

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

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

Commission File Number: 0-26824

TEGAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [] No

As of November 12, 2009 there were 8,415,676 of the Registrant’s common stock outstanding. The number of shares outstanding reflects a 1-for-12 reverse stock split effected by the Registrant on July 25, 2006.

TEGAL CORPORATION AND SUBSIDIARIES

INDEX

PART I. FINANCIAL INFORMATION

Page

Item 1.	Condensed Consolidated Financial Statements (Unaudited)	
	Condensed Consolidated Balance Sheets as of September 30, 2009 and March 31, 2009	4
	Condensed Consolidated Statements of Operations for the three months and six months ended September 30, 2009 and September 30, 2008	5
	Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2009 and September 30, 2008	6
	Notes to Condensed Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	16
Item 4.	Controls and Procedures	16

PART II. OTHER INFORMATION

Item 1A.	Risk Factors	17
Item 6.	Exhibits	18
	Signatures	19

PART I — FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

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

	September 30, 2009	March 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,616	\$ 12,491
Accounts receivable, net of allowances for sales returns and doubtful accounts of \$159 and \$207 at September 30, 2009 and March 31, 2009 respectively.	2,469	2,775
Inventories, net	14,484	14,480
Prepaid expenses and other current assets	372	372
Total current assets	<u>25,941</u>	<u>30,118</u>
Property and equipment, net	1,176	1,154
Intangible assets, net	2,673	2,998
Other assets	62	67
Total assets	<u>\$ 29,852</u>	<u>\$ 34,337</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,545	\$ 1,487
Accrued product warranty	444	702
Common stock warrant liability	444	--
Deferred revenue	198	113
Accrued expenses and other current liabilities	1,803	2,004
Total current liabilities	<u>4,434</u>	<u>4,306</u>
Commitments and contingencies (Item 2)		
Stockholders' equity:		
Preferred stock; \$0.01 par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common stock; \$0.01 par value; 50,000,000 shares authorized; 8,415,676 and 8,412,676 shares issued and outstanding at September 30, 2009 and March 31, 2009, respectively	84	84
Additional paid-in capital	127,952	128,484
Accumulated other comprehensive loss	(504)	(372)
Accumulated deficit	(102,114)	(98,165)
Total stockholders' equity	<u>25,418</u>	<u>30,031</u>
Total liabilities and stockholders' equity	<u>\$ 29,852</u>	<u>\$ 34,337</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Revenue	\$ 3,117	\$ 2,010	\$ 4,200	\$ 6,739
Cost of revenue	2,269	989	3,259	3,391
Gross profit	<u>848</u>	<u>1,021</u>	<u>941</u>	<u>3,348</u>
Operating expenses:				
Research and development expenses	1,170	1,145	2,411	2,280
Sales and marketing expenses	670	839	1,374	1,682
General and administrative expenses	810	1,471	1,973	2,801
Total operating expenses	<u>2,650</u>	<u>3,455</u>	<u>5,758</u>	<u>6,763</u>
Operating loss	(1,802)	(2,434)	(4,817)	(3,415)
Other income (expense), net	114	(65)	471	125
Loss before income tax benefit	(1,688)	(2,499)	(4,346)	(3,290)
Income tax expense (benefit)	1	-	(50)	-
Net loss	<u>\$ (1,689)</u>	<u>\$ (2,499)</u>	<u>\$ (4,296)</u>	<u>\$ (3,290)</u>
Net loss per share:				
Basic	\$ (0.20)	\$ (0.34)	\$ (0.51)	\$ (0.45)
Diluted	\$ (0.20)	\$ (0.34)	\$ (0.51)	\$ (0.45)
Weighted average shares used in per share computation:				
Basic	8,415	7,339	8,415	7,338
Diluted	8,415	7,339	8,415	7,338

See accompanying notes to condensed consolidated financial statements.

TEGAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended September 30	
	2009	2008
Cash flows from operating activities:		
Net (Losses)	\$ (4,296)	\$ (3,290)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	617	374
Stock compensation expense	313	647
Stock issued under stock purchase plan	4	14
Fair value adjustment of common stock warrants	(58)	--
(Recovery) provision for doubtful accounts and sales returns allowances	(47)	22
Loss on disposal of property and equipment	61	16
Changes in operating assets and liabilities:		
Accounts receivables	491	2,119
Inventories, net	(214)	(746)
Prepaid expenses and other assets	(137)	143
Accounts payable	9	(872)
Accrued expenses and other current liabilities	(121)	(1,687)
Accrued product warranty	(150)	(848)
Deferred revenue	84	8
Net cash used in operating activities	<u>(3,444)</u>	<u>(4,100)</u>
Cash flows used in investing activities:		
Purchases of property and equipment	(376)	(241)
Net cash used in AMMS asset acquisition	-	(1,000)
Net cash used in investing activities	<u>(376)</u>	<u>(1,241)</u>
Cash flows used in financing activities:		
Payments on capital lease financing	-	(8)
Net cash used in financing activities	<u>-</u>	<u>(8)</u>
Effect of exchange rates on cash and cash equivalents	(55)	95
Net decrease in cash and cash equivalents	(3,875)	(5,254)
Cash and cash equivalents at beginning of period	12,491	19,271
Cash and cash equivalents at end of period	<u>\$ 8,616</u>	<u>\$ 14,017</u>
Supplemental disclosure of non-cash financing activities:		
Shares issued in asset acquisition	\$ 0	\$ 4,000
Reclassification of common stock warrant liability upon adoption of EITF 07-05 (Topic 815)	<u>\$ 848</u>	<u>\$ 0</u>

See accompanying notes to condensed consolidated financial statements.

TEGAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(All amounts in thousands, except share data)

1. Basis of Presentation:

In the opinion of management, the unaudited condensed consolidated interim financial statements have been prepared on the same basis as the March 31, 2009 audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the information set forth herein. The statements have been prepared in accordance with the regulations of the Securities and Exchange Commission ("SEC"), but omit certain information and footnote disclosures necessary to present the statements in accordance with generally accepted accounting principles. These interim financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2009. The results of operations for the three and six months ended September 30, 2009 are not necessarily indicative of results to be expected for the entire year.

