

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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED MARCH 31, 1997

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)

<TABLE>

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

2201 SOUTH MCDOWELL BLVD. P.O. BOX 6020 PETALUMA, CALIFORNIA		94955-6020
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)	

</TABLE>

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (707) 763-5600

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:

COMMON STOCK, \$0.01 PAR VALUE

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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing sale price of the Common Stock on June 13, 1997, as reported on the Nasdaq National Market was \$30,148,170. As of June 13, 1997, 10,282,489 shares of the Registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for Registrant's 1997 Annual Meeting of Stockholders to be held on September 23, 1997, will be filed with the Commission within 120 days after the close of the Registrant's fiscal year and are incorporated by reference in Part III.

TABLE OF CONTENTS

PART I

<TABLE>
<CAPTION>

	PAGE
<S>	----
<C>	<C>
Item 1. Business.....	2
Item 2. Properties.....	19
Item 3. Legal Proceedings.....	19
Item 4. Submission of Matters to a Vote of Security Holders.....	19
PART II	
Item 5. Market for Registrant's Common Equity and Related Shareholder Matters.....	22
Item 6. Selected Financial Data.....	22
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.....	22
Item 8. Financial Statements and Supplementary Data.....	26
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.....	26
PART III	
Item 10. Directors and Executive Officers of the Registrant.....	27
Item 11. Executive Compensation.....	27
Item 12. Security Ownership of Certain Beneficial Owners and Management.....	27
Item 13. Certain Relationships and Related Transactions.....	27
PART IV	
Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K.....	28
Signatures.....	46

</TABLE>

PART I

ITEM 1. BUSINESS

Information contained or incorporated by reference 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 following contains cautionary statements identifying important factors with respect to such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

THE COMPANY

Tegal Corporation ("Tegal" or the "Company") designs, manufactures, markets and services plasma etch systems used in the fabrication of integrated circuits ("ICs"). Etching constitutes one of the principal IC production process steps and must be performed numerous times in the production of an IC.

The Company was formed in December 1989 to acquire the operations of the former Tegal Corporation, a division of Motorola. The predecessor company was founded in 1972 and acquired by Motorola in 1978. The Company's current management was recruited beginning in 1991.

SEMICONDUCTOR INDUSTRY BACKGROUND

Growth of Semiconductor and Semiconductor Equipment Industries

The semiconductor industry has experienced significant growth in recent years. This growth has resulted from the increasing demand for ICs from traditional IC markets, such as personal computers, telecommunications, consumer electronics, automotive electronics and office equipment, as well as the recently developing markets, such as multimedia, wireless communications and portable and network computing. As a result of this increased demand, semiconductor device manufacturers in recent years have expended significant amounts of capital to build new semiconductor fabrication facilities ("fabs")

and to expand existing fabs. In spite of the continuing growth in demand for semiconductors, the industry periodically experiences periods of excess supply and excess capacity as additions to capacity are brought online in large increments which exceed the short-term growth in demand for ICs such as has occurred in late 1995 and continues through the date of this report.

Growth in the semiconductor industry has been driven, in large part, by advances in semiconductor performance at a decreasing cost per function. Increasingly advanced semiconductor processing technologies allow semiconductor manufacturers to produce ICs with smaller features, thereby increasing processing speed and expanding device functionality and memory capacity. As ICs have become more complex, however, both the number and price of state of the art process tools required to manufacture ICs have increased significantly. As a result, the cost of semiconductor manufacturing equipment is becoming an increasingly large part of the total cost in producing advanced ICs. Today, the average state of the art dynamic random access memory (DRAM) fab costs from \$500 million to over \$1.0 billion, with semiconductor manufacturing equipment costs representing the majority of total fab costs.

Semiconductor Production Processes

To create an IC, semiconductor wafers are subjected to a large number of complex process steps. The three primary steps in manufacturing ICs are (1) deposition, in which a layer of insulating or conducting material is deposited on the wafer surface, (2) photolithography, in which the circuit pattern is projected onto a light sensitive material (the photoresist), and (3) etch, in which the unmasked parts of the deposited material on the wafer are selectively removed to form the IC circuit pattern.

Each step of the manufacturing process for ICs requires specialized manufacturing equipment. Today, plasma etch systems are used for the great majority of etching processes. During a plasma etch process (also

2

known as "dry etch"), a semiconductor wafer is exposed to a plasma composed of a reactive gas, such as chlorine, which etches away selected portions of the layer underlying the patterned photoresist layer.

Segmentation of the Etch Market

The Company believes that the dry etch market is becoming increasingly segmented. Certain dry etch technologies or processes are better suited for etching different types of materials (films) and, as a result, the dry etch market may be segmented according to the type of film being etched. In addition, as ICs become increasingly complex, certain etch steps required to manufacture a state of the art IC demand leading edge (or "critical") etch performance. For example, to produce a 64-megabit DRAM device, semiconductor manufacturers are required to etch certain device features at dimensions as small as 0.35 micron. Nonetheless, even in the most advanced ICs, a significant number of production steps can be performed with a significantly less demanding (or "non-critical") etch performance. As a result, the Company believes the etch market has also begun to segment according to the required level of etch performance -- critical or noncritical.

Segmentation of the Etch Market by Film

The dry etch market is generally segmented into the following market segments, defined according to the class of film being etched: polysilicon, oxide (dielectric) and metal. According to VLSI Research Inc., the polysilicon, oxide and metal segments of the dry etch market represented approximately 40%, 42% and 18%, respectively, of the total sales of dry etch systems in 1996. New films are continually being developed in each of these three market segments.

Today, the semiconductor industry is faced with the need to develop and adopt an unprecedented number of new films as conventional materials, are running out of the physical properties needed to support continuing shrinks in die size and to provide improved performance. Certain of these films present unique etch production problems. For example, the use of certain new films, such as platinum, currently being used in the development of high-density DRAM devices, and Lead Zirconium Titanate (PZT), currently being used in the development of non-volatile, ferroelectric random access memory (FRAM) devices, is presenting new challenges to semiconductor manufacturers. While these new

films contribute to improved IC performance and reduced die size, their unique properties make them particularly difficult to etch and, therefore, require more advanced etch process technologies. Similarly, corrosion of metal etched wafers within 48 to 72 hours after completion of the etch process has been a chronic problem for semiconductor manufacturers, regardless of the line geometries involved. The reaction byproducts of a chlorine based metal etch process tend to redeposit on the wafer and corrode when exposed to water in the atmosphere. Removal of these contaminants from the wafer is essential to prevent this corrosion.

Segmentation of the Etch Market into Critical and Non-Critical Production Steps

As device complexity has increased, the number of process steps required to manufacture a state of the art IC has increased dramatically. The Company estimates that a 64-megabit DRAM device requires more than 500 process steps, and the Company believes approximately 50 of these process steps are etch. Each etch step varies significantly in the degree of etch performance required to complete that step successfully. As a result, the Company estimates that approximately 20% to 25% of the etch systems currently required to produce a 64-megabit DRAM device need only provide non-critical etch performance.

Examples of non-critical etch processes involved in the production of a 64-megabit DRAM device include pad etching, zero layer etching and backside etching. The pad etching process involves the formation of relatively sizable areas, or pads, on which wires are bonded to attach to the metal leads of the IC's package. Pad etching typically requires a relatively large, non-critical etch 20 to 50 microns square. Zero layer etching, the etching of targets into the wafer for alignment of photolithography equipment, usually requires dimensions of 2 to 5 microns. Backside etching, in which the build-up of films resulting from the deposition process is removed from the backside of the wafer, has no dimensional requirement. Each of these process requirements has remained relatively constant over succeeding generations of IC devices, and the Company believes that

3

these and many other non-critical etch processes currently required to produce state of the art ICs will remain non-critical for the foreseeable future.

Over time, the disparity in relative prices for etch systems capable of etching at non-critical versus critical dimensions has grown significantly. The Company believes that in 1993, the cost of an eight inch wafer-capable system ranged from approximately \$500,000 to \$700,000. Given the relatively modest price differential among etchers, manufacturers of ICs and similar devices tended to purchase one system, the one they believed provided the most technologically advanced solution for their particular etch requirements, to perform all their etching. In contrast, the cost today of an eight inch capable etch system ranges from approximately \$500,000, for reliable, non-critical etchers, to more than \$2.5 million, for advanced, state of the art critical etchers. Consequently, the Company believes it is no longer cost effective to use state of the art etchers to perform both critical and non-critical etching.

As a result, the Company believes that semiconductor manufacturers will increasingly implement a "mix and match" purchasing philosophy to minimize their capital equipment expenditures by purchasing expensive, state of the art etch systems for their critical etch process requirements and less expensive, though reliable, etch systems for their noncritical etch requirements. When critical etching is required in the production process, the Company believes that the leading purchasing factor for a semiconductor manufacturer will continue to be, ultimately, the product's etch performance. When non-critical etching is required in the production process, the Company believes the leading system purchasing factor for a semiconductor manufacturer implementing a "mix and match" purchasing philosophy will be the overall product cost, with particular emphasis on the system's sale price. In either case, however, the semiconductor manufacturer is driven to make a value-oriented purchasing decision which minimizes the overall etch system costs, while meeting the required etch process performance. The Company believes that a well-implemented "mix and match" purchasing philosophy already adopted by a significant number of semiconductor manufacturers to minimize their expenditures for photolithography equipment, could allow a semiconductor manufacturer to realize significant etch system savings.

BUSINESS STRATEGY

Tegal believes it currently has one of the largest installed bases of etch equipment in the industry and that over the years it has earned a reputation as a supplier of reliable, value-oriented etch systems. The Company's systems are sold throughout the world to both domestic and international customers. In fiscal 1997, approximately 69% of the Company's revenues resulted from international sales. To support its systems sales, the Company maintains local service and support in every major geographic market in which it has an installed base, backed up by a spares logistics system designed to provide delivery within 24 hours anywhere in the world.

The Company's objective is to build on its technical knowledge, experience and reputation in the etch industry, as well as its established sales, marketing and customer service infrastructure, to be a leading supplier of etch systems for both the critical and non-critical segments of the etch market. To meet this objective, the Company is implementing a business strategy incorporating the following elements:

- Use the performance capabilities and value positioning of the Company's 6500 series systems to penetrate the critical etch market for emerging film, polysilicon and metal etch applications;
- Use the Company's existing installed base and established customer relationships to increase sales of both non-critical and critical etch systems to its existing customers;
- Leverage the Company's reputation as a supplier of value-oriented, non-critical etch systems to sell such systems to new customers implementing a "mix and match" purchasing philosophy, and follow such sales by aggressively marketing critical etch systems to these customers; and
- Continue to focus research and development efforts on identifying and designing critical etch system solutions to address new or unsatisfied etch process requirements, particularly selected etch applications where the Company believes its process technologies and development experience provide it with a competitive advantage.

4

TEGAL'S CRITICAL ETCH SOLUTION

The Company believes a value-oriented critical etch system must be designed to (i) provide high performance critical etching, (ii) deliver a high average wafer throughput, (iii) minimize up-front investment costs, (iv) minimize operating costs and (v) provide a solution for the production of multiple generations of ICs. In 1991, the Company began developing a new generation of technology and systems in order to provide a value-oriented system solution for future critical etch needs, initially in the polysilicon and metal segments of the etch market. In July 1994, the Company introduced its 6510 system, designed for polysilicon etch applications at the sub-0.5 micron level. In July 1995, the Company introduced its 6520 system, designed for metal etch applications, and its 6540 system, designed for new, emerging film etch applications. In July 1996, the Company introduced its 6510i, designed for isolation trench and selective nitride applications. The Company's 6500 series critical etch systems typically range between \$1.8 million and \$2.5 million.

Provide for High Performance Critical Etch

A high performance critical etch system must etch features with anisotropic profiles (i.e. straight, vertical sidewalls) while etching selectively, to minimize damage to the underlayer or other wafer materials, and etching uniformly over a non-uniform area. These performance requirements become increasingly difficult to achieve at critical etch line geometries, especially the smaller line geometries below 0.5 micron required by current, state of the art ICs. The Company believes that its High-density Reflected electron ("HRe-") process chamber, incorporating a low pressure, high density, low energy plasma source and its patented tri-electrode energy source, produces the straight, vertical etching and high selectivity required to provide superior etch performance at these critical line geometries. In addition, the Company's 6520 metal etch system incorporates a patent-pending etch-rinse-strip-rinse process sequence which, the Company believes, provides a system solution for many of the

corrosion problems common to metal etch applications. The Company is finding that customers are increasingly adopting these same rinse and strip capabilities on its emerging film and polysilicon systems in order to minimize post etch corrosion and to remove residues created by those etch processes.

Deliver a High Average Throughput

Throughput is a measure of the number of wafers a particular system can etch in a given period of time. The industry has usually measured a system's throughput in terms of the number of wafers processed per hour. A system with a high hourly throughput, however, may have a significantly lower average throughput over the long term depending upon system design and durability. As a result, the Company believes that a value-oriented system must deliver not only a high hourly throughput but also, and perhaps more importantly, a high average system throughput over the long term. Due to the corrosive nature of the etch process, etching produces a large amount of contaminants and erodes process chamber parts (consumables). Therefore, in order to deliver the precision and repeatability necessary for superior etch results, etch systems require periodic cleaning and maintenance. The 6500 series system architecture is designed so that only six of the Company's HRe- process chamber parts are exposed to the corrosive etch plasma. These six parts are designed to be easily removable and replaceable in order to allow for off-line cleaning and to minimize disruption to the etch process. In addition, the Company's HRe- process chamber incorporates a high speed vacuum pump located above and close to the wafer surface in order to remove contaminants from the chamber more effectively, resulting in a cleaner etch process and relatively fewer scheduled cleanings. Finally, the Company's 6500 series system is designed to maximize reliability in order to minimize unscheduled maintenance down-time.

Minimize Up-front Investment Costs

While performance remains crucial to purchasing decision in the critical etch segment, cost containment pressures are causing semiconductor manufacturers to demand critical etch performance with lower up-front investment cost.

Consequently, a value-oriented critical etch system must sell for an attractive price, relative to comparable etch systems. A value-oriented system should also be designed to minimize installation costs,

5

which can be substantial, and should have a small "footprint" (the production area occupied by the system) to maximize the efficient use of limited, expensive fab production space. The Company believes the design of its 6500 series systems allows the Company to sell these systems at prices which are generally significantly below the prices of comparable systems offered by the Company's competitors. The Company has also designed its 6500 series systems to minimize the time and expense required for system installation. In addition, with a footprint of only 32 square feet, the 6500 series system occupies substantially less production space than any comparable critical etch system currently offered in the market.

Minimize Operating Costs

Given the complexity of the critical etch process, the costs of operating a critical etch system can be substantial. A significant portion of overall operating costs relates to the cost of servicing and replacing consumables, or process chamber parts destroyed in the corrosive etch production process. A value-oriented system, therefore, must be designed to minimize consumables. In the Company's HRe- process chamber only six process chamber parts are exposed to the corrosive plasma. In addition, the Company believes a magnetic field designed to concentrate the plasma over the wafer also has the effect of protecting process chamber parts from the corrosive plasma. As a result of its process chamber design, the Company believes its 6500 series systems have significantly lower consumables costs than its competitors' current systems.

Provide Solutions for Multiple Generations of Device Production Requirements

The Company also believes that a value-oriented critical etch system should be responsive not only to the manufacturers' current etch requirements, but also should be capable of delivering the etch performance required for the production of multiple generations of ICs in order to maximize the useful life of the system. As ICs continue to become increasingly complex, production requirement

will demand 0.25 micron and smaller processing technology. Systems that have not been designed to meet these demands will eventually need to be replaced at a significant expense. The Company's 6500 series systems have demonstrated the ability to etch circuit lines down to 0.18 micron. As a result, the Company believes its 6500 series systems will continue to provide solutions for future isolation trench, emerging film, polysilicon and metal etch requirements.

TEGAL'S NON-CRITICAL ETCH SOLUTION

The Company believes that its 900 and 980 systems provide a value-oriented non-critical etch solution for etch applications on polysilicon and oxide films. The Company introduced its 900 series etch system in 1984 and since that time has sold more than 1,200 of these systems worldwide. The Company believes that the durability and performance of its 900 series systems have earned the Company a reputation as a leading non-critical etch system supplier. The 900 series as originally designed, however, was capable of etching only six inch and smaller wafers and, therefore, did not address the needs of the eight inch wafer market. As a result, the Company expanded its non-critical product offerings in July 1994 with the introduction of its eight inch wafer capable 980 system. The Company introduced an enhanced 980 system in July 1995 which has a smaller footprint and provides higher throughput and improved yields as compared to the prior 980 system design. The Company's 900 and 980 systems sell for a typical price of \$350,000 and \$500,000, respectively. The Company believes that these systems provide some of the best values currently available on the market for the large number of non-critical etch steps required to produce today's state of the art ICs. The Company intends to market its 900 and 980 systems aggressively as value-oriented solutions for the developing non-critical market segment. The Company will also seek to lever its large installed base of non-critical etch systems with its existing customers in order to sell them not only additional non-critical etch systems, but also critical etch systems.

TECHNOLOGY

In 1991, the Company began developing a new generation of technology for leading edge etch requirements, initially in the polysilicon and metal segments of the market. The Company's product development efforts culminated in the Company's HRe- process chamber and its etch-rinse-strip-rinse

6

("E-R-S-R") process sequence, incorporated into the Company's 6520 systems for metal etch applications and offered as an option on its 6510 and 6540 systems for polysilicon and emerging film etch applications, respectively.

HRe- Process Chamber

The HRe- process chamber, formally introduced in April 1993, incorporates advances in five interrelated areas: (i) the plasma source, (ii) control of electrical energy flow, (iii) gas flow technology, (iv) process chamber design, and (v) gas chemistries and recipes.

