==

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004

OR

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

COMMISSION FILE NUMBER: 0-26824

TEGAL CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	68-0370244
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

2201 SOUTH MCDOWELL BLVD.
PETALUMA, CALIFORNIA 94954
(Address of Principal Executive Offices)

TELEPHONE NUMBER (707) 763-5600
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange List. Yes [ ] No [X]

As of November 8, 2004 there were 46,557,672 shares of our common stock outstanding.

==

TEGAL CORPORATION AND SUBSIDIARIES

INDEX

<TABLE>
<CAPTION>

</TABLE>

PART I -- FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

TEGAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(IN THOUSANDS)

ASSETS

<TABLE>
<CAPTION>

	SEPTEMBER 30, 2004	MARCH 31, 2004
Current assets:		
<S>	<C>	<C>
Cash and cash equivalents	$ 4,322	$ 7,049
Accounts receivable, net of allowances for sales returns and doubtful accounts of $296 and $270 at September 30, 2004 and March 31, 2004, respectively	5,162	4,729
Inventories	3,793	3,719
Prepaid expenses and other current assets	802	905
Total current assets	14,079	16,402
Property and equipment, net	3,824	4,039
Intangible assets, net	1,974	1,190
Other assets	743	1,027
Total assets	$ 20,620	$ 22,658
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and bank lines of credit	$ 941	$ 2,450
2% Convertible debentures, net	--	74
Accounts payable	2,673	1,645
Accrued product warranty	251	366
Deferred revenue	306	440
Accrued expenses and other current liabilities	3,252	2,604
Total current liabilities	7,423	7,579
Long-term portion of capital lease obligations	20	26
Other long term obligations	95	98
Total long term liabilities	115	124
Total liabilities	7,538	7,703

Commitments and contingencies (Note 6)		
Stockholders' equity:		
Preferred stock; $0.01 par value; 5,000,000 shares authorized; none issued and outstanding	--	--
Common stock; $0.01 par value; 100,000,000 shares authorized; 46,557,672 and 36,583,850 shares issued and outstanding at September 30, 2004 and March 31, 2004, respectively	466	366
Additional paid-in capital	92,144	85,376
Accumulated other comprehensive income	209	124
Accumulated deficit	(79,737)	(70,911)
Total stockholders' equity	13,082	14,955
Total liabilities and stockholders' equity	$ 20,620	$ 22,658

</TABLE>

See accompanying notes.

TEGAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE DATA)

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		SIX MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
<S>	<C>	<C>	<C>	<C>
Revenue:				
Product	$ 4,809	$ 2,882	$ 7,843	$ 6,424
Services	179	328	586	671
Total revenue	4,988	3,210	8,429	7,095
Cost of sales:				
Cost of product	2,565	1,794	4,742	4,286
Cost of services	522	424	986	780
Total cost of sales	3,087	2,218	5,728	5,066
Gross profit (loss)	1,901	992	2,701	2,029
Operating expenses:				
Research and development	1,539	836	2,665	1,539
Sales and marketing	876	556	1,526	1,168
General and administrative	1,992	916	3,593	1,952
In Process Research and Development	--	--	1,653	--
Total operating expenses	4,407	2,308	9,437	4,659
Operating loss	(2,506)	(1,316)	(6,736)	(2,630)
Other income (expense), net	5	(354)	(2,090)	(293)
Net loss	$ (2,501)	$ (1,670)	$ (8,826)	$ (2,923)
Net loss per share, basic and diluted	$ (0.05)	$ (0.10)	$ (0.20)	$ (0.18)
Shares used in per share computations:				
Basic	45,804	16,342	43,808	16,215
Diluted	45,804	16,342	43,808	16,215

</TABLE>

See accompanying notes.

TEGAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(IN THOUSANDS)

<TABLE>
<CAPTION>

	SIX MONTHS ENDED SEPTEMBER 30, 2004	2003
Cash flows from operating activities:		
<S>	<C>	<C>
Net loss	$ (8,826)	$ (2,923)
Adjustments to reconcile net loss to cash provided by (used) in operating activities:		
Depreciation and amortization	712	665
Allowance for doubtful accounts and sales return allowances	26	74
Fair value of warrants issued for services rendered	174	159
Non-cash amortization of beneficial conversion feature and debt issuance costs	2,019	292
In-process research and development	1,653	--
Changes in operating assets and liabilities:		
Receivables	(487)	(77)
Inventories	(44)	858
Prepaid expenses and other assets	(121)	(390)
Accounts payable	1,057	935
Accrued expenses and other liabilities	318	(236)
Accrued warranty	(80)	(348)
Customer deposits	--	1,120
Deferred revenue	(133)	91
Net cash provided by (used in) operating activities	(3,732)	220
Cash flows used in investing activities -- purchases of property and equipment	(234)	(17)
Cash flows from financing activities:		
Gross proceeds from the issuance of convertible debentures	--	7,165
Convertible debentures issuance costs	--	(982)
Net proceeds from issuance of common stock	2,779	9
Borrowings under lines of credit	874	177
Repayment of borrowings under lines of credit	(2,383)	(397)
Payments on capital lease financing	(5)	(5)
Net cash provided by financing activities	1,265	5,967
Effect of exchange rates on cash and cash equivalents	(26)	38
Net increase (decrease) in cash and cash equivalents	(2,727)	6,208
Cash and cash equivalents at beginning of period	7,049	912
Cash and cash equivalents at end of period	$ 4,322	$ 7,120

</TABLE>

SUPPLEMENTAL SCHEDULE OF NON CASH INVESTING ACTIVITIES (IN THOUSANDS):

On May 28, 2004, Tegal purchased substantially all of the assets and assumed certain liabilities of First Derivative Systems, Inc. ("FDSI") a development stage company for 1,410,632 shares of common stock, $150 in debt forgiveness, approximately $50 in assumed liabilities, and $158 in acquisition costs, pursuant to a purchase agreement dated April 28, 2004. The purchase price was allocated as follows:

Fair value fixed assets acquired	$ 111
Non compete agreements	203
Patents	733

In-process research and development	1653
Debt forgiveness	(150)
Assumed liabilities	(50)

	$ 2,500
	==========

See accompanying notes.

TEGAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA)

1. BASIS OF PRESENTATION:

In the opinion of management, the unaudited condensed consolidated interim financial statements have been prepared on the same basis as the March 31, 2004 audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the information set forth herein. The statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (the "SEC"), but omit certain information and footnote disclosures necessary to present the statements in accordance with generally accepted accounting principles. These interim financial statements should be read in conjunction with the consolidated financial statements and footnotes included in the Annual Report on Form 10-K of Tegal Corporation (the "Company") for the fiscal year ended March 31, 2004. The results of operations for the three months and six months ended September 30, 2004 are not necessarily indicative of results to be expected for the entire year.

The consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred net losses of $8,826 and $2,923 for the six months ended September 30, 2004 and 2003, respectively. The company generated negative cash flows from operations of $3,732 for the period ended September 30, 2004 and positive cash flows from operations of $220 for the period ended September 30, 2003. Our past performance raised substantial doubt as to our ability to continue as a going concern, and our former independent registered public accounting firm included a going concern uncertainty explanatory paragraph in their report dated June 25, 2004, which is included in our Form 10-K for the year ended March 31, 2004. Management believes that proceeds from the debenture financing in fiscal year 2004, and additional funds which may be available to the Company through the issuance of stock under the structured secondary financing with Kingsbridge Capital, Ltd., (including the $2,600 already raised through this facility) will be adequate to fund operations through fiscal year 2005, including the continued development of recently acquired products. However, projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, the Company will need to reduce expenses further and raise additional capital through the issuance of debt or equity securities. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of common stock, and debt covenants could impose restrictions on the Company's operations. The sale of equity or debt could result in additional dilution to current stockholders, and such financing may not be available to the Company on acceptable terms, if at all. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amount or classification of liabilities or any other adjustments that might be necessary should the Company be unable to continue as a going concern.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of temporary cash investments and accounts receivable. Substantially all of the Company's temporary investments are invested in highly liquid money market funds. The Company's accounts receivables are derived primarily from sales to customers located in the U.S., Europe, and Asia. The Company performs ongoing credit evaluations of its customers and generally requires no collateral. The Company maintains reserves for potential credit losses. Write-offs during the periods presented have been insignificant. As of September 30, 2004 and September 30, 2003 one customer accounted for approximately 54% and one customer accounted for approximately 45 %, respectively, of the accounts receivable balance.

During the three months ended September 30, 2004 and 2003, one customer accounted for 52% and one customer accounted for 35% of total revenues, respectively. During the six months ended September 30, 2004 and September 30, 2003, one customer accounted for 30% and, two customers accounted for 42% of total revenues, respectively.

STOCK BASED COMPENSATION

The Company accounts for stock-based employee compensation under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB No. 25) and related interpretations. Under APB No. 25, compensation cost is equal to the difference, if any, on the date of grant between the fair value of the Company's stock and the amount an employee must pay to acquire the stock. SFAS No. 123, Accounting for Stock-based Compensation, established accounting and disclosure requirements using a fair value based method of accounting for stock-based employee compensation plans. As allowed

by SFAS No. 123, the Company has elected to continue to apply the intrinsic value based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123 and related SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure.

The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation (in thousands, except per share data):

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		SIX MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
<S>	<C>	<C>	<C>	<C>
Net loss as reported	$ (2,501)	$ (1,670)	$ (8,826)	$ (2,923)
Add: Stock-based employee compensation expense included in Reported net loss	--	--	--	--
Deduct: Total stock-based employee compensation expense Determined under fair value method for all awards	(282)	(34)	(640)	(71)
Proforma net loss	$ (2,783)	$ (1,704)	$ (9,466)	$ (2,994)
Basic net loss per share:				
As reported	$ (0.06)	$ (0.10)	$ (0.22)	$ (.18)
Proforma	$ (0.06)	$ (0.10)	$ (0.22)	$ (.18)

</TABLE>

The disclosure provisions of SFAS No. 123 and SFAS No. 148 require judgments by management as to the estimated lives of the outstanding options. Management has based the estimated life of the options on historical option exercise patterns. If the estimated life of the options increases, the valuation of the options will increase as well.

ACCOUNTS RECEIVABLE - ALLOWANCE FOR SALES RETURNS AND DOUBTFUL ACCOUNTS

We maintain an allowance for doubtful accounts receivable for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, or even a single customer was otherwise unable to make payments, additional allowances may be required. Given the average selling prices of our systems, a single customer default could have a material adverse effect on our consolidated financial position, results of operations, and cash flows. In addition we maintain an allowance for product returns.

ACCOUNTING FOR FREIGHT CHARGED TO CUSTOMERS

Spares and systems are typically shipped "freight collect" therefore no shipping revenue or cost is associated with the sale. When freight is charged, it is booked to revenue and offset for the cost of that freight in the COGS accounts pursuant to EITF 00:10

2. INVENTORIES:

Inventories consisted of:

	SEPTEMBER 30, 2004	MARCH 31, 2004
Raw materials	$ 1,387	$ 1,563
Work in progress	1,240	1,147
Finished goods and spares	1,166	1,009
	$ 3,793	$ 3,719

3. PRODUCT WARRANTY:

The Company provides warranty on all system sales based on the estimated cost of product warranties at the time revenue is recognized. The warranty obligation is affected by product failure rates, material usage rates, and the efficiency by which the product failure is corrected. Should actual product failure rates, material usage rates and labor efficiencies differ from estimates, revisions to the estimated warranty liability may be required.

Warranty activity for the three-month and six-month periods ended September 30, 2004 and 2003 was:

<TABLE>
<CAPTION>

	WARRANTY ACTIVITY FOR THE THREE MONTHS ENDED SEPTEMBER 30,		WARRANTY ACTIVITY FOR THE SIX MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
<S>	<C>	<C>	<C>	<C>
Balance at the beginning of the period	$ 312	$ 751	$ 366	$ 734
Additional warranty accruals for warranties issued during the period	97	25	230	145
Accruals related to pre-existing warranties	--	(227)	--	(227)
Settlements made during the period	(158)	(163)	(345)	(266)
Balance at the end of the period	$ 251	$ 386	$ 251	$ 386

</TABLE>

Certain of the Company's sales contracts include provisions under which customers would be indemnified by the Company in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to the Company's products. There are no limitations on the maximum potential future payments under these guarantees. The Company has accrued no amounts in relation to these provisions as no such claims have been made and the Company believes it has valid, enforceable rights to the intellectual property embedded in its products.

4. NET LOSS PER COMMON SHARE:

Basic earnings per share ("EPS") is calculated by dividing net income (loss) for the period by the weighted average common shares outstanding for that period. Diluted EPS takes into account the number of additional common shares that would have been outstanding if the dilutive potential common shares ("common stock equivalents") had been issued.

Common stock equivalents for the three months ended September 30, 2004 and September 30, 2003, and the six months ended September 30, 2004 and September 30, 2003 were 6,677,260 and 7,942,352 and 8,042,487 and 3,921,964, respectively, and have been excluded from shares used in calculating diluted loss per share because their effect would be antidilutive.