Our consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business for the foreseeable future. We incurred net losses of (\$4,296) and (\$3,290) for the six months ended September 30, 2009 and 2008, respectively. We used cash flows from operations of \$3,444 and \$4,100 for the six months ended September 30, 2009 and 2008, respectively. We believe that our outstanding balances, combined with continued cost containment will be adequate to fund operations through fiscal year 2010. Our business is dependent upon the sales of our capital equipment, and projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, we will need to reduce expenses further and/or raise additional capital which may include capital raises through the issuance of debt or equity securities. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of our common stock, and debt covenants could impose restrictions on our operations. Moreover, such financing may not be available to us on acceptable terms, if at all. Failure to raise any needed funds would materially adversely affect us. It is not possible to predict when our business and results of operations will improve in light of the current economic downturn that continues to dramatically affect our industry. Therefore, the realization of assets and discharge of liabilities are each subject to significant uncertainty. Accordingly, substantial doubt exists as to whether we will be able to continue as a going concern. If the going concern basis is not appropriate in future filings, no adjustments will be necessary to the carrying amounts and/or classification of assets and liabilities in our consolidated financial statements included in such filings as the consolidated financial statements have been prepared using the going concern basis, which assumes that we will be able to realize our assets and discharge our liabilities in the normal course of business for the foreseeable future. We indicated this concern in our Annual Report on Form 10-K for fiscal year ended March 31, 2009, which was also reflected in the audit opinion at that time.

In consideration of these circumstances, we have been in the process of evaluating strategic alternatives for the Company, which may include a merger with or into another company, a sale of all or substantially all of our assets and the liquidation or dissolution of the Company, including through a bankruptcy proceeding. We cannot assure you that we will be successful in pursuing any of these strategic alternatives.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash investments and accounts receivable. Substantially all of the Company's liquid investments are invested in money market funds. The Company's accounts receivable are derived primarily from sales to customers located in the United States, Europe and Asia. The Company performs ongoing credit evaluations of its customers and generally requires no collateral. The Company maintains reserves for potential credit losses. Write-offs during the periods presented have been insignificant.

As of September 30, 2009, two customers accounted for approximately 52% of the accounts receivable balance. As of September 30, 2008, two customers accounted for approximately 48% of the accounts receivable balance.

During the quarter ended September 30, 2009, Perkin Elmer and the University of Michigan accounted for 38% and 23%, respectively, of total revenue. During the six months ended September 30, 2009, Perkin Elmer and the University of Michigan accounted for 28% and 17%, respectively, of total revenue. During the quarter ended September 30, 2008, Abbot Point of Care and International Rectifier accounted for 22% and 19%, respectively, of total revenue. During the six month ended September 30, 2008, SVTC Tech, LLC, and a leading global manufacturer of power management components for the communications, consumer electronics, and industrial markets accounted for 29% and 20% respectively, of our total revenue.

Intangible Assets

Intangible assets include patents and trademarks that are amortized on a straight-line basis over periods ranging from 5 years to 15 years. The Company performs an ongoing review of its identified intangible assets to determine if facts and circumstances exist that indicate the useful life is shorter than originally estimated or the carrying amount may not be recoverable. If such facts and circumstances exist, the Company assesses the recoverability of identified intangible assets by comparing the projected undiscounted net cash flow associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets. Based on reduced estimates of future revenue and future negative cash flow, we identified a potential indicator of impairment. The Company recorded an impairment charge of \$497 for the fiscal year ended 2009. No impairment charges were recorded for the six month period ended September 30, 2009.

Stock-Based Compensation

We have adopted several stock plans that provide for issuance of equity instruments to our employees and non-employee directors. Our plans include incentive and non-statutory stock options and restricted stock awards. These equity awards generally vest ratably over a four-year period on the anniversary date of the grant, and stock options expire ten years after the grant date. Certain restricted stock awards may vest on the achievement of specific performance targets. We also have an ESPP that allows qualified employees to purchase Tegal shares at 85% of the fair market value on specified dates.

Total stock-based compensation expense related to stock options and restricted stock units (“RSUs”) for the three months ended September 30, 2009 and 2008 was \$120 and \$344, respectively. Total stock-based compensation expense related to stock options and restricted stock units (“RSUs”) for the six months ended September 30, 2009 and 2008 was \$313 and \$647, respectively. The total compensation expense related to non-vested stock options and RSUs not yet recognized is \$945.

The Company used the following valuation assumptions to estimate the fair value of options granted for the periods ended September 30, 2009 and 2008, respectively:

STOCK OPTIONS:	<u>2009</u>	<u>2008</u>
Expected life (years)	6.0	4.0
Volatility	80.0%	64.7%
Risk-free interest rate	2.31%	2.18%
Dividend yield	0%	0%

ESPP awards were valued using the Black-Scholes model with expected volatility calculated using a six-month historical volatility.

ESPP:	<u>2009</u>	<u>2008</u>
Expected life (years)	0.5	0.5
Volatility	79.8%	74.4%
Risk-free interest rate	0.14%	1.87%
Dividend yield	0%	0%

During the three months ended September 30, 2009, the Company granted no stock option awards .

Stock Options & Warrants

A summary of stock option and warrant activity during the quarter ended September 30, 2009 is as follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (in Years)</u>	<u>Aggregate Intrinsic Value</u>
Beginning outstanding	2,534,899	\$ 8.97		
Granted				
Price = market value	--	-		
Total	--	-		
Exercised	--	0.00		
Cancelled				
Forfeited	(36,151)	2.79		
Expired	(12,265)	15.08		
Total	<u>(48,416)</u>	5.90		
Ending outstanding	<u>2,486,483</u>	<u>\$ 9.03</u>	<u>3.78</u>	<u>\$-</u>
Ending vested and expected to vest	<u>2,387,940</u>	<u>\$ 9.28</u>	<u>3.57</u>	<u>\$-</u>
Ending exercisable	<u>1,912,515</u>	<u>\$ 10.79</u>	<u>2.32</u>	<u>\$-</u>

The aggregate intrinsic value of stock options and warrants outstanding at September 30, 2009 is calculated as the difference between the exercise price of the underlying options and the market price of our common stock as of September 30, 2009.

The following table summarizes information with respect to stock options and warrants outstanding as of September 30, 2009:

Range of Exercise Prices		Number Outstanding As of Sept 30, 2009	Weighted Average Remaining Contractual Term (in years)	Weighted Average Exercise Price	Number Exercisable As of Sept 30, 2009	Weighted Average Exercise Price As of Sept 30, 2009
\$ 2.34	2.34	343,847	9.10	2.34	-	-
3.44	4.20	258,765	8.18	4.09	84,922	3.99
4.60	4.68	250,339	6.61	4.61	201,458	4.61
5.26	8.28	271,232	3.97	6.66	265,085	6.68
12.00	12.00	1,284,990	0.93	12.00	1,284,990	12.00
12.36	46.50	63,983	3.38	18.51	62,733	18.56
56.28	56.28	6,248	0.53	56.28	6,248	56.28
92.26	92.26	416	0.44	92.26	416	92.26
92.52	92.52	4,165	0.38	92.52	4,165	92.52
99.00	99.00	2,498	0.49	99.00	2,498	99.00
<u>\$ 2.34</u>	<u>\$ 99.00</u>	<u>2,486,483</u>	<u>3.78</u>	<u>\$ 9.03</u>	<u>1,912,515</u>	<u>\$ 10.79</u>

As of September 30, 2009, there was \$777 of total unrecognized compensation cost related to outstanding options and warrants which the Company expects to recognize over a period of 2.67 years.