HRe- Plasma Source

The Company's HRe- plasma source includes a magnetic field which contains the plasma at a low pressure, high density and low energy. For sub-0.5 micron devices, the plasma source must operate at a low pressure with a high density of activated gases at the wafer and a low energy in order to deliver superior etch results. A low pressure plasma improves the overall quality of the etch by minimizing the undercutting of wafer features as well as the effects of microloading (etching concentrated features more rapidly than less concentrated features), both of which adversely affect overall yield. Low pressure, however, requires a high density plasma at the wafer to increase the number of plasma particles reacting with the film being etched in order to maintain a fast etch rate. A fast etch rate is one factor leading to a higher average throughput. Low ion energy leads to improved etch selectivity and minimizes wafer damage, both of which improve overall yield.

Tri-electrode Control System

The Company's patented tri-electrode control system is designed to direct most of the electrical energy flow through the side wall of the etch chamber instead of the wafer. As a result, only four to eight watts of energy generally flow through wafers processed in the Company's HRe- chamber, as compared to 200

to 500 watts in most major competitors' systems. High energy levels flowing through the wafer can result in uncontrolled wafer overheating, which can lead to wafer damage. As a result, many of the Company's competitors are forced to include process technology designed to cool their wafers to avoid such damage. In contrast, the Company's tri-electrode control system controls energy flows through the wafer to such an extent that the process chamber actually heats the wafer by non-electrical means to help evaporate the solids and eliminate particles and residues on the wafer surface. The Company believes that less energy flowing through the wafer allows the HRe- process chamber to be used for a large variety of films. In addition, lower wafer temperatures allow the use of traditional masking materials instead of requiring newly developed hard masking materials. Hard masking materials require additional process steps to remove.

Gas Flow Technology

In order to maintain high etch rates, it is essential to maintain a fresh supply of activated gases. Similarly, consumed gases and evaporated materials must be removed from the etch chamber as quickly as possible to minimize condensation on the wafer and chamber surfaces. To maximize the removal of consumed gases and evaporated materials, the HRe- process chamber incorporates a high-speed pump located close to, and directly above, the wafer surface. The Company believes that its process chamber has one of the highest gas flow rates in the industry. The Company designed the HRe- etch chamber to be small in volume with a high gas flow rate in order to allow the evaporated materials less time to condense on the surface of the wafer and chamber, resulting in a cleaner etch process. A cleaner etch process requires less frequent chamber cleaning and maintenance, thereby maximizing processing time and average throughput.

Process Chamber Design

Given the corrosive nature of the high density etch process, consumables (i.e. chamber parts eroded by the etch process) have historically resulted in significant repair and down-time costs for semiconductor manufacturers. The HRe-process chamber was designed so that only six chamber parts, as compared to many

7

more in most competitors' current systems, contact the chamber's corrosive environment. All six chamber parts have been designed to be easily removed and replaced to allow for off-line cleaning and minimal disruption of processing time.

Chemistries and Recipes

Each different film being etched requires a different etch chemistry or "recipe" which generally consists of two or three of the following gases: Chlorine, bromine, fluorine and argon. Development of the optimal etch recipe for a given film is an experimental science in which the Company has a large degree of experience due to its large installed base of applications and experienced applications engineers.

"E-R-S-R" Process Sequence

Corrosion of metal etch wafers within a 48 to 72 hour period following completion of the etch process has been a chronic problem for semiconductor manufacturers performing metal etch applications, regardless of the line geometries involved. In order to address this corrosion problem, the Company's 6520 system for critical metal applications has been designed to incorporate an etch-rinse-strip-rinse ("E-R-S-R") process sequence for which the Company has been notified it will shortly be granted a patent. The Company believes that rinsing the wafer prior to the strip process significantly reduces corrosion by removing the chlorinated metal contaminants from the wafer surface before they can react with the air to form the acids which corrode the metal lines. In addition, removal of reaction byproducts before the strip process prevents the chlorinated metals from oxidizing to form metal residues which become water insoluble as a byproduct of the stripping process. The Company believes that additional time consuming processing steps are required to remove these post metal etch strip residues, thereby adding to total production cycle time and capital equipment cost. The Company believes that no other system on the market today is capable of providing this on-line process sequence. Most other competitive critical etch systems are designed to provide only an etch-strip-rinse process sequence, if they provide a rinse process at all. As a result, the Company believes that its 6520 HRe- metal etch system, with its

E-R-S-R process sequence, greatly reduces residue contamination and increases wafer throughput, while reducing capital costs and clean room floor space requirements. The Company believes that this E-R-S-R process sequence is also beneficial to certain emerging film applications and, therefore, provides this process sequence as an option on its 6540 systems for emerging films and on its 6510 systems for polysilicon side wall veil removal.

PRODUCTS

Critical Etch Products

The Company offers several models of its 6500 series critical etch products based on film type and application desired by the customer. In 1994, Tegal introduced 6500 series etch system for sub-0.5 micron polysilicon etching.

In 1995, the Company introduced its emerging films 6500 series etch system for the etching of new materials at sub-0.5 micron, such as platinum used in the development of high-density DRAM devices, Lead Zirconium Titanate (PZT), currently being used in the development of FRAM devices, and alternative films used for these same purposes such as Iridium and Y1 or Barium Strontium Titanate (BST). The Company also introduced its metal etch system for sub-0.5 micron critical etching of aluminum/copper alloys, 5 layer composite films with aluminum and aluminum/silicon/titanium alloys in 1995. In 1996, the Company introduced its isolation technology 6500 series etch system aimed at isolation trench and selective nitride etch applications used in the development and production of memory devices employing design rules at or below 0.35 micron. All 6500 series models offer one and two-chamber configurations.

The Company's 6500 series systems have been engineered to provide process flexibility and competitive throughput for wafers up to eight inches, while minimizing cost and space requirements. A dual chamber platform design allows for either parallel or integrated etch processes. The Company seeks to maximize the 6500 series systems' average throughput by incorporating a process chamber technology and system

8

architecture designed to minimize processing down-time required for cleaning and maintenance. Each 6500 series system has a central wafer handling system with full cassette (25-wafer) vacuum loadlocks, noncontact optical wafer alignment and a vacuum transport system. Individual process module servicing is possible without shutting down the system or other chambers. Contamination control features in the 6500 series systems include pick and place wafer handling with no moving parts above the wafer, four-level vacuum isolation from the atmosphere to the etch chamber, and individual high-throughput, turbo-pumped vacuum systems for the cassettes, wafer handling platform and each process module. These and other features of the 6500 series are designed to enable a semiconductor manufacturer to reduce wafer particle contamination to a level which the Company believes exceeds industry standards and to improve etch results and process flexibility.

In addition, the Company's 6500 series systems incorporate a software system which has been designed and tested to minimize the risk of the system operator "crashing" the system or interrupting wafer fabrication and to be easy to use. This software system incorporates a software architecture designed to operate in multiple interface modes, including operator, maintenance engineer, process engineer and diagnostic modes. Features include icon-based touch screen menus for ease of use. In addition, the software provides a quick-response interface which allows the semiconductor manufacturer access to all necessary system information for factory automation. The system includes data archiving and remote, real time diagnostics.

Non-Critical Etch Products

The Company first introduced its 900 series etch system in 1984 as a critical etch tool of that era. Over the years, the Company has repositioned the 900 series system as a non-critical etch system capable of performing the less-demanding etch steps required in the production of an IC. In 1994, the Company introduced a 8 inch wafer capable 900 series system (capable of etching 5 inch to 8 inch wafers) that was a scaled-up version of its 3 inch to 6 inch wafer capable noncritical etch system. The 900 series non-critical etch systems are aimed at pad, zero layer, non-selective nitride, backside, planarization and small flat panel display applications and more recently, at thin film etch

applications used in the manufacture of read-write heads for the disk drive industry.

The 900 and 980 series systems incorporate a single diode process chamber on a non-loadlocked modular platform for reliability and ease of maintenance, which the Company believes results in higher average throughput and lower operating costs. Continued improvements in both reliability and performance have enabled the Company to offer the 900 and 980 series systems as a solution for non-critical applications involving line widths of 0.8 micron and greater.

CUSTOMERS

The Company sells its systems to semiconductor manufacturers throughout the world. Major customers over the last three fiscal years have included the following:

<TABLE>

<S>	<C>	<C>	
Austria Mikro Systeme International	Motorola	Siemens	
Bosch	Newport Wafer Fab	Sony	
EMM	Northern Telecom	Telecom Semiconductor	
Hewlett-Packard	Rohm	Toshiba	
Hyundai	SGS-Thomson Microelectronics Corporation	United Microelectronics Corporation	
International Rectifier - Hex Fet America	Samsung	VLSI Technology	
Linear Technology	Seiko	Winbond	
Matsushita	SEL		
Micrel Semiconductor	Shanghai Belling		

</TABLE>

9

All of these customers, except Austria Mikro Systeme International, Newport Wafer Fab, Rohm, Telecom Semiconductor, United Microelectronics Corporation and VLSI Technology ordered one or more systems from the Company in fiscal 1997. The composition of the Company's top five customers has changed from year to year, but net system sales to the Company's top five customers in each of fiscal 1997, 1996 and 1995 accounted for 46.7%, 48.6% and 54.3%, respectively, of the Company's total net system sales. Winbond, Hyundai and Motorola represented 16.8%, 13.6% and 10.2%, respectively, of the Company's net system sales in fiscal 1997. Sony and Motorola represented 16.3% and 14.9%, respectively, of the Company's net system sales in fiscal 1996. Motorola and SGS-Thomson Microelectronics represented 18.5% and 17.2%, respectively, of the Company's net system sales in fiscal 1995. Other than the above customers, no single customer represented more than 10% of the Company's net system sales in fiscal 1997, 1996 or 1995. Although the composition of the group comprising the Company's 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 material adverse effect on the Company's business, financial condition and results of operations.

BACKLOG

The Company schedules production of its systems based upon order backlog and customer commitments. The Company includes in its backlog only orders for which written authorizations have been accepted and shipment dates within the next 12 months have been assigned. As of March 31, 1997 and 1996 the Company's order backlog was approximately \$8.3 million and \$16.5 million, respectively. Systems orders are subject to cancellation by the customer, but with substantial penalties other than in the case of orders for evaluation systems or for systems which have not yet incurred production costs. Orders may be subject to rescheduling with limited or no penalty. Some orders are received for systems to be shipped in the same quarter as the order is received. Because of the factors just mentioned, the Company's backlog at any particular date is not necessarily indicative of actual sales for any succeeding period.

MARKETING, SALES AND SERVICE

The Company sells its systems worldwide through a network of 14 direct sales representatives and 18 independent sales representatives in 15 sales

offices located throughout the world. In the United States, the Company markets its systems through direct sales personnel located in its Petaluma, California headquarters, a regional sales office and through two independent sales representatives. In addition, the Company provides field service and applications engineers out of three regional offices and its Petaluma headquarters in order to ensure dedicated technical and field process support throughout the United States on short notice.

The Company maintains sales, service, and process support capabilities in Japan, Taiwan, France and Germany and service/support operations in Austria, China, Italy and the United Kingdom. In addition to its international direct sales and support organizations, the Company markets its systems through independent sales representatives in China, Israel, Italy, Korea and Singapore.

International sales, which consist of export sales from the United States either directly to the end user or to one of the Company's foreign subsidiaries, accounted for 69.0%, 63.2% and 62.7% of total revenue for fiscal 1997, 1996 and 1995, respectively. The Company generally sells its systems on 30-to-60 day credit terms to its domestic and European customers. Customers in Pacific Rim countries, other than Japan, are generally required to deliver a letter of credit payable in U.S. dollars upon system shipment. Sales to other international customers, including Japan, are either billed in local currency or U.S. dollars. The Company anticipates that international sales will continue to account for a significant portion of revenue in the foreseeable future. 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 the Company's 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 distributors or representatives, difficulties in staffing and managing international operations and potentially adverse tax consequences. There can be no

10

assurance that any of these factors will not have a material adverse effect on the Company's business, financial condition and results of operations.

The Company generally warrants its new systems for 12 months and its refurbished systems for six months from shipment. Installation is included in the price of the system. The Company's field process engineers provide customers with call-out repair and maintenance services for a fee. Customers may also enter into repair and maintenance service contracts covering the Company's systems. The Company trains customers' service engineers to perform routine service for a fee and provides telephone consultation services generally free of charge.

The sales cycles for the Company's systems vary depending upon whether the system is an initial design-in, reorder or used equipment. Initial design-in sales cycles are typically 12 to 18 months, particularly for 6500 series systems. In contrast, reorder sales cycles are typically four to six months, and used system sales cycles are generally one to three months. The initial design-in sales cycle begins with the generation of a sales lead, which is followed by qualification of the lead, an analysis of the customer's particular applications needs and problems, one or more presentations to the customer, frequently including extensive participation by the Company's senior management, two to three wafer sample demonstrations, followed by customer testing of the results and extensive negotiations regarding the equipment's process and reliability specifications. Initial design-in sales cycles are monitored by senior management for correct strategy approach and prioritization. The Company may, in some instances, need to provide the customer with an evaluation critical etch system for three to six months prior to the receipt of a firm purchase order.

RESEARCH AND DEVELOPMENT

The market for semiconductor capital equipment is characterized by rapid technological change. The Company believes that continued and timely development of new systems and enhancements to existing systems is necessary for it to maintain its competitive position. Accordingly, the Company devotes a significant portion of its personnel and financial resources to research and development programs and seeks to maintain close relationships with its

customers in order to be responsive to their system needs.

The Company's research and development encompasses the following areas: plasma technology, process characterization and development, material sciences applicable to the etch environment, system design and architecture, electro-mechanical design and software engineering. Management emphasizes advanced plasma and reactor chamber modeling capabilities in order to accelerate bringing advanced chamber designs to market. The Company employs multi-discipline teams to facilitate short engineering cycle times and rapid product development. There can be no assurance that the Company will be able to develop, introduce or sell new and enhanced systems. In particular, if the 6500 series does not achieve significant sales or volume production due to a lack of customer acceptance, inability to correct technical, manufacturing or other difficulties which may develop with this series, or for any other reason, the Company's business, financial condition and results of operations would be materially adversely affected.

As of March 31, 1997, the Company had 68 full-time employees dedicated to equipment design engineering, process support and research and development. Research and development expenses for fiscal 1997, 1996 and 1995 were \$10.5 million, \$10.0 million and \$8.1 million, respectively, and represented 18.3%, 16.1% and 18.1% of total revenue, respectively. Such expenditures were used for the development of new systems and the continued enhancement and customization of existing systems. The Company expects that research and development expenses will continue at current levels or increase slightly in fiscal 1998.

MANUFACTURING

The Company's etch systems are produced at its headquarters in Petaluma, California. The Company's manufacturing activities consist of assembling and testing components and sub-assemblies which are then integrated into finished systems. The Company has structured its production facility to be driven either by orders or by forecasts and has adopted a modular system architecture to increase assembly efficiency and design flexibility. The Company has also implemented "just-in-time" manufacturing techniques in its assembly processes. The Company believes that improvements in manufacturing processes have allowed the

11

Company to reduce significantly its non-critical system manufacturing cycle times. Non-critical system manufacturing cycle times, which typically took nearly three months in 1990, now take approximately 14 days. The Company's cycle times for its critical etch products are currently two to three months. The Company seeks to improve these cycle times as the Company continues to manufacture 6500 systems.

The Company procures certain components and sub-assemblies included in its systems from a limited group of suppliers, and occasionally from a single source supplier. In particular, the Company is dependent upon MECS, a robotic equipment supplier, as the sole source for the robotic arm used in all of its 6500 series systems. The Company currently has no existing supply contract with MECS, and the Company currently purchases all robotic assemblies from MECS on a purchase order basis. Disruption or termination of certain of these sources, including its robotic sub-assembly source, could have an adverse effect on the Company's operations. While the Company believes that alternative sources could be obtained and qualified to supply these components or sub-assemblies, a prolonged inability to obtain such components or sub-assemblies, receipt of defective components or sub-assemblies, as well as difficulties or delays in shifting to alternative sources could have a material adverse effect on the Company's operating results and could damage customer relationships.

ENVIRONMENTAL MATTERS

The Company is 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 the manufacturing process. The Company believes that it is currently in compliance in all material respects with these regulations and that it has obtained all necessary environmental permits to conduct its business, which permits generally relate to the discharge of hazardous wastes. Nevertheless, the failure to comply with present or future regulations could result in fines being imposed on the Company, suspension of production, alteration of the Company's manufacturing processes, or cessation of

operations. Such regulations could require the Company to acquire expensive remediation equipment or to incur other expense to comply with environmental regulations. Any failure by the Company to control the use, disposal or storage of, or adequately restrict the discharge of, hazardous substances could subject the Company to future liabilities.

COMPETITION

The semiconductor capital equipment industry is highly competitive. The Company believes that the principal competitive factor in the critical segment of the etch industry is technical performance of the system, followed closely by the existence of customer relationships, the overall system price, the ability to provide service and technical support on a global basis and other related cost factors. The Company believes that the principal competitive factor in the non-critical segment of the etch industry is system price, followed closely by the technical performance of the system, the existence of established customer relationships, the ability to provide service and technical support on a global basis and other related cost factors.

The Company believes that to be competitive, it 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 the Company's existing and potential competitors, including, among others, Applied Materials, Inc., Lam Research Corporation, Hitachi Ltd. 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 and other production equipment and broader process equipment offerings as well as greater name recognition than the Company. The Company expects its competitors to continue to improve the design and performance of their current systems and processes and to introduce new systems and processes with improved price and performance characteristics. No assurance can be given that the Company will be able to compete successfully in the United States or worldwide.