5. STOCK-BASED COMPENSATION:

ISSUANCE OF COMMON STOCK TO KINGSBRIDGE CAPITAL LIMITED

On February 11, 2004, the Company signed a $25 million equity facility with Kingsbridge Capital Limited ("Kingsbridge"). The arrangement will allow the Company to sell shares of common stock to Kingsbridge at the Company's sole discretion over a 24-month period on a "when and if needed" basis. Kingsbridge is required under the terms of the arrangement to purchase stock following the effectiveness of a registration statement. The price of the common shares issued under the agreement is based on a discount to the volume-weighted average market price during a specified drawdown period. The Company has no obligation to draw down all or any portion of the commitment. The maximum amount of shares that may be issued to Kingsbridge under the equity facility is 8,851,661. In connection with the agreement, on February 11, 2004, the Company issued fully vested warrants to Kingsbridge to purchase 300,000 shares of common stock at an exercise price of $4.11 per share. The Company intends to use any proceeds from such sale to Kingsbridge to finance acquisitions, including any product development activity related to such acquisitions. This transaction was effected in reliance on Regulation D under the Securities Act.

During the three months ended September 30, 2004, the Company issued to Kingsbridge Capital, Ltd. a total of 2,372,689 shares of its common stock in connection with the Amended and Restated Common Stock Purchase Agreement dated as of May 19, 2004. Gross proceeds from the sale of stock were $2,600. On September 21, 2004, in addition to $156 in cash payments, the Company issued warrants to purchase 23,727 shares of common stock at $1.45 to advisors, in connection with the sale of stock to Kingsbridge which were charged against equity as stock issuance costs. Pursuant to our agreement, broker fees of 6% in cash and 1% of stock in the form of warrants will be paid upon each future drawdown of the facility. Additionally, warrants issued at the time of the agreement have been held in current assets. These warrants will be amortized on a prorated basis at the time of the drawdown and also charged against equity as stock issuance costs.

ISSUANCE OF WARRANTS TO CONSULTANTS

As reported in our Quarterly Report on Form 10-Q dated June 30, 2004, on August 4, 2004, the Company agreed to issue warrants equally over a two-year period to purchase a total 240,000 shares of common stock at $1.08 per share to consultants for services to be rendered over a period of two years. These warrants are vested at the time of issuance. If the agreement with the consultant is terminated for any reason, the unissued warrants are forfeited. During the quarter ended September 30, 2004, the 74,999 warrants were vested and accounted for as an operating expense of $59.

6. LINES OF CREDIT:

On January 19, 2004, the Company entered into a line of credit facility with Silicon Valley Bank that will be available until January 19, 2005. The line of credit has a maximum borrowing capacity of $3,500, bears interest at prime plus 1.0% (5% as of September 30, 2004), is collateralized by substantially all of the Company's domestic and Japanese assets, and is further limited by the amounts of accounts receivable and inventories on the Company's consolidated balance sheets. As of September 30, 2004, the Company had no amounts outstanding under this domestic line of credit.

In addition, as of September 30, 2004, the Company's Japanese subsidiary had $847 outstanding under its line of credit, which is collateralized by Japanese customer promissory notes held by the Japanese subsidiary in advance of payment on customers' accounts receivable. The Japanese line of credit bears interest at Japanese prime (1.375% as of September 30, 2004) plus 1.0%, and has a total capacity of 150 million yen (approximately $1,353 at exchange rates prevailing on September 30, 2004).

In addition, notes payable as of September 30, 2004 consisted of one outstanding note to the California Trade and Commerce Agency for $94. The unsecured note from the California Trade and Commerce Agency carries an annual interest rate of 5.75% with payments of approximately $4 per month. Although the payment deadlines are being met, the note is currently in technical default due to the merger of Sputtered Films and Tegal Corporation. The default could result in the California Trade and Commerce Agency calling the note; therefore, this note payable is classified as a current liability.

7. COMPREHENSIVE INCOME (LOSS):

The components of comprehensive loss for the three and six-month periods ended September 30, 2004 and 2003 are as follows:

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		SIX MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
<S>	<C>	<C>	<C>	<C>
Net loss	$ (2,501)	$ (1,670)	$ (8,826)	$ (2,923)
Foreign currency translation adjustment	61	(63)	85	(100)
	$ (2,440)	$ (1,733)	$ (8,741)	$ (3,023)

</TABLE>

8. ACQUISITION:

On May 28, 2004, Tegal purchased substantially all of the assets and assumed certain liabilities of First Derivative Systems, Inc. ("FDSI") a development stage company for 1,410,632 shares of common stock valued at $2,342, $150 in debt forgiveness, approximately $50 in assumed liabilities, and $158 in acquisition costs, pursuant to a purchase agreement dated April 28, 2004. All of the shares of common stock are subject to a registration rights agreement in which the Company has agreed to register the shares with the Securities and Exchange Commission for resale. In addition, the Company entered into employment agreements with key FDSI personnel. FDSI, a privately held development stage company based in Goleta, CA, was founded in 1999 as a spin-off of Sputtered Films, Inc., which itself was acquired by Tegal in August 2002. FDSI had developed a high-throughput, low cost-of-ownership physical vapor deposition ("PVD") system with highly differentiated technology for leading edge memory and logic device production on 200 and 300 millimeter wafers. This transaction was accounted for as a purchase of assets in accordance with EITF Issue No. 98-3, "Determining whether a nonmonetary transaction involves receipt of productive assets or of a business".

The following table represents the allocation of the purchase price for FDSI. In estimating the fair value of assets acquired and liabilities assumed management considered various factors, including an independent appraisal.

Fair value fixed assets acquired	$ 111
Non compete agreements	203
Patents	733
In-process research and development	1653
Debt forgiveness	(150)
Assumed liabilities	(50)
	$ 2,500

The assets will be amortized over a period of years shown on the following table:

Fixed assets acquired .... 3 to 5 years
Non compete agreements .... 3 years
Patents .... 15 years

The fair value underlying the $1,653 assigned to acquired in-process research and development ("IPR&D") in the FDSI acquisition was charged to the Company's results of operations during the quarter ended June 30, 2004, and was determined by identifying research projects in areas for which technological feasibility had not been established and there was no alternative future use. Projects in the IPR&D category are primarily certain design change improvements, software integration and hardware modifications, which are estimated to cost approximately $1 - $2 million, are approximately 50% complete, and will be completed by December 31, 2005.

The IPR&D value of $1,653 was determined by an income approach where fair value is the present value of projected free cash flows that will be generated by the products incorporating the acquired technologies under development, assuming they are successfully completed. The estimated net free cash flows generated by the products over a seven-year period were discounted at a rate of 32% in relation to the stage of completion and the technical risks associated with achieving technological feasibility. The net cash flows for such projects were based on management's estimates of revenue, expenses and asset requirements. Any delays or failures in the completion of these projects could impact expected return on investment and future results of operations. In addition, the Company's operating results would be adversely affected if the value of other intangible assets acquired became impaired.

All of these projects have completion risks related to functionality, architecture, performance, process technology, continued availability of key technical personnel, product reliability and software integration. To the extent that estimated completion dates are not met, the risk of competitors' product introductions is greater and revenue opportunity may be permanently lost.

9. CONVERTIBLE DEBENTURE FINANCING:

On June 30, 2003, the Company signed definitive agreements with investors to raise up to $7,165 in a private placement of convertible debt financing to be completed in two tranches. The first tranche, which closed on June 30, 2003, involved the sale of debentures in the principal amount of $929. The Company received $424 in cash on June 30, 2003 and the remaining balance of $505 on July 1, 2003, which was recorded as an other receivable as of June 30, 2003. The closing of the second tranche, which occurred on September 9, 2003 following shareholder approval on September 8, 2003, resulted in the receipt of approximately $6,236 in gross proceeds on September 10, 2003.

The Company was required to pay a cash fee of up to 6.65% of the gross proceeds of the debentures to certain financial advisors upon the closing of the second tranche. A fee of $448 was recorded as a debt issuance cost and was paid in September 2003. The financial advisors also were granted warrants to purchase 1,756,127 shares of the Company's common stock at an exercise price of $0.35 per share. These warrants were valued at $1,387 using the Black-Scholes option pricing model with the following variables: stock fair value of $0.93, term of five years, volatility of 95% and risk-free interest rate of 2.5%. During fiscal year ended March 31, 2004, the financial advisors exercised warrants for 1,536,605 shares (plus 23,393 warrants remitted as payments for stock under a cash-less exercise provision of the warrant agreement), leaving advisor warrants for 196,129 shares unexercised at the end of the fiscal year. From April 1, 2004 through September 30, 2004, no additional advisor warrants had been exercised and there remained 196,129 shares unexercised.

The debentures accrued interest at the rate of 2% per annum. Both the principal and accrued interest thereon of these debentures were convertible at the rate of $0.35 per share. The principal of the debentures converted into 20,471,428 shares of the Company's common stock. The closing prices of the Company's common stock on June 30, 2003 and September 9, 2003, the closing dates for the first and second tranches, were $0.55 and $1.49. Therefore, a beneficial conversion feature existed which was accounted for under the provisions of EITF 00-27, Application of Issue 98-5 to Certain Convertible Instruments. A beneficial feature also existed in connection with the conversion of the interest on the debentures into shares of common stock.

As of June 30, 2004, debenture holders had converted all the debentures in the principal amount of $7,165 into 20,471,428 shares of the Company's common stock. Of the 3,542,436 shares that were registered for payment of interest in-kind, 135,068 shares had been issued for such interest payments, and the interest obligation to the debenture holders had been satisfied in full.

In addition, the debenture holders were granted warrants to purchase 4,094,209 shares of the Company's common stock at an exercise price of $0.50. The warrants expire after eight years. The warrants were valued using the Black-Scholes model with the following variables: fair value of common stock of $0.35 for the first tranche debentures and $0.93 for the second tranche debentures, volatility of 37% and risk-free interest rate of 2.5%. The debenture holders had exercised warrants to purchase 2,239,832 shares (plus 168,695 warrants remitted as payments for stock under a cash-less exercise provision of the warrant agreement) of the Company's common stock. As of September 30, 2004, there remained unexercised warrants held by the debenture holders for 1,685,682 of the Company's common stock.

The relative fair value of the warrants has been classified as equity with the beneficial conversion feature because it meets all the equity classification criteria of EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.

The value of the beneficial conversion feature, warrants and debt issuance costs were amortized as interest expense over the life of the debt using the effective interest method. Related interest expense for the quarter ended June 30, 2004 amounted to $2,019. This amount is comprised of nominal interest, amortization of beneficial conversion feature and amortization of debt issuance costs.

The debt issuance costs associated with the debentures amounted to $2,369 and are comprised of $982 in cash issuance costs and $1,387 associated with warrants issued to financial advisors. Approximately $603 of these costs were allocable to the warrants and were therefore charged to equity. The remaining balance of $1,766 was recorded as an asset and was amortized over the life of the debt. As of June 30, 2004, the debentures had been fully converted, therefore these costs have been fully expensed.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information herein contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, which can be identified by the use of forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," or "continue" or the negative thereof or other variations thereon or comparable terminology or which constitute projected financial information. The forward-looking statements relate to the near-term semiconductor capital equipment industry outlook, demand for our products, our quarterly revenue and earnings prospects for the near-term future and other matters contained herein. Such statements are based on current expectations and beliefs and involve a number of uncertainties and risks that could cause the actual results to differ materially from those projected. Such uncertainties and risks include, but are not limited to, the cyclicality of the semiconductor industry, impediments to customer acceptance, fluctuations in quarterly operating results, competitive pricing pressures, the introduction of competitor products having technological and/or pricing advantages, product volume and mix and other risks detailed from time to time in our SEC reports. For further information, refer to the business description and risk factors sections included in our Form 10-K for the year ended March 31, 2004 and the risk factors section included in this Form 10-Q (Part II, Item 5) as filed with the SEC.

The following summarizes our contractual obligations at September 30, 2004, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands) excluding 2% convertible debentures which were fully redeemed June 15, 2004:

<TABLE>
<CAPTION>

Contractual obligations:	LESS THAN	AFTER

	TOTAL	1 YEAR	1-3 YEARS	3-5 YEARS	5 YEARS
<S>	<C>	<C>	<C>	<C>	<C>
Non-cancelable capital lease obligations .	$ 32	$ 12	$ 19	$ 1	$ --
Non-cancelable operating lease obligations	5,659	1,283	2,131	1,866	379
Notes payable and bank lines of credit ...	941	941	--	--	--
Total contractual cash obligations	$ 6,632	$ 2,236	$ 2,150	$ 1,867	$ 379

</TABLE>

Certain sales contracts of the Company include provisions under which customers would be indemnified by the Company in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to the Company's products. There are no limitations on the maximum potential future payments under these guarantees. The Company has accrued no amounts in relation to these provisions as no such claims have been made and the Company believes it has valid, enforceable rights to the intellectual property embedded in its products.

RESULTS OF OPERATIONS

Tegal designs, manufactures, markets and services plasma etch and deposition systems that enable the production of integrated circuits ("ICs"), memory and related microelectronics devices used in personal computers, wireless voice and data telecommunications, contact-less transaction devices, radio frequency identification devices ("RFID's"), smart cards, data storage and micro-level actuators. Etching and deposition constitute two of the principal IC and related device production process steps and each must be performed numerous times in the production of such devices.