Restricted Stock Units

The following table summarizes the Company's RSU activity for the three months ended September 30, 2009:

	Number of Shares	Weighted Avg. Grant Date Fair Value
Balance June 30, 2009	87,224	\$ 1.28
Granted	-	-
Forfeited	(2,500)	\$ 2.61
Vested	-	-
Balance, September 30, 2009	<u>84,724</u>	<u>\$ 1.28</u>

Unvested restricted stock at September 30, 2009

As of September 30, 2009 there was \$167 of total unrecognized compensation cost related to outstanding RSUs which the Company expects to recognize over a period of 1.13 years.

2. Inventories:

Inventories are stated at the lower of cost or market, reduced by provisions for excess and obsolescence. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis and includes material, labor and manufacturing overhead costs. We estimate the effects of excess and obsolescence on the carrying values of our inventories based upon estimates of future demand and market conditions. We establish provisions for related inventories in excess of production demand. Should actual production demand differ from our estimates, additional inventory write-downs may be required. Any excess and obsolete provision is released only if and when the related inventories is sold or scrapped. During the six months ended September 30, 2009 and September 30, 2008, the Company sold or scrapped previously reserved inventory of \$77 and \$29, respectively. The inventory provision balance at September 30, 2009 and March 31, 2009 was \$549 and \$626, respectively.

Inventories for the periods presented consisted of:

	September 30, 2009	March 31, 2009
Raw materials	\$ 5,509	\$ 5,634
Work in progress	4,317	4,348
Finished goods and spares	4,658	4,498
	<u>\$ 14,484</u>	<u>\$ 14,480</u>



We periodically analyze any systems that are in finished goods inventory to determine if they are suitable for current customer requirements. At the present time, our policy is that, if after approximately 18 months, we determine that a sale will not take place within the next 12 months and the system would be useable for customer demonstrations or training, it is transferred to fixed assets. Otherwise, it is expensed.

3. Product Warranty:

The Company provides warranty on all system sales based on the estimated cost of product warranties at the time revenue is recognized. The warranty obligation is affected by product failure rates, material usage rates, and the efficiency by which the product failure is corrected. Warranty activity for the three and six months ended September 30, 2009 and 2008 is as follows:

	Warranty Activity for the Three Months Ended September 30,		Warranty Activity for the Six Months Ended September 30,	
	2009	2008	2009	2008
Balance at the beginning of the period	\$ 522	\$ 1,315	\$ 702	\$ 1,770
Additional warranty accruals for warranties issued during the period	201	20	242	182
Warranty expense during the period	(279)	(388)	(500)	(1,005)
Balance at the end of the period	\$ 444	\$ 947	\$ 444	\$ 947

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

4. Net Loss Per Common Share (EPS):

Basic EPS is computed by dividing loss available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) for the period. Diluted EPS gives effect to all dilutive potential common shares outstanding during the period. The computation of diluted EPS uses the average market prices during the period.

The following table represents the calculation of basic and diluted net loss per common share (in thousands, except per share data):

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Net loss applicable to common stockholders	\$ (1,689)	\$ (2,499)	\$ (4,296)	\$ (3,290)
Basic and diluted:				
Weighted-average common shares outstanding	8,415	7,339	8,415	7,338
Weighted-average common shares used in diluted net (loss) income per common share	8,415	7,339	8,415	7,338
Basic net loss per common share	\$ (0.20)	\$ (0.34)	\$ (0.51)	\$ (0.45)
Diluted net loss per common share	\$ (0.20)	\$ (0.34)	\$ (0.51)	\$ (0.45)

Outstanding options, warrants and RSUs of 2,594,981 and 2,549,587 shares of common stock at a weighted-average exercise price per share of \$8.69 and \$9.70 on September 30, 2009 and 2008 respectively, were not included in the computation of diluted net loss per common share for the periods presented as a result of their anti-dilutive effect. Such securities could potentially dilute earnings per share in future periods.

5. Stock-Based Transactions:

Issuance of Warrants to Consultants

The Company issued no warrants to any party for the six months ended September 30, 2009 and 2008.

6. Financial Instruments:

The carrying amount of the Company's financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, notes payable, accrued expenses and other liabilities approximates fair value due to their relatively short maturity. The Company has foreign subsidiaries, which operate and sell the Company's products in various global markets. As a result, the Company is exposed to changes in foreign currency exchange rates. The Company does not hold derivative financial instruments for speculative purposes. Foreign currency transaction gains and (losses) included in other income (expense), net were not significant for the six months ended September 30, 2009 and 2008, respectively. Periodically, the Company enters into foreign exchange contracts to sell Euros, which are used to hedge a sales transactions in which costs are denominated in U.S. dollars and the related revenue are generated in Euros. These contracts are valued using Level 1 inputs as defined by SFAS No. 157 (Topic 820). On April 7, 2009 the Company concluded a foreign exchange contract for a net gain of \$24. As of September 30, 2009 the Company had one outstanding foreign exchange contract due to expire November 5, 2009.

7. AMMS Asset Acquisition:

On September 16, 2008, the Company acquired certain assets from Alcatel Micro Machining Systems ("AMMS") and Alcatel Lucent ("Alcatel", and together with AMMS, the "Sellers"), for an aggregate consideration of \$5,000 comprised of \$1,000 in cash and 1,044,386 shares of the Company's common stock.

In connection with this acquisition, the Company obtained limited rights to use the AMMS trademark pursuant to a trademark license agreement and agreed to purchase certain equipment from an affiliate of the Sellers pursuant to a preferred supplier agreement.

The purchase price was allocated as follows (in thousands):

Assets acquired:

Trademarks	\$	428
Patents		2,648
Total Intangible Assets		3,076
Fixed Assets		24
Inventory		1,900
Total Tangible Assets		1,924
Total Acquired Assets	\$	5,000

8. Geographical Information:

The Company operates in one segment for the manufacture, marketing and servicing of integrated circuit fabrication equipment. In accordance with SFAS No. 131, *Disclosures About Segments of an Enterprise and Related Information*, ("SFAS 131") (Topic 280) the company's chief operating decision-maker has been identified as the President and Chief Executive Officer, who reviews operating results to make decisions about allocating resources and assessing performance for the entire company.