A substantial investment is required to install and integrate capital equipment into a semiconductor production line. The Company believes that once a device manufacturer has selected a particular vendor's capital equipment, that manufacturer generally relies upon that vendor's equipment for the specific production

line application and, to the extent possible, subsequent generations of similar systems. Accordingly, it may be extremely difficult to achieve significant sales to a particular customer once another vendor's capital equipment has been selected by that customer unless there are compelling reasons to do so, such as significant performance or cost advantages. Certain of the Company's competitors have entered into strategic relationships or alliances with leading semiconductor manufacturers, particularly with respect to the generation of devices at 1.0 to 0.5 micron line geometries for which the Company did not offer competitive systems at the time buying decisions were made. If such relationships or alliances cover etch equipment similar to those sold by the Company, the Company's ability to sell its 6500 series systems would be adversely affected. In addition, certain of the Company's competitors may seek to sell, as an attractively priced package, etch equipment together with other process equipment, such as deposition equipment. Furthermore, some semiconductor manufacturers have already made initial buying decisions for the next generation of sub-0.5 micron etch requirements. Any failure to gain access and achieve sales to new customers will adversely affect the successful commercial introduction of the Company's 6500 series systems and would have a material adverse effect on the Company's business, financial condition and results of operations.

INTELLECTUAL PROPERTY

The Company holds an exclusive license to 25 United States patents, including its tri-electrode control system, and 26 corresponding foreign patents covering various aspects of its systems. The Company has been formally notified that it will shortly be granted a patent for its E-R-S-R process sequence directly, and has applied for 5 additional United States patents. The Company believes that the duration of such patents generally exceed the life cycles of the technologies disclosed and claimed therein. The Company believes that although the patents it has exclusively licensed or holds directly will be of

value, they will not determine the Company's success, which depends principally upon its engineering, marketing, service and manufacturing skills. However, in the absence of patent protection, the Company may be vulnerable to competitors who attempt to imitate the Company's systems or processes and manufacturing techniques and processes. In addition, other companies and inventors may receive patents that contain claims applicable to the Company's systems and processes. The sale of the Company's systems covered by such patents could require licenses that may not be available on acceptable terms, if at all. The Company also relies on trade secrets and proprietary technology that it seeks to protect, at least in part, through confidentiality agreements with employees, vendors, consultants and other parties. There can be no assurance that these agreements will not be breached, that the Company will have adequate remedies for any breach, or that the Company's trade secrets will not otherwise become known to or independently developed by others.

The original version of the system software for the Company's 6500 series systems was jointly developed by the Company and Realtime Performance, Inc., a third party software vendor. Tegal holds a perpetual, non-exclusive, nonroyalty bearing license to use and enhance this software. The enhanced version of the software currently used on the Company's 6500 series systems has undergone multiple releases of the original software, and such enhancements were developed exclusively by the Company. Neither the software vendor nor any other party has any right to use the Company's current release of the system software.

Although the Company attempts to protect its intellectual property rights through patents, copyrights, trade secrets and other measures, there can be no assurance that the Company will be able to protect its technology adequately or that competitors will not be able to develop similar technology independently. There can be no assurance that any patent applications that the Company may file will be issued or that foreign intellectual property laws will protect the Company's intellectual property rights. There can be no assurance that any patent licensed by or issued to the Company will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide competitive advantages to the Company. Furthermore, there can be no assurance that others will not independently develop similar systems, duplicate the Company's systems or design around the patents licensed by or issued to the Company.

As is typical in the semiconductor industry, the Company has received notices from time to time from third parties alleging infringement claims. In July 1991, the Company was advised by General Signal Corporation ("GSC") that the Company may need a license under certain U.S. patents owned by GSC relating to "cluster tool" equipment. The Company's 6500 series systems are generally configured with

13

multiple process chambers and, therefore, may be deemed "cluster tool" equipment. A number of companies which were contacted by GSC with regard to licensing these patents formed an ad-hoc committee to investigate the validity of the GSC patents. As a result of such investigation, in November 1992 the committee members, including the Company, jointly notified GSC that they believe the subject patents are invalid and that, accordingly, no license is necessary. In the fall of 1994, GSC filed suit against Applied Materials, a non-member of the ad-hoc investigative committee, alleging infringement of such patents. To date, GSC has taken no action against the Company in connection with the licensing of these patents. There can be no assurance that GSC will not take any such action in the future or, if any such action is taken, as to the outcome of such action.

On June 10, 1996, Lucent Technologies Inc. filed a claim with the United States District Court for the Northern District of California alleging patent infringement by Austria Mikro Systeme International AG and AMS Austria Mikro Systeme International, Inc. (AMS) for the sale of integrated circuits manufactured with the Company's dry plasma etch systems. On March 7, 1995, the Company executed an indemnification agreement with AMS, covering certain uses of select equipment sold to AMS. The lawsuit between Lucent and AMS has been settled, and AMS and the Company are discussing the indemnity issue. The Company believes that the ultimate outcome of any defense of any required indemnification obligation to AMS is unlikely to have a material adverse effect on the Company's results of operations or financial condition. No assurance can be given, however, as to the outcome of such legal proceedings or as to the effect of any such outcome on the Company's results of operations or financial condition.

Although there are currently no pending claims or lawsuits against the Company regarding possible infringement claims, there can be no assurance that infringement claims by other third parties, or claims for indemnification resulting from infringement claims, will not be asserted in the future or that such assertions, if proven to be true, will not materially adversely affect the Company's business, financial condition and results of operations. In the future, litigation may be necessary to enforce patents issued or exclusively licensed to the Company, to protect trade secrets or know-how exclusively licensed to or owned by the Company or to defend the Company against claimed infringement of the rights of others and to determine the scope and validity of the proprietary rights of others. Any such litigation could result in substantial cost and diversion of effort by the Company, which by itself could have a material adverse effect on the Company's financial condition and operation results. Further, adverse determinations in such litigation could result in the Company's loss of proprietary rights, subject the Company to significant liabilities to third parties, require the Company to seek licenses from third parties or prevent the Company from manufacturing or selling its systems, any of which could have a material adverse effect on the Company's financial condition and results of operations. In addition, there can be no assurance that a license under a third party's intellectual property rights will be available on reasonable terms, if at all.

EMPLOYEES

As of March 31, 1997, the Company had a total of 252 employees consisting of 233 full-time permanent employees and 19 temporary or contract personnel, including 68 in engineering, research and development, 56 in manufacturing, 94 in marketing, sales and customer service and support and 34 in executive and administrative activities. Many of the Company's employees are highly skilled, and the Company's success will depend in part upon its ability to attract, retain and develop such employees. Skilled employees, especially employees with extensive technological backgrounds, are currently in great demand. There can be no assurance that the Company will be able to attract or retain the skilled employees which may be necessary to continue its research and development, manufacturing or marketing programs. The loss of any such persons, as well as the failure to recruit additional key personnel in a timely manner, could have a material adverse effect on the Company's business, financial condition and operating results.

None of the Company's employees are represented by a labor union or covered by a collective bargaining agreement. The Company considers its employee relations to be good.

ADDITIONAL RISK FACTORS

DEPENDENCE ON RECENTLY INTRODUCED SYSTEMS FOR CRITICAL ETCH MARKETS

The Company's 6500 series systems, its new generation of critical etch systems, have been designed initially for sub-0.5 micron critical etch applications in emerging films, isolation, polysilicon and metal which the Company believes to be the leading edge of critical etch applications. The Company's 6500 series systems which have been installed are currently being used primarily for research and development activities or in pilot production. For the 6500 series systems to achieve market acceptance, the Company's customers must utilize these systems for volume production. Achieving market acceptance of the Company's 6500 series systems is very important to the Company's future financial results.

Because new product development commitments must be made well in advance of sales, new product decisions must anticipate both the future requirements for etch processes needed by semiconductor manufacturers and the equipment required to address such applications. There can be no assurance that the market for critical etch emerging film, isolation, polysilicon or metal etch systems will develop as quickly or to the degree the Company expects. There can be no assurance whether or when the 6500 series systems will achieve market acceptance. In addition, the selling cycles of these new systems are typically lengthy.

The 6500 series has had only limited production life. Therefore, unforeseen technical or manufacturing difficulties may arise which may hinder market

acceptance or volume production. The Company may be required to incur substantial, unanticipated costs to ensure the functionality and reliability of the 6500 series systems, which may materially and adversely affect the business, financial condition and results of operation of the Company. Such costs may include substantial expenditures to upgrade or re-engineer installed equipment that fails to perform to customer specifications. If the Company is unable to re-engineer 6500 series non-performing systems under evaluation to customer satisfaction and a number of 6500 series systems are returned to the Company, the Company's ability to sell 6500 series systems in the future may be adversely affected. In addition, in connection with the development and production of the 6500 series, the Company is increasing its operating expenses and is likely to invest in increased inventory levels in the future. The failure to complete the commercial introduction of this new generation of systems in a timely manner could result in, among other things, an increase in operating expenses and inventory obsolescence without corresponding sales, any of which could have a material adverse effect on the Company's business, financial condition and results of operations.

If the 6500 series does not achieve significant sales or volume production due to a lack of customer acceptance, inability to correct technical, manufacturing or other difficulties which may develop with this series, or for any other reason, the Company's business, financial condition and results of operations would be materially adversely affected.

IMPEDIMENTS TO CUSTOMER ACCEPTANCE

A substantial investment is required to install and integrate capital equipment into a semiconductor production line. The Company believes 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 another vendor's capital equipment has been selected by that customer unless there are compelling reasons to do so, such as significant performance or cost advantages. Certain of the Company's competitors have entered into strategic relationships or alliances with leading semiconductor manufacturers, particularly with respect to the generation of devices at 1.0 to 0.5 micron line geometries for which the Company did not offer competitive systems at the time such buying decisions were made. If such relationships or alliances cover etch equipment similar to those sold by the Company, the Company's ability to sell its 6500 series systems would be adversely affected. In addition, certain of the Company's competitors may seek to sell, as an attractively priced package, etch equipment together with other process equipment, such as deposition equipment. Furthermore, some semiconductor manufacturers have already made initial buying decisions for the next generation of sub-0.5 micron etch requirements. Any failure to gain access and achieve sales to new customers will adversely affect

15

the successful commercial introduction of the Company's 6500 series systems and would have a material adverse effect on the Company's business, financial condition and results of operations.

In addition, the Company believes that its future long term success also depends on its ability to increase sales of its etch systems, particularly its new generation 6500 series, to Japanese semiconductor manufacturers. The Japanese semiconductor market represents a substantial percentage of the worldwide market and may pose additional challenges to penetrate successfully. The Company believes that it must invest substantial resources in order to increase its penetration of the Japanese semiconductor market and that, even with such investments, there can be no assurance that it will be successful in increasing its penetration of this market.

FLUCTUATIONS IN QUARTERLY OPERATING RESULTS

The Company's 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.

The Company's 900 and 980 non-critical etch systems typically sell for prices ranging between \$350,000 and \$500,000, while prices of the Company's 6500 series critical etch systems typically range between \$1.8 million and \$2.5

million. To the extent the Company is successful in selling 6500 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.

The Company's backlog at the beginning of each quarter does not normally include all systems sales needed to achieve planned revenue for the quarter. Consequently, the Company depends on obtaining orders for shipment within a particular quarter to achieve its revenue objectives for that period. Because the Company builds a portion of its systems according to forecast, the absence of significant backlog for an extended period of time could hinder the Company's ability to plan expense, production and inventory levels, which could materially adversely affect its operating results. Furthermore, a substantial portion of the Company's net revenue has historically been realized near the end of the quarter. Accordingly, the failure to receive anticipated orders or delays in shipments near the end of a quarter, due, for example, to unanticipated customer delays, cancellations or manufacturing difficulties, may cause quarterly net revenue to fall significantly short of the Company's objectives, which could materially adversely affect the Company's operating results.

The timing of new systems and technology announcement and releases by the Company and others may also contribute to fluctuations in quarterly operating results, including cases in which new systems or technology offerings cause customers to defer ordering systems from the Company's existing product lines. The Company's revenue and operating results may also fluctuate due to the timing and mix of systems sold, the volume of service provided and spare parts delivered in a particular quarter and changes in pricing by the Company, its competitors or suppliers. The impact of these and other factors on the Company's revenue and operating results in any future periods are, and will continue to be, difficult for the Company to forecast.

The need for continued investment in research and development, for capital equipment requirements and for extensive ongoing customer service and support capability worldwide result in significant fixed costs which will be difficult to reduce in the event that the Company does not meet its sales objectives. The Company's expense levels are based, in part, on expectations of future revenue. If revenue in a particular quarter does not meet expectations, fixed operating expenses will adversely affect results of operations. A variety of factors influence the level of revenue in a particular quarter. Those factors include the timing and mix of systems sales, the introduction or announcement of new systems by the Company or the Company's competitors, management decisions to commence or discontinue product lines, the Company's ability to design, introduce and manufacture new systems on a timely basis, the timing of research and development expenditures and expenses attendant to the further development of marketing, process support and service capabilities, specific economic conditions in the semiconductor industry or major global semiconductor markets, general economic conditions and exchange rate fluctuations. The impact of these and other factors on the Company's revenue and operating results in any future periods are, and will continue to be, difficult for the Company to forecast.

CYCLICALITY OF THE SEMICONDUCTOR INDUSTRY

The Company's business depends upon the capital expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits and systems utilizing integrated circuits. The semiconductor industry is highly cyclical and historically has experienced periodic downturns, which often have had a material adverse effect on the semiconductor industry's demand for semiconductor capital equipment, including etch systems manufactured by the Company. The semiconductor industry is currently experiencing such a slowdown. The current and prior semiconductor industry downturns have adversely affected the Company's revenue, gross margins and results of operations. In addition, the need for continued investment in research and development, substantial capital equipment requirements, and extensive ongoing customer service and support requirements worldwide will continue to limit the Company's ability to reduce expenses in response to any such downturn or slowdown. The Company's revenue, gross margin and results of operations may continue to be materially adversely affected by the current slowdown or by future downturns or slowdowns in the rate of capital investment in the semiconductor industry. Moreover, although the semiconductor industry may experience growth that causes significant growth in the semiconductor capital

equipment industry, there can be no assurance that such growth can be sustained or that the Company will be positioned to benefit from such growth.

RAPID TECHNOLOGICAL CHANGE; IMPORTANCE OF TIMELY PRODUCT INTRODUCTION

The semiconductor manufacturing industry is subject to rapid technological change and new system introductions and enhancements. The Company believes that its future success depends on its ability to continue to enhance its existing systems and their process capabilities, and to develop and manufacture in a timely manner new systems with improved process capabilities. The industry also is subject to fundamental changes in equipment requirements, such as the recent shift from six inch wafer equipment to eight inch wafer equipment and the anticipated shift from eight inch wafer equipment to twelve inch wafer equipment.

The Company must manage system transitions successfully, as introductions of new systems could adversely affect sales of existing systems, including its recently introduced 6500 series. There can be no assurance that the Company will be successful in the introduction and volume manufacture of new systems or that the Company will be able to develop and introduce, in a timely manner, new systems or enhancements to its existing systems and processes which satisfy customer needs or achieve market acceptance. In this regard, the Company did not offer a competitive etch product for the recent generation of devices with 1.0 to 0.5 micron line geometries. The failure of the Company to accomplish any of the above would adversely affect the Company's business, financial condition and results of operations. In addition, the Company may incur substantial unanticipated costs to ensure product functionality and reliability early in its products' life cycles. If new products have quality or reliability problems, the Company could experience reduced orders, delays in collecting accounts receivable, higher manufacturing costs, and additional service and warranty expenses, any of which could have a material adverse effect on the Company's business, financial condition and operating results.

LENGTHY SALES CYCLE

Sales of the Company's 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. The Company often experiences delays in finalizing system sales following initial system qualification while the customer evaluates and receives approvals for the purchase of the Company's systems and completes a new or expanded facility. Due to these and other factors, the Company's systems typically have a lengthy sales cycle (often 12 to 18 months in the case of critical etch systems) during which the Company may expend substantial funds and management effort. Lengthy sales cycles subject the Company to a number of significant risks, including inventory obsolescence and fluctuations in operating results over which the Company has little or no control.

17

IMPORTANCE OF "MIX AND MATCH" PURCHASING PHILOSOPHY TO NON-CRITICAL SYSTEM SALES

A significant element of the Company's strategy is to sell its non-critical etch systems to semiconductor manufacturers who have adopted a "mix and match" purchasing philosophy to meet their non-critical etch process requirements. This strategy depends, in significant part, upon the recognition by IC manufacturers that costs can be minimized by purchasing more expensive, state of the art etch systems for their critical etch process requirements and less expensive, but reliable, etch systems for their non-critical etch process requirements, and the willingness of such manufacturers to implement such a purchasing philosophy to lower manufacturing costs. Many semiconductor manufacturers have limited or no experience with integrating etch systems in the manner necessary for full implementation and acceptance of a "mix and match" purchasing philosophy, and there can be no assurance that semiconductor manufacturers will adopt such a strategy. Also, there can be no assurance that certain of the Company's competitors will not offer competitive non-critical etch systems to respond to semiconductor manufacturers' non-critical etch needs. Any of these developments could have a material adverse effect on the Company's business, financial condition and results of operations.