The following table sets forth certain financial items as a percentage of revenue for the three and six-month periods ended September 30, 2004 and 2003:

<TABLE>
<CAPTION>

	THREE MONTHS ENDED SEPTEMBER 30,		SIX MONTHS ENDED SEPTEMBER 30,	
	2004	2003	2004	2003
<S>	<C>	<C>	<C>	<C>
Revenue:				
Product revenue	96.4%	89.8%	93.0%	90.5%
Services revenue	3.6	10.2	7.0	9.5
Total revenue	100.0	100.0	100.0	100.0
Cost of sales:				
Cost of product	51.4	55.9	56.3	60.4
Cost of services	10.5	13.2	11.7	11.0
Total cost of sales	61.9	69.1	68.0	71.4
Gross profit (loss)	38.1	30.9	32.0	28.6
Operating expenses:				
Research and development	30.9	26.0	31.6	21.7
Sales and marketing	17.6	17.3	18.1	16.5
General and administrative	39.8	28.6	42.6	27.5
In-process research and development	--	--	19.6	--
Total operating expenses	88.3	71.9	111.9	65.7
Operating loss	(50.2)	(41.0)	(79.9)	(37.1)
Other expense, net	.1	(11.0)	(24.8)	(4.1)
Net loss	(50.1)	(52.0)	(104.7)	(41.2)

</TABLE>

Product revenue. Product revenue for the three and six months ended September 30, 2004 was $4,809 and $7,843, respectively, an increase of $1,927 and $1,419, respectively, over the comparable periods in 2003. The increase for the three and six months ended September 30, 2004 was principally due to the sale of an Endeavor series system compared to the sale of a 6500 series system upgrade in the same period of the previous year.

Services revenue. Revenue from service sales for the three and six-month periods ended September 30, 2004 was $179 and $586, respectively, down from $328 and $671 for the three and six-month periods ended September 30, 2003, due to the change of service revenue mix from contract revenues to billable service which fluctuates according to customer demand.

International sales as a percentage of the Company's revenue for the three and six months ended September 30, 2004 were approximately 88.8% and 79.3%, respectively. International sales as a percentage of the Company's revenue for the three and six months ended September 30, 2003 were approximately 81.3% and 81.8%, respectively. We believe that international sales will continue to represent a significant portion of our revenue.

Gross profit. Gross profit as a percentage of revenue was 38.1% and 30.9% for the three months ended September 30, 2004 and 2003, respectively, and 32.0% and 28.6% for the six months ended September 30, 2004 and 2003, respectively. The increase in gross profit for the three and six months ended September 30, 2004 compared to the same periods in the prior year was principally attributable to reduced fixed costs in the current year as a result of the cost cutting measures taken in the prior year spread over a higher revenue base, and the sale of previously reserved inventory, resulting in lower material costs of $277.

Research and development. Research and development expenses consist primarily of salaries, prototype material and other costs associated with our ongoing systems and process technology development, applications and field process support efforts. Research and development expenses were $1,539 and $836 for the three months ended September 30, 2004 and 2003, respectively, and $2,665 and $1,539 for the six months ended September 30, 2004 and 2003, respectively, representing 30.9% and 26.0% of revenue for the three months and 31.6% and 21.7% of revenue for the six months ended September 30, 2004 and 2003, respectively. The increase in research and development spending resulted from new product development efforts related to the Company's recent acquisitions.

Sales and marketing. Sales and marketing expenses consist primarily of salaries, commissions, trade show promotion and travel and living expenses associated with those functions. Sales and marketing expenses were $876 and $556 for the three months ended September 30, 2004 and 2003, respectively, and $1,526 and $1,168 for the six months ended September 30, 2004 and 2003, respectively, representing 17.6% and 17.3% of revenue for the three months ended September 30, 2003 and 2002, respectively, and

18.1% and 16.5% of revenue for the six months ended September 30, 2004 and 2003, respectively. The increase in sales and marketing spending was primarily due to additional sales personnel and commissions on system sales.

General and administrative. General and administrative expenses consist primarily of compensation for general management, accounting and finance, human resources, information systems and investor relations functions and for legal, consulting and accounting fees of the Company. General and administrative expenses were $1,992 and $916 for the three months ended September 30, 2004 and 2003, respectively, and $3,593 and $1,952 for the six months ended September 30, 2003 and 2002, respectively, representing 39.8% and 28.6% of revenue for the three months ended September 30, 2003 and 2002, respectively, and 42.6% and 27.5% of revenue for the six months ended September 30, 2003 and 2002, respectively. The increase in spending was primarily due to legal fees associated with the defense of patents, which increased from the prior period by $550. Additionally payments to outside consultants increased by $300 primarily to assist in the integration of the acquired companies. There have also been additional incremental increases in costs related to the integration of the two businesses we acquired in the past twelve months. These costs result from additional facility costs such as rent, utilities, supplies, and insurance, and costs associated with additional employees.

Other income (expense), net. Other expense, net consists principally of, interest income, interest expense and gains and losses on foreign exchange. We recorded net non-operating income of $5 and a net non-operating expense of $354 during the three months ended September 30, 2004 and 2003, respectively. Net non-operating expense was $2,090 during the six-month period ended September 30, 2004 as compared to $293 during the same period in the previous year. The increase of non-operating expense during the six months ended September 30, 2004 was primarily attributable to the accretion of the debt discount and the amortization of the debt issuance costs related to the debenture financing during the quarter ended June 30, 2004. These debentures were fully converted to equity prior to June 30, 2004 (see Note 9).

LIQUIDITY AND CAPITAL RESOURCES

For the six-month periods ended September 30, 2004 and 2003, we financed our operations through the use of outstanding cash balances, the drawdown of the Kingsbridge facility, and borrowings against our credit facilities in Japan, as well as our domestic line of credit.

Net cash used in operations was $3,732 during the six months ended September 30, 2004, due principally to a net loss of $8,826 offset by non cash expense from depreciation and amortization, warrants issued for services rendered, and non cash interest expense, and a non cash charge for acquired IPR&D related to the FDSI acquisition. Additionally, the net loss is offset by a net decrease in inventory and accounts receivable and an increase in accounts payable and accrued liabilities, offset by a decrease of deferred revenue.

Capital expenditures were $234 for the six months ended September 30, 2004.

Net cash provided by financing activities totaled $1,265 for the six months ended September 30, 2004 and was primarily related to the issuance of stock to Kingsbridge Capital offset by the repayment of the domestic line of credit and the partial repayment of the Japanese borrowing.

On January 19, 2004, the Company entered into a line of credit facility with Silicon Valley Bank that will be available until January 19, 2005. The line of credit has a maximum borrowing capacity of $3,500, bears interest at prime plus 1.0% (5% as of September 30, 2004), is collateralized by substantially all of the Company's domestic and Japanese assets, and is further limited by the amounts of accounts receivable and inventories on the Company's consolidated balance sheets. As of September 30, 2004, the Company had no amounts outstanding under this domestic line of credit.

In addition, as of September 30, 2004, the Company's Japanese subsidiary had $847 outstanding under its line of credit, which is collateralized by Japanese customer promissory notes held by the Japanese subsidiary in advance of payment on customers' accounts receivable. The Japanese line of credit bears interest at Japanese prime (1.375% as of September 30, 2004) plus 1.0%, and has a total capacity of 150 million yen (approximately $1,353 at exchange rates prevailing on September 30, 2004).

In addition, notes payable as of September 30, 2004 consisted of one outstanding note to the California Trade and Commerce Agency for $94. The unsecured note from the California Trade and Commerce Agency carries an annual interest rate of 5.75% with monthly payments of approximately $4 per month. Although the payment deadlines are being met, the note is currently in technical

default due to the merger of Sputtered Films and Tegal Corporation. The default could result in the California Trade and Commerce Agency calling the note; therefore, this note payable is classified as a current liability.

The consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred net losses of $8,826 and $2,923 for the six months ended September 30, 2004 and 2003, respectively. The company generated negative cash flows from operations of $3,732 for the period ended September 30, 2004 and positive cash flows from operations of $220 for the period ended September 30, 2003. Our past performance raised substantial doubt as to our ability to continue as a going concern, and our former independent registered public accounting firm included a going concern uncertainty explanatory paragraph in their report dated June 25, 2004, which is included in our Form 10-K for the year ended March 31, 2004. Management believes that proceeds from the debenture financing in fiscal year 2004 and additional funds which may be available to the Company through the issuance of stock under the structured secondary financing with Kingsbridge Capital, Ltd. (including the $2,600 already raised through this facility), will be adequate to fund operations through fiscal year 2005, including the continued development of recently acquired products. However, projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, the Company will need to reduce expenses further and raise additional capital through the issuance of debt or equity securities. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of common stock, and debt covenants could impose restrictions on the Company's operations. The sale of equity or debt could result in additional dilution to current stockholders, and such financing may not be available to the Company on acceptable terms, if at all. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amount or classification of liabilities or any other adjustments that might be necessary should the Company be unable to continue as a going concern.

For more information on our capital resources, see "Risk Factors" in Part II, Item 5.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our cash equivalents are principally comprised of money market accounts. As of September 30, 2004, we had cash and cash equivalents of $4,322. These accounts are subject to interest rate risk and may fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in short-term securities having a maturity of three months or less. Due to the nature of our cash and cash equivalents, we have concluded that there is no material market risk exposure.

We have foreign subsidiaries that operate and sell our products in various global markets. As a result, our cash flow and earnings are exposed to fluctuations in interest and foreign currency exchange rates. We attempt to limit these exposures through the use of various hedge instruments, primarily forward exchange contracts and currency option contracts (with maturities of less than three months) to manage our exposure associated with firm commitments and net asset and liability positions denominated in non-functional currencies. There have been no material changes regarding market risk since the disclosures made in our Form 10-K for the fiscal year ended March 31, 2004.

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and, in reaching reasonable level of assurance management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

During the quarter ended December 31, 2003, a reportable condition arose solely as a result of the accounting for interest expense related to the 2% convertible debentures in the three-month period ending December 31, 2003. Management review of the accounting for the offering of debentures during that period, which included preparation of journal entries by Tegal's Corporate Controller, review of the entries by our Chief Financial Officer, review by our independent auditors and review by our Audit Committee was not sufficient to discover the error. We believe that the error resulted from both a lack of familiarity among all parties in the review process with the proper accounting for such convertible debentures, as well as some ambiguities in the accounting literature on this subject.

15

The error in accounting for interest expense for the converted portion of the debentures was discovered during the preparation of the audited financial statements for the year, which took place in April of 2004. The error was brought to Management's attention by our independent auditors, following review by their national office. Financial statements were prepared and reported on Form 10-K on June 15, 2004, fully incorporating the correctly stated interest expense. In addition, revised and restated financial statements for the period ending December 31, 2003 were filed on Form 10-Q/A.

As of September 30, 2004, as required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level.

Other than that which has been disclosed above, there has been no change in the Company's internal controls over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

16

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Sputtered Films, Inc. v. Advanced Modular Sputtering, et al., filed in Santa Barbara County Superior Court.

On December 22, 2003, the Company filed an action against two former employees, Sergey Mishin and Rose Stuart-Curran, and a company they formed after leaving the Company, Advanced Modular Sputtering, Inc., alleging misappropriation of trade secrets, violation of signed employee Secrecy Agreements, unfair business practices and other claims arising out of AMS's apparent possession and use of the Company's drawings and specifications for the Company's Endeavor Sputtering Machine and the Series IV S-Gun. The Company believes that the sputtering tools marketed by AMS results from unauthorized use of the Company's drawings, specifications and other trade secret technology.

The parties have stipulated to an appropriate protective order, and are now in the discovery phase. No trial date has been set, but it is anticipated that the trial will occur in late 2005. In accordance with the ABA Statement of Policy, we are not able to state that the likelihood of an unfavorable outcome in this matter is either "probable" or "remote" as those terms are defined in the ABA Statement of Policy. Nor can we estimate in dollar terms the potential amount of loss or range of loss in the event of an unfavorable outcome, since the probability of inaccuracy of any such estimate is not "slight" as that term is used in the ABA Statement of Policy.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On February 11, 2004, the Company signed a Common Stock Purchase Agreement with Kingsbridge Capital Limited ("Kingsbridge"), which was subsequently amended and restated on May 19, 2004. The agreement permits the Company to sell shares of common stock to Kingsbridge at the Company's sole discretion over a 24-month period on a "when and if needed" basis, to a maximum value of $25 million. Kingsbridge is required under the terms of the agreement to purchase stock from the Company upon its request at any time following July 9, 2004, which is the date that the registration statement became effective. The price of the common shares issued under the agreement is based on a discount to the volume-weighted average market price during a specified drawdown period, but in no case may be lower than $1.00 per share. The Company has no obligation to draw down all or any portion of the commitment. The maximum amount of shares that may be issued to Kingsbridge under the equity facility is 8,851,661. In connection with the agreement, on February 11, 2004, the Company issued fully vested warrants to

Kingsbridge to purchase 300,000 shares of common stock at an exercise price of $4.11 per share. The Company intends to use any proceeds from such sale to Kingsbridge to finance acquisitions, including any product development activity related to such acquisitions. This transaction was effected in reliance on Regulation D under the Securities Act. During the three months ended September 30, 2004, the Company issued to Kingsbridge Capital, Ltd. a total of 2,372,689 shares of its common stock in connection with the Amended and Restated Common Stock Purchase Agreement dated as of May 19, 2004. Gross proceeds from the sale of stock were $2,600. On September 21, 2004, in addition to $156 in cash payments, the Company issued warrants to purchase 23,727 shares of common stock at $1.45 to advisors, in connection with the sale of stock to Kingsbridge which were charged against equity as stock issuance costs. Pursuant to our agreement, broker fees of 6% in cash and 1% of stock in the form of warrants will be paid upon each future drawdown of the facility. Additionally warrants issued at the time of the agreement have been held in current assets. These warrants will be amortized on a prorated basis at the time of the drawdown and also charged against equity as stock issuance costs.

