay, so it's 10.3 as of 9-30 as well?

Christine Hergenrother - Tegal Corporation - CFO

It was 8.9 million as of the end of September.

Tom Mika - Tegal Corporation - President, CEO

And then between September 30th and today we booked some additional business.

Glenn Mattson - GTK Capital Partners - Analyst

Well again, Tom, congratulations on a great quarter and it sounds like you're on the right track, especially with your unique technology and products.

Operator

Steve Sullivan with Horizon Financial Group.

Steve Sullivan - *Horizon Financial Group - Analyst*

Tom, congratulations. It's been a lot of work, I know. And first question, Tom, what's the headcount now and where was it say a year ago and where do you think it's going to go in the next six to nine months?

Tom Mika - *Tegal Corporation - President, CEO*

That's a good question. I think we reported last quarter that our headcount was as low as it has been in several years. Christine is reminding me that it's around 85. I think we added -- that would be about 4 up from what we reported last quarter. And I don't really see it increasing by very much at all. What I said last quarter was that I thought that there were a few engineering positions that we needed to fill and we have done so, but I don't see anything beyond that.

Steve Sullivan - *Horizon Financial Group - Analyst*

Going forward in the next couple of quarters, Tom, the gross margin, how sustainable do you think it is?

Tom Mika - *Tegal Corporation - President, CEO*

I think it's very sustainable. Two things help our gross margin. One is the product mix. I think the product mix has been pretty good. The other is the amount of absorption of overhead and when we get above about \$8 million per quarter, we're pretty much fully absorbed.

One of the challenges that we have on the gross margin side, is that we've gotten some opportunities to sell tools to university environments that are operating in areas that are of extreme interest to us. And if we're able to deliver tools that are at a reasonable price with a relatively low gross margin, we get the subsequent benefit of some collaboration on development activities in those university environments. We haven't traditionally done that as a company and we're attempting to do more of that.

We did so recently with a sale that we inherited from AMS to University of Pennsylvania for an AMS tool. We have some other opportunities that I have a great deal of interest in and I know my team does, so we have to figure out how to make those happen, even though they might involve some downward pressure on gross margins.

Steve Sullivan - *Horizon Financial Group - Analyst*

Two quick ones. The operating margin, can you give me a sense on the revenues go up 2 or 3 million, how much leverage is still in the operating margins relative to what we achieved last quarter? Year-over-year, I'm sorry Tom, not sequentially, but year-over-year, the quarter rundown.

Tom Mika - Tegal Corporation - President, CEO

Well, we had a substantial -- the problem is that we had a couple of things going on. If you look year-over-year, we have substantial reductions in our legal fees and OpEx. I think the way to look at this is that I think the high 30s to 40% gross margins are achievable and then what you're seeing in terms of our operating expenses are not really likely to change. They're likely to remain flat.

Steve Sullivan - Horizon Financial Group - Analyst

So in actual dollars, Tom?

Tom Mika - Tegal Corporation - President, CEO

In actual dollars, yes, that's correct. So since we're not increasing operating expenses by very much quarter to quarter, you can expect most of those sales increases or the gross margin to drop to the operating income line.

Steve Sullivan - Horizon Financial Group - Analyst

Last, then I'll let someone else get on. The \$300,000 in other expenses, can I get a little more clarification there? Was that more one-time than ongoing?

Christine Hergenrother - Tegal Corporation - CFO

You mean in other income?

Steve Sullivan - Horizon Financial Group - Analyst

Christine, I thought you mentioned in G&A there was a \$300,000--?

Christine Hergenrother - Tegal Corporation - CFO

Oh, in G&A, not other income. No, those are one-time for this quarter expenses.

Steve Sullivan - Horizon Financial Group - Analyst

Okay, what exactly was involved there again?

Christine Hergenrother - Tegal Corporation - CFO

One was a compensation study and the other was legal fees related to the arbitration that we just went through in September.

Steve Sullivan - Horizon Financial Group - Analyst

Okay. So that will go virtually -- I gather the study will go to zero, but the legal fees can linger on?

Tom Mika - Tegal Corporation - President, CEO

Assuming that there's any activity past the arbitration. That activity really ended as far as legal fees are concerned, on September 11th at about 5:00. Actually no, there was a small subsequent brief requested. But those have dropped substantially and it just depends on what we decide to do after we hear from the Bar Association in terms of what their ultimate decision is.

Steve Sullivan - Horizon Financial Group - Analyst

Well congratulations again.

Operator

(OPERATOR INSTRUCTIONS) Follow-up question from Glenn Mattson.

Glenn Mattson - GTK Capital Partners - Analyst

Tom, speaking of the arbitration, I guess what's the next step if this is nonbinding? And a follow-up question after that.

Tom Mika - Tegal Corporation - President, CEO

Well, the next step is that each side decides whether or not whatever we hear from the Bar Association is acceptable and if it's not -- you know, if it's not acceptable to the litigation attorneys, then they will continue their lawsuit and we'll see them in court. And if it's not acceptable to us, we will see them in court.

Glenn Mattson - *GTK Capital Partners - Analyst*

Right. You won't be booking that income until this is all settled then, I guess?

Tom Mika - *Tegal Corporation - President, CEO*

That's correct.

Glenn Mattson - *GTK Capital Partners - Analyst*

And lastly, on the balance sheet, inventories are up considerably. Can we expect that to level off here, pending the sale and completion and placement of new orders, new equipment?

Tom Mika - *Tegal Corporation - President, CEO*

Yes. We had a pretty big upsurge to cover the backlog that we had. Remember as of last quarter we had about a \$20 million backlog.

Glenn Mattson - *GTK Capital Partners - Analyst*

Right. Of which you shifted about 10, so I'm surprised inventory is still this high.

Tom Mika - *Tegal Corporation - President, CEO*

We've got that systems inventory and I think we're keeping -- remember, a good chunk of that inventory involves Compact and NLD tools that we hold in inventory because we expect to move those as beta systems.

Glenn Mattson - *GTK Capital Partners - Analyst*

Okay, good. So that's encouraging on the NLD side. So that inventory will basically stay the same or decline slightly then I guess?

Tom Mika - *Tegal Corporation - President, CEO*

Yes.

Glenn Mattson - *GTK Capital Partners - Analyst*

Okay, great. Again, congratulations and good luck.

Operator

Follow-up question from Steve Sullivan.

Steve Sullivan - *Horizon Financial Group - Analyst*

Two quick ones then I'll let you go. What is the total NOLs, roughly, now?

Tom Mika - *Tegal Corporation - President, CEO*

We're just conferring. 14 million.

Christine Hergenrother - *Tegal Corporation - CFO*

Somewhere between 14 and 16, cumulative.

Tom Mika - *Tegal Corporation - President, CEO*

But Steve, I'd like to caution you on the NOLs, you know, as you probably know, you only study whether you've got the NOLs when you actually think you're going to use them and you lose some based on certain equity events that occur. But even going back to our last equity event, which I think is what Christine is doing, we think we have plenty to cover any of the income that may come in as a result of the resolution of the lawsuit.

Steve Sullivan - *Horizon Financial Group - Analyst*

So basically that should fall to the bottom line?

Tom Mika - Tegal Corporation - President, CEO

Yes.

Operator

You have no other questions at this time.

Tom Mika - Tegal Corporation - President, CEO

Okay. Well, thank you very much, gentlemen, thanks for your attention. Ladies and gentlemen, this concludes today's conference call and I look forward to seeing you next quarter.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.

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