For geographical reporting, revenues are attributed to the geographic location in which the customers' facilities are located. Long-lived assets consist of property, plant and equipment and are attributed to the geographic location in which they are located. Net sales and long-lived assets by geographic region were as follows:

	Revenue for the Three Months Ended September 30,		Revenue for the Six Months Ended September 30,	
	2009	2008	2009	2008
Sales to customers located in:				
United States	\$ 2,512	\$ 1,166	\$ 3,152	\$ 4,874
Asia	193	265	395	717
Germany	58	60	87	175
France	121	--	181	--
Europe, excluding Germany & France	233	519	385	973
Total sales	\$ 3,117	\$ 2,010	\$ 4,200	\$ 6,739

Long-Lived assets at period-end:	<u>2009</u>	<u>2008</u>
United States	\$ 879	\$ 1,200
Europe	297	10
Total Long-lived assets	<u>\$ 1,176</u>	<u>\$ 1,210</u>

9. Recent Accounting Pronouncements:

Effective July 1, 2009, the Financial Accounting Standards Board's ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 168 (Topic 105), "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles". Accounting Standards Codification ("ASC") became the single official source of authoritative, nongovernmental generally accepted accounting principles ("GAAP") in the United States. This standard establishes two levels of GAAP, authoritative and non-authoritative. The FASB Accounting Standards Codification (the "Codification") became the source of authoritative, non-governmental GAAP, except for rules and interpretive releases of the SEC, which are sources of authoritative GAAP for SEC registrants. All other non-grandfathered, non-SEC accounting literature not included in the Codification became non-authoritative. The Company adopted SFAS 168 (Topic 105) as of July 1, 2009. As the Codification was not intended to change or alter existing GAAP, it did not have any impact on our Condensed Consolidated Financial Statements. However, references to specific accounting standards in the footnotes to our consolidated financial statements have been changed to also refer to the appropriate topic of ASC.

In September 2006, FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements* ("SFAS 157") or Topic 820. SFAS 157 (Topic 820) defines fair value, establishes a framework for measuring fair value in accordance with generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 (Topic 820) does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The provisions of SFAS 157 (Topic 820) are to be applied prospectively as of the beginning of the fiscal year in which it is initially applied, with any transition adjustment recognized as a cumulative-effect adjustment to the opening balance of retained earnings. The provisions of SFAS 157 (Topic 820) became effective for fiscal years beginning after November 15, 2007. The Company adopted SFAS 157 (Topic 820) as of April 1, 2008. There was no material effect to the consolidated financial statements as a result.

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* ("SFAS 159") (Topic 825). SFAS 159 (Topic 825) provides entities with the option to report selected financial assets and liabilities at fair value. Business entities adopting SFAS 159 (Topic 825) will report unrealized gains and losses in earnings at each subsequent reporting date on items for which fair value option has been elected. SFAS 159 (Topic 825) establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 (Topic 825) requires additional information that will help investors and other financial statement users to understand the effect of an entity's choice to use fair value on its earnings. SFAS 159 (Topic 825) became effective for fiscal years beginning after November 15, 2007, with earlier adoption permitted. The Company adopted SFAS 159 (Topic 825) on April 1, 2008 and chose not to elect the fair value option for its financial assets and liabilities that had not previously been carried at fair value.

In December 2007, FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ("SFAS 141R") which replaces SFAS No. 141(Topic 805). SFAS 141R (Topic 805) retains the purchase method of accounting for acquisitions, but requires a number of changes, including changes in the way assets and liabilities are recognized in the purchase accounting. It also changes the recognition of assets acquired and liabilities assumed arising from contingencies, requires the capitalization of in-process research and development at fair value, and requires the expensing of acquisition-related costs as incurred. SFAS 141R (Topic 805) became effective for the Company beginning April 1, 2009 and will apply prospectively to business combinations completed on or after that date. The Company expects this to have a material impact on any possible future acquisitions.

In December 2007, FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statement, - an amendment of ARB No. 51*, ("SFAS 160") (Topic 810) which changes the accounting and reporting for minority interests. Minority interests will be recharacterized as noncontrolling interests and will be reported as a component of equity separate from the parent's equity, and purchases or sales of equity interests that do not result in a change in control will be accounted for as equity transactions. In addition, net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement and, upon a loss of control, the interest sold, as well as any interest retained, will be recorded at fair value with any gain or loss recognized in earnings. SFAS 160 (Topic 810) is effective for the Company beginning April 1, 2009 and will apply prospectively, except for the presentation and disclosure requirements, which will apply retrospectively. Adoption of this standard did not have a material effect to the Company's consolidated financial statements.

In April 2008, FASB issued FASB Staff Position Statement of Financial Accounting Standards 142-3, *Determination of the Useful Life of Intangible Assets* ("FSP SFAS 142-3") (Topic 350). FSP SFAS 142-3 (Topic 350) provides guidance with respect to estimating the useful lives of recognized intangible assets acquired on or after the effective date and requires additional disclosure related to the renewal or extension of the terms of recognized intangible assets. FSP SFAS 142-3 (Topic 350) became effective for fiscal years and interim periods beginning after December 15, 2008. The Company adopted FSP SFAS 142-3 (Topic 350) as of December 31, 2008 and it did not have a material impact on the Company's consolidated financial statements.

In June 2008, FASB ratified the EITF consensus on EITF Issue No. 07-05, *Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock* ("EITF Issue 07-05") (Topic 815) which applies to the determination of whether any freestanding financial instruments or embedded features that have the characteristics of a derivative, as defined by SFAS No. 133 (Topic 815), *Accounting for Derivative Instruments and Hedging Activities*, and to any freestanding financial instruments are potentially indexed to an entity's own common stock .. EITF Issue No. 07-05(Topic 815) became effective for fiscal years beginning after December 15, 2008. The Company adopted EITF 07-05 (Topic 815) as of April 1, 2009. As a result, warrants to purchase 1,427,272 shares of our common stock previously treated as equity pursuant to the derivative treatment exemption were no longer afforded equity treatment. The warrants had exercise prices ranging from \$6.00-\$99.00 and expire between September 2009 and September 2013. As such, effective April 1, 2009, the Company reclassified the fair value of these warrants to purchase common stock, which had exercise price reset features, from equity to liability status as if these warrants were treated as a derivative liability since their date of issue between February 2000 and January 2006. On April 1, 2009, the Company reclassified from additional paid-in capital, as a cumulative effect adjustment, \$347 to beginning accumulated deficit and \$501 to common stock warrant liability to recognize the fair value of such warrants on such date. As of September 30, 2009, the fair value of the warrants was estimated using the Black-Scholes pricing model with the following weighted average assumptions, risk-free interest rate of 2.31%, expected life of 1.08 years, an expected volatility factor of 75.05% and a dividend yield of 0.0%. The fair value of these warrants to purchase common stock decreased to \$444 as of September 30, 2009. As such, the Company recognized a \$58 non-cash loss from the change in fair value of these warrants for the three months ended September 30, 2009, which is included in other income (expense), net.

