

PHOTRONICS INC
Form 10-K
January 16, 2009

**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 November 2, 2008

OR

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

For the transition period from ___ to ___

Commission file number 0-15451

PHOTRONICS, INC.

(Exact name of registrant as specified in its charter)

Connecticut

*(State or other jurisdiction
of incorporation or organization)*

06-0854886

*(IRS Employer
Identification Number)*

15 Secor Road, Brookfield, Connecticut 06804

(Address of principal executive offices and zip code)

(203) 775-9000

(Registrant's telephone number, including area code)

*Securities registered pursuant to Section 12(b) of the Act: **Common Stock, \$0.01 par value per share - NASDAQ***

*Securities registered pursuant to Section 12(g) of the Act: **None***

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 such 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer 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 April 27 2008, which was the last business day of the registrant's most recently completed second fiscal quarter, the aggregate market value of the shares of the registrant common stock held by non-affiliates was approximately \$422,607,705 (based upon the closing price of \$10.76 per share as reported by the Nasdaq National Market on that date).

As of December 31, 2008, 42,078,718 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Proxy Statement for the 2009
Annual Meeting of Shareholders
to be held in April 2009

Incorporated into Part III
of this Form 10-K

Forward-Looking Information

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements made by or on behalf of Photronics, Inc. ("Company"). These statements are based on management's beliefs, as well as assumptions made by and information currently available to management. Forward-looking statements may be identified by words like "expect", "anticipate", "believe", "plan", "projects", and similar expressions. All forward-looking statements involve risks and uncertainties that are difficult to predict. In particular, any statement contained in this annual report on Form 10-K, in press releases, written statements or other documents filed with the Securities and Exchange Commission, or in the Company's communications and discussions with investors and analysts in the normal course of business through meetings, phone calls and conference calls, regarding the consummation and benefits of future acquisitions, expectations with respect to future sales, financial performance, operating efficiencies and product expansion, are subject to known and unknown risks, uncertainties and contingencies, many of which are beyond the control of the Company. These factors may cause actual results, performance or achievements to differ materially from anticipated results, performances or achievements. Factors that might affect such forward-looking statements include, but are not limited to, overall economic and business conditions; the demand and receipt of orders for the Company's products; competitive factors in the industries and geographic markets in which the Company competes; changes in federal, state and international tax requirements (including tax rate changes, new tax laws and revised tax law interpretations); the Company's ability to place new equipment in service on a timely basis; interest rate fluctuations and other capital market conditions, including foreign

currency rate fluctuations; economic and political conditions in international markets; the ability to obtain additional financings; the ability to achieve anticipated synergies and other cost savings in connection with acquisitions and productivity programs; the timing, impact and other uncertainties of future acquisitions; the seasonal and cyclical nature of the semiconductor and flat panel display industries; the availability of capital; management changes; damage or destruction to the Company's facilities by natural disasters, labor strikes, political unrest or terrorist activity; the ability to fully utilize its tools; the ability of the Company to receive desired yields, pricing, product mix, and market acceptance of its products; changes in technology; and the ability of the Company to obtain necessary export licenses. Any forward-looking statements should be considered in light of these factors. Accordingly, there is no assurance that the Company's expectations will be realized. The Company does not assume responsibility for the accuracy and completeness of the forward-looking statements and does not assume an obligation to provide revisions to any forward-looking statements.

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PART I

ITEM 1. BUSINESS

General

Photronics, Inc. ("Company") is a Connecticut corporation, organized in 1969. Its principal executive offices are located at 15 Secor Road, Brookfield, Connecticut 06804, telephone (203) 775-9000. Photronics, Inc. and its subsidiaries are collectively referred to herein as "Photronics" or the "Company". The Company's website is located at <http://www.photronics.com>. The Company makes available, free of charge through its website, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after such materials are electronically filed or furnished to the Securities and Exchange Commission. The information contained or incorporated in the Company's website is not part of these documents.