FUTURE CAPITAL NEEDS

The development, manufacture and marketing of etch systems are highly capital intensive. In order to be competitive, the Company must continue to make significant expenditures for, among other things, capital equipment and the manufacture of evaluation and demonstration unit inventory for its new 6500 series etch systems. The Company expects that its existing cash balances, anticipated cash flow from operations and funds available under its existing lines of credit will satisfy its financing requirements for the next twelve months. To the extent that such financial resources are insufficient to fund the Company's activities, additional funds will be required. There can be no assurance that additional financing will be available on reasonable terms or at all. To the extent that additional capital is raised through the sale of additional equity or convertible debt securities, the issuance of such securities could result in additional dilution to the Company's stockholders.

DEPENDENCE ON KEY EMPLOYEES

The future success of the Company is dependent, in part, on its ability to retain certain key personnel, including Robert V. Hery, President and Chief Executive Officer, and Stephen P. DeOrnellas, Vice President, Technology and Corporate Development and Chief Technical Officer. Many of these key personnel would be difficult to replace. The Company also needs to attract additional skilled personnel in all areas of its business to grow. The competition for these personnel is intense, and the loss of any such persons, as well as the failure to recruit additional key personnel in a timely manner, could have a material adverse effect on the Company's business, financial condition and operating results. There can be no assurance that the Company will be able to retain its existing personnel or attract additional qualified employees in the future.

CUSTOMER CONCENTRATION

Although the composition of the group comprising the Company's 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 material adverse effect on the Company's business, financial condition and results of operations. The Company's ability to increase its sales in the future will depend, in part, upon its ability to obtain orders from new customers as well as the financial condition and success of its existing customers and the general economy of which there can be no assurance.

ADDITIONAL RISKS ASSOCIATED WITH INTERNATIONAL SALES AND OPERATIONS

Sales of the Company's systems in certain countries are billed in local currency, and the Company has two lines of credit denominated in Japanese Yen. The Company generally attempts to offset a portion of its U.S. dollar denominated balance sheet exposures subject to foreign exchange rate remeasurement each period held by its foreign subsidiaries whose books are denominated in currencies other than U.S. dollars by purchasing currency options and forward currency contracts for future delivery. There can be no assurance

18

that the Company's future results of operations will not be adversely affected by foreign currency fluctuations. In addition, the laws of certain countries in which the Company's products are sold may not provide the Company's products and intellectual property rights with the same degree of protection as the laws of the United States.

CONTROL BY EXISTING STOCKHOLDERS

The Company's principal stockholders and the Company's executive officers and directors beneficially owned approximately 56.3% of the Company's outstanding shares of common stock as of March 31, 1997. Accordingly, these stockholders are able to elect all of the Company's directors and to determine the outcome of corporate actions requiring stockholder approval, such as mergers and acquisitions, regardless of how other stockholders of the Company may vote. Such a high level of ownership by such persons or entities may have a significant effect in delaying, deferring or preventing a change in control of the Company and may adversely affect the voting and other rights of holders of common stock. In addition to the foregoing, the ability of the Company's Board of Directors to issue preferred stock without further stockholder approval or to

exercise the anti-takeover provisions of its Shareholder Rights Plan in the event of an unsolicited attempt to assume control of the Company could have the effect of delaying, deferring or preventing a change in control of the Company.

VOLATILITY OF STOCK PRICE

The Company believes that factors such as announcements of developments related to the Company's business, fluctuations in the Company's operating results, sales of the Company's common stock into the market place, failure to meet or changes in analysts' expectations, natural disasters, outbreaks of hostilities, general conditions in the semiconductor industry or the worldwide economy, announcements of technological innovations or new products or enhancements by the Company or its competitors, developments in patents or other intellectual property rights and developments in the Company's relationships with its customers and suppliers could cause the price of the Company's common stock to fluctuate, perhaps 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 the Company's common stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to the Company's performance.

ITEM 2. PROPERTIES

The Company maintains its headquarters, encompassing its executive office, manufacturing, engineering, research and development operations, in one leased 120,000 square foot facility in Petaluma, California. The Company currently occupies 90,000 square feet of this building, with the remaining portion sublet or being offered for sublet. The lease expires in March 2004. Other than certain large pieces of capital equipment leased by the Company, the Company owns substantially all of the machinery and equipment used in its facilities. The Company believes that its existing facilities are adequate to meet its requirements for several years.

The Company leases sales, service and process support space in Phoenix, Arizona; Sunnyvale, California; Austin, Texas; Paris, France; Munich, Germany; Kawasaki, Japan; Catania, Italy; Seoul, Korea and Hsin Chu City, Taiwan. The Company also leases space for administrative offices in Hoofddorp, The Netherlands.

ITEM 3. LEGAL PROCEEDINGS

There are no material legal proceedings pending against the Company.

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

No matters were submitted to a vote of security holders during the fourth quarter ended March 31, 1997.

19

EXECUTIVE OFFICERS OF THE REGISTRANT

The following sets forth certain information regarding the executive officers of the Company as of June 13, 1997:

<TABLE>

<CAPTION>

NAME	AGE	POSITION
Robert V. Hery	54	Chairman of the Board, President and Chief Executive Officer
David Curtis	43	Vice President, Finance and Administration, Chief Financial Officer, Secretary and Treasurer
Stephen P. DeOrnellas	42	Vice President, Technology and Corporate Development and Chief Technical Officer
Diane M. Fennell	52	Vice President, Marketing and Customer Applications Support
George B. Landreth	42	Vice President, Product Development
James D. McKibben	46	Vice President, Worldwide Sales
Mark L. Siegel	59	Vice President, Worldwide Customer Support and

</TABLE>

Robert V. Hery has been a Director of the Company since 1990 and assumed the additional roles of President and Chief Executive Officer in January 1991 and Chairman of the Board in March 1995. From 1987 to 1990, Mr. Hery was President and Chief Executive Officer of AMOT Controls Corporation, an international manufacturer of machinery control components used in explosive and hazardous areas. From 1985 to 1987, Mr. Hery served as Vice President and General Manager of KLA Instruments Corporation ("KLA"), a manufacturer of semiconductor capital equipment, where he started the Wafer Inspection Systems Division. Prior to 1985, Mr. Hery held numerous posts as a marketing troubleshooter, marketing and new business development, manufacturing and product development executive positions, principally in the computer industry.

David Curtis joined the Company in August 1991 as Vice President of Finance and Administration and Chief Financial Officer and from May 1995 until June 1996, he assumed the additional role of Vice President of Operations. Prior to joining the Company, Mr. Curtis served as Chief Financial Officer of AMOT Controls Corporation from 1988 until 1991. Prior to 1991, he held consulting positions with Pittiglio Rabin Todd and McGrath, an operations consulting firm specializing in implementing planning and control processes in rapidly growing technology companies and with Arthur Andersen & Co.'s systems consulting division.

Stephen P. DeOrnellas joined the Company in July 1990 as Vice President of Marketing and Technology, served as Vice President of Process Technology from April 1995 until June 1996, at which time he was appointed Vice President, Technology and Corporate Development and Chief Technical Officer. From 1989 to 1990 he was Vice President of Marketing for the Wafer Inspection Systems Division of KLA. From 1981 to 1989 he held a variety of product development and marketing management positions, including Vice President Marketing from 1987 to 1989, Vice President of Process Engineering from 1983 to 1987, and Senior Process Engineer from 1981 to 1983, with Lam Research Corporation where he had responsibility for the development and introduction of the Lam Autoetch and Rainbow product lines.

Diane M. Fennell joined the Company in January 1997 as Vice President, Marketing and Customer Applications Support. From 1995 to 1996, Ms. Fennell was Group Manager of Product Management for Unit Instruments responsible for introducing several new products. From 1991 to 1995, she owned and operated Fennell Associates, Inc., a sales representative organization representing multiple lines of semiconductor capital equipment and capital equipment components to the semiconductor and capital equipment industries. From 1987 to 1991, Ms. Fennell held product marketing and sales support management positions with LAM Research Corporation. Prior to 1987, she held several process engineering and lab manager positions with Applied Materials, Inc., Temescal, Signetics Corporation and Texas Instruments.

George B. Landreth joined the Company in November 1992 as Manager of Mechanical Engineering where he was responsible for directing the development of the Company's 6500 series critical etch systems platform. From June 1996 until April 1997 he served as Director of Program Development, at which time he

was promoted to Vice President, Product Development. Prior to joining the Company, Mr. Landreth held product development engineering management and design engineering positions with KLA, Silicon Valley Group, Inc., Optoscan Corporation, Eaton Corporation, Siltec Corporation and Peterbilt Motors.

James D. McKibben joined the Company in June 1996 as Vice President, Worldwide Sales. From July 1996 until January 1997 he assumed the additional role of Vice President, Marketing and Customer Applications Support. Prior to joining the Company, from 1995 to 1996 and from 1988 to 1992, Mr. McKibben was Vice President, Marketing, Sales and Customer Support for MRS Technology, Inc., a lithography equipment manufacturer for flat panel displays. From 1993 to 1995, he served as Director of Marketing and Sales for Semiconductor Systems, Inc., a maker of capital equipment for the flat panel display and large area multichip module markets. From 1992 to 1993, he was Regional Manager for Kulicke and Soffa Industries, Inc., a maker of wire bonders and other back-end assembly equipment for the IC industry. Prior to 1988, Mr. McKibben held several sales and service management positions with Wild/Lietz, Inc., GCA Corporation and J.T. Baker

Chemical Company.

Mark L. Siegel joined the Company in June 1996 as Vice President, Operations. In April 1997, he assumed the additional role of Vice President of Worldwide Customer Support responsible for the Company's field service, spare parts and refurbished systems businesses. From 1991 to 1996 he was Vice President, Operations at Megatest Corporation up through its merger with Teradyne Corporation. From 1989 to 1991 he served as President of Semiconductor Systems, a unit of General Signal and a semiconductor capital equipment company. From 1987 to 1989 he served as Vice President and General Manager for VLSI Technology, Inc.'s ASIC Memory Division and from 1984 to 1987, was Vice President and General Manager of Signetics Corporation's Application Specific Products Division. Prior to 1984, Mr. Siegel held several senior management positions with, Motorola, Inc., Xerox and Univac.

21

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

Since October 19, 1995, Tegal's common stock has been traded on the Nasdaq National Market System under the symbol TGAL. The following table sets forth the range of high and low sales prices for the Company's common stock for the periods indicated since the Company's initial public offering on October 19, 1995.

<TABLE>
<CAPTION>

	HIGH	LOW
	-----	-----
<S>	<C> <C>	<C> <C>
FISCAL YEAR 1996		
Third Quarter.....	13 7/8	9 1/4
Fourth Quarter.....	10 1/2	6 7/8
FISCAL YEAR 1997		
First Quarter.....	11 1/8	6 3/8
Second Quarter.....	8	4 5/8
Third Quarter.....	6 5/8	4 1/2
Fourth Quarter.....	9 1/8	4 3/4

</TABLE>

The approximate number of record holders of the Company's common stock as of March 31, 1997 was 156. Tegal has not paid any cash dividends since its inception and does not anticipate paying cash dividends in the foreseeable future. Further, the Company's domestic lines of credit restrict the declaration and payment of cash dividends.

ITEM 6. SELECTED FINANCIAL DATA

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,				
	1997	1996	1995	1994	1993
	-----	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>	<C>
(IN THOUSANDS, EXCEPT PER SHARE DATA)					
CONSOLIDATED STATEMENTS OF OPERATIONS					
DATA:					
Revenue.....	\$57,423	\$62,046	\$ 44,645	\$ 38,022	\$ 42,777
Gross profit.....	25,901	28,577	20,583	16,508	19,458
Operating income (loss).....	3,180	6,572	1,376	(1,072)	2,705
Income (loss) before income taxes...	4,180	6,186	949	(1,501)	1,792
Net income (loss).....	3,140	5,566	828	(1,501)	1,526
Net income per share.....	\$.29	\$.63	\$.11		
Shares used in per share computation.....	10,710	8,899	7,373		

CONSOLIDATED BALANCE SHEET DATA:

Cash and cash equivalents.....	\$30,323	\$23,283	\$ 2,351	\$ 3,462	\$ 7,396
--------------------------------	----------	----------	----------	----------	----------

Working capital.....	45,392	41,726	11,432	11,297	11,690
Total assets.....	63,524	64,672	33,744	27,468	24,008
Short-term notes payable to banks and others.....	252	243	8,164	3,947	0
Long-term obligations.....	301	356	4,338	3,749	3,295
Redeemable preferred stock.....	0	0	21,695	22,382	22,207
Stockholders' equity (deficit).....	50,542	47,626	(11,633)	(12,018)	(10,196)

</TABLE>

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Information contained 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

22

variations thereon or comparable terminology or which constitute projected financial information. The following contains cautionary statements identifying important factors with respect to such forward-looking statements, including certain risks and uncertainties, that could cause actual results to differ materially from those in such forward-looking statements.

RESULTS OF OPERATIONS

The following table sets forth certain financial data for the years indicated as a percentage of revenue:

<TABLE>

<CAPTION>

	MARCH 31,		
	1997	1996	1995
<S>	<C>	<C>	<C>
Revenue.....	100.0%	100.0%	100.0%
Cost of sales.....	54.9	53.9	53.9
Gross profit.....	45.1	46.1	46.1
Operating expenses:			
Research and development.....	18.3	16.1	18.1
Sales and marketing.....	10.8	10.7	14.3
General and administrative.....	10.5	8.7	10.7
Total operating expenses.....	39.6	35.5	43.1
Operating income.....	5.5	10.6	3.0
Other income (expense), net.....	1.7	(0.6)	(1.0)
Income before income taxes.....	7.2	10.0	2.0
Provision for income taxes.....	1.7	1.0	0.3
Net income.....	5.5%	9.0%	1.7%

</TABLE>

YEARS ENDED MARCH 31, 1997, 1996 AND 1995

Revenue

The Company's revenue is derived from sales of new and refurbished systems, spare parts and non-warranty service. Revenue increased 39.0 percent from \$44.6 million in fiscal 1995 to \$62.0 million in fiscal 1996, and declined 7.4 percent to \$57.4 million in fiscal 1997. Revenue growth in fiscal 1996 as compared to fiscal 1995 occurred principally due to increased customer acceptance of the Company's new 6500 series critical etch systems and its new eight inch wafer capable non-critical etch systems. Spare parts sales grew substantially in fiscal 1996 due to the Company shifting its sales from a distributor arrangement to direct sales of spare parts in Taiwan and an expansion in the Company's installed base of systems. The revenue decline in fiscal 1997 as compared to

fiscal 1996 was principally attributable to a decline in the number of non-critical etch systems sold as the semiconductor industry curtailed its capital equipment expenditures for capacity expansion in the face of an industry-wide over-supply of manufacturing capacity. The Company's sales of spare parts also declined in fiscal 1997 over fiscal 1996, which the Company believes was primarily caused by customers depleting their supplies of spare parts during the industry slowdown. Revenues derived from the sale of the Company's 6500 series critical etch systems continued to increase as a result of both increased unit sales and higher average selling prices in fiscal 1997, partially offsetting the declines experienced in non-critical etch systems and spare parts sales. International sales accounted for approximately 69 percent of total revenue in fiscal 1997, and 63 percent in fiscal 1996 and 1995. The Company expects that international sales will continue to account for a significant portion of its revenue.

Gross Profit

The Company's gross profit as a percentage of revenue declined from 46.1 percent in fiscal 1995 and fiscal 1996 to 45.1 percent in fiscal 1997. The gross profit percentage in fiscal 1996 was the same as that in fiscal 1995 as a result of start-up inefficiencies on the new 6500 series etch system, which were offset, in part, by improved manufacturing efficiencies associated with spreading substantially fixed manufacturing overhead over a larger revenue volume. The Company also had a more favorable product mix, due principally to an

23

increase in sales of the Company's mature four- to six-inch wafer capable 900 series etch systems and spare parts, which carry higher gross profits. The one point decline in gross profit as a percentage of revenue in fiscal 1997 over fiscal 1996 was principally attributable to a change in product mix in which sales of non-critical etch systems and spare parts, which carry higher gross margins, declined and sales of the Company's 6500 series systems, which continue to carry lower start-up related gross margins, increased.

The Company's gross profit as a percentage of revenue has been, and will continue to be, affected by a variety of factors, including the mix and average selling prices of systems sold and the costs to manufacture, service and support new product introductions and enhancements. Gross margins for the Company's new systems are typically lower than those of its more mature products due to the inefficiencies associated with the start-up of manufacturing operations, smaller vendor discounts due to lower order volumes and increased service installation and warranty support. As a result of such factors, an anticipation that the product mix change toward the lower margin 6500 series etch systems is likely to continue, and an anticipation that demand for its non-critical etch systems is not likely to recover until late calendar year 1997 or early 1998, the Company does not expect that its gross margin for fiscal 1998 is likely to improve over the fiscal 1997 level.

Research and Development

Research and development expenses consist primarily of salaries, prototype material and other costs associated with the Company's research and product development efforts. In absolute dollars, research and development expenses increased from \$8.1 million in fiscal 1995 to \$10.0 million in fiscal 1996 and \$10.5 million in fiscal 1997. Nevertheless, research and development as a percentage of revenue decreased from 18.1 percent in fiscal 1995 to 16.1 percent in fiscal 1996 as revenues increased more rapidly than research and development expenses and increased to 18.3 percent in fiscal 1997, as the Company continued to enhance and support its new 6500 series systems in spite of the overall revenue decline in fiscal 1997. The absolute dollar increase in fiscal 1996 expenses compared to fiscal 1995 was primarily attributable to the hiring of additional personnel to staff ongoing and new product development, product enhancement and applications engineering support, particularly for recently introduced products and for increased prototype material spending. The absolute dollar increase in fiscal 1997 expenses over fiscal 1996 expenses was attributable to the hiring of additional personnel in the applications engineering customer support area and increased spending on prototype material for product enhancement programs. The Company anticipates that fiscal 1998 research and development expenses in absolute dollars will continue at or increase slightly from fiscal 1997 levels to permit the Company to support new product applications at its new 6500 series customer installations and to further enhance that product line.