During the period July 1, 2004 through September 30, 2004, the Company agreed to issue warrants equally over a two-year period to purchase a total 240,000 shares of common stock at $1.08 per share to consultants for services to be rendered over a period of two years. These warrants are vested at the time of issuance. If the agreement with the consultant is terminated for any reason, the unissued warrants are forfeited.. The issuance of these securities was exempt from registration under the Securities Act pursuant to Section 4(2) thereof.

On May 28, 2004, Tegal purchased substantially all of the assets of First Derivative Systems, Inc. ("FDSI") for 1,410,632 shares of common stock and approximately $200 in assumed liabilities, pursuant to a purchase agreement dated April 28, 2004. All of the shares of common stock are subject to a registration rights agreement in which the Company has agreed to register the shares with the Securities and Exchange Commission for resale. Such registration was filed with the Securities and Exchange Commission on August 30, 2004 and was declared effective in its amended form on October 13, 2004. This transaction was effected in reliance on Regulation D.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On September 21, 2004 the Company held its annual meeting of the stockholders. There were present at the meeting, in person or by proxy, the holders of 39,503,979 shares of common stock of the Company, representing 84.85% of the total votes eligible to be cast, constituting a majority and more than a quorum of the outstanding shares entitled to vote.

The following individuals were re-elected to the board of directors:

	Votes for	Votes Withheld
Edward A. Dohring.............	38,368,549	1,135,430
Jeffrey M. Krauss.............	38,084,764	1,419,215
Michael L. Parodi.............	38,408,102	1,095,877
Duane Wadsworth................	38,375,849	1,128,130

The proposal to adopt an amendment to the Company's 1998 Equity Participation Plan to increase the maximum authorized shares from 6,400,000 to 10,000,000 was approved by the stockholders as follows:

For..	9,180,015
Against..	2,976,424
Abstain..	157,956
Broker Non Vote................................	27,189,584

The proposal to adopt an amendment to the Company's Option Plan for Outside Directors to increase the maximum authorized shares from 600,000 to 1,600,000 was approved by stockholders as follows:

For...	7,859,528
Against..	4,307,324
Abstain..	147,543
Broker Non Vote................................	27,189,584

The proposal to adopt an amendment to the Company's Employee Qualified Stock Purchase Plan to increase the maximum authorized shares from 500,000 to 1,000,000.

For..	10,279,093
Against..	1,926,870
Abstain..	108,432
Broker Non Vote................................	27,189,584

The proposal to ratify the appointment of Moss Adams LLP as independent auditors for the fiscal year ending March 31, 2005.

For..	38,870,465
Against..	465,372
Abstain..	168,151
Broker Non Vote................................	-0-

ITEM 5. OTHER INFORMATION - CHANGES IN THE COMPANY'S CERTIFYING ACCOUNTANT

On July 8, 2004, the Audit Committee of the Board of Directors of Tegal Corporation (the "Company") dismissed PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm. The Company decided to change accounting firms in order to reduce costs as part of the Company's ongoing efforts to reduce operating expenses.

PricewaterhouseCoopers LLP reports on the consolidated financial statements of the Company as of, and for the years ended, March 31, 2004 and 2003 contained no adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principle, except for an explanatory paragraph included in each of such reports which explanatory paragraph identified factors raising substantial doubt about the Company's ability to continue as a going concern.

During the period from April 1, 2002 through July 8, 2004, there were no disagreements with PricewaterhouseCoopers LLP on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of PricewaterhouseCoopers LLP, would have caused PricewaterhouseCoopers LLP to make reference thereto in its reports on the consolidated financial statements of the Company as of and for the years ended March 31, 2004 and 2003.

On July 8, 2004, the Audit Committee of the Board of Directors of the Company appointed Moss Adams LLP as its new independent registered public accounting firm as of July 9, 2004.

During the two most recent fiscal years and through November 11, 2004, neither the Company nor anyone on its behalf consulted Moss Adams LLP regarding either the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on the Company's consolidated financial statements, nor has Moss Adams LLP provided to the Company a written report or oral advice regarding such principles or audit opinion.

RISK FACTORS

WE HAVE INCURRED OPERATING LOSSES AND MAY NOT BE PROFITABLE IN THE FUTURE; OUR PLANS TO MAINTAIN AND INCREASE LIQUIDITY MAY NOT BE SUCCESSFUL; THE REPORT OF THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM INCLUDES A GOING CONCERN UNCERTAINTY EXPLANATORY PARAGRAPH; THE ACCOUNTING FOR THE 2% CONVERTIBLE DEBENTURES RESULTED IN SIGNIFICANT EXPENSE AMOUNTS.

We incurred net losses of $8,826 and $2,923 for the six months ended September 30, 2004 and 2003, respectively. The company generated negative cash flows from operations of $3,732 for the period ended September 30, 2004 and generated cash flows from operations of $220 for the period ended September 30, 2003. Our past performance raised substantial doubt as to our ability to continue as a going concern, and our former independent registered public accounting firm included a going concern uncertainty explanatory paragraph in their report dated June 25, 2004, which is included in our Form 10-K for the year ended March 31, 2004. Management believes that proceeds from the debenture financing in fiscal year 2004 and additional funds which may be available to the Company through the issuance of stock under the structured secondary financing with Kingsbridge Capital, Ltd. (including the $2,600 already raised through this facility), will be adequate to fund operations through fiscal year 2005, including the continued development of recently acquired products. However, projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, the Company will need to reduce expenses further and raise additional capital through the issuance of debt or equity securities. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of common stock, and debt covenants could impose restrictions on the Company's operations. The sale of equity or debt could result in additional dilution to current stockholders, and such financing may not be available to the Company on acceptable terms, if at all. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amount or classification of liabilities or any other adjustments that might be necessary should the Company be unable to continue as a going concern.

THE EXERCISE OF OUTSTANDING WARRANTS, OPTIONS AND OTHER RIGHTS TO OBTAIN ADDITIONAL SHARES WILL DILUTE THE VALUE OF THE SHARES.

As of September 30, 2004, there were debenture holder warrants exercisable for approximately 1,685,682 shares and advisor warrants exercisable into 219,856 shares of our common stock. In addition, we have warrants outstanding from previous offerings for approximately 2,575,480 shares of our common stock.

The exercise of these warrants and the issuance of the common stock will result in dilution in the value of the shares of our outstanding common stock and the voting power represented thereby. In addition, the exercise price of the warrants may be lowered under the price adjustment provisions in the event of a "dilutive issuance," that is, if we issue common stock at any time prior to their maturity at a per share price below such conversion or exercise price, either directly or in connection with the issuance of securities that are convertible into, or exercisable for, shares of our common stock. A reduction in the exercise price may result in the issuance of a significant number of additional shares upon the exercise of the warrants.

The warrants do not establish a "floor" that would limit reductions in such conversion price or exercise price. The downward adjustment of the exercise price of these warrants could result in further dilution in the value of the shares of our outstanding common stock and the voting power represented thereby.

SALES OF SUBSTANTIAL AMOUNTS OF OUR SHARES OF COMMON STOCK COULD CAUSE THE PRICE OF OUR COMMON STOCK TO GO DOWN.

To the extent the holders of our convertible securities and warrants convert or exercise such securities and then sell the shares of our common stock they receive upon conversion or exercise, our stock price may decrease due to the additional amount of shares available in the market. The subsequent sales of these shares could encourage short sales by our stockholders and others which could place further downward pressure on our stock price. Moreover, holders of these convertible securities and warrants may hedge their positions in our common stock by shorting our common stock, which could further adversely affect our stock price. The effect of these activities on our stock price could increase the number of shares issuable upon future conversions of our convertible securities or exercises of our warrants.

We received stockholder approval to increase the number of authorized shares of common stock to 100,000,000 shares. We may issue additional capital stock, convertible securities and/or warrants to raise capital in the future. In addition, to attract and retain key personnel, we may issue additional securities, including stock options. All of the above could result in additional dilution of the value of our common stock and the voting power represented thereby. No prediction can be made as to the effect, if any, that future sales of shares of our common stock, or the availability of shares for future sale, will have on the market price of our common stock prevailing from time to time. Sales of substantial amounts of shares of our common stock in the public market, or the perception that such sales could occur, may adversely affect the market price of our common stock and may make it more difficult for us to sell our equity securities in the future at a time and price which we deem appropriate. Public or private sales of substantial amounts of shares of our common stock by persons or entities that have exercised options and/or warrants could adversely affect the prevailing market price of the shares of our common stock.

THE SEMICONDUCTOR INDUSTRY IS CYCLICAL AND MAY EXPERIENCE PERIODIC DOWNTURNS THAT MAY NEGATIVELY AFFECT CUSTOMER DEMAND FOR OUR PRODUCTS AND RESULT IN LOSSES SUCH AS THOSE EXPERIENCED IN THE PAST.

Our business depends upon the capital expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits. The semiconductor industry is highly cyclical and historically has experienced periodic downturns, which often have had a detrimental effect on the semiconductor industry's demand for semiconductor capital equipment, including etch and deposition systems manufactured by us. During periods of a prolonged industry slow-down, we would have to initiate a substantial cost containment program and complete a corporate-wide restructuring to preserve our cash. However, the need for continued investment in research and development, possible capital equipment requirements and extensive ongoing customer service and support requirements worldwide will continue to limit our ability to reduce expenses in response to the any downturn.

OUR COMPETITORS HAVE GREATER FINANCIAL RESOURCES AND GREATER NAME RECOGNITION THAN WE DO AND THEREFORE MAY COMPETE MORE SUCCESSFULLY IN THE SEMICONDUCTOR CAPITAL EQUIPMENT INDUSTRY THAN WE CAN.

We believe that to be competitive, we will require significant financial resources in order to offer a broad range of systems, to maintain customer service and support centers worldwide and to invest in research and development. Many of our existing and potential competitors, including, among others, Applied Materials, Inc., Lam Research Corporation, Novellus and Tokyo Electron Limited, have substantially greater financial resources, more extensive engineering, manufacturing, marketing and customer service and support capabilities, larger installed bases of current generation etch, deposition and other production equipment and broader process equipment offerings, as well as greater name recognition than we do. We cannot assure you that we will be able to compete successfully against these companies in the United States or worldwide.

IF WE FAIL TO MEET THE CONTINUED LISTING REQUIREMENTS OF THE NASDAQ STOCK MARKET, OUR STOCK COULD BE DELISTED.

Our stock is currently listed on The Nasdaq SmallCap Market. The Nasdaq Stock Market's Marketplace Rules impose certain minimum financial requirements on us for the continued listing of our stock. One such requirement is the minimum bid price on our stock of $1.00 per share. Beginning in 2002, there have been periods of time during which we have been out of compliance with the $1.00 minimum bid requirements of The Nasdaq SmallCap Market.

On September 6, 2002, we received notification from Nasdaq that for the 30 days prior to the notice, the price of our common stock had closed below the minimum $1.00 per share bid price requirement for continued inclusion under Marketplace Rule 4450(a)(5) (the "Rule"), and were provided 90 calendar days, or until December 5, 2002, to regain compliance. Our bid price did not close above the minimum during that period. On December 6, 2002, we received notification from Nasdaq that our securities would be delisted from The Nasdaq National Market, the exchange on which our stock was listed prior to May 6, 2003, on December 16, 2002 unless we either (i) applied to transfer our securities to The Nasdaq SmallCap Market, in which case we would be afforded additional time to come into compliance with the minimum $1.00 bid price requirement; or (ii) appealed the Nasdaq staff's determination to the Nasdaq's Listing Qualifications Panel (the "Panel"). On December 12, 2002 we requested an oral hearing before the Panel and such hearing took place on January 16, 2003 in Washington, D.C. Our appeal was based, among other things, on our intention to seek stockholder approval for a reverse split of our outstanding common stock. On April 28, 2003 at a special meeting of our stockholders, our board of directors was granted the authority to effect a reverse split of our common stock within a range of two-for-one to fifteen-for-one. This authority was reaffirmed by our stockholders at the Annual Meeting on September 8, 2003. The timing and ratio of a reverse split, if any, is at the sole discretion of our board of directors, but it must have been completed on or before December 2, 2003. On May 6, 2003, we transferred the listing of our common stock to The Nasdaq SmallCap Market. In connection with this transfer, and by additional notice, Nasdaq granted us an extension until December 31, 2003, to regain compliance with the Rule's minimum $1.00 per share bid price requirement for continued inclusion on The Nasdaq SmallCap Market. On September 16, 2003, the bid price for our stock had closed at $1.00 or above for ten consecutive days. On September 17, 2003, we received a letter from Nasdaq confirming that Tegal had regained compliance with the minimum bid price requirement and that the question of its continued listing on The SmallCap Market was now closed.

If we are out of compliance in the future with Nasdaq listing requirements, we may take actions in order to achieve compliance, which actions may include a reverse split of our common stock, which would require stockholder approval. If an initial delisting decision is made by the Nasdaq's staff, we may appeal the decision as permitted by Nasdaq rules. If we are delisted and cannot obtain listing on another major market or exchange, our stock's liquidity would suffer, and we would likely experience reduced investor interest. Such factors may result in a decrease in our stock's trading price. Delisting also may restrict us from issuing additional securities or securing additional financing.