Photronics, Inc. and its subsidiaries (the "Company" or "Photronics") is one of the world's leading manufacturers of photomasks, which are high precision photographic quartz plates containing microscopic images of electronic circuits. Photomasks are a key element in the manufacture of semiconductors and flat panel displays ("FPDs"), and are used as masters to transfer circuit patterns onto semiconductor wafers and flat panel substrates during the fabrication of integrated circuits ("IC") and a variety of FPDs and, to a lesser extent, other types of electrical and optical components. The Company currently operates principally from ten manufacturing facilities; two of which are located in Europe, two in Taiwan, one each in Korea, Singapore, and China; and three in the United States, including a state-of-the-art nanofab facility ("U.S. Nanofab") in Boise, Idaho, which commenced production during the second quarter of fiscal 2008. In the fourth quarter of fiscal 2008, the Company announced its intention to streamline its European operations and close its photomask manufacturing facility in Manchester, United Kingdom, which ceased production in January 2009.

Manufacturing Technology

The Company manufactures photomasks, which are used as masters to transfer circuit patterns onto semiconductor wafers and flat panel substrates. The Company's photomasks are manufactured in accordance with circuit designs provided on a confidential basis by its customers. The typical manufacturing process for a photomask involves the receipt and conversion of circuit design data to manufacturing pattern data. A lithography system then exposes the

circuit pattern onto the photomask blank. The exposed areas are developed and etched to produce that pattern on the photomask. The photomask is inspected for defects and conformity to the customer design data, any defects are repaired, any required pellicles (protective translucent cellulose membranes) are applied and, after final inspection, the photomask is shipped to the customer.

The Company currently supports customers across the full spectrum of IC production and large area technologies by manufacturing photomasks using electron beam or optical-based technologies. Electron beam and laser-based systems are the predominant technologies used for photomask manufacturing. These technologies are capable of producing the finer line resolution, tighter overlay and larger die size for the larger and more complex circuits currently being designed. Electron beam and laser generated photomasks can be used with the most advanced processing techniques to produce the most advanced semiconductor devices intended for use in an array of products. These include devices used for microprocessors, memory, telecommunications and related applications. The Company currently owns a number of high-end and mature electron beam and laser-based systems. The production of photomasks by the optical method is less expensive and less precise than those manufactured on high-end electron beam systems.

The first several layers of photomasks are sometimes required to be delivered by the Company within 24 hours from the time it receives customers' design data. The ability to manufacture high quality photomasks within short time periods is dependent upon efficient manufacturing methods, high yield and high equipment reliability. The Company works to meet these requirements by making significant investments in manufacturing and data processing systems and utilizing statistical process control methods to optimize the manufacturing process and reduce cycle times.

Quality control is an integral part of the photomask manufacturing process. Photomasks are manufactured in temperature, humidity, and particulate controlled clean rooms because of the high level of precision, quality and yields required. Each photomask is inspected several times during the manufacturing process to ensure compliance with customer specifications. The Company continues to make substantial investments in equipment to inspect and repair photomasks to ensure that customer specifications are met. After inspection and any necessary repair, the Company utilizes proprietary processes to clean the photomasks prior to shipment.

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The vast majority of photomask units produced for the semiconductor industry employ geometries of 90 nanometer or larger for ICs, and Generation 7 technologies or lower for FPDs. At these geometries, the Company can produce full lines of photomasks and there is no significant technology employed by the Company's competitors that is not available to the Company. Semiconductor fabrication also occurs below the 90 nanometer range for IC photomask technology and Generation 7 and above for FPD photomask technology. The Company is currently capable of producing a selective range of photomasks at these smaller geometries. However, as is typical of industries in the midst of technological change, some of the Company's competitors may be able to achieve higher manufacturing yields than the Company when producing these smaller geometry photomasks, in part because these competitors may have completed more cycles of learning than the Company in this area, and, in part, because of the Company's need to replicate production of these complex photomasks at its many locations worldwide. The Company believes that these cases are few and are not material to its business.