Sales and Marketing

Sales and marketing expenses primarily consist of salaries, commissions, trade show promotion and advertising expenses. In absolute dollars, sales and marketing expenses increased from \$6.4 million in fiscal 1995 to \$6.6 million in fiscal 1996, and declined to \$6.2 million in fiscal 1997. As a percentage of revenue, sales and marketing expenses declined from 14.3 percent in fiscal 1995 to 10.7 percent in fiscal 1996 and remained at approximately the same level in fiscal 1997 at 10.8 percent. The increase in sales and marketing expenses in absolute dollars in fiscal 1996 over fiscal 1995 was attributable principally to the growth in revenue offset, in part, by a reduction in third party representative commissions as the Company shifted to a direct sales organization in Taiwan and as the systems sales mix shifted toward customers and regions where the Company sells via direct sales engineers, whose commission rates are lower than those of third party sales representative organizations. The decline in sales and marketing expenses in fiscal 1997 over fiscal 1996 was principally due to a decline in systems sales volume, resulting in lower commission spending and to reduced spending on advertising. The Company expects to increase its absolute dollar spending on sales and marketing in fiscal 1998 to fund further advertising and to hire several additional sales and marketing persons.

General and Administrative

General and administrative expenses consist of salaries, legal, accounting and related administrative services and expenses associated with general management, finance, information systems, human resources and investor relations activities. General and administrative expenses in absolute dollars increased from \$4.8 million in fiscal 1995 to \$5.4 million in fiscal 1996, and to \$6.0 million in fiscal 1997. As a percentage of revenues, general and administrative expenses decreased from 10.7 percent in fiscal 1995 to 8.7 percent in

24

fiscal 1996, and increased to 10.5 percent of revenues in fiscal 1997. The increase in general and administrative expenses in fiscal 1996 as compared to fiscal 1995 was attributable to increased legal, auditing and insurance expenses associated with the additional, ongoing expenses incurred as a public company, which commenced in the second half of fiscal 1996, and to outside consulting and training expenses incurred to upgrade the Company's business systems in the second half of fiscal 1996. The increase in general and administrative expenses in fiscal 1997 over fiscal 1996 was attributable to the Company incurring the expenses of being a public company for the full year of fiscal 1997 that only partially impacted fiscal year 1996. In addition, the Company incurred approximately \$0.2 million in the first quarter of fiscal 1997 to complete the business system upgrade begun in late fiscal 1996. The Company anticipates that its general and administrative expenses for fiscal 1998 will be approximately the same as fiscal 1997 spending.

Other Income (Expense), Net

Other income (expense), net, consists principally of interest income, interest expense, and gains and losses on foreign exchange and the sale of fixed assets. The Company recorded net non-operating expenses of \$0.4 million in fiscal 1995 and 1996 and net non-operating income of \$1.0 million in fiscal 1997. In fiscal 1995, such expenses were primarily attributable to interest expense incurred on outstanding loan balances. In fiscal 1996, such expenses reflected interest expenses incurred on loan balances outstanding through the Company's IPO in the middle of fiscal 1996 and foreign exchange losses offset, in part, by interest income on the unused portion of the proceeds from the public offering. In fiscal 1997, net non-operating income was primarily attributable to interest income on outstanding cash balances.

Provision for Income Taxes

The Company's effective tax rate was 12.8 percent, 10.0 percent and 25.0 percent in fiscal 1995, 1996 and 1997, respectively. Effective tax rates for these three years have been materially lower than the statutory tax rate due to extensive operating loss carryforwards generated in prior years. As a result of a recent review of its tax position, the Company expects that its effective tax rate for fiscal 1998 will not exceed 20 percent of income before income taxes.

Liquidity and Capital Resources

For fiscal 1997, the Company financed its operations through cash generated from operations. In fiscal 1996, the Company financed its operations through bank borrowings and net proceeds from its IPO.

Operating activities generated approximately \$9.1 million in cash flow for fiscal 1997 as the Company generated approximately \$5.5 million from net income, depreciation and amortization expenses, with the balance derived principally from a reduction in working capital as the Company's second half of fiscal 1997's sales volume was lower than the comparable period in the prior year. Operating activities generated approximately \$0.2 million in cash flow for fiscal 1996. Approximately \$5.4 million of net cash was generated from net income plus depreciation, senior term loan accretion, purchase credit redemptions and accounts receivable reserve accruals, which was almost entirely offset by increases in working capital due to the Company's increased sales volume in that year.

Net cash used in investing activities in fiscal 1997 was \$1.4 million for capital expenditures including the purchase of analytical equipment used in research and development, customer service and manufacturing, leasehold improvements and computer equipment. Net cash used in investing activities for fiscal 1996 was \$2.1 million for similar purposes.

As of March 31, 1997, the Company had approximately \$30.3 million of cash and cash equivalents. In addition, the Company's other principal sources of liquidity consisted of the unused portions of several bank borrowing facilities. The Company has available two domestic bank lines of credit totaling \$13.0 million that are available until August 15, 1997. At March 31, 1997, both domestic credit lines were unused, providing \$13.0 million of available borrowing capacity. In April 1997, the Company executed commitment letters with two banks to increase its domestic borrowing facilities to a maximum of \$20.0 million for one year from the execution of loan documents. The Company expects to execute those loan documents in August 1997. In addition to the foregoing facilities, as of March 31, 1997, the Company's Japanese subsidiary had available 569 million Yen (approximately \$4.6 million at exchange rates prevailing at March 31, 1997) unused under two lines of credit for a maximum of 600 million Yen (approximately \$4.8 million at exchange rates prevailing

25

at March 31, 1997) with two Japanese banks, secured by customer promissory notes held by such subsidiary in advance of payment on customers' accounts receivable.

The Company believes that anticipated cash flow from operations, existing cash and cash equivalent balances and funds available under its lines of credit will be sufficient to meet the Company's cash requirements for at least the next 12 months.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's Financial Statements and notes thereto appear on this Form 10-K according to the following Index of Consolidated Financial Statements:

<TABLE>
<CAPTION>

	PAGE
<S>	<C>
Consolidated Balance Sheets as of March 31, 1997 and 1996.....	30
Consolidated Statements of Operations for the years ended March 31, 1997, 1996 and 1995.....	31
Consolidated Statements of Stockholders' Equity (Deficit) for the years ended March 31, 1997, 1996 and 1995.....	32
Consolidated Statements of Cash Flows for the years ended March 31, 1997, 1996 and 1995.....	33
Notes to Consolidated Financial Statements.....	34
Independent Accountants' Report.....	44
Independent Auditors' Report.....	45

</TABLE>

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

KPMG Peat Marwick, LLP ("KPMG") served as the Company's auditors and advised the Company on federal, state and local tax matters from December 1989 through December 16, 1996. On December 17, 1996, the Company reported on a Form 8-K the following:

- (i) On December 17, 1996, the Company dismissed KPMG as its independent accountants.
- (ii) The reports of KPMG on the financial statements of the Company for each of the prior two fiscal years contained no adverse opinion or disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope or accounting principle.
- (iii) The Company's Audit Committee and full Board of Directors participated in and approved the decision to change independent accountants.
- (iv) During the Company's two prior fiscal years and through the date of the Form 8-K, the Company had no disagreements with KPMG on any matter of accounting principles or practices, financial statement disclosure or auditing scope and procedure, which disagreements if not resolved to the satisfaction of KPMG would have caused them to make reference thereto in their report on the financial statements of the Company for such years, except for the disagreement over auditing scope and procedure described below.

In June 1996, the Company's management disagreed with KPMG over an issue of auditing scope and procedure. KPMG asked the Company to confirm an accounts receivable balance which Company management felt did not need to be confirmed in the manner requested by KPMG. However, the Company subsequently did obtain the required confirmation. Nevertheless, the objection of Company management may be deemed a disagreement over audit scope and procedure as defined by SEC rules. The Company has subsequently received payment for all of the invoice in question.

The Audit Committee met and discussed via teleconference the above described disagreement over audit scope and procedure with KPMG on August 5, 1996.

- (iv) During the Company's two most recent fiscal years and through the date of its Form 8-K, the Company had no reportable events (as defined in Item 304 (a) (1) (v) of Regulation S-K).

26

- (vi) The Company requested that KPMG furnish it with a letter addressed to the SEC stating whether or not it agreed with the above statements. A copy of such letter, dated December 17, 1996, was filed as Exhibit 16 to that Form 8-K.
- (vii) The Company engaged Price Waterhouse LLP as its new independent accountants as of December 17, 1996. During the two most recent fiscal years and through the date of the Form 8-K, the Company had not consulted with Price Waterhouse LLP on items which (1) were or should have been subject to SAS 50 or (2) concerned the subject matter of a disagreement or reportable event with KPMG (as described in Item 304 (a) (2) Regulation S-K). The Company has authorized KPMG to respond fully to the inquiries of Price Waterhouse LLP, with respect to the disagreement summarized above.

In connection with the filing of this Form 10-K, the Company requested KPMG to consent to the inclusion of its reports on the Company's consolidated financial statements and the related consolidated financial statement schedule as of March 31, 1996 and for each of the years in the two year period then ended to be incorporated by reference in the Company's Registration Statement on Form S-8, which reports are included in this Form 10-K. Such consent is required with respect to filings, including the Company's Form S-8, under the Securities Act of 1933, as amended (the "1933 Act"). KPMG informed the Company that it would not consent to the inclusion of its reports unless the Company indemnifies KPMG against and from any and all losses, claims, damages or liabilities

(collectively, the "Claims") to which it may become subject in connection with its consent under federal securities laws or other statutes, common law or otherwise; provided, however, that KPMG would not be indemnified to the extent such Claims result from a court adjudication finding KPMG guilty of professional malpractice. In order to be able to file the Company's Form S-8, the Company has agreed to KPMG's request for indemnification.

PART III

Certain information required by Part III is omitted from this Report in that the Registrant will file a definitive proxy statement pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report, and certain information included therein is incorporated herein by reference. Only those sections of the Proxy Statement that specifically address the items set forth herein are incorporated by reference. Such incorporation does not include the Compensation Committee Report or the Performance Graph included in the Proxy Statement.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information concerning the Company's directors required by this Item is incorporated by reference to the Company's Proxy Statement under the caption "Election of Directors."

The information required by this Item relating to the Company's executive officers is included under the caption "Executive Officers of the Registrant" in Part I, Item 4, of this Form 10-K Report.

The information regarding compliance with Section 16(a) of the Securities and Exchange Act of 1934, as amended, is incorporated by reference to the Company's Proxy Statement under the caption "Compliance with Section 16(a) of the Exchange Act".

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to the Company's Proxy Statement under the caption "Executive Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by this Item is incorporated by reference to the Company's Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this Item is incorporated by reference to the Company's Proxy Statement under the caption "Certain Transactions."

27

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this Form 10-K Report:

(1) Financial Statements

See Index to Consolidated Financial Statements at page 26 of this Report.

(2) Financial Statement Schedules

The following consolidated financial statement schedule is included herein:

<TABLE>
<CAPTION>

PAGE

<S>

<C>

Schedule II -- Valuation and Qualifying Accounts..... S-1

Independent Accountants' Report on Schedule..... S-2

Independent Auditors' Report on Schedule..... S-3

</TABLE>

Schedules other than those listed above have been omitted since they are either not required, not applicable, or the required information is shown in the consolidated financial statements or related notes.

(3) Exhibits

The following exhibits are referenced or included in this report:

<TABLE>

<CAPTION>

EXHIBIT	DESCRIPTION
<S>	<C>
3.1	Certificate of Incorporation of the Registrant, as amended (incorporated by reference to Exhibits 3(i).1 and 3(i).2 included in Registrant's Registration Statement on Form S-1 (File No. 33-84702) declared effective by the Securities and Exchange Commission on October 18, 1995)
3.2	By-laws of Registrant (incorporated by reference to Exhibit 3(ii) included in Registrant's Registration Statement on Form S-1 (File No. 33-84702) declared effective by the Securities and Exchange Commission on October 18, 1995)
*4.1	Form of Certificate For Common Stock
*4.2	Information and Registration Rights Agreement between the Registrant and the investors listed on Schedule A thereto dated December 19, 1989, as amended to date
*4.3	Imperial Bank Warrant issued by the Registrant, dated as of March 14, 1995
*10.1	Amended and Restated Equity Incentive Plan
*10.2	1990 Stock Option Plan
*10.4	Employee Qualified Stock Purchase Plan
*10.5	Stock Option Plan for Outside Directors
*10.6	Amended and Restated Agreement of Purchase and Sale between the Registrant, Nazem & Company III, L.P. and Motorola, Inc. dated December 18, 1989
*10.7	Restructuring Agreement between the Registrant and Motorola, Inc. Dated October 31, 1991
*10.8	Conversion Agreement between the Registrant and Motorola, Inc. dated August 31, 1994 and amendment thereto dated August 8, 1995
*10.10	Employment Letter Agreement between the Registrant and Stephen P. DeOrnellas dated April 30, 1990
*10.11	Lease dated August 15, 1986, as amended, between the Registrant and South McDowell Investments

</TABLE>

28

<TABLE>

<CAPTION>

EXHIBIT	DESCRIPTION
<S>	<C>
*10.12	Technology License Agreement between the Registrant and Motorola, Inc. dated December 19, 1989
*10.14	Security and Loan Agreement between the Registrant and Imperial Bank dated as of August 15, 1995
*10.15	Supplemental Source Code License Agreement with the Registrant and Realtime Performance, Inc. dated as of November 1, 1991
*10.16	Incentive Stock Option Agreement between the Registrant and Robert V. Hery dated as of September 28, 1993
10.17	Lease Amendment dated March 10, 1997, between Registrant and South McDowell Investments
11	Statement of Computation of Net Income Per Share
16	Letter of KPMG Peat Marwick dated December 17, 1996 incorporated by reference to Exhibit 16 included in the Company's Form 8-K dated December 17, 1996
*21	List of Subsidiaries of the Registrant
23.1	Consent of Independent Accountants
23.2	Consent of Independent Auditors
24.1	Power of Attorney (included on page 46 of this Report)

</TABLE>

* Incorporated by reference to identically numbered exhibits included in Registrant's Registration Statement on Form S-1 (File No. 33-84702) declared effective by the Securities and Exchange Commission on October 18, 1995.

(b) Reports on Form 8-K.

No reports on Form 8-K were filed during the Company's fourth quarter ended March 31, 1997.

29

TEGAL CORPORATION
 CONSOLIDATED BALANCE SHEETS

<TABLE>
 <CAPTION>

	MARCH 31,	
	1997	1996
	(IN THOUSANDS, EXCEPT SHARE DATA)	
<S>	<C>	<C>
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$30,323	\$23,283
Accounts receivable, less allowance for doubtful accounts of \$764 and \$453.....	12,322	16,191
Inventory.....	13,154	16,947
Prepaid expenses and other current assets.....	2,274	1,995
	-----	-----
Total current assets.....	58,073	58,416
Property and equipment, net.....	5,298	6,027
Other assets, net.....	153	229
	-----	-----
	<u>\$63,524</u>	<u>\$64,672</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Notes payable.....	\$ 252	\$ 243
Accounts payable.....	3,442	4,700
Accrued expenses and other current liabilities.....	8,987	11,747
	-----	-----
Total current liabilities.....	12,681	16,690
Long term portion of capital lease obligations.....	301	356
	-----	-----
Total liabilities.....	12,982	17,046
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; \$0.01 par value; 5,000,000 shares authorized.....	--	--
Common stock; \$0.01 par value; 35,000,000 shares authorized; 10,279,721 and 10,064,404 shares issued and outstanding.....	103	101
Additional paid-in capital.....	54,821	54,455
Cumulative translation adjustment.....	23	615
Accumulated deficit.....	(4,405)	(7,545)
	-----	-----
Total stockholders' equity.....	50,542	47,626
	-----	-----
	<u>\$63,524</u>	<u>\$64,672</u>

</TABLE>

See accompanying notes to consolidated financial statements.

30

TEGAL CORPORATION
 CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>
<CAPTION>

YEAR ENDED MARCH 31,

1997 1996 1995

(IN THOUSANDS, EXCEPT PER SHARE
DATA)

<S>	<C>	<C>	<C>
Revenue.....	\$57,423	\$62,046	\$44,645
Cost of sales.....	31,522	33,469	24,062
Gross profit.....	25,901	28,577	20,583
Operating expenses:			
Research and development.....	10,531	10,000	8,065
Sales and marketing.....	6,182	6,622	6,366
General and administrative.....	6,008	5,383	4,776
Total operating expenses.....	22,721	22,005	19,207
Operating income.....	3,180	6,572	1,376
Other income (expenses), net.....	1,000	(386)	(427)
Income before income taxes.....	4,180	6,186	949
Provision for income taxes.....	1,040	620	121
Net income.....	\$ 3,140	\$ 5,566	\$ 828
Net income per share.....	\$.29	\$.63	\$.11
Shares used in per share computation.....	10,710	8,899	7,373

</TABLE>

See accompanying notes to consolidated financial statements.