WE DEPEND ON SALES OF OUR ADVANCED PRODUCTS TO CUSTOMERS THAT MAY NOT FULLY ADOPT OUR PRODUCT FOR PRODUCTION USE.

We have designed our advanced etch and deposition products for customer applications in emerging new films, polysilicon and metal which we believe to be the leading edge of critical applications for the production of advanced semiconductor and other microelectronic devices. Revenues from the sale of our advanced etch and deposition systems accounted for 40%, 25% and 36% of total revenues in fiscal 2004, 2003 and 2002, respectively. Our advanced systems are currently being used primarily for research and development activities or low volume production. For our advanced systems to achieve full market adoption, our customers must utilize these systems for volume production. There can be no assurance that the market for devices incorporating emerging films, polysilicon or metal will develop as quickly or to the degree we expect.

If our advanced systems do not achieve significant sales or volume production due to a lack of full customer adoption, our business, financial condition, results of operations and cash flows will be materially adversely affected.

OUR POTENTIAL CUSTOMERS MAY NOT ADOPT OUR PRODUCTS BECAUSE OF THEIR SIGNIFICANT COST OR BECAUSE OUR POTENTIAL CUSTOMERS ARE ALREADY USING A COMPETITOR'S TOOL.

A substantial investment is required to install and integrate capital equipment into a semiconductor production line. Additionally, we believe that once a device manufacturer has selected a particular vendor's capital equipment, that manufacturer generally relies upon that vendor's equipment for that specific production line application and, to the extent possible, subsequent generations of that vendor's systems. Accordingly, it may be extremely difficult to achieve significant sales to a particular customer once that customer has selected another vendor's capital equipment unless there are compelling reasons to do so, such as significant performance or cost advantages. Any failure to gain access and achieve sales to new customers will adversely affect the successful commercial adoption of our products and could have a detrimental effect on us.

OUR QUARTERLY OPERATING RESULTS MAY CONTINUE TO FLUCTUATE.

Our revenue and operating results have fluctuated and are likely to continue to fluctuate significantly from quarter to quarter, and there can be no assurance as to future profitability.

Our 900 series etch systems typically sell for prices ranging between $250,000 and $600,000, while prices of our 6500 series critical etch systems and our Endeavor deposition system typically range between $1.8 million and $3.0 million. To the extent we are successful in selling our 6500 and Endeavor series systems, the sale of a small number of these systems will probably account for a substantial portion of revenue in future quarters, and a transaction for a single system could have a substantial impact on revenue and gross margin for a given quarter.

Other factors that could affect our quarterly operating results include:

- our timing of new systems and technology announcements and releases and ability to transition between product versions;

- seasonal fluctuations in sales;

- changes in the mix of our revenues represented by our various products and customers;

- adverse changes in the level of economic activity in the United States or other major economies in which we do business;

- foreign currency exchange rate fluctuations;

- expenses related to, and the financial impact of, possible acquisitions of other businesses; and

- changes in the timing of product orders due to unexpected delays in the introduction of our customers' products, due to lifecycles of our customers' products ending earlier than expected or due to market acceptance of our customers' products.

BECAUSE TECHNOLOGY CHANGES RAPIDLY, WE MAY NOT BE ABLE TO INTRODUCE OUR PRODUCTS IN A TIMELY ENOUGH FASHION.

The semiconductor manufacturing industry is subject to rapid technological change and new system introductions and enhancements. We believe that our future success depends on our ability to continue to enhance our existing systems and their process capabilities, and to develop and manufacture in a timely manner new systems with improved process capabilities. We may incur substantial unanticipated costs to ensure product functionality and reliability early in our products' life cycles. There can be no assurance that we will be successful in the introduction and volume manufacture of new systems or that we will be able to develop and introduce, in a timely manner, new systems or enhancements to our existing systems and processes which satisfy customer needs or achieve market adoption.

SOME OF OUR SALES CYCLES ARE LENGTHY, EXPOSING US TO THE RISKS OF INVENTORY OBSOLESCENCE AND FLUCTUATIONS IN OPERATING RESULTS.

Sales of our systems depend, in significant part, upon the decision of a prospective customer to add new manufacturing capacity or to expand existing manufacturing capacity, both of which typically involve a significant capital commitment. We often experience delays in finalizing system sales following initial system qualification while the customer evaluates and receives approvals for the purchase of our systems and completes a new or expanded facility. Due to these and other factors, our systems typically have a lengthy sales cycle (often 12 to 18 months in the case of critical etch and deposition systems) during which we may expend substantial funds and management effort. Lengthy sales cycles subject us to a number of significant risks, including inventory obsolescence and fluctuations in operating results over which we have little or no control.

WE MAY NOT BE ABLE TO PROTECT OUR INTELLECTUAL PROPERTY OR OBTAIN LICENSES FOR THIRD PARTIES' INTELLECTUAL PROPERTY AND THEREFORE WE MAY BE EXPOSED TO LIABILITY FOR INFRINGEMENT OR THE RISK THAT OUR OPERATIONS MAY BE ADVERSELY AFFECTED.

Although we attempt to protect our intellectual property rights through patents, copyrights, trade secrets and other measures, we may not be able to protect our technology adequately and competitors may be able to develop similar technology independently. Additionally, patent applications that we may file may not be issued and foreign intellectual property laws may not protect our intellectual property rights. There is also a risk that patents licensed by or issued to us will be challenged, invalidated or circumvented

and that the rights granted thereunder will not provide competitive advantages to us. Furthermore, others may independently develop similar systems, duplicate our systems or design around the patents licensed by or issued to us.

Litigation could result in substantial cost and diversion of effort by us, which by itself could have a detrimental effect on our financial condition, operating results and cash flows. Further, adverse determinations in such litigation could result in our loss of proprietary rights, subject us to significant liabilities to third parties, require us to seek licenses from third parties or prevent us from manufacturing or selling our systems. In addition, licenses under third parties' intellectual property rights may not be available on reasonable terms, if at all.

OUR CUSTOMERS ARE CONCENTRATED AND THEREFORE THE LOSS OF A SIGNIFICANT CUSTOMER MAY HARM OUR BUSINESS.

Our top five customers accounted for 85%, 88% and 54% of our systems revenues in fiscal 2004, 2003 and 2002, respectively. Three customers each accounted for more than 10% of net systems sales in fiscal 2004. Although the composition of the group comprising our largest customers may vary from year to year, the loss of a significant customer or any reduction in orders by any significant customer, including reductions due to market, economic or competitive conditions in the semiconductor manufacturing industry, may have a detrimental effect on our business, financial condition, results of operations and cash flows. Our ability to increase our sales in the future will depend, in part, upon our ability to obtain orders from new customers, as well as the financial condition and success of our existing customers and the general economy, which is largely beyond our ability to control.

WE ARE EXPOSED TO ADDITIONAL RISKS ASSOCIATED WITH INTERNATIONAL SALES AND OPERATIONS.

International sales accounted for 67%, 66% and 67% of total revenue for fiscal 2004, 2003 and 2002, respectively. International sales are subject to certain risks, including the imposition of government controls, fluctuations in the U.S. dollar (which could increase the sales price in local currencies of our systems in foreign markets), changes in export license and other regulatory requirements, tariffs and other market barriers, political and economic instability, potential hostilities, restrictions on the export or import of technology, difficulties in accounts receivable collection, difficulties in managing representatives, difficulties in staffing and managing international operations and potentially adverse tax consequences. There can be no assurance that any of these factors will not have a detrimental effect on our operations, financial results and cash flows.

We generally attempt to offset a portion of our U.S. dollar denominated balance sheet exposures subject to foreign exchange rate remeasurement by purchasing forward currency contracts for future delivery. There can be no assurance that our future results of operations and cash flows will not be adversely affected by foreign currency fluctuations. In addition, the laws of certain countries in which our products are sold may not provide our products and intellectual property rights with the same degree of protection as the laws of the United States.

EVOLVING REGULATION OF CORPORATE GOVERNANCE AND PUBLIC DISCLOSURE MAY RESULT IN ADDITIONAL EXPENSES AND CONTINUING UNCERTAINTY.

Changing laws, regulations and standard relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq National Market rules are creating uncertainty for public companies. We continually evaluate and monitor developments with respect to new and proposed rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs. These new or changed laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we have invested resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may initiate legal proceedings against us and we may be harmed.

WE MUST INTEGRATE OUR ACQUISITIONS OF SIMPLUS SYSTEMS CORPORATION AND FIRST DERIVATIVE SYSTEMS, INC., AND WE MAY NEED TO MAKE ADDITIONAL FUTURE ACQUISITIONS TO REMAIN COMPETITIVE. THE PROCESS OF IDENTIFYING, ACQUIRING AND INTEGRATING FUTURE ACQUISITIONS MAY CONSTRAIN VALUABLE MANAGEMENT RESOURCES, AND OUR FAILURE TO EFFECTIVELY INTEGRATE FUTURE ACQUISITIONS MAY RESULT IN THE LOSS OF KEY EMPLOYEES AND THE DILUTION OF STOCKHOLDER VALUE AND HAVE AN ADVERSE EFFECT ON OUR OPERATING RESULTS.

On November 11, 2003, we acquired substantially all of the assets of Simplus Systems Corporation, and on April 28, 2004, we acquired substantially all of the assets of First Derivative Systems, Inc. We may in the future seek to acquire or invest in additional businesses, products or technologies that we believe could complement or expand our business, augment our market coverage, enhance our technical capabilities or that may otherwise offer growth opportunities. We may encounter problems with the assimilation of Simplus or businesses, products or technologies acquired in the future including:

- difficulties in assimilation of acquired personnel, operations, technologies or products;
- unanticipated costs associated with acquisitions;
- diversion of management's attention from other business concerns and potential disruption of our ongoing business;
- adverse effects on our existing business relationships with our customers;
- potential patent or trademark infringement from acquired technologies;
- adverse effects on our current employees and the inability to retain employees of acquired companies;
- use of substantial portions of our available cash as all or a portion of the purchase price;
- dilution of our current stockholders due to the issuance of additional securities as consideration for acquisitions; and
- inability to complete acquired research and development projects.

If we are unable to successfully integrate our acquired companies or to create new or enhanced products and services, we may not achieve the anticipated benefits from our acquisitions. If we fail to achieve the anticipated benefits from the acquisitions, we may incur increased expenses and experience a shortfall in our anticipated revenues and we may not obtain a satisfactory return on our investment. In addition, if a significant number of employees of acquired companies fail to remain employed with us, we may experience difficulties in achieving the expected benefits of the acquisitions.

Completing any potential future acquisitions could cause significant diversions of management time and resources. Financing for future acquisitions may not be available on favorable terms, or at all. If we identify an appropriate acquisition candidate for any of our businesses, we may not be able to negotiate the terms of the acquisition successfully, finance the acquisition or integrate the acquired business, products, technologies or employees into our existing business and operations. Future acquisitions may not be well-received by the investment community, which may cause our stock price to fall. We have not entered into any agreements or understanding regarding any future acquisitions and cannot ensure that we will be able to identify or complete any acquisition in the future.

If we acquire businesses, new products or technologies in the future, we may be required to amortize significant amounts of identifiable intangible assets and we may record significant amounts of goodwill that will be subject to annual testing for impairment. If we consummate one or more significant future acquisitions in which the consideration consists of stock or other securities, our existing stockholders' ownership could be significantly diluted. If we were to proceed with one or more significant future acquisitions in which the consideration included cash, we could be required to use a substantial portion of our available cash.

OUR FINANCIAL PERFORMANCE MAY ADVERSELY AFFECT THE MORALE AND PERFORMANCE OF OUR PERSONNEL AND OUR ABILITY TO HIRE NEW PERSONNEL.

Our common stock has declined in value below the exercise price of many options granted to employees pursuant to our stock option plans. Thus, the intended benefits of the stock options granted to our employees, the creation of performance and retention incentives, may not be realized. As a result, we may lose employees whom we would prefer to retain. As a result of these factors, our remaining personnel may seek employment with larger, more established companies or companies perceived as having less volatile stock prices.

PROVISIONS IN OUR AGREEMENTS, CHARTER DOCUMENTS, STOCKHOLDER RIGHTS PLAN AND DELAWARE LAW MAY DETER TAKEOVER ATTEMPTS, WHICH COULD DECREASE THE VALUE OF YOUR SHARES.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. Our board of directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Delaware law imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, we have adopted a stockholder rights plan that makes it more difficult for a third party to acquire us without the approval of our board of directors. These provisions apply even if the offer may be considered beneficial by some stockholders.

OUR STOCK PRICE IS VOLATILE AND COULD RESULT IN A MATERIAL DECLINE IN THE VALUE OF YOUR INVESTMENT IN TEGAL.

We believe that factors such as announcements of developments related to our business, fluctuations in our operating results, sales of our common stock into the marketplace, failure to meet or changes in analysts' expectations, general conditions in the semiconductor industry or the worldwide economy, announcements of technological innovations or new products or enhancements by us or our competitors, developments in patents or other intellectual property rights, developments in our relationships with our customers and suppliers, natural disasters and outbreaks of hostilities could cause the price of our common stock to fluctuate substantially. In addition, in recent years the stock market in general, and the market for shares of small capitalization stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. There can be no assurance that the market price of our common stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to our performance.