Sales and Marketing

The market for photomasks primarily consists of domestic and international semiconductor and FPD manufacturers and designers, including a limited number of manufacturers who have the capability to manufacture photomasks. Generally, the Company and each of its customers engage in a qualification and correlation process before the Company becomes an approved supplier. Thereafter, the Company typically negotiates pricing parameters for a

customer's orders based on the customer's specifications. Some prices may remain in effect for an extended period. In some instances, the Company enters into sales arrangements, based on the understanding that, as long as the Company's performance is competitive, the Company will receive a specified percentage of that customer's photomask requirements.

The Company conducts its sales and marketing activities primarily through a staff of full-time sales personnel and customer service representatives who work closely with the Company's management and technical personnel. In addition to the sales personnel at the Company's manufacturing facilities, the Company has sales offices throughout the United States, Europe and Asia.

The Company supports international customers through both its domestic and international facilities. The Company considers its presence in international markets important to attracting new customers, providing global solutions to its existing customers, and serving customers that utilize manufacturing foundries outside of the United States, principally in Asia. For the amount of net sales and long-lived assets attributable to each of the Company's geographic areas of operations (see Note 16 to the Company's consolidated financial statements).

Customers

The Company primarily sells its products to leading semiconductor and FPD manufacturers. The Company's largest customers during the fiscal year ended November 2, 2008 ("fiscal 2008"), included the following:

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|-------------------------------------|--|
| AU Optronics Corp. | MStar Semiconductor, Inc. |
| Fairchild Semiconductor Intl., Inc. | National Semiconductor Corporation |
| Freescale Semiconductor, Inc. | Novatek Microelectronics Corp., Ltd. |
| HannStar Display Corp. | NXP Semiconductors |
| IM Flash Technologies, LLC | Samsung Electronics Co., Ltd. |
| Integrated Device Technology, Inc. | Skyworks Solutions, Inc. |
| Jazz Semiconductor, Inc. | ST Microelectronics, Inc. |
| LG Philips LCD Co., Ltd. | Systems on Silicon Mfg. Co., Pte. Ltd. |
| Magnachip Semiconductor | Texas Instruments Incorporated |
| Micron Technology, Inc. | United Microelectronics Corp. |

During fiscal 2008, the Company sold its products and services to approximately 600 customers. Samsung Electronics Co., Ltd. accounted for approximately 25% of the Company's net sales in fiscal 2008, 2007 and 2006. This included sales of both IC and FPD photomasks. The Company's five largest customers, in the aggregate, accounted for approximately 44% in fiscal 2008, 43% in fiscal 2007 and 46% in fiscal 2006, of net sales. A significant decrease in the amount of sales to any of these customers could have a material adverse effect on the financial performance and business prospects of the Company.

Seasonality

The Company's quarterly revenues can be affected by the seasonal purchasing of its customers. The Company is typically impacted during its first fiscal quarter by the North American and European holiday periods, as some customers reduce their effective workdays and orders during this period. Additionally, the Company can be impacted

during its first or second quarter by the Asian New Year holiday period which also may reduce customer orders. For fiscal 2009, the Asian New Year holiday will be in the Company's first fiscal quarter, in contrast to fiscal 2008 when it occurred in the Company's second fiscal quarter. At times, the Company's first quarter revenues have been down sequentially by as much as 10%. During the past three years, the second quarter resulted in increased sequential revenues of 3% to 7%.

Research and Development

The Company conducts its primary research and development activities at the MP Mask Technology Center, LLC ("MP Mask") joint venture operation located in Boise, Idaho, and in site-specific research and development programs at various locations around the world, primarily at its research and development center at PK, Ltd. ("PKL") located in Korea. The MP Mask research and development programs, coupled with site specific research and development initiatives, are designed to advance the Company's leadership in technology and manufacturing efficiency. The Company also conducts research and development activities to support advanced product integration including, but not limited to, numerical modeling and simulation of photomask processes, fabrication and delivery of product prototypes for next generation customer needs, and development of software tools and workflows necessary for the effective integration of the most advanced mask-based optical lithography solutions. Currently, research and development photomask activities are focused on 65, 45 and 32 nanometer node IC technology and Generation 8 and higher FPD technology. The Company believes these core competencies will continue to be a critical part of semiconductor manufacturing as