31

TEGAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT)

<TABLE>
<CAPTION>

	COMMON STOCK SHARES	PAID-IN AMOUNT	ADDITIONAL TRANSLATION CAPITAL	CUMULATIVE ACCUMULATED ADJUSTMENTS	TOTAL ACCUMULATED DEFICIT	TOTAL STOCKHOLDERS' EQUITY (DEFICIT)
	<C>	<C>	<C>	<C>	<C>	<C>
(IN THOUSANDS, EXCEPT SHARE DATA)						
Balances at March 31, 1994.....	457,097	\$ 5	\$ 106	\$ 548	\$(12,677)	\$(12,018)
Common stock issued.....	39,398	--	17	--	--	17
Exercise of common stock warrants.....	154,285	2	--	--	--	2
Cumulative translation adjustment.....	--	--	391	--	391	
Accretion of Series B preferred stock.....	--	--	--	(853)	(853)	
Net income.....	--	--	--	828	828	
Balances at March 31, 1995.....	650,780	7	123	939	(12,702)	(11,633)
Common stock issued under option and stock purchase plans.....	358,245	3	124	--	127	
Net proceeds from IPO.....	3,179,300	32	34,153	--	--	34,185
Contribution of paid-in capital through conversion of Motorola preferred stock.....	--	--	891	--	891	
Conversion of redeemable preferred stock to common stock at IPO.....	5,876,079	59	19,164	--	--	19,223

Cumulative translation adjustment.....	--	--	--	(324)	--	(324)	
Accretion of Series B preferred stock.....	--	--	--	--	(409)	(409)	
Net income.....	--	--	--	--	5,566	5,566	
	-----	-----	-----	-----	-----	-----	
Balances at March 31, 1996.....	10,064,404	101	54,455	615	(7,545)	47,626	
Common stock issued under option and stock purchase plans.....	215,317	2	366	--	--	368	
Cumulative translation adjustment.....	--	--	--	(592)	--	(592)	
Net income.....	--	--	--	--	3,140	3,140	
	-----	-----	-----	-----	-----	-----	
Balances at March 31, 1997.....	10,279,721	\$103	\$ 54,821	\$ 23	\$ (4,405)	\$ 50,542	

</TABLE>

See accompanying notes to consolidated financial statements.

TEGAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

YEAR ENDED MARCH 31,

1997 1996 1995

(IN THOUSANDS)
<C> <C> <C>

<S>

Cash flows from operating activities:			
Net income.....	\$ 3,140	\$ 5,566	\$ 828
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Deferred tax asset.....	(638)	(900)	--
Depreciation and amortization.....	2,349	1,435	1,050
Accretion of senior term loan.....	--	303	485
Purchase credit for preferred stock redemptions.....	(1,587)	(1,857)	(1,540)
Allowance for doubtful accounts and sales return allowances.....	311	(22)	261
Changes in operating assets and liabilities:			
Accounts receivable.....	3,559	(1,540)	(3,647)
Inventory.....	3,967	(6,509)	(3,681)
Prepaid expenses and other current assets.....	435	207	(53)
Accounts payable and other current liabilities.....	(2,467)	3,474	1,717
	-----	-----	-----
Net cash provided by (used in) operating activities.....	9,069	157	(4,580)
	-----	-----	-----
Cash flows used in investing activities for the purchases of property and equipment.....	(1,427)	(2,067)	(1,037)
	-----	-----	-----
Cash flows from financing activities:			
Proceeds from issuance of common stock.....	368	34,312	19
Borrowings under (repayments of) notes payable.....	9	(7,922)	4,217
Repayment of capital lease financing.....	(386)	(224)	(121)
Repayment of long-term debt.....	--	(3,000)	--
	-----	-----	-----
Net cash provided by (used in) financing activities.....	(9)	23,166	4,115
Effect of exchange rates on cash and cash equivalents.....	(593)	(324)	391
	-----	-----	-----
Net increase (decrease) in cash and cash equivalents.....	7,040	20,932	(1,111)
Cash and cash equivalents at beginning of year.....	23,283	2,351	3,462
	-----	-----	-----
Cash and cash equivalents at end of year.....	\$30,323	\$23,283	\$ 2,351
	=====	=====	=====
Supplemental disclosures of cash paid during the year:			
Interest.....	\$ 118	\$ 605	\$ 348
	=====	=====	=====
Income taxes.....	\$ 1,727	\$ 45	\$ 90
	=====	=====	=====

Supplemental disclosure of noncash investing and financing activities:			
Accretion of Series B preferred stock.....	\$ --	\$ 409	\$ 853
	=====	=====	=====
Transfer of demo lab equipment from inventory to fixed assets.....	\$ 127	\$ 2,230	\$ --
	=====	=====	=====

</TABLE>

See accompanying notes to consolidated financial statements.

33

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

NOTE 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

Tegal Corporation (the "Company") designs, manufactures, markets, and services plasma etch systems used in the fabrication of integrated circuits.

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of the Company and all of its subsidiaries. Intercompany transactions and balances are eliminated in consolidation. Accounts denominated in foreign currencies are translated using the foreign currencies as the functional currencies. Assets and liabilities of foreign operations are translated to U.S. dollars at current rates of exchange and revenues and expenses are translated using weighted average rates. Gains and losses from foreign currency translation are included as a separate component of other income (expense).

These financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. This requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could vary from those estimates.

RECLASSIFICATIONS

Certain prior year amounts have been reclassified to conform to fiscal 1997 financial statement presentation.

CASH AND CASH EQUIVALENTS

The Company considers all highly liquid debt instruments having a maturity of three months or less on the date of purchase to be cash equivalents.

At March 31, 1997 and 1996, all of the Company's investments are classified as cash equivalents on the balance sheet. The investment portfolio at March 31, 1997 and 1996, is comprised of money market funds. At March 31, 1997 and 1996, the fair value of the Company's investments approximated cost.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of the Company's financial instruments, including accounts receivable, approximates fair value.

CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to significant concentration of credit risk consist primarily of temporary cash investments, and accounts receivable. Substantially all of the Company's temporary investments are invested in money market funds. The Company's accounts receivable are derived primarily from sales to customers located in the U.S., Europe, and the Far East. 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 March 31, 1997, two customers accounted for approximately 22% and 14% of the accounts receivable balance. As of March 31, 1996, two customers accounted for approximately 21% and 11% of the accounts receivable balance.

34

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

INVENTORY

Inventory is stated at the lower of cost or market, with cost being determined under the first-in, first-out method.

PROPERTY AND EQUIPMENT

Property and equipment is recorded at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to seven years. Leasehold improvements are stated at cost and are amortized using the straight-line method over the shorter of the estimated useful life of the improvements or the lease term.

FOREIGN EXCHANGE HEDGING

At March 31, 1997, the Company had forward exchange contracts maturing at various dates throughout fiscal 1998 to exchange 468,000 Yen into \$4,290. The Company uses hedge accounting to account for these contracts as they are a hedge against currency exposures related to firm sales commitments. The fair value of these instruments at March 31, 1997 was 532,000 Yen. The counterparties to these contracts consist of U.S. financial institutions.

The Company enters into foreign exchange options to hedge partially net accounts receivable or payable U.S. dollar positions on the books of its subsidiaries which are subject to periodic remeasurement. Foreign exchange options permit, but do not require, the Company to exchange currencies at a future date with another party at a contracted exchange rate. The expense of the premiums paid for such options is amortized on a straight-line basis over the term of the option (generally two to three months in duration) as a foreign currency expense. Gains on the options that offset any losses on the underlying balance sheet exposures are recognized as a foreign exchange gain over the term of the options. To date, foreign currency gains on foreign exchange options have been immaterial, and the only expenses incurred have been the premium cost of the options. At March 31, 1997, the Company had no foreign exchange options outstanding.

REVENUE RECOGNITION

Product revenue is recognized generally upon shipment, except in Japan where revenue is generally recognized upon delivery. A provision for installation costs and estimated future warranty costs is recorded at the time revenue is recognized. Service revenue is recognized on a monthly basis as billed, unless services are paid for in advance according to service contracts, in which case revenue is deferred and recognized over the service period using the straight-line method.

NET INCOME PER SHARE

Net income per share is computed using the weighted average number of common and common equivalent shares outstanding during the period. Common equivalent shares for the year ended March 31, 1997 consist of stock options using the treasury stock method except when antidilutive. Common equivalent shares for the years ended March 31, 1996 and 1995 consist of common stock issuable upon the conversion of the Company's mandatorily redeemable convertible preferred stock using the as if converted method and stock options and warrants using the treasury stock method, except when antidilutive. Pursuant to the requirements of the Securities and Exchange Commission, common stock equivalent shares relating to stock options and warrants using the treasury stock method, and the mandatorily redeemable convertible preferred stock using the as if converted method, issued subsequent to September 30, 1994 through the initial

public offering date (October 18, 1995), are included in the computation of net income per share for the years ended March 31, 1996 and 1995 as if they were outstanding for the entire period.

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company's policy is to grant options with an exercise price equal to the closing market price of the Company's stock on the grant date. Accordingly, no compensation cost for stock option grants has been recognized in the Company's statements of operations. The Company provides additional pro forma disclosures as required under Statement of Financial Accounting Standard No. 123 (SFAS 123), "Accounting for Stock-Based Compensation" (see Note 7).

RECENT ACCOUNTING PRONOUNCEMENTS

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 128 "Earnings per share." This statement is effective for the Company's fiscal year ending March 31, 1998. The Statement redefines earnings per share under generally accepted accounting principals. Under the new standard, primary earnings per share is replaced by basic earnings per share and fully diluted earnings per share is replaced by diluted earnings per share. If the Company had adopted this Statement earnings per share would have been:

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
<S>	<C>	<C>	<C>
Basic earnings per share		\$ 0.31	\$ 1.19
Diluted earnings per share		\$ 0.29	\$ 0.63

</TABLE>

NOTE 2. BALANCE SHEET AND INCOME STATEMENT DETAIL

Inventory consisted of:

<TABLE>
<CAPTION>

	MARCH 31,	
	1997	1996
<S>	<C>	<C>
Raw materials	\$ 3,988	\$ 4,036
Work in process	2,126	3,173
Finished goods and spares	7,040	9,738
	\$13,154	\$16,947

</TABLE>

Property and equipment consisted of:

<TABLE>
<CAPTION>

	MARCH 31,	
	1997	1996

<S>	<C>	<C>		
Machinery and equipment		\$ 7,090	\$ 6,670	
Demo lab equipment		2,542	2,230	
Leasehold improvements		2,452	2,279	
		-----	-----	
		12,084	11,179	
Less accumulated depreciation and amortization			(6,786)	(5,152)
		-----	-----	
		\$ 5,298	\$ 6,027	
		=====	=====	

</TABLE>

Machinery and equipment at March 31, 1997 and 1996 includes approximately \$1,370 and \$1,006, respectively of assets under leases that have been capitalized. Accumulated depreciation for such equipment approximated \$700 and \$315, respectively.

36

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

A summary of accrued expenses and other current liabilities follows:

<TABLE>

<CAPTION>

	MARCH 31,		
	1997	1996	
	-----	-----	
<S>	<C>	<C>	
Accrued compensation costs.....	\$ 1,554	\$ 1,532	
Income taxes payable.....	1,221	944	
Product warranty.....	2,251	2,586	
Motorola credit liability.....	--	1,587	
Other.....	3,961	5,098	
	-----	-----	
	\$ 8,987	\$ 11,747	
	=====	=====	

</TABLE>

Other income (expenses), net, consisted of the following:

<TABLE>

<CAPTION>

	YEAR ENDED MARCH 31,			
	1997	1996	1995	
	-----	-----	-----	
<S>	<C>	<C>	<C>	
Interest income.....	\$ 1,250	\$ 526	\$ 72	
Interest expense.....	(118)	(870)	(802)	
Foreign currency exchange gain (loss), net.....	(186)	(383)	92	
Other.....	54	341	211	
	-----	-----	-----	
	\$ 1,000	\$(386)	\$(427)	
	=====	=====	=====	

</TABLE>

NOTE 3. NOTES PAYABLE TO BANKS AND OTHERS

The Company has two lines of credit totaling \$13,000 with a U.S. bank. Both lines bear interest at prime (8.25 percent as of March 31, 1997), are secured by a blanket security in all of the Company's assets, and are available until August 15, 1997. No amount was outstanding on either of these two lines of credit at March 31, 1997 and 1996. The lines of credit restrict the declaration and payment of cash dividends and include, among other terms and conditions, requirements that the Company maintain certain financial ratios and covenants. The Company was in compliance with such covenants as of March 31, 1997 and 1996.

The Company's Japanese subsidiary has two lines of credit available for 300,000 Yen each (approximately \$4,839 at exchange rates prevailing as of March 31, 1997), bearing interest at 0.125 percent, in excess of Japanese prime (1.625 percent as of March 31, 1997). Both lines of credit are available until November 1997, and are secured by Japanese customer promissory notes provided in advance of payment. Outstanding balances on these lines in U.S. dollars as of March 31, 1997 and 1996, were \$252 and \$243, respectively.

NOTE 4. INCOME TAXES

The components of income before income taxes are as follows:

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
<S>	<C>	<C>	<C>
Domestic.....	\$3,400	\$4,173	\$1,392
Foreign.....	780	2,013	(443)
	<u>\$4,180</u>	<u>\$6,186</u>	<u>\$ 949</u>

</TABLE>

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

The components of the provision for income taxes are as follows:

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
<S>	<C>	<C>	<C>
Current:			
U.S. federal.....	\$1,143	\$1,100	\$ 9
State and local.....	432	200	7
Foreign.....	103	220	105
	<u>1,678</u>	<u>1,520</u>	<u>121</u>
Deferred:			
U.S. federal.....	(589)	(900)	--
State and local.....	(49)	--	--
	<u>(638)</u>	<u>(900)</u>	<u>--</u>
Total.....	<u>\$1,040</u>	<u>\$ 620</u>	<u>\$ 121</u>

</TABLE>

The income tax provision differs from the amount computed by applying the statutory U.S. federal income tax rate as follows:

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
<S>	<C>	<C>	<C>
Income tax provision at U.S. statutory rate.....	\$1,424	\$2,103	\$ 323
State taxes net of federal benefit.....	254	132	--

Foreign losses not utilized.....	--	--	32
Reversal of deferred tax assets previously reserved.....	(178)	--	--
Reduction in valuation allowance.....	(460)	(1,700)	(250)
Other.....	--	85	16
	-----	-----	-----
Income tax expense.....	\$1,040	\$ 620	\$ 121
	=====	=====	=====

</TABLE>

The components of deferred taxes are as follows:

<TABLE>

<CAPTION>

	MARCH 31,	
	-----	-----
	1997	1996
	-----	-----
<S>	<C>	<C>
Revenue recognized for tax and deferred for book.....	\$ 556	\$ 1,078
Non-deductible accruals and reserves.....	2,910	2,739
Foreign net operating loss carryforward.....	1,601	1,612
Uniform cap adjustment.....	330	120
Other.....	83	113
	-----	-----
	5,480	5,662
Valuation allowance.....	(4,302)	(4,762)
	-----	-----
Net deferred tax asset.....	\$ 1,178	\$ 900
	=====	=====

</TABLE>

The Company has recorded net deferred tax assets of approximately \$1,178 and \$900 at March 31, 1997 and 1996, respectively. Management's evaluation of the recoverability of the Company's deferred tax is based upon the Company's ability to carry back temporary differences for future tax deductions against previously taxed income.

38

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

At March 31, 1997, the Company has operating loss carryforwards in foreign jurisdictions amounting to approximately \$4,000, which begin to expire on March 31, 1998.

NOTE 5. LEASE COMMITMENTS

The Company has several noncancelable operating leases and capital leases, primarily for general office, production, and warehouse facilities, that expire over the next five years. Future minimum lease payments under these leases are as follows:

<TABLE>

<CAPTION>

	YEAR ENDED MARCH 31,	
	-----	-----
	CAPITAL LEASES	OPERATING LEASES
	-----	-----
<S>	<C>	<C>
1998.....	\$ 401	\$1,700
1999.....	236	1,632
2000.....	58	1,564
2001.....	32	1,446
2002.....	3	7
	-----	-----
Total minimum lease payments.....	\$ 730	\$6,349
	=====	=====
Less amount representing interest.....	(77)	

</TABLE>

The above schedule of minimum payments excludes minimum annual sublease rentals payable to the Company totaling \$145 through January 31, 1998, under operating subleases. In addition, most leases provide for the Company to pay real estate taxes and other maintenance expenses. Rent expense for operating leases was \$2,406, \$2,613, and \$2,441 during the years ended March 31, 1997, 1996, and 1995, respectively.

NOTE 6. PREFERRED STOCK

On October 24, 1995, the Company closed an initial public offering ("IPO") of its common stock. Under the terms of the IPO, all of the then outstanding Series A, C, and D mandatorily redeemable preferred stock was converted into 5,876,079 shares of common stock. In addition, in accordance with a Conversion Agreement between the Company and Motorola dated August 31, 1994, as amended August 8, 1995, all of the then outstanding Series B redeemable preferred stock was converted into an obligation to Motorola in the form of a credit liability (payable in cash and through the issuance of purchase credits on sales of products or services to Motorola).

NOTE 7. EMPLOYEE BENEFIT PLANS

Equity Incentive Plan

Pursuant to the Amended and Restated Equity Incentive Plan ("Equity Incentive Plan"), options and stock purchase rights to purchase 3,500,000 shares of common stock may be granted to management and consultants. The exercise price of options and the purchase price of stock purchase rights generally is the fair value of the Company's common stock on the date of grant. At the date of issuance of the stock options, all options are exercisable; however the Company has the right to repurchase any stock acquired pursuant to the exercise of stock options upon termination of employment or consulting agreement at the original exercise price for up to four years from the date the options were granted, with the repurchase rights ratably expiring over that period of time. Incentive stock options are exercisable for up to 10 years from the grant date of the option. Nonqualified stock options are exercisable for up to 15 years from the grant date of the option.