POTENTIAL DISRUPTION OF OUR SUPPLY OF MATERIALS REQUIRED TO BUILD OUR SYSTEMS COULD HAVE A NEGATIVE EFFECT ON OUR OPERATIONS AND DAMAGE OUR CUSTOMER RELATIONSHIPS.

Materials delays have not been significant in recent years. Nevertheless, we procure certain components and sub-assemblies included in our systems from a limited group of suppliers, and occasionally from a single source supplier. For example, we depend on MECS Corporation, a robotic equipment supplier, as the sole source for the robotic arm used in all of our 6500 series systems. We currently have no existing supply contract with MECS Corporation, and we currently purchase all robotic assemblies from MECS Corporation on a purchase order basis. Disruption or termination of certain of these sources, including our robotic sub-assembly source, could have an adverse effect on our operations and damage our relationship with our customers.

ANY FAILURE BY US TO COMPLY WITH ENVIRONMENTAL REGULATIONS IMPOSED ON US COULD SUBJECT US TO FUTURE LIABILITIES.

We are subject to a variety of governmental regulations related to the use, storage, handling, discharge or disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing process. We believe that we are currently in compliance in all material respects with these regulations and that we have obtained all necessary environmental permits generally relating to the discharge of hazardous wastes to conduct our business. Nevertheless, our failure to comply with present or future regulations could result in additional or corrective operating costs, suspension of production, alteration of our manufacturing processes or cessation of our operations.

THE STRUCTURED SECONDARY OFFERING FACILITY WE ENTERED INTO IN FEBRUARY 2004 AND AMENDED IN MAY 2004 MAY HAVE A DILUTIVE IMPACT ON OUR STOCKHOLDERS, AND THE POTENTIAL UNAVAILABILITY OF THIS FACILITY WOULD NEGATIVELY IMPACT OUR FINANCING ACTIVITIES.

On February 11, 2004, we entered into a structured secondary offering facility (the "Structured Secondary") with Kingsbridge Capital Limited ("Kingsbridge"), which was amended on May 19, 2004. Under the terms of an Amended and Restated Common Stock Purchase Agreement (the "Purchase Agreement") entered into by the Company and Kingsbridge on May 19, 2004 with respect to the Structured Secondary, we may, at our sole discretion, sell to Kingsbridge, and Kingsbridge would be obligated to purchase, up to $25 million of shares of our common stock, par value $0.01 per share. The price at which we may sell shares of common stock under the Purchase Agreement is based on a discount to the volume weighted average market price of the common stock for a specified number of trading days following each of our respective elections to sell shares thereunder. The lowest threshold price at which our stock may be sold is at the sole discretion of the Company, but in no case may be lower than $1.00 per share, and in the event the price of our common stock falls below this $1.00 threshold, the Structured Secondary will not be an available source of financing. We may utilize the Structured Secondary through July 7, 2006 from time to time in our sole discretion, subject to various conditions and terms contained in the Purchase Agreement. Among the terms of the Purchase Agreement is a "Material Adverse Effect" clause which permits Kingsbridge to terminate the Structured Secondary if Kingsbridge determines that an event has occurred that results in any effect on the business, operations, properties or financial condition of the Company and its subsidiaries that is material and adverse to

the Company and such subsidiaries, taken as a whole, and/or any condition, circumstance, or situation that would prohibit or otherwise interfere with our ability to perform any of our obligations under the Purchase Agreement.

In connection with our entering into the Structured Secondary, we issued to Kingsbridge a warrant (the "Warrant") to purchase 300,000 shares of common stock at an exercise price of $4.11 per share. The Warrant will not be exercisable until August 11, 2004, and will expire on August 11, 2009.

There are 9,151,661 shares of our common stock that are reserved for issuance under the Structured Secondary with Kingsbridge, 300,000 of which are issuable under the Warrant we granted to Kingsbridge. The issuance of shares under the Structured Secondary and upon exercise of the Warrant will have a dilutive impact on other stockholders and the issuance or even potential issuance of such shares could have a negative effect on the market price of our common stock. In addition, if we draw down the Structured Secondary, we will issue shares to Kingsbridge at a discount of 10% of the daily volume weighted average prices of our common stock during a specified period of trading days after initiation of each respective draw down. Issuing shares at such a discount will further dilute the interests of other stockholders. As of September 30, 2004, we have issued 2,372,689 shares of our common stock to Kingsbridge. On September 21, 2004, in addition to $156 in cash payments, the Company issued warrants to purchase 23,727 shares of common stock at $1.45 to advisors, in connection with the sale of stock to Kingsbridge which were charged against equity as stock issuance costs. Pursuant to our agreement, broker fees of 6% in cash and 1% of stock in the form of warrants will be paid upon each future drawdown of the facility. Additionally warrants issued at the time of the agreement have been held in current assets. These warrants will be amortized on a prorated basis at the time of the drawdown and also charged against equity as stock issuance costs.

To the extent that Kingsbridge sells shares of our common stock issued under the Structured Secondary to third parties, our stock price may decrease due to the additional selling pressure in the market. The perceived risk of dilution from sales of stock to or by Kingsbridge may cause holders of our common stock to sell their shares, or it may encourage short sales. This could contribute to a decline in our stock price.

THE STRUCTURED SECONDARY IMPOSES CERTAIN LIMITATIONS ON OUR ABILITY TO ISSUE EQUITY OR EQUITY-LINKED SECURITIES.

During the two-year term of the Structured Secondary, we may not engage in certain equity or equity-linked financings without the prior written consent of Kingsbridge, which consent will not be unreasonably withheld, conditioned or delayed. However, we may engage in the following capital raising transactions without Kingsbridge's consent: (1) establish stock option or award plans or agreements (for directors, employees, consultants and/or advisors) and amend such plans or agreements, including increasing the number of shares available thereunder, (2) use equity securities to finance the acquisition of other companies, equipment, technologies or lines of business, (3) issue shares of common stock and/or preferred stock in connection with our option or award plans, stock purchase plans, rights plans, warrants or options, (4) issue shares of common stock and/or preferred stock in connection with the acquisition of products, licenses, equipment or other assets and strategic partnerships or joint ventures (the primary purpose of which is not to raise equity capital), (5) issue shares of common and/or preferred stock to consultants and/or advisors as consideration for services rendered, (6) issue and sell shares in an underwritten public offering of common stock, and (7) issue shares of common stock to Kingsbridge under any other agreement entered into between our company and Kingsbridge.

In addition, we may not issue securities that are, or may become, convertible or exchangeable into shares of common stock where the purchase, conversion or exchange price for such common stock is determined using a floating or otherwise adjustable discount to the market price of the common stock (including pursuant to an equity line or other financing that is substantially similar to an equity line with an investor other than Kingsbridge) during the two-year term of our agreement with Kingsbridge.

WE MAY ISSUE ADDITIONAL SHARES AND DILUTE YOUR OWNERSHIP PERCENTAGE.

Certain events over which you have no control could result in the issuance of additional shares of our common stock, which would dilute your ownership percentage in our company. As of September 30, 2004, there were 46,557,672 shares of our common stock issued and outstanding and there were 3,247,021 shares of common stock reserved for issuance under our equity incentive and stock purchase plans. In addition, as of September 30, 2004, there were outstanding options, warrants and other rights to acquire up to approximately 12,755,846 (8,236,468 in equity compensation plans and 4,519,378 in warrants) shares of common stock. We may also issue additional shares of common stock or preferred stock:

o to raise additional funds for working capital, commercialization, production and marketing activities;

o upon the exercise or conversion of additional outstanding options and warrants; and

o in lieu of cash payment of dividends.

Moreover, although the issuance of our common stock under the Structured Secondary will have no effect on the rights or privileges of existing holders of common stock, the economic and voting interests of each stockholder will be diluted as a result of such issuance. Although the number of shares of common stock that stockholders presently own will not decrease, such shares will represent a smaller percentage of our total shares that will be outstanding after such events. If we satisfy the conditions that allow us to draw down the entire $25 million available under the Structured Secondary, and we choose to do so, then generally, as the market price of our common stock decreases, the number of shares we will have to issue upon each draw down on the Structured Secondary increases, to a maximum of 8,851,661 shares. Therefore drawing down upon the Structured Secondary when the price of our common stock is decreasing will have an additional dilutive effect to your ownership percentage and may result in additional downward pressure on the price of our common stock.

SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This Form 10-Q includes or incorporates by reference 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 us. Important factors that could cause actual results to differ materially from the forward-looking statements we make in this Form 10-Q are set forth under the caption "Risk Factors" and elsewhere in this prospectus and the documents incorporated by reference in this Form 10-Q. If one or more of these risks or uncertainties materialize, or if any underlying assumptions prove incorrect, our actual results, performance or achievements may vary materially from any future results, performance or achievements expressed or implied by these forward-looking statements. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirely by the cautionary statements in this paragraph.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1* Form of Non-Qualified Stock Option Agreement for Employees from the Sixth Amended and Restated 1998 Equity Participation Plan of Tegal Corporation.

10.2* Form of Stock Option Agreement for Outside Directors of Tegal Corporation.

31 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- -----------

* Indicates a management contract or compensatory plan or arrangement

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 thereunto duly authorized.

TEGAL CORPORATION
(Registrant)

/s/ THOMAS R. MIKA

Thomas R. Mika
Chief Financial Officer

Dated: November 12, 2004

EXHIBIT 10.1

FORM OF NON-QUALIFIED STOCK OPTION AGREEMENT (EMPLOYEES)

THIS AGREEMENT, dated ____________, 2004, is made by and between Tegal Corporation, a Delaware corporation hereinafter referred to as "Company," and ____________________, an employee of the Company or a Subsidiary of the Company, hereinafter referred to as "Employee":

WHEREAS, the Company wishes to afford the Employee the opportunity to purchase shares of its $0.01 par value Common Stock; and

WHEREAS, the Company wishes to carry out The Sixth Amended and Restated 1998 Equity Participation Plan of Tegal Corporation (as so amended, the "Plan") (the terms of which are hereby incorporated by reference and made a part of this Agreement); and

WHEREAS, the Committee, appointed to administer the Plan, has determined that it would be to the advantage and best interest of the Company and its shareholders to grant the Non-Qualified Stock Option provided for herein to the Employee as an inducement to enter into or remain in the service of the Company or its Subsidiaries and as an incentive for increased efforts during such service, and has advised the Company thereof and instructed the undersigned officers to issue said Option;

NOW, THEREFORE, in consideration of the mutual covenants herein contained and other good and valuable consideration, receipt of which is hereby acknowledged, the parties hereto do hereby agree as follows:

ARTICLE I.
DEFINITIONS

Whenever the following terms are used in this Agreement, they shall have the meaning specified below unless the context clearly indicates to the contrary. The masculine pronoun shall include the feminine and neuter, and the singular the plural, where the context so indicates. All capitalized terms used herein without definition shall have the meanings ascribed to such terms in the Plan.

Section 1.1 Officer

"Officer" shall mean an officer of the Company, as defined in Rule 16a-1(f) under the Exchange Act, as such Rule may be amended in the future.

Section 1.2 Option

"Option" shall mean the non-qualified stock option to purchase Common Stock of the Company granted under this Agreement.

Section 1.3 Plan

"Plan" shall mean The Sixth Amended and Restated 1998 Equity Participation Plan of Tegal Corporation.

Section 1.4 Secretary

"Secretary" shall mean the Secretary of the Company.

ARTICLE II.
GRANT OF OPTION

Section 2.1 Grant of Option

In consideration of the Employee's agreement to remain in the employ of the Company or its Subsidiaries and for other good and valuable consideration, on the date hereof the Company irrevocably grants to the Employee the option to purchase any part or all of an aggregate of ________ shares of its $0.01 par value Common Stock upon the terms and conditions set forth in this Agreement.

Section 2.2 Purchase Price

The purchase price of the shares of stock covered by the Option shall be $_____ per share without commission or other charge.

Section 2.3 Consideration to Company

In consideration of the granting of this Option by the Company, the Employee agrees to render faithful and efficient services to the Company or a Subsidiary, with such duties and responsibilities as the Company shall from time to time prescribe, for a period of at least one (1) year from the date this Option is granted. Nothing in this Agreement or in the Plan shall confer upon any Optionee any right to continue in the employ of the Company or any Subsidiary, or shall interfere with or restrict in any way the rights of the Company and any Subsidiary, which are hereby expressly reserved, to discharge any Optionee at any time for any reason whatsoever, with or without cause, except to the extent expressly provided otherwise in a written employment agreement between the Optionee and the Company and any Subsidiary.

Section 2.4 Adjustments in Option

The Committee shall make adjustments with respect to the Option in accordance with the provisions of Section 10.3 of the Plan.

ARTICLE III.
PERIOD OF EXERCISABILITY

Section 3.1 Commencement of Exercisability

(a) The Option shall become exercisable as follows:

(i) The first installment shall consist of twenty-five percent (25%) of the shares covered by the Option and shall become exercisable on the first anniversary of the date the Option is granted.

(ii) The second installment shall consist of twenty-five percent (25%) of the shares covered by the Option and shall become exercisable on the second anniversary of the date the Option is granted.

(iii) Thereafter, 2.083% shall become exercisable on the last day of each month commencing with the 25th month, with full vesting on the last day of the 48th month.

(b) No portion of the Option which is unexercisable at Termination of Employment shall thereafter become exercisable.

Section 3.2 Duration of Exercisability

The installments provided for in Section 3.1 are cumulative. Each such installment which becomes exercisable pursuant to Section 3.1 shall remain exercisable until it becomes unexercisable under Section 3.3.