Adoption of this standard had a material non-cash impact on the Company's consolidated financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations – (Amounts in thousands)

Special Note Regarding Forward Looking Statements

Information contained or incorporated by reference in this report contains forward-looking statements. These forward-looking statements are based on current expectations and beliefs and involve numerous risks and uncertainties that could cause actual results to differ materially from expectations. These forward-looking statements should not be relied upon as predictions of future events as we cannot assure you that the events or circumstances reflected in these statements will be achieved or will occur. You can identify forward-looking statements 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 which constitutes projected financial information. These forward-looking statements are subject to risks, uncertainties and assumptions about Tegal Corporation including, but not limited to, industry conditions, economic conditions, acceptance of new technologies and market acceptance of Tegal Corporation's products and service. For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see the "Part Item 1A—Risk Factors" and the "Liquidity and Capital Resources" section set forth in this section and such other risks and uncertainties as set forth below in this report or detailed in our other SEC reports and filings. We assume no obligation to update forward-looking statements.

We design, manufacture, market and service plasma etch and deposition systems that enable the production of micro-electrical mechanical systems ("MEMS"), power integrated circuits ("ICs") and optoelectronic devices found in products like smart phones, networking gear, solid-state lighting and digital imaging. Our plasma etch and deposition tools enable sophisticated manufacturing techniques, such as 3-D interconnect structures formed by intricate silicon etch, also known as Deep Reactive Ion Etching ("DRIE"). Etching and deposition constitute two of the principal device production process steps and each must be performed numerous times in the production of such devices.

Our business objective is to utilize the technologies that we have developed internally or acquired externally in order to increase our market share in process equipment for MEMS and power device fabrication, advanced 3-D packaging, and certain areas of semiconductor manufacturing, including compound semiconductors and light-emitting diodes ("LEDs"). In the recent past, we focused on competing with more established competitors by being "designed-in" to the advanced device fabrication plans of our customers. We have done so primarily by engaging in research and development activities on behalf of our customers that our more established competitors were unwilling or unable to perform, including several applications of our technology in certain types of new, non-volatile memory devices intended as replacements for flash memory, such as MRAM, RRAM and FeRAM. Many of these advanced new memory devices promised substantial returns as consumer demand for certain functions grew and new markets were created. However, the timing of the emergence of such demand was highly uncertain and, as of today, these markets as of today have not developed as expected.

In September 2008, we took the step of acquiring the products lines of AMMS and the related intellectual property of Alcatel, in order to pursue more fully the smaller, but higher-growth markets of MEMS and 3-D packaging. Our acquisition of these products served two purposes: (1) to increase revenue, as demand for our etch and deposition systems in more traditional semiconductor markets fell dramatically with the collapse of semiconductor capital spending; and (2) to enable us to focus our various technologies on specific applications that served the common markets of MEMS and 3-D device manufacturing and packaging.

At the present time, we are continuing to transition our involvement in specialized aspects of traditional semiconductor markets to the faster-growth but smaller markets for MEMS, power devices and specialized compound semiconductors. However, given the severe economic downturn generally, and in the semiconductor capital equipment industry in particular, achieving wins with customers in these markets has been extremely challenging for us. We expect that orders for our systems will continue to fluctuate from quarter to quarter, and we expect demand to continue to be low and our ability to forecast demand will be limited as the global financial crisis and the resulting recession continues. Although we have over the past several years streamlined our cost structure by headcount reductions, salary and benefit reductions and limits on discretionary spending of all types, our costs for maintaining our research and development efforts and our service and manufacturing infrastructure have remained constant or in some cases increased. We intend to continue our cost-containment measures, including outsourcing certain activities, such as engineering and software development, and maintaining or further reducing our headcount as we strive to improve operational efficiency within this challenging economic environment. However, since we are unable to predict the timing of a stable reemergence of demand for our products and services, we believe that the realization of assets and discharge of liabilities are each subject to significant uncertainty and a substantial doubt exists as to whether we will be able to continue as a going concern. In consideration of these circumstances, we have begun the process of evaluating strategic alternatives for the Company, which may include a merger with or into another company, a sale of all or substantially all of our assets and the liquidation or dissolution of the Company, including through a bankruptcy proceeding. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The audited consolidated financial statements have been prepared using the going concern basis, which assumes that we will be able to realize our assets and discharge our liabilities in the normal course of business for the foreseeable future. However, it is not possible to predict when our business and results of operations will improve in light of the current economic downturn that continues to dramatically affect our industry. Therefore, the realization of assets and discharge of liabilities are each subject to significant uncertainty. Accordingly, substantial doubt exists as to whether we will be able to continue as a going concern. If the going concern basis is not appropriate in future filings, adjustments will be necessary to the carrying amounts and/or classification of assets and liabilities in our consolidated financial statements included in such filings.

The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, bad debts, sales returns allowance, inventory, intangible and long lived assets, warranty obligations, restructure expenses, deferred taxes and freight charged to customers. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies are the most significant to the presentation of our consolidated financial statements:

Revenue Recognition

Each sale of our equipment is evaluated on an individual basis in regard to revenue recognition. We have integrated in our evaluation the related interpretative guidance included in Topic 13 of the codification of staff accounting bulletins, and recognize the role of the consensus on Emerging Issues Task Force Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* ("EITF Issue 00-21"). We first refer to EITF Issue 00-21 in order to determine if there is more than one unit of accounting and then we refer to Staff Accounting Bulletin ("SAB") 104 (Topic 605) for revenue recognition topics for the unit of accounting. We recognize revenue when persuasive evidence of an arrangement exists, the seller's price is fixed or determinable and collectability is reasonably assured.

For products produced according to our published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% of the sales value of the related equipment.

For products produced according to a particular customer's specifications, revenue is recognized when the product has been tested and it has been demonstrated that it meets the customer's specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount (generally 10%), which is not payable by the customer until installation is completed and final customer acceptance is achieved.

For new products, new applications of existing products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, 100% of revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the entire contract amount. The revenue on these transactions is deferred and recorded as deferred revenue. We reserve for warranty costs at the time the related revenue is recognized.

Revenue related to sales of spare parts is recognized upon shipment. Revenue related to maintenance and service contracts is recognized ratably over the duration of the contracts. Unearned maintenance and service revenue is included in deferred revenue.

Accounting for Stock-Based Compensation

The Company has adopted several stock plans that provide for issuance of equity instruments to the Company's employees and non-employee directors. The Company's plans include incentive and non-statutory stock options and restricted stock awards and restricted stock units ("RSUs"). Stock options and RSUs generally vest ratably over a four-year period on the anniversary date of the grant, and stock options expire ten years after the grant date. On occasion RSUs may vest on the achievement of specific performance targets. The Company also has an employee stock purchase plan (an "ESPP") that allows qualified employees to purchase Company shares at 85% of the lower of the common stock's market value on specified dates. The stock-based compensation for our ESPP was determined using the Black-Scholes option pricing model and the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), *Share Based Payment*, ("SFAS 123R") (Topic 718).