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

1990 Stock Option Plan

Pursuant to the terms of the Company's 1990 Stock Option Plan ("Option Plan"), options and stock purchase rights to purchase 550,000 shares of common stock may be granted to employees of the Company or its affiliates. Incentive stock options are exercisable for a period of up to 10 years from the date of grant of the option and nonqualified stock options are exercisable for a period of up to 10 years and 2 days from the date of grant of the option. At the date of issuance of the stock options, all options are exercisable, however, the Company has the right to repurchase any stock acquired pursuant to the exercise of stock options upon termination of employment at the original exercise price for up to four years from the date the options were granted, with the repurchase rights ratably expiring over that period of time.

Directors Stock Option Plan

Pursuant to the terms of the Directors Plan, up to 300,000 shares of common stock may be granted to Directors. Under the Directors Plan each Outside Director who was a member of the Board at the date of the IPO received 30,000 shares of which 10,000 shares vested immediately and the right to purchase the remaining 20,000 shares vesting over the next three years in equal annual installments on the anniversary of such effective date. Any shares granted subsequent to the date of the "IPO" will vest annually over four years,

contingent upon continued service as a director.

The following table summarizes the Company's stock option activity for the three plans described above and weighted average exercise price within each transaction type for each of the years ended March 31, 1997, 1996, and 1995 (number of shares in thousands):

<TABLE>

<CAPTION>

	1997		1996		1995	
	SHARES	PRICE	SHARES	PRICE	SHARES	PRICE
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Options outstanding at beginning of year.....	1,163	\$4.90	996	\$ 0.40	997	\$0.40
Options canceled.....	(183)	9.52	(65)	0.27	(28)	0.43
Options granted.....	595	5.50	590	10.25	34	0.53
Options exercised.....	(162)	0.33	(358)	0.36	(7)	0.27
Options outstanding March 31.....	1,413	\$4.36	1,163	\$ 4.90	996	\$0.40

</TABLE>

At March 31, 1997, the repurchase right associated with 512,135 of the options outstanding had elapsed. Additionally, the Company had the right to repurchase 152,255 shares related to options which were exercised.

Significant option groups outstanding at March 31, 1997, and related weighted average exercise price of options granted for which the Company no longer has the right to repurchase and contractual life information are as follows (share information in thousands):

<TABLE>

<CAPTION>

EXERCISE PRICE RANGE	OPTIONS NO LONGER SUBJECT TO REPURCHASE		REMAINING LIFE (YEARS)
	SHARES OUTSTANDING	RIGHTS	
<S>	<C>	<C>	<C>
\$.24 - \$.53	446	\$.45 378	\$.44 4.72
\$4.75 - \$5.50	644	5.25 30	5.23 10.18
\$6.25	55	6.25 23	6.25 10.16
\$6.88 - \$8.00	196	7.04 46	6.89 8.84
\$12.00	72	\$12.00 35	\$12.00 9.13

</TABLE>

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

As described in Note 1, the Company has adopted the disclosure provisions as required by SFAS 123. Accordingly, no compensation cost has been recognized in the Company's statements of operations as all options were granted at an exercise price equal to the market value of the Company's common stock at the date of grant.

As required by SFAS 123 for pro forma disclosure purposes only, the Company has calculated the estimated grant date fair value using the Black-Scholes Model. The Black-Scholes model, as well as other currently accepted option valuation models, was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock option awards. These models also require highly subjective assumptions, including future stock price volatility and expected time until exercise, which greatly affect the calculated grant date fair value.

The following weighted average assumptions are included in the estimated grant date fair value calculations for the Company's stock option awards:

<TABLE>
<CAPTION>

	1997	1996
	-----	-----
<S>	<C>	<C>
Expected life (years).....	4 years	4 years
Risk-free interest rate.....	6.07%	5.97%
Volatility.....	60%	60%
Dividend yield.....	0%	0%

</TABLE>

The weighted average estimated grant date fair value, as defined by SFAS 123, for options granted during 1997 and 1996 was \$3.67 and \$4.90 per option, respectively. The estimated fair value, as defined by SFAS 123, attributable to options canceled and reissued during 1997 was \$1.53 per option. In addition, included in pro forma net income for fiscal year 1997 is an adjustment of \$104 related to the cancellation of vested options not exercised due to employee terminations. There is no such adjustment in fiscal year 1996.

Stock Purchase Plan

Since 1996, the Company has offered an Employee Qualified Stock Purchase Plan ("Employee Plan") under which rights are granted to purchase shares of common stock at 85% of the lesser of the market value of such shares at the beginning of a twelve month offering period or at the end of that twelve month period. For 1997 forward, the offering period has been reduced from twelve months to six months. Under the Employee Plan, the Company is authorized to grant options to purchase up to 250,000 shares of common stock. 53,633 common shares were purchased under the Employee Plan in fiscal 1997 at a price of \$4.46. No shares were purchased in fiscal 1996. Shares available for future purchase under the Employee Plan were 196,367 at March 31, 1997.

Compensation cost (included in pro forma net income and net income per share amounts only) for the grant date fair value, as defined by SFAS 123, of the purchase rights granted under the Employee Plan was calculated using the Black-Scholes model. Included in the pro forma net income for fiscal year 1996 is compensation expense related to purchase rights granted during the period December 15, 1995 through March 31, 1996. Fiscal year 1997 reflects purchase rights earned for the full fiscal year. The weighted average estimated grant date fair value per share for rights granted under the Plan, as defined by SFAS 123, for stock purchased under the Employee Stock Purchase Plan during 1997, was \$3.69.

41

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

Pro Forma Net Income and Net Income Per Share

Had the Company recorded compensation costs based on the estimated grant date fair value (as defined by SFAS 123) for awards granted under its stock option plans and stock purchase plan, the Company's net income and earnings per share would have been reduced to the pro forma amounts below for the years ended March 31, 1997 and 1996:

<TABLE>
<CAPTION>

	1997	1996
	-----	-----
<S>	<C>	<C>
Pro forma net income.....	\$1,865	\$5,155
Pro forma net income per share.....	\$0.18	\$0.58

</TABLE>

The pro forma effect on net income and net income per share takes into consideration pro forma compensation related only to grants made after December

15, 1995. Consequently, the pro forma effect on net income and net income per share for 1997 and 1996 is not necessarily representative of the pro forma effect on net income in future years.

Savings and Investment Plan

The Company has established a defined contribution plan that covers substantially all U.S. employees who are regularly scheduled to work 20 or more hours per week. Employee contributions of up to 4% of each covered employee's compensation will be matched by the Company based upon a percentage to be determined annually by the Board of Directors. Employees may contribute up to 15% of their compensation, not to exceed a prescribed maximum amount. The Company made contributions to the plan of \$28, \$27, and \$21 in the years ended March 31, 1997, 1996, and 1995, respectively.

NOTE 8. SHAREHOLDER RIGHTS PLAN

On June 11, 1996, the Board of Directors ("Board") adopted a Preferred Shares Rights Agreement ("Agreement") and pursuant to the Agreement authorized and declared a dividend of one preferred share purchase right ("Right") for each common share outstanding of the Company at the close of business on July 1, 1996. The Rights are designed to protect and maximize the value of the outstanding equity interests in the Company in the event of an unsolicited attempt by an acquiror to take over the Company, in a manner or under terms not approved by the Board. Each Right becomes exercisable to purchase one one-hundredth of a share of Series A Junior Participating Preferred Stock at an exercise price of \$45.00 upon certain circumstances associated with an unsolicited takeover attempt and expires on June 11, 2006. The Company may redeem the Rights at a price of \$0.01 per Right.

NOTE 9. CUSTOMERS AND FOREIGN OPERATIONS

The Company's sales are primarily to domestic and international semiconductor manufacturers. The top five customers accounted for approximately 46%, 42%, and 42% of the Company's total net sales for the years ended March 31, 1997, 1996, and 1995, respectively. Two customers accounted for approximately 17% and 10%, respectively, of net sales for the year ended March 31, 1997, two customers accounted for approximately 14% and 13%, respectively, of net sales for the year ended March 31, 1996, and two customers accounted for 15% and 14%, respectively, of the Company's net sales for the year ended March 31, 1995.

42

TEGAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) MARCH 31, 1997, 1996, AND 1995

(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE DATA, UNLESS OTHERWISE NOTED)

The Company's operations by geographical region were as follows:

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
	<C>	<C>	<C>
Revenues:			
Sales to unaffiliated customers:			
United States:			
Customers in United States.....	\$ 17,795	\$ 22,816	\$16,644
Customers in Asia.....	18,640	10,928	10,070
Europe.....	10,061	13,769	13,465
Japan.....	10,927	14,533	4,466
	-----	-----	-----
Total external sales.....	\$ 57,423	\$ 62,046	\$44,645
	=====	=====	=====
Intercompany sales among geographic areas:			
From United States.....	\$ 10,052	\$ 19,401	\$ 8,474
From Europe.....	684	562	739
Consolidation eliminations.....	(10,736)	(19,963)	(9,213)
	-----	-----	-----

Net intercompany sales..... \$ -- \$ -- \$ --
=====

</TABLE>

Intercompany sales among the Company's geographic areas are recorded on the basis of intercompany prices established by the Company.

<TABLE>

<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
<S>	<C>	<C>	<C>
Operating income (loss):			
United States.....	\$ 2,378	\$ 4,465	\$ 2,502
Europe.....	115	594	(158)
Japan.....	687	1,513	(968)
Operating income.....	\$ 3,180	\$ 6,572	\$ 1,376

</TABLE>

<TABLE>

<CAPTION>

	MARCH 31,	
	1997	1996
<S>	<C>	<C>
Identifiable assets at year-end:		
United States.....	\$ 62,494	\$ 68,108
Europe.....	8,345	11,842
Japan.....	4,215	9,684
Consolidation eliminations.....	(11,530)	(24,962)
Total identifiable assets.....	\$ 63,524	\$ 64,672

</TABLE>

43

INDEPENDENT ACCOUNTANTS' REPORT

To the Board of Directors and Stockholders of
Tegal Corporation

In our opinion, the consolidated financial statements listed in the index appearing under item 14(a)(1) on page 28 present fairly, in all material respects, the financial position of Tegal Corporation and its subsidiaries at March 31, 1997 and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles. These consolidated financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for the opinion expressed above.

The consolidated financial statements of Tegal Corporation for the years ended March 31, 1996 and March 31, 1995, included herein, were audited by other independent accountants whose report dated April 23, 1996 expresses an unqualified opinion on those statements.

Price Waterhouse LLP
San Jose, California
April 23, 1997

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Tegal Corporation:

We have audited the accompanying consolidated balance sheet of Tegal Corporation and subsidiaries as of March 31, 1996, and related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the two-year period ended March 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tegal Corporation and subsidiaries as of March 31, 1996, and the results of their operations and their cash flows for each of the years in the two-year period ended March 31, 1996, in conformity with generally accepted accounting principles.

/s/ KPMG Peat Marwick LLP
KPMG PEAT MARWICK LLP

Palo Alto, California
April 23, 1996

45

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: June 24, 1997

TEGAL CORPORATION

By: /s/ ROBERT V. HERY

Robert V. Hery
Chairman, President & Chief
Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Robert V. Hery and David Curtis, jointly and severally, his attorneys-in-fact, each with the powers of substitution, for him in any and all capacities, to sign any amendments to this Report of Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<TABLE>
<CAPTION>

SIGNATURE	TITLE	DATE
<S>	<C>	<C>
/s/ ROBERT V. HERY	Chairman, President, Chief Executive Officer and Director (Principal Executive Officer)	June 24, 1997
Robert V. Hery		
/s/ DAVID CURTIS	Chief Financial Officer (Principal Financial Officer)	June 24, 1997
David Curtis		
/s/ WILLIAM F. O'SHEA	Corporate Controller (Principal Accounting Officer)	June 24, 1997
William F. O'Shea		
/s/ FRED NAZEM	Director	June 24, 1997
Fred Nazem		
/s/ JEFFREY KRAUSS	Director	June 24, 1997
Jeffrey Krauss		
/s/ THOMAS R. MIKA	Director	June 24, 1997
Thomas R. Mika		
/s/ EDWARD A. DOHRING	Director	June 24, 1997
Edward A. Dohring		

</TABLE>

46

SCHEDULE II

TEGAL CORPORATION

VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED MARCH 31, 1995, 1996, 1997
(IN THOUSANDS)

<TABLE>
<CAPTION>

DESCRIPTION	BALANCE AT BEGINNING OF YEAR	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS	BALANCE AT END DEDUCTIONS OF YEAR	
<S>	<C>	<C>	<C>	<C>	
Year ended March 31, 1995:					
Product warranty.....	\$1,786	\$2,608	\$ (239)	\$ (3,000)	\$ 1,155
Doubtful accounts.....	15	253	--	(7)	261
Sales returns and allowances.....	177	--	389	(381)	185
Cash discounts.....	22	84	--	(77)	29
Year ended March 31, 1996:					
Product warranty.....	1,155	3,634	(4)	(2,199)	2,586
Doubtful accounts.....	261	262	(94)	(68)	361
Sales returns and allowances.....	185	298	(171)	(229)	83
Cash discounts.....	29	87	(78)	(29)	9
Year ended March 31, 1997:					
Product warranty.....	2,586	4,406	(118)	(4,623)	2,251
Doubtful accounts.....	361	13	--	(54)	320
Sales returns and allowances.....	83	592	(1)	(230)	444
Cash discounts.....	9	51	--	(19)	41

</TABLE>

S-1

INDEPENDENT ACCOUNTANTS' REPORT ON SCHEDULE

The Board of Directors

Tegal Corporation:

Our audit of the consolidated financial statements for the year ended March 31, 1997 referred to in our report dated April 23, 1997, appearing on page 44 in the 1997 Annual Report on Form 10-K also included an audit of the Financial Statement Schedule for the year ended March 31, 1997 listed in Item 14 (a) of this Form 10-K. In our opinion, the Financial Statement Schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

/s/ Price Waterhouse LLP
PRICE WATERHOUSE LLP

San Jose, California
April 23, 1997

S-2

INDEPENDENT AUDITORS' REPORT ON SCHEDULE

The Board of Directors
Tegal Corporation:

Under date of April 23, 1996, we reported on the consolidated balance sheet of Tegal Corporation and subsidiaries as of March 31, 1996, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the two-year period ended March 31, 1996. These consolidated financial statements and our report thereon are included herein. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement schedule as listed in the accompanying index in Item 14, as of and for each of the years in the two-year period ended March 31, 1996. This consolidated financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statement schedule based on our audits.

In our opinion, the consolidated financial statement schedule, referred to above, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG Peat Marwick LLP
KPMG PEAT MARWICK LLP

Palo Alto, California
April 23, 1996

S-3

INDEX TO EXHIBITS

<TABLE>

<CAPTION>

EXHIBIT

NUMBER

DESCRIPTION OF EXHIBIT

<S> <C>

10.17	Lease Amendment dated March 10, 1997 between Registrant and South McDowell Investments
11	Statement Regarding Computation of Net Income Per Share
23.1	Consent of Independent Accountants
23.2	Consent of Independent Auditors
24.1	Powers of Attorney (included on page 46)
27	Financial Data Schedule

</TABLE>

LEASE AMENDMENT

THIS LEASE AMENDMENT (this "Amendment") is entered into as of this 10th day of March, 1997, by and between SOUTH MCDOWELL INVESTMENTS, a California general partnership, ("Landlord"), and TEGAL CORPORATION, a Delaware corporation ("Tenant").

RECITALS

A. On or about August 15, 1986, Justin M. Jacobs, Jr., dba Landbank Investments as predecessor-in-interest to Landlord ("Landbank") and Tenant entered into that certain Lease (the "Original Lease"), whereby Landlord leased to Tenant and Tenant leased from Landlord that certain premises commonly known as 2201 South McDowell Blvd. (the "Premises"), as more specifically described in the Original Lease.

B. The Original Lease was amended by that certain Amendment dated as of August 31, 1987, by and between Landlord, as successor-in-interest to Landbank, and Tenant (the "First Amendment").

C. The Original Lease was further amended by that letter amendment dated as of September 11, 1987, by and between Landlord and Tenant (the "Second Amendment").

D. The Original Lease was further amended by that certain Amendment dated as of December 17, 1987, by and between Landlord and Tenant (the "Third Amendment").

E. The Original Lease was further amended by that letter amendment dated as of January 15, 1988, by and between Landlord and Tenant (the "Fourth Amendment").

F. The Original Lease was further amended by that certain Amendment dated as of March 8, 1988, by and between Landlord and Tenant (the "Fifth Amendment"). The Original Lease together with the First Amendment, the Second Amendment, the Third Amendment, the Fourth Amendment, and the Fifth Amendment are collectively referred to herein as the "Lease."

G. Landlord and Tenant desire to amend the Lease as provided in this Amendment.

NOW THEREFORE, for good and valuable consideration the receipt and adequacy of which are hereby acknowledged, the parties hereto agree as follows:

SECTION 1. Term.

Section 2 of the Original Lease is hereby modified to extend the end of the term to March 9, 2004 (the "Extended Expiration Date").

SECTION 2. Rent.