Section 3.3 Expiration of Option

The Option may not be exercised to any extent by anyone after the first to occur of the following events:

(a) The expiration of ten (10) years from the date the Option was granted; or

(b) The expiration of three (3) years from the date of the Employee's Termination of Employment by reason of his retirement, death or disability (within the meaning of Section 22(e)(3) of the Code); or

(c) The expiration of one (1) year from the date of the Employee's Termination of Employment by reason of his being discharged not for good cause; or

(d) The expiration of three (3) months from the date of the Employee's Termination of Employment by reason of his resignation or by reason of his being discharged for good cause; or

(e) In the event of a Change of Control, unless the Committee waives this provision in connection with such transaction. At least ten (10) days prior to the effective date of

such merger, consolidation, acquisition, liquidation or dissolution, the Committee shall give the Employee notice of such event if the Option has then neither been fully exercised nor become unexercisable under this Section 3.3.

Section 3.4 Acceleration of Exercisability

(a) Notwithstanding any other provision of the Plan, in the event of a Change in Control, the Option shall, immediately prior to the effective date of the Change in Control, automatically become fully exercisable for all of the shares of Common Stock at the time subject to the Option and may be exercised for any or all of those shares as fully-vested shares of Common Stock, notwithstanding that this Option may not yet have become fully exercisable under Section 3.1(a); provided, however, that this acceleration of exercisability shall not take place if this Option becomes unexercisable under Section 3.3 prior to said effective date.

The Committee may make such determinations and adopt such rules and conditions as it, in its absolute discretion, deems appropriate in connection with such acceleration of exercisability, including, but not by way of limitation, provisions to ensure that any such acceleration and resulting exercise shall be conditioned upon the consummation of the contemplated corporate transaction.

ARTICLE IV.
EXERCISE OF OPTION

Section 4.1 Person Eligible to Exercise

Unless the Option has been transferred in accordance with Section 5.2, during the lifetime of the Employee, only he may exercise the Option or any portion thereof. After the death of the Employee, any exercisable portion of the Option may, prior to the time when the Option becomes unexercisable under Section 3.3, be exercised by his personal representative or by any person empowered to do so under the deceased Employee's will or under the then applicable laws of descent and distribution, and subject to the consent of the Committee pursuant to a DRO or by a Permitted Transferee.

Section 4.2 Partial Exercise

Any exercisable portion of the Option or the entire Option, if then wholly exercisable, may be exercised in whole or in part at any time prior to the time when the Option or portion thereof becomes unexercisable under Section 3.3.

Section 4.3 Manner of Exercise

The Option, or any exercisable portion thereof, may be exercised solely by delivery to the Secretary or his office of all of the following prior to the time when the Option or such portion becomes unexercisable under Section 3.3:

(a) A written notice complying with the applicable rules established by the Committee stating that the Option, or a portion thereof, is exercised. The notice shall be signed by the Employee or other person then entitled to exercise the Option or such portion; and

(b)

(i) Full cash payment to the Secretary of the Company for the shares with respect to which such Option or portion is exercised; or

(ii) With the consent of the Committee, (A) shares of the Company's Common Stock owned for at least six months by the Employee, duly endorsed for transfer to the Company, with a Fair Market Value on the date of delivery equal to the aggregate exercise price of the Option or exercised portion thereof, or (B) shares of the Company's Common Stock issuable to the Employee upon exercise of the Option, with a Fair Market Value on the date of delivery equal to the aggregate exercise price of the Option or exercised portion thereof; or

(iii) With the consent of the Committee, a full recourse promissory note bearing interest (at no less than a market rate of interest which then precludes the imputation of interest under the Code or successor provision) and payable upon such terms as may be prescribed by the Committee. The Committee may also prescribe the form of such note and the security to be given for such note. The Option may not be exercised, however, by delivery of a promissory note or by a loan from the Company when or where such loan or other extension of credit is prohibited by law; or

(iv) With the consent of the Committee, property of any kind which constitutes good and valuable consideration; or

(v) With the consent of the Committee, a notice that the Employee has placed a market sell order with a broker with respect to shares of the Company's Common Stock then issuable upon exercise of the Option, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to the Company in satisfaction of the Option exercise price; or

(vi) With the consent of the Committee, any combination of the consideration provided in the foregoing subparagraphs (i), (ii), (iii), (iv) and (v); and

(c) Full payment to the Company (or other employer corporation) of all amounts which, under federal, state or local tax law, it is required to withhold upon exercise of the Option; with the consent of the Committee, (i) shares of the Company's Common Stock owned by the Employee for at least six months, duly endorsed for transfer, with a Fair Market Value equal to the sums required to be withheld, or (ii) shares of the Company's Common Stock issuable to the Employee upon exercise of the Option with a Fair Market Value equal to the sums required to be withheld, may be used to make all or part of such payment; and

(d) In the event the Option or portion thereof shall be exercised pursuant to Section 4.1 by any person or persons other than the Employee, appropriate proof of the right of such person or persons to exercise the Option.

Section 4.4 Conditions to Issuance of Stock Certificates

The shares of stock deliverable upon the exercise of the Option, or any portion thereof, may be either previously authorized but unissued shares or issued shares which have then been reacquired by the Company. Such shares shall be fully paid and nonassessable. The Company shall not be required to issue or deliver any certificate or certificates for shares of stock purchased upon the exercise of the Option or portion thereof prior to fulfillment of all of the following conditions:

(a) The admission of such shares to listing on all stock exchanges on which such class of stock is then listed; and

(b) The completion of any registration or other qualification of such shares under any state or federal law or under rulings or regulations of the Securities and Exchange Commission or of any other governmental regulatory body, which the Committee shall, in its absolute discretion, deem necessary or advisable; and

(c) The obtaining of any approval or other clearance from any state or federal governmental agency which the Committee shall, in its absolute discretion, determine to be necessary or advisable; and

(d) The receipt by the Company of full payment for such shares, including payment of all amounts which, under federal, state or local tax law, the Company (or other employer corporation) is required to withhold upon exercise of the Option; and

(e) The lapse of such reasonable period of time following the exercise of the Option as the Committee may from time to time establish for reasons of administrative convenience.

Section 4.5 Rights as Shareholder

The holder of the Option shall not be, nor have any of the rights or privileges of, a shareholder of the Company in respect of any shares purchasable upon the exercise of any part of the Option unless and until certificates representing such shares shall have been issued by the Company to such holder.

ARTICLE V.
OTHER PROVISIONS

Section 5.1 Administration

The Committee shall have the power to interpret the Plan and this Agreement and to adopt such rules for the administration, interpretation and application of the Plan as are consistent therewith and to interpret, amend or revoke any such rules and to amend this Agreement provided that the rights or obligations of the Employee are not affected adversely. All actions taken and all interpretations and determinations made by the Committee in good faith shall be final and binding upon the Employee, the Company and all other interested persons. No member of the Committee shall be personally liable for any action, determination or

interpretation made in good faith with respect to the Plan or the Option. In its absolute discretion, the Board may at any time and from time to time exercise any and all rights and duties of the Committee under the Plan and this Agreement except with respect to matters which under Rule 16b-3 or Section 162(m) of the Code, or any regulations or rules issued thereunder, are required to be determined in the sole discretion of the Committee.

Section 5.2 Option Not Transferable

Neither the Option nor any interest or right therein or part thereof shall be sold, pledged, assigned, or transferred in any manner other than by will or the laws of descent and distribution and subject to consent of the Committee, pursuant to a DRO or to a "Permitted Transferee" (as defined below), unless and until such Option has been exercised, or the shares underlying such Option have been issued, and all restrictions applicable to such shares have lapsed. Any transfer to a "Permitted Transferee" shall be subject to the following terms and conditions: (i) an Option transferred to a Permitted Transferee shall not be assignable or transferable by the Permitted Transferee other than by DRO or by will or the laws of descent and distribution; (ii) any Option which is transferred to a Permitted Transferee shall continue to be subject to all the terms and considerations of the Option as applicable to the original holder (other than the ability to further transfer the Option); (iii) the Employee and the Permitted Transferee shall execute any and all documents reasonably requested by the Administrator, including, without limitation, documents to (a) confirm the status of the transferee as a Permitted Transferee, (b) satisfy any requirements for an exemption for the transfer under applicable federal and state securities laws and (c) provide evidence of the transfer; (iv) the shares of Common Stock acquired by a Permitted Transferee through exercise of an Option have not been registered under the Securities Act, or any state securities act and may not be transferred, nor will any assignee or transferee thereof be recognized as an owner of such shares of Common Stock for any purpose, unless a registration statement under the Securities Act and any applicable state securities act with respect to such shares shall then be in effect or unless the availability of an exemption from registration with respect to any proposed transfer or disposition of such shares shall be established to the satisfaction of counsel for the Company. As used in this Section 5.2, "Permitted Transferee" shall mean (i) one or more of the following family members of an Employee: spouse, former spouse, child (whether natural or adopted), stepchild, any other lineal descendant of the Employee, (ii) a trust, partnership or other entity established and existing for the sole benefit of, or under the sole control of, one or more of the above family members of the Employee, or (iii) any other transferee specifically approved by the Administrator after taking into account any state or federal tax or securities laws applicable to transferable Options.

Neither the Option nor any interest or right therein or part thereof shall be sold, pledged, assigned, or transferred in any manner other than by will or the laws of descent and distribution and subject to consent of the Committee, pursuant to a DRO or by a Permitted Transferee, unless and until such Option has been exercised, or the shares underlying such Option have been issued, and all restrictions applicable to such shares have lapsed. Neither the Option nor any interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Employee or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law by judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including bankruptcy), and

any attempted disposition thereof shall be null and void and of no effect, except to the extent that such disposition is permitted by the preceding sentence.

Section 5.3 Shares to Be Reserved

The Company shall at all times during the term of the Option reserve and keep available such number of shares of stock as will be sufficient to satisfy the requirements of this Agreement.

Section 5.4 Notices

Any notice to be given under the terms of this Agreement to the Company shall be addressed to the Company in care of its Secretary, and any notice to be given to the Employee shall be addressed to him at the address given beneath his signature hereto. By a notice given pursuant to this Section 5.4, either party may hereafter designate a different address for notices to be given to him. Any notice which is required to be given to the Employee shall, if the Employee is then deceased, be given to the Employee's personal representative if such representative has previously informed the Company of his status and address by written notice under this Section 5.4. Any notice shall be deemed duly given when enclosed in a properly sealed envelope or wrapper addressed as aforesaid, deposited (with postage prepaid) in a post office or branch post office regularly maintained by the United States Postal Service.

Section 5.5 Titles

Titles are provided herein for convenience only and are not to serve as a basis for interpretation or construction of this Agreement.

Section 5.6 Construction

This Agreement shall be administered, interpreted and enforced under the internal laws of the State of Delaware without regard to conflicts of laws thereof.

Section 5.7 Conformity to Securities Laws

The Employee acknowledges that the Plan is intended to conform to the extent necessary with all provisions of the Securities Act and the Exchange Act and any and all regulations and rules promulgated by the Securities and Exchange Commission thereunder, including without limitation Rule 16b-3. Notwithstanding anything herein to the contrary, the Plan shall be administered, and the Option is granted and may be exercised, only in such a manner as to conform to such laws, rules and regulations. To the extent permitted by applicable law, the Plan and this Agreement shall be deemed amended to the extent necessary to conform to such laws, rules and regulations.

IN WITNESS WHEREOF, this Agreement has been executed and delivered by the parties hereto.

TEGAL CORPORATION

Thomas R. Mika
Executive Vice President and Chief
Financial Officer

- ----------------------------

Employee

- ----------------------------

- ----------------------------
Address

Employee's Taxpayer
Identification Number:

- ----------------------------

NON-QUALIFIED STOCK OPTION AGREEMENT (EMPLOYEES)

EXERCISE NOTICE

Tegal Corporation
2201 S. McDowell Blvd.
Petaluma, CA 94955

1. Exercise of Option. Effective as of today, ________________, the undersigned ("Optionee") hereby elects to exercise Optionee's option to purchase _________ shares of the Common Stock (the "Shares") of Tegal Corporation, a Delaware corporation (the "Company"), under and pursuant to The Sixth Amended and Restated 1998 Equity Participation Plan of Tegal Corporation (the "Plan") and the Nonstatutory Stock Option Agreement dated _____________ (the "Option Agreement").

2. Delivery of Payment. Optionee herewith delivers to the Company the full purchase price for the Shares. I hereby elect to pay the Exercise Price by delivery of cash or check to the Secretary of the Company.

In the event I have elected to exercise options via the same day exercise and sale method, you are hereby authorized to instruct __________________ (the "Broker") to accept the proceeds deriving from the sale of the Shares, and to take the following actions: (i) to deduct from the proceeds of the sale any Company expenses; (ii) to deduct from the proceeds any tax withholding requested by the Company and to request in writing from the Company a statement of the tax amounts to be withheld, if no request has been given by the company; (iii) to deliver the above amounts so deducted to the Company ; and (iv) to deliver the remaining proceed to me as I shall direct the Broker.

These instructions shall be construed as authorizing the Broker and the Company to take any other actions reasonably necessary to effect the purposes hereof and the Broker and the Company may rely upon any statements and undertakings made herein by the undersigned, as if said statements and undertakings were made directly to the Broker and the Company.