Accounts Receivable – Allowance for Sales Returns and Doubtful Accounts

The Company maintains an allowance for doubtful accounts receivable for estimated losses resulting from the inability of the Company's customers to make required payments. If the financial condition of the Company's customers were to deteriorate, or even a single customer was otherwise unable to make payments, additional allowances may be required. As of September 30, 2009, two customers accounted for approximately 52% of the accounts receivable balance. As of September 30, 2008, two customers accounted for approximately 48% of the accounts receivable balance.

The Company's return policy is for spare parts and components only. A right of return does not exist for systems. Customers are allowed to return spare parts if they are defective upon receipt. The potential returns are offset against gross revenue on a monthly basis. Management

reviews outstanding requests for returns on a quarterly basis to determine that the reserves are adequate.

Inventories

Inventories are stated at the lower of cost or market, reduced by provisions for excess and obsolescence. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis and includes material, labor and manufacturing overhead costs. We estimate the effects of excess and obsolescence on the carrying values of our inventories based upon estimates of future demand and market conditions. We establish provisions for related inventories in excess of production demand. Should actual production demand differ from our estimates, additional inventory write-downs may be required. Any excess and obsolete provision is released only if and when the related inventories is sold or scrapped. The inventory provision balance at September 30, 2009 and March 31, 2009 was \$549 and \$626, respectively. During the six months ended September 30, 2009, and September 30, 2008, we reduced the reserve by \$77 and \$29, respectively when the Company sold or scrapped previously reserved inventory.

The Company periodically analyzes any systems that are in finished goods inventory to determine if they are suitable for current customer requirements. At the present time, the Company's policy is that, if after approximately 18 months, it determines that a sale will not take place within the next 12 months and the system would be useable for customer demonstrations or training, it is transferred to fixed assets. Otherwise, it is expensed.

The carrying value of systems used for demonstrations or training is determined by assessing the cost of the components that are suitable for sale. Any parts that may be rendered unsellable as a result of such use are removed from the system and are not included in finished goods inventory. The remaining saleable parts are valued at the lower of cost or market, representing the system's net realizable value. The depreciation period for systems that are transferred to fixed assets is determined based on the age of the system and its remaining useful life (typically five to eight years).

Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If undiscounted expected future cash flows are less than the carrying value of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets. During the fourth quarter of 2009, we reviewed our long-lived assets for indicators of impairment in accordance with SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. (Topic 360) Based on reduced estimates of future revenues and future negative cash flow, we identified a potential indicator of impairment. No impairment charge was recorded for the six months ended September 30, 2009. The company recorded an impairment charge, related to intangibles, of \$497 for the fiscal year ended 2009. No impairment charges were recorded for the year ended 2008.

Warranty Obligations

We provide for the estimated cost of our product warranties at the time revenue is recognized. Our warranty obligation is affected by product failure rates, material usage rates and the efficiency by which the product failure is corrected. The warranty reserve is based on historical cost data related to warranty. Should actual product failure rates, material usage rates and labor efficiencies differ from our estimates, revisions to the estimated warranty liability may be required. Actual warranty expense is typically low in the period immediately following installation.

Deferred Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Based on the uncertainty of future taxable income, we have fully reserved our deferred tax assets. In the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax asset would increase income in the period such determination was made.

Results of Operations

The following table sets forth certain financial data for the three and six months ended September 30, 2009 and 2008 as a percentage of revenue:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	72.8%	49.2%	77.6%	50.3%
Gross profit	27.2%	50.8%	22.4%	49.7%
Operating expenses:				
Research and development	37.5%	57.0%	57.4%	33.8%
Sales and marketing	21.5%	41.7%	32.7%	25.0%
General and administrative	26.0%	73.2%	47.0%	41.6%
Total operating expenses	85.0%	171.9%	137.1%	100.4%
Operating loss	(57.8%)	(121.1%)	(114.7%)	(50.7%)
Other income (expense), net	3.7%	(3.2%)	11.2%	1.9%
Loss before income tax benefit	(54.1%)	(124.3%)	(103.5%)	(48.8%)
Tax Expense	--%	--%	(1.2%)	--%
Net loss	(54.1%)	(124.3%)	(102.3%)	(48.8%)

The following table sets forth certain financial items for the three and six months ended September 30, 2009 and 2008:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2009	2008	2009	2008
Revenue	\$ 3,117	\$ 2,010	\$ 4,200	\$ 6,739
Cost of revenue	2,269	989	3,259	3,391
Gross profit	848	1,021	941	3,348
Operating expenses:				
Research and development expenses	1,170	1,145	2,411	2,280
Sales and marketing expenses	670	839	1,374	1,682
General and administrative expenses	810	1,471	1,973	2,801
Total operating expenses	2,650	3,455	5,758	6,763
Operating loss	(1,802)	(2,434)	(4,817)	(3,415)
Other income (expense), net	114	(65)	471	125

Loss before income tax benefit	(1,688)	(2,499)	(4,346)	(3,290)
Income tax expense (benefit)	<u>1</u>	<u>-</u>	<u>(50)</u>	<u>-</u>
Net loss	<u>\$ (1,689)</u>	<u>\$ (2,499)</u>	<u>\$ (4,296)</u>	<u>\$ (3,290)</u>

Net loss per share:

Basic	\$ (0.20)	\$ (0.34)	\$ (0.51)	\$ (0.45)
Diluted	\$ (0.20)	\$ (0.34)	\$ (0.51)	\$ (0.45)

Weighted average shares used in per share computation:

Basic	8,415	7,339	8,415	7,338
Diluted	8,415	7,339	8,415	7,338

Revenue

Revenue of \$3,117 for the three months ended September 30, 2009 increased by \$1,107 from revenue of \$2,010 for the three months ended September 30, 2008, representing a 55% increase. The revenue increase was due principally to the number and mix of systems sold. Revenue for the three months ended September 30, 2009 was mainly from the sale of one new SMT system and one DRIE system. Revenue for the three months ended September 30, 2008 was mainly from the sale of spares and service. Revenue for the six months ended September 30, 2009 decreased by \$2,539 from revenue for the six months ended September 30, 2008, representing a 38% decrease. The revenue decrease was due principally to the number and mix of systems sold and the global economic recession that dramatically impacted our industry. Revenue for the six months ended September 30, 2009 was mainly from the sale of two new SMT systems and one new DRIE system. Revenue for the six months ended September 30, 2008 was mainly from the sale of two used systems (one advanced etch, one Endeavor) and higher spares sales.