(a) Section 5 of the Original Lease hereby modified to provide that commencing with the Effective Date of this Amendment, Tenant agrees to pay to Landlord at such place as Landlord may from time to time designate without deduction, offset, abatement, prior notice or demand, and Landlord agrees to accept as Basic Rent for the leased Premises:

<TABLE>

<CAPTION>

Period	Monthly Rent	Annual Rent
-----	-----	-----
<S>	<C>	<C>
March 10, 1997, through March 9, 1998	\$ 102,000	\$1,224,000
March 10, 1998, through March 9, 1999	\$ 102,000	\$1,224,000
March 10, 1999, through March 9, 2000	\$ 126,000	\$1,512,000
March 10, 2000, through March 9, 2001:	\$ 126,000	\$1,512,000

</TABLE>

(b) Commencing on March 10, 2001 (the "Initial Adjustment Date"), and

thereafter on the anniversary date thereof (each an "Adjustment Date"), the Basic Rent shall be increased in an amount equal to the greater of (i) one percent (1%) of the Basic Rent payable for the month immediately preceding such Adjustment Date; or (ii) an amount calculated by multiplying the Basic Rent for the month immediately preceding the Adjustment Date, by a fraction, the numerator of which shall be the Index (as hereinafter defined), published nearest but prior to the Adjustment Date, and the denominator of which shall be (A) as to the adjustment occurring on the Initial Adjustment Date, the Index published nearest but prior to the commencement of the twelve (12) month period immediately preceding the Initial Adjustment Date, and (B) as to each adjustment occurring after the Initial Adjustment Date, the Index published nearest but prior to the commencement of the twelve (12) month period immediately preceding such Adjustment Period, provided however that the annual adjustment due to an increase in the Index shall not exceed six percent (6%) of the Basic Rent payable for the month immediately preceding such adjustment Date.

(c) The term Index as used in this Amendment shall mean Consumer Price Index, All Urban Consumers, All Items, San Francisco-Oakland-San Jose (1982-84 equals 100), or the successor of such index, published by the Bureau of Labor Statistics of the United States Department of Labor. If the Bureau of Labor Statistics revises the Index, the parties agree that the Bureau of Labor Statistics shall be the sole judge of the comparability of successive indexes. If that agency, however, fails to supply indexes that it deems comparable, or if no succeeding index is published, the parties shall then negotiate to determine an appropriate alternative published price index. If they are unable to agree on an alternative index within thirty (30) days after the request to do so is made by one party to the other, then either party may request that each appoint a person, within fifteen (15) days after the request, to select an alternative published price index. The two persons so appointed, within fifteen (15) days after the later of them is appointed, shall appoint a third person to act with them in the selection of an alternative price index. If Landlord or Tenant fails to appoint one of the first two, then the person appointed by the other party shall determine the alternative published price index. If the two persons appointed fail to appoint a third, upon the request of either Landlord or Tenant, the vacancy shall be filled by an impartial person appointed by the presiding judge of the court of general jurisdiction for the county in which the Premises are located, with that judge acting in the judge's individual rather than judicial capacity. If any appointee declines or is unable to serve, the appointee shall be replaced by another person appointed in the same manner.

2

Within thirty (30) days after the appointment process is completed, and on the basis of all pertinent facts, the appointees, by majority vote, shall select an alternative published price index and advise Landlord and Tenant in writing of the selection. All fees and expenses incurred in the appointment of the persons shall be shared equally by Landlord and Tenant.

SECTION 3. Condition.

Tenant shall continue its tenancy of the Premises, on an "as-is" basis, without any allowance for retrofitting or tenant improvements. Nothing contained in the foregoing sentence shall be deemed to relieve Landlord of its ongoing maintenance obligations under the Lease.

SECTION 4. Removal of Alterations.

(a) Upon written request by Tenant therefor, such request to be made within six months of the Effective Date, Landlord shall notify Tenant as to which of the tenant improvements specifically identified in such request and installed by Tenant after the original build-out of the Premises (other than such improvements identified on Exhibit "M" to the Lease), Landlord shall require Tenant to remove following the termination of the Lease.

(b) From and after the Effective Date, as and when Tenant requests the right to make alterations to the Premises (the "Requested Alterations"), Landlord shall identify, within ten (10) business days after the receipt by Landlord of Tenant's request and plans describing such Requested Alterations (collectively an "Alteration Request"), which of the Requested Alterations shall be required to be removed at the termination of the Lease, provided that Tenant's request specifically requests Landlord to so identify which of the Requested Alterations Landlord desires to have removed at the termination of the Lease. In the event that Landlord fails to respond, within ten (10) business

days after the receipt by Landlord of an Alteration Request, Tenant shall notify Landlord in writing of Landlord's failure to so respond (the "Second Notice") and if Landlord fails thereafter to respond within five (5) business days after receiving the Second Notice, Landlord shall be deemed to have waived its right to require Tenant to remove the Requested Alterations. It is expressly agreed that a request by Landlord for additional information shall be deemed a "response" for purposes of this Section 4.

SECTION 5. Insurance.

From and after February 1, 1998, Section 12.c of the Lease shall be deemed deleted. Except as provided in this Section 5, Tenant shall not be relieved from obtaining and maintaining at Tenant's sole cost and expense the various policies of insurance required to be obtained and maintained by Tenant pursuant to Section 12 of the Lease.

SECTION 6. Motorola Guarantee.

The guarantee of the Lease (the "Guaranty") by Motorola Inc., a Delaware corporation ("Motorola"), shall remain in full force and effect until January 31, 1998, after which it shall terminate and be of no further force or effect. As of February 1, 1998, any obligations or liabilities of Motorola under the Guaranty, the Lease or this Amendment shall cease. This Amendment shall be conditioned

3

upon the consent by Motorola hereto. Landlord shall provide to Motorola on or before the execution of this Amendment, a letter in the form attached hereto and incorporated herein as Exhibit A.

SECTION 7. Repair and Maintenance.

The second sentence of Section 9.A. of the Original Lease is hereby deleted and replaced with the following:

"Landlord may engage contractors of its choice to perform the obligations required of it by this Section, and the necessity of any expenditure to perform such obligations shall be at the reasonable discretion of Landlord."

SECTION 8. Lease Termination.

Notwithstanding anything else contained herein to the contrary, Tenant shall have the right to terminate the Lease as to the whole Premises effective March 10, 2001, which right shall be exercisable by delivery of written notice of such election to Landlord no later than March 10, 2000. Thereafter, Tenant shall have the right to terminate the Lease as to the whole Premises on each anniversary thereafter, provided that Tenant provides Landlord notice of such election no later than fifteen months prior to such anniversary.

SECTION 9. Option to Extend.

Landlord grants to Tenant the option to extend the term of this Lease (the "Option") for one (1) period of five (5) years, commencing on the day immediately following the Extended Expiration Date, upon each and all of the following terms and conditions:

- (a) Tenant shall give to Landlord written notice of the exercise of the Option no earlier than twenty-four (24) months prior to the Extended Expiration Date, and no later than twelve (12) months prior to the Extended Expiration Date, time being of the essence. If said notification of the exercise of said option is not so given then the Option shall automatically expire.
- (b) At the time the notification of exercise of the Option is given and on the Extended Expiration Date, Tenant shall not be in material default under any of Tenant's material obligations under the Lease and no event shall have occurred which with the giving of notice or the passage of time would constitute a material default on the part of Tenant under the Lease;

- (c) The Basic Rent for each year of the Option Term shall be determined in accordance with Section 2(b) hereof,
- (d) All of the terms and conditions of the Lease shall remain the same, except that Tenant's right to terminate the Lease pursuant to Section 8 hereof, shall terminate, and be of no further force or effect.

4

SECTION 10. Assignment and Subletting.

(a) The third sentence of Section 14.A.(1) of the Original Lease is hereby deleted and replaced with the following:

"If Landlord fails to respond in writing to Tenant's request for Landlord's consent to a Transfer within ten (10) business days after receipt of such request, then Landlord shall be deemed to have consented to such Transfer."

(b) The first sentence of Section 14.A.(2) of the Original Lease is hereby deleted and replaced with the following:

"Tenant shall give Landlord prior written notice of any desired Transfer and of the proposed terms of such Transfer including but not limited to (i) the name and legal composition of the proposed transferee; (ii) a current financial statement of the transferee, and/or its parent, covering the preceding three (3) years, and (if readily available) an audited financial statement of the transferee for a period ending not more than one year prior to the proposed effective date of the transfer, all of which statements shall be prepared in accordance with generally accepted accounting principles; (iii) the nature of the proposed transferee's business to be carried on in the Premises; (iv) a description of all consideration to be given on account of the Transfer; and (v) such other information as may be reasonably requested by Landlord."

SECTION 11. Deleted Provisions.

Sections 29, 30, 31, and 36 are hereby deleted in their entirety.

SECTION 12. Brokers.

(a) Tenant represents and warrants to Landlord that no real estate broker, agent or finder negotiated or was instrumental in negotiating or representing Tenant in the negotiation of this Amendment or the consummation hereof except for Meridian Commercial, Inc ("Broker"). Tenant shall be responsible for the payment of the commission or fee, if any, owed to Broker pursuant to a separate fee agreement between Broker and Tenant. Tenant shall pay the commission or fee of any other broker, agent or finder, including but not limited to, Michael Lieberman and Jerry Angel, acting for or on behalf of, or claiming to act for or on behalf of, Tenant or claiming any commissions or fees on the basis of contacts or dealings with Tenant and not disclosed herein by Tenant and Tenant shall indemnify and hold Landlord harmless from and against any claims made by any such broker, agent or finder of Tenant and any and all costs and damages suffered by Landlord as a consequence thereof, including without limitation attorneys' fees.

(b) Landlord represents and warrants to Tenant that no real estate broker, agent or finder negotiated or was instrumental in negotiating or representing Landlord in the negotiation of this Amendment or the consummation hereof. Landlord shall pay the commission or fee of any broker, agent or finder acting for or on behalf of, or claiming to act for or on behalf of, Landlord or claiming

5

any commissions or fees on the basis of contacts or dealings with Landlord and not disclosed herein by Landlord and Landlord shall indemnify and hold Tenant harmless from and against any claims made by any such broker, agent or finder of Landlord and any and all costs and damages suffered by Tenant as a consequence thereof, including without limitation attorneys' fees.

SECTION 13. Conditions Precedent.

This Amendment shall be conditioned upon the following conditions precedent:

- (a) Approval of this Amendment by Landlord's lender;
- (b) Consent to this Amendment by Motorola; and
- (c) Approval of this Amendment by Tenant's Board of Directors and the provision to Landlord of a certified resolution of Tenant's Board of Directors evidencing such approval.

SECTION 14. No Other Modifications.

Except as otherwise modified herein, all terms and conditions of the Lease shall be unmodified and remain in full force and effect.

6

SECTION 15. Conflicts.

In the event there shall be any conflict between the provisions of the Lease and its Exhibit and this Amendment, the provisions of the Amendment shall control.

IN WITNESS WHEREOF, the parties have executed this Amendment as of the date first set forth above.

LANDLORD:

SOUTH MCDOWELL INVESTMENTS,
a California general partnership

By: /s/ Jane Crocker

Jane Crocker, its General Partner

TENANT.

TEGAL CORPORATION,
a Delaware Corporation

By: /s/ David Curtis

David Curtis, its Vice President of Finance

By: /s/ Robert V. Hery

Robert V. Hery, its Chairman, President and CEO

MOTOROLA, INC. hereby consents to this Amendment.

MOTOROLA, INC.,
a Delaware corporation

By: /s/ William E. Spencer

Name: William E. Spencer
Title: Vice President

7

EXHIBIT A

SOUTH MCDOWELL INVESTMENTS
P.O. 1433
MENLO PARK, CA 94026

January 27, 1997

Motorola, Inc.
1303 E. Algonquin Rd.
Schaumburg, ILL 60196

Attn: Theodore W. Schaffner, Vice President
& Corporate Director of Business Development

Gentlemen:

Reference is made to the Lease (the "Lease"), dated as of August 15, 1986, between Justin M. Jacobs, Jr., doing business as Landbank Investments ("Landbank"), as Landlord, and Tegal Corporation, as Tenant, under which the Landlord leased to Tenant the premises commonly known as 2201 South McDowell Boulevard, Petaluma, California 94955.

Whereas, Motorola, Inc. ("Motorola") has guaranteed the performance of Tegal Corporation under the Lease; and

Whereas, South McDowell Investments, as successor-in-interest to Landbank and as the present Landlord under the Lease, and Tegal Corporation intend to amend the Lease and extend its term (the "Amendment"); and

Whereas, Motorola has requested certain assurances about the status of the Lease and Motorola's guarantee after the effective date of the amendment.

NOW, THEREFORE, South McDowell Investments represents to Motorola as follows:

1. The Lease is presently in full force and effect as amended August 31, 1987, September 11, 1987, December 17, 1987, January 15, 1988, and March 8, 1988.

2. Tegal Corporation is not in default in the payment of rent and, to the best of Landlord's knowledge, without investigation or inquiry, in the performance of its other obligations, or otherwise, under the Lease.

3. To the best of Landlord's knowledge, without investigation or inquiry, no event has occurred or presently exists which would give South McDowell Investments the right to proceed against or call upon Motorola to perform or fulfill its guarantee of the Lease (the "Guaranty").

4. To the best of Landlord's knowledge, South McDowell Investments is not in default
Motorola, Inc.
January 27, 1997
Page 2

in the performance of any of its obligations under the Lease.

5. The Guaranty shall terminate and be of no further force or effect as of 12:00 p.m. midnight, January 31, 1998. and at that time, all obligations and liabilities of Motorola under the Guaranty and the Lease shall cease, notwithstanding that the term of the Lease has been extended to January 31, 2004 by agreement between Tegal Corporation and South McDowell Investments.

6. A true and correct copy of the Amendment is attached hereto and incorporated herein as Exhibit A. It is not Landlord's present understanding or intent that the Amendment (i) imposes any additional obligations which will be covered by the Guaranty, or (ii) increases the liability of Motorola in any respect under the Guaranty.

Sincerely,

SOUTH MCDOWELL INVESTMENTS,
a California general partnership

By:

Jane Crocker
General Partner

cc: Norman E. MacKay, Esq
Alexander E. Hamilton, Esq.

EXHIBIT 11

TEGAL CORPORATION AND SUBSIDIARIES

STATEMENT REGARDING COMPUTATION
OF NET INCOME PER SHARE
(IN THOUSANDS, EXCEPT PER SHARE DATA)

<TABLE>
<CAPTION>

	YEAR ENDED MARCH 31,		
	1997	1996	1995
	-----	-----	-----
	<C>	<C>	<C>
Net income.....	\$ 3,140	\$5,566	\$ 828
	-----	-----	-----
Weighted average shares outstanding during the period.....	10,138	4,692	534
Preferred stock on an "as if" converted basis.....	--	3,309	5,876
Common shares issued and stock options granted in accordance with Staff Accounting Bulletin No. 83.....	--	1	774
Common stock equivalent.....	572	897	189
	-----	-----	-----
Shares used in per share computation.....	10,710	8,899	7,373
	=====	=====	=====
Net income per share.....	\$ 0.29	\$ 0.63	\$ 0.11
	=====	=====	=====

</TABLE>

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-462 and 333-12473) of Tegal Corporation of our report dated April 23, 1997 appearing on page 44 of Tegal Corporation's Annual Report on Form 10-K. We also consent to the incorporation by reference of our report on the Financial Statement Schedule, which appears on page S-2 of this annual report on Form 10-K.

/s/ Price Waterhouse LLP
PRICE WATERHOUSE LLP

San Jose, California
June 24, 1997

EXHIBIT 23.2

CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
Tegal Corporation:

We consent to incorporation by reference in the registration statements (No. 333-462 and 333-12473) on Form S-8 of Tegal Corporation of our reports dated April 23, 1996, relating to the consolidated financial statements of Tegal Corporation as of March 31, 1996, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for each of the years in the two-year period ended March 31, 1996, and the related schedule, which reports appear in the March 31, 1997, annual report on Form 10-K of Tegal Corporation.

/s/ KPMG Peat Marwick LLP
KPMG PEAT MARWICK LLP

Palo Alto, California
June 24, 1997

<TABLE> <S> <C>

<ARTICLE> 5

<S>	<C>	<C>	<C>	<C>	<C>
<PERIOD-TYPE>	YEAR	YEAR	YEAR		
<FISCAL-YEAR-END>	MAR-31-1997	MAR-31-1996	MAR-31-1996	MAR-31-1995	
<PERIOD-START>	APR-01-1996	APR-01-1995	APR-01-1995	APR-01-1994	
<PERIOD-END>	MAR-31-1997	MAR-31-1996	MAR-31-1996	MAR-31-1995	
<CASH>	30,323	23,283	0		
<SECURITIES>	0	0	0		
<RECEIVABLES>	13,086	16,644	0		
<ALLOWANCES>	764	453	0		
<INVENTORY>	13,154	16,947	0		
<CURRENT-ASSETS>	58,073	58,416	0		
<PP&E>	12,084	11,179	0		
<DEPRECIATION>	6,786	5,152	0		
<TOTAL-ASSETS>	63,524	64,672	0		
<CURRENT-LIABILITIES>	12,681	16,690	0		
<BONDS>	0	0	0		
<PREFERRED-MANDATORY>	0	0	0		
<PREFERRED>	0	0	0		
<COMMON>	103	101	0		
<OTHER-SE>	50,439	47,525	0		
<TOTAL-LIABILITY-AND-EQUITY>		63,524	64,672	0	
<SALES>	57,423	62,046	44,645		
<TOTAL-REVENUES>	57,423	62,046	44,645		
<CGS>	31,522	33,469	24,062		
<TOTAL-COSTS>	31,522	33,469	24,062		
<OTHER-EXPENSES>	10,531	10,000	8,065		
<LOSS-PROVISION>	13	262	253		
<INTEREST-EXPENSE>	118	870	802		
<INCOME-PRETAX>	4,180	6,186	949		
<INCOME-TAX>	1,040	620	121		
<INCOME-CONTINUING>	3,140	5,566	828		
<DISCONTINUED>	0	0	0		
<EXTRAORDINARY>	0	0	0		
<CHANGES>	0	0	0		
<NET-INCOME>	3,140	5,566	828		
<EPS-PRIMARY>	.29	.63	.11		
<EPS-DILUTED>	.29	.63	.11		

</TABLE>