I further acknowledge that I shall bear sole responsibility for any commissions and fees relating to the performance of these instructions by the Broker or the Company and any other banking activities and will, upon demand, indemnify and defend the Broker or the Company against any amounts which may be owning in this regard.

3. Representations of Optionee. Optionee acknowledges that Optionee has received, read and understood the Plan and the Option Agreement and agrees to abide by and be bound by their terms and conditions.

4. Rights as Shareholder. Until the stock certificate evidencing such Shares is issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a

shareholder shall exist with respect to the Shares, notwithstanding the exercise of the Option. In the event Optionee has not sold the Shares in a same day exercise and sale, the Company shall issue (or cause to be issued) such stock certificate promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in the Plan.

5. Tax Consultation. Optionee understands that Optionee may suffer adverse tax consequences as a result of Optionee's purchase or disposition of the Shares. Optionee represents that Optionee has consulted with any tax consultants Optionee deems advisable in connection with the purchase or disposition of the Shares and that Optionee is not relying on the Company for any tax advice.

Purchaser agrees to satisfy all applicable federal, state and local income and employment tax withholding obligations with respect to the exercise of the Option and, if applicable, the sale of the Shares and will, upon demand, indemnify and defend the Company and if applicable the Broker, against any amounts which may be owning in this regard.

6. Successors and Assigns. The Company may assign any of its rights under this Agreement to single or multiple assignees, and this Agreement shall inure to the benefit of the successors and assigns of the Company. Subject to the restrictions on transfer herein set forth, this Agreement shall be binding upon Optionee and his or her heirs, executors, administrators, successors and assigns.

7. Interpretation. Any dispute regarding the interpretation of this Agreement shall be submitted by Optionee or by the Company forthwith to the Company's Board of Directors or the committee thereof that administers the Plan, which shall review such dispute at its next regular meeting. The resolution of such a dispute by the Board or committee shall be final and binding on the Company and on Optionee.

8. Governing Law; Severability. This Agreement shall be governed by and construed in accordance with the laws of the State of California excluding that body of law pertaining to conflicts of law. Should any provision of this Agreement be determined by a court of law to be illegal or unenforceable, the other provisions shall nevertheless remain effective and shall remain enforceable.

9. Notices. Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given upon personal delivery or upon deposit in the United States mail by certified mail, with postage and fees prepaid, addressed to the other party at its address as shown below beneath its signature, or to such other address as such party may designate in writing from time to time to the other party.

10. Further Instruments. The parties agree to execute such further instruments and to take such further action as may be reasonably necessary to carry out the purposes and intent of this Agreement.

11. Delivery of Payment. Optionee herewith delivers to the Company the full Exercise Price for the Shares.

12. Entire Agreement. The Plan and Notice of Grant/Option Agreement are incorporated herein by reference. This Agreement, the Plan and the Option Agreement constitute the entire agreement of the parties and supersede in their entirety all prior undertakings and agreements of the Company and Optionee with respect to the subject matter hereof.

Submitted by: Accepted by:

OPTIONEE: TEGAL CORPORATION

By:

- ---------------------------------- ----------------------------------

Its:

Address:

- ----------------------------------

- -----------------------------------

- -----------------------------------

EXHIBIT 10.2

TEGAL CORPORATION
OUTSIDE DIRECTOR
STOCK OPTION AGREEMENT

THIS STOCK OPTION AGREEMENT, made as of ________________ (the "Grant Date") between Tegal Corporation, a Delaware corporation (the "Company"), and ____________________ (the "Optionee"). Unless otherwise defined herein, the terms defined in the Plan shall have the same defined meanings in this Stock Option Agreement.

W I T N E S S E T H:

WHEREAS, the Company desires to provide the Optionee with the opportunity to purchase shares of its common stock, $.01 par value per share (the "Common Stock"), in accordance with the terms of the Fourth Amended and Restated Stock Option Plan for Outside Directors of Tegal Corporation (the "Plan"):

NOW THEREFORE, in consideration of the premises and of the mutual covenants and agreements hereinafter contained, the parties hereto mutually covenant and agree as follows:

1. GRANT OF OPTION. The Company hereby grants to the Optionee a nonstatutory stock option (the "Option") to purchase all or any part of an aggregate of _____________ shares of Common Stock on the terms and conditions hereinafter set forth.

2. PURCHASE PRICE. The per share purchase price of the shares of Common Stock issuable upon exercise of the Option shall be $_______, which is the fair market value of a share of Common Stock on the Grant Date.

3. TERM. Except as provided in Section 6 hereof, the term of the Option shall be a period of ten (10) years from the Grant Date.

4. VESTING. Subject to the forfeiture provisions of Section 6 hereof, the Attendance Period provisions of Section 4.3(b) of the Plan, if applicable, and the accelerated vesting provisions of Section 4.7 of the Plan, the shares subject to this Option shall vest and become exercisable as follows:

[SPECIFY VESTING SCHEDULE]

5. EXERCISE. Except as otherwise provided herein, the Option shall be exercisable only to the extent vested and prior to the termination of the Option (as provided in Section 6 hereof). Notwithstanding the foregoing, the Option shall not be exercisable after the expiration date of the Option.

6. TERMINATION OF OPTION ON CERTAIN EVENTS. The Option term and the Optionee's rights hereunder shall terminate on the date of Optionee's services as a director of the Company are terminated ("Termination Date"), subject to the following:

(a) TERMINATION OTHER THAN FOR CAUSE. Subject to Section 4.7 of the Plan, in the event the Optionee's services as a director are terminated for reasons other than "cause" (as defined below), the Optionee shall forfeit any nonvested right to purchase shares of Common Stock under the Option as of the Termination Date. The Option, to the extent vested, may thereafter be exercised in accordance with Section 5 hereof by the Optionee or, if the Optionee dies, by the Optionee's executor, administrator or other personal or legal representative, as applicable for a period equal to the length of service of such Optionee as a director of the Company, but in no event after the expiration date of the Option.

(b) TERMINATION FOR CAUSE. Subject to Section 4.7 of the Plan, in the event the Optionee's services as a director are terminated for "cause," the Optionee shall forfeit any nonvested right to purchase shares of Common Stock under the Options as of the Termination Date. The Option, to the extent vested, may thereafter be exercised in accordance with Section 5 hereof by the Optionee until the earlier of (i) six (6) months after the Termination Date or (ii) the expiration date of the Option. The Company shall have "cause" to terminate Optionee's services as a director on the basis of (i) Optionee's willful misconduct or gross negligence in connection with the performance of Optionee's responsibilities and duties for the Company, (ii) an act by Optionee of fraud, misappropriation or dishonesty that results in or is intended to result in Optionee's personal enrichment at the expense of the Company or any of its customers, vendors or suppliers, (iii) Optionee's commission of any act that constitutes a felony, (iv) Optionee's commission of any other crime or offense that involves the property, business relationships or employees of the Company, or (v) the breach by Optionee of any obligation of confidentiality, non-solicitation or non-competition under any written agreement with the Company or any obligation to the Company imposed or imputed by applicable law.

7. NONTRANSFERABILITY. No Option or interest or right therein or part thereof shall be liable for the debts, contracts or engagements of the Optionee or his successors in interest or shall be subject to disposition by transfer, alienation, anticipation, pledge, encumbrance, assignment or any other means whether such disposition be voluntary or involuntary or by operation of law, by judgment, levy, attachment, garnishment or any other legal or equitable proceedings (including, without limitation, bankruptcy), and any attempted disposition thereof shall be null and void and of no effect; provided, however, that nothing in this Section 7 shall prevent transfers by will or by the applicable laws of descent and distribution or pursuant to a qualified domestic relations order as defined under the Internal Revenue Code of 1986, as amended. During the lifetime of the Optionee, only the Optionee may exercise an Option granted to the Optionee, or any portion thereof unless it has been disposed of pursuant to a qualified domestic relations order as defined under the Internal Revenue Code of 1986, as amended, or Title I of the Employee Retirement Income Security Act of 1974, as amended, or the rules thereunder.

8. METHOD OF EXERCISING OPTION.

(a) Subject to the terms and conditions of this Agreement, the Option may be exercised by written notice by registered or certified mail, return receipt requested, addressed to the Company at its offices at the address for notices set forth in Section 10 hereof. Such notice shall state that the Option is being exercised thereby and the number of shares of Common Stock in respect of which it is being exercised. It shall be signed by the person or persons so exercising the Option and shall be accompanied by payment in full of the Option price for such shares of Common Stock (i) in cash, (ii) with the consent of the Board, in shares of Common Stock held for at least six months to be valued at the Fair Market Value (as defined in Section 6(b) of the Plan) thereof on the date of such exercise, (iii) with the consent of the Board, in surrendered Shares issuable upon the exercise of the Option having a Fair Market Value on the date of exercise equal to the aggregate Exercise Price of the Option or exercised portion thereof; (iv) with the consent of the Board, any combination of the foregoing, or (v) by other means authorized by the Board. If the Option is exercised by any person or persons other than the Optionee under Section 6(a) hereof, the notice shall be accompanied by appropriate proof of the right of such person or persons to exercise the Option. The Company shall issue, in the name of the person or persons exercising the Option, and deliver a certificate or certificates representing such shares as soon as practicable after notice and payment shall be received.

(b) The Option may be exercised in accordance with Section 5 hereof and the terms of the Plan with respect to any whole number of shares included therein, but in no event may an Option be exercised as to less than one hundred (100) shares at any one time, or the remaining shares covered by the Option if less than two hundred (200).

(c) The Optionee shall have no rights of a stockholder with respect to shares of Common Stock to be acquired by the exercise of the Option until the date of issuance of a certificate or certificates representing such shares. Except as otherwise expressly provided in the Plan, no adjustment shall be made for dividends or other rights for which the record date is prior to the date such stock certificate is issued. All shares of Common Stock purchased upon the exercise of the Option as provided herein shall be fully paid and non-assessable.

(d) If at any time the Company is required to withhold tax on ordinary income recognized by the Optionee with respect to the shares received under the Option, the amount required to be withheld shall be provided to the Company by the Optionee. Such amount shall be paid in due course by the Company to the applicable taxing authorities as income taxes withheld.

9. GENERAL. The Company shall during the term of the Option reserve and keep available such number of shares of Common Stock as will be sufficient to satisfy the requirements of this Agreement, shall pay all original issue taxes, if any, with respect to the issuance of shares of Common Stock hereunder and all other fees and expenses necessarily incurred by the Company in connection herewith, and shall, from time to time, use its best efforts

to comply with all laws and regulations which, in the opinion of counsel for the Company, shall be applicable hereto.

10. NOTICES. Each notice relating to this Agreement shall be in writing and shall be sufficiently given if sent by registered or certified mail, or by nationally recognized overnight delivery service, postage or charges prepaid, to the address as hereinafter provided. Any such notice or communication given by mail shall be deemed to have been given two business days after the date so mailed, and such notice or communication given by overnight delivery service shall be deemed to have been given one business day after the date so sent. Each notice to the Company shall be addressed to it at its offices at 2201 South McDowell Blvd., Petaluma, California 94954 (Attention: Corporate Secretary). Each notice to the Optionee or other person or persons then entitled to exercise the Option shall be addressed to the Optionee or such other person or persons at the Optionee's last known address.

11. INCORPORATION OF THE PLAN. Notwithstanding the terms and conditions contained herein, this Agreement shall be subject to and governed by all the terms and conditions of the Plan. A copy of the Plan has been delivered to the Optionee and is hereby incorporated by reference. In the event of any discrepancy or inconsistency between the terms and conditions of this Agreement and of the Plan, the terms and conditions of the Plan shall control.

12. CONTINUANCE OF INVOLVEMENT WITH THE COMPANY. The granting of the Option is in consideration of the Optionee's continuing as a director of the Company; provided, that nothing in this Agreement shall confer upon the Optionee the right to continue as a member of the board, or to be employed by the Company or any subsidiary or affect the right of the Company or any subsidiary to terminate the Optionee's membership, or employment at any time in the sole discretion of the Company, with or without cause.

13. INTERPRETATION. The interpretation and construction of any terms or conditions of the Plan, or of this Agreement or other matters related to the Plan by the Board shall be final and conclusive.

14. ENFORCEABILITY. This Agreement shall be binding upon the Optionee and such Optionee's estate, personal representative and beneficiaries.

* * *

IN WITNESS WHEREOF, the Company has caused this Agreement to be duly executed by its officer thereunto duly authorized, and the Optionee has executed this Agreement all as of the day and year first above written.

TEGAL CORPORATION

By:

Its:

OPTIONEE:

DIRECTOR'S NAME

EXHIBIT 31

CERTIFICATIONS

I, Thomas R. Mika, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tegal Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e), for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004 /s/ THOMAS R. MIKA

Thomas R. Mika
Chief Financial Officer

I, Michael L. Parodi, certify that:

1. I have reviewed this report on Form 10-Q of Tegal Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e), for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2004 /s/ MICHAEL L. PARODI

Michael L. Parodi
Chief Executive Officer

EXHIBIT 32

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

Pursuant to 18 U.S.C. ss. 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Tegal Corporation (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 12, 2004 /s/ MICHAEL L. PARODI

Michael L. Parodi
Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

Pursuant to 18 U.S.C. ss. 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Tegal Corporation (the "Company") hereby certifies, to such officer's knowledge, that:

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2004 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 12, 2004 /s/ THOMAS R. MIKA

Thomas R. Mika
Chief Financial Officer