As a percentage of total revenue for the three months ended September 30, 2009 international sales was approximately 19%. International sales as a percentage of total revenue for the three months ended September 30, 2008 was approximately 42%. The decrease in international sales as a percentage of revenue can be attributed to fewer systems sold. As a percentage of total revenue for the six months ended September 30, 2009 international sales was approximately 25%. International sales as a percentage of total revenue for the six months ended September 30, 2008 was approximately 28%. The Company typically sells more systems in international markets. Although the systems sold in the six months ended September 30, 2009 and 2008 were domestic sales, we believe that international sales will continue to represent a significant portion of our future revenue.

Gross Profit

Gross profit of \$848 for the three months ended September 30, 2009 decreased by \$173 from gross profit of \$1,021 for the three months ended September 30, 2008, representing a 17% decrease. The decrease in the gross margin was attributable to the number of systems sold and product mix. Gross profit of \$941 for the six months ended September 30, 2009 decreased by \$2,407 from gross profit of \$3,348 for the six months ended September 30, 2008, representing a 72% decrease. The decrease in the gross margin was attributable to the number of systems sold and product mix. Our gross profit margin for the three months September 30, 2009 was 27% compared to 51% for the same period last year. The decrease in the gross margin was attributable to the number of systems sold and the specific mix of sales from different products. Gross margins for our DRIE series systems are typically lower than those of our more mature systems due to the competitive differences in this segment of the market compared to the rest of the semi-conductor industry. The Company believes that the dominant business model driving the lower margins in this market segment is unsustainable and expects gross margins for this product to normalize to levels comparable with our other products.

Our 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.

Future gross profit and gross margin are highly dependent on the level and product mix included in net revenues. This includes the mix of sales between lower and higher margin products. Accordingly, we are not able to predict future gross profit levels or gross margins with certainty. However, gross profit improvement is one of our highest priorities. We believe that the completion of the integration of our new product line and the results of our expense reduction efforts will begin to exhibit themselves in gross profit improvements, especially as we expect our sales volume to increase.

Research and Development

Research and development ("R&D") expenses consist primarily of salaries, prototype material and other costs associated with our ongoing systems and process technology development, applications and field process support efforts. The spending increase of \$25 and \$131 for the three and six months ended September 30, 2009 compared to the three and six months ended September 30, 2008 resulted primarily from an increase in the amortization of DRIE intangibles and offset by lower spending on projects cost, legal fees for patent maintenance, and a decrease in employee related expenses. There were no engineering reimbursements during the six months ended September 30, 2009.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries, commissions, trade show promotion and travel and living expenses associated with those functions. The decrease of \$169 and \$308 in sales and marketing spending for the three and six months ended September 30, 2009, as compared to the same periods in 2008 was primarily due to the decrease of employee costs, lower trade show expenses, and decreased sales commissions for systems over the same period last year.

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 relation's activities. The decrease of \$661 and \$828 for the three and six months, respectively, ended September 30, 2009 as compared to the three and six months ended September 30, 2008 was primarily due to decreases in stock related compensation expense, payroll costs, and consulting costs, offset by higher legal expenses.

Other Income (Expense), net

Other income (expense), net consists of interest income, other income, gains and losses on foreign exchange and gain and losses on the disposal of fixed assets. For the three and six months ended September 30, 2009 as compared to the three and six months ended September 30, 2008, other income (expense), net increased by \$179 and \$346, respectively, primarily due to changes in foreign exchange rates, the change in fair value of the common stock warrant liability pursuant to EITF 07-05 (Topic 815), and reimbursement monies received from the French government for R&D projects, offset by the decrease in interest rate and value of the money market account.



Contractual Obligation

The following summarizes our contractual obligations at September 30, 2009, and the effect such obligations are expected to have on our liquidity and cash flows in future periods (in thousands).

Contractual obligations:					
	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Non-cancelable operating lease obligations	\$ 681	\$ 503	\$ 165	\$ 13	\$ -

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

Liquidity and Capital Resources

For the six months ended September 30, 2009, we financed our operations from existing cash on hand. In fiscal 2009 we financed our operations through net cash provided by operations. The primary significant changes in our cash flow statement for the six months ended September 30, 2009 were decreases in accounts receivable and stock compensation expense and increased depreciation and amortization expense offset by our net loss of \$4,296. The Company acquired significant intangible assets in the prior fiscal year as a result of the AMMS acquisition.

Net cash used in operations in the six months ending September 30, 2009 was \$3,444, primarily due to our net loss of \$4,296 offset by decreases in accounts receivable. Net cash used in operations in the period ending September 30, 2008 was \$4,100, due primarily to the net loss of \$3,290, increases in inventory, accrued expenses, accrued product warranty, and accounts payable. This was offset by decreases in accounts receivable.

Net cash used in investing activities totaled \$376 and \$1,241 for the periods ending September 30, 2009 and 2008, respectively. In both periods, net cash used in investing activities was primarily for capital expenditures principally for demonstration equipment, leasehold improvements and to acquire design tools, analytical equipment and computers. In fiscal 2009 net cash was also used in AMMS asset acquisition.

The consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business for the foreseeable future. We incurred net losses of \$1,689 and \$2,499 for the three months ended September 30, 2009 and 2008, respectively. We incurred net losses of \$4,296 and \$3,290 for the six months ended September 30, 2009 and 2008, respectively. We used cash flows from operations of \$3,444 and \$4,100 for the six months ended September 30, 2009 and 2008, respectively. We believe that our outstanding balances, combined with continued cost containment will be adequate to fund operations through fiscal year ending March 31, 2010. Our business is dependent upon the sales of our capital equipment, and projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, we will need to reduce expenses further and/or raise additional capital which may include capital raises through the issuance of debt or equity securities. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of our common stock, and debt covenants could impose restrictions on our operations. Moreover, such financing may not be available to us on acceptable terms, if at all. Failure to raise any needed funds would materially adversely affect us. It is not possible to predict when our business and results of operations will improve in light of the current economic downturn that continues to dramatically affect our industry. Therefore, the realization of assets and discharge of liabilities are each subject to significant uncertainty. Accordingly, substantial doubt exists as to whether we will be able to continue as a going concern. If the going concern basis is not appropriate in future filings, no adjustments will be necessary to the carrying amounts and/or classification of assets and liabilities in our consolidated financial statements included in such filings as the consolidated financial statements have been prepared using the going concern basis, which assumes that we will be able to realize our assets and discharge our liabilities in the normal course of business for the foreseeable future.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Risk

At September 30, 2009 and 2008, all of the Company's investments were classified as cash equivalents in the consolidated balance sheets. The investment portfolio at September 30, 2009 and 2008 was comprised of money market funds. Our exposure to foreign currency fluctuations is primarily related to inventories held in Europe, which are denominated in the Euro. Changes in the exchange rate between the Euro and the U.S. dollar could adversely affect our operating results. Exposure to foreign currency exchange rate risk may increase over time as our business evolves and our products continue to be sold into international markets. For the most recent three month period, fluctuations of the U.S. dollar in relation to the Euro were immaterial to our financial statements. These fluctuations primarily affect cost of goods sold as it relates to varying levels of inventory held in Europe and denominated in the Euro.

Interest Rate Risk

We are only marginally exposed to interest rate risk through interest earned on money market accounts. Interest rates that may affect these items in the future will depend on market conditions and may differ from the rates we have experienced in the past. We do not hold or issue derivatives, commodity instruments or other financial instruments for trading purposes.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

As of the period covered by this quarterly report, management performed, with the participation of our Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rule 13a-15(e) and 15d-15(e) of the Exchange Act. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the report we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2009, such disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2009 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Disclosure Controls and Internal Controls for Financial Reporting

Disclosure controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act such as this Quarterly Report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Internal controls for financial reporting are procedures which are designed with the objective of providing reasonable assurance that our transactions are properly authorized, our assets are safeguarded against unauthorized or improper use and our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with U.S. GAAP.

PART II — OTHER INFORMATION

Item 1A. Risk Factors

We wish to caution you that there are risks and uncertainties that could affect our business. A description of the risk factors associated with our business that you should consider when evaluating our business is included under "Risk Factors" contained in Item 1A. of our Annual Report on Form 10-K for the year ended March 31, 2009. In addition to those factors and to other information in this Form 10-Q, the following updates to the risk factors should be considered carefully when evaluating Tegal or our business.

We have incurred operating losses and may not be profitable in the future. Our plans to maintain and increase liquidity may not be successful.

We had net (losses) income of (\$7,902), \$18,104, and (\$13,213) for the years ended March 31, 2009, 2008, and 2007, respectively. We (used) generated cash flows from operations of (\$5,541), (\$5,057), and \$12,772 in these respective years. For the three and six months ended September 30, 2009, we had a net loss of (\$1,689) and (\$4,296), respectively. Although we believe that our outstanding cash balances, combined with continued cost containment will be adequate to fund operations through fiscal year 2010, we believe there is substantial doubt as to our ability to continue as a going concern if there is not significant improvement in the semiconductor capital equipment industry that has been dramatically impacted by the global economic recession. Our long-term viability of our operations is dependent upon our ability to generate sufficient cash to support our operating needs, fulfill business objectives and fund continued investment in technology and product development without incurring substantial indebtedness that will hinder our ability to compete, adapt to market changes and grow our business in the future. More specifically, our business is dependent upon the sales of our capital equipment, and projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, we would need to reduce expenses further and/or raise additional capital which may include capital raises through the issuance of debt or equity securities in order to continue our business. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of our common stock, and debt covenants could impose restrictions on our operations. Moreover, such financing may not be available to us on acceptable terms, if at all. Failure to raise any needed funds would materially adversely affect us.

In consideration of these circumstances, we have engaged Cowen & Co., LLC to assist us in evaluating strategic alternatives for the Company, which may include a merger with or into another company, a sale of all or substantially all of our assets and the liquidation or dissolution of the company, including through a bankruptcy proceeding. We cannot assure you that we will be successful in pursuing any of these strategic alternatives. If we were to liquidate or dissolve the company through or outside of a bankruptcy proceeding, you could lose all of your investment in Tegal common stock.

If we are not able to regain compliance with NASDAQ Stock Market rules, our common stock could be delisted, which would make our common stock significantly less liquid.

On June 16, 2009, we notified The NASDAQ Stock Market that, as a result of the resignation of Edward A. Dohring from our Board of Directors, we no longer were in compliance with NASDAQ's independent directors requirement for continued listing as set forth in NASDAQ Listing Rule 5606(b)(1) and NASDAQ's audit committee composition requirements for continued listing as set forth in NASDAQ Listing Rule 5605(c)(2)(A). We currently have four directors, only two of whom the Board has determined to be an "independent director" as such term is defined in NASDAQ Listing Rule 5605(a)(2). On June 19, 2009, we received a letter from NASDAQ indicating that, in accordance with Rules 5605(b)(1) and 5605(c)(4) of the NASDAQ Listing Rules, NASDAQ will provide us a cure period to regain compliance equal to the earlier of our next annual shareholders' meeting or June 16, 2010, or, if the next annual shareholders' meeting is held before December 14, 2009, then we must evidence compliance no later than December 14, 2009. We intend to evaluate candidates who are qualified to serve on the Board and the Audit Committee of the Board.

If we are unable to regain compliance with the NASDAQ rules, our common stock could be delisted from the NASDAQ Capital Market. We do not know if a market maker would enable our common stock to be traded on the Pink Sheets, and even if a market maker did so, trading on the Pink Sheets would not be within our control and could be discontinued at any time if no market maker is willing to offer a quote. Furthermore, over-the-counter (OTC) transactions involve risks in addition to those associated with transactions on a stock exchange. Many OTC stocks trade less frequently and in smaller volumes than stocks listed on an exchange. Accordingly, OTC-traded shares are less liquid and are likely to be more volatile than exchange-traded stocks. Consequently, the liquidity of our common stock could be greatly impaired, not only in the number of shares which could be bought and sold, but also through difficulties in obtaining price quotations, reduction in our coverage by security analysts and in the news media and lower prices for our securities than might otherwise be attained. These circumstances could have an adverse effect on the ability of an investor to sell any shares of our common stock as well as on the selling price for such shares.

Item 6. Exhibits

Exhibit

<u>Number</u>	<u>Description</u>
31.1	Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

TEGAL CORPORATION
(Registrant)

/s/ CHRISTINE HERGENROTHER
Christine Hergenrother
Chief Financial Officer

Date: November 13, 2009

**CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Thomas R. Mika, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tegal Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-14(e)) for the registrant and have:

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

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

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

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 13, 2009

/s/ Thomas R. Mika

Chief Executive Officer and President

**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Christine Hergenrother, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tegal Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-14(e)) for the registrant and have:

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

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

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

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

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 13, 2009
/s/ Christine Hergenrother
Chief Financial Officer

**CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Tegal Corporation, a Delaware corporation (the "Company"), on Form 10-Q for the quarter ended December 31, 2008 as filed with the Securities and Exchange Commission (the "Report"), I, Thomas R. Mika, President and Chief Executive Officer of the Company, certify, pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Sec. 1350), that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Thomas R. Mika
Chief Executive Officer and President
November 13, 2009

**CERTIFICATION PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the Quarterly Report of Tegal Corporation, a Delaware corporation (the "Company"), on Form 10-Q for the quarter ended December 31, 2008 as filed with the Securities and Exchange Commission (the "Report"), I, Christine Hergenrother, Chief Financial Officer of the Company, certify, pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Sec. 1350), that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Christine Hergenrother
Chief Financial Officer
November 13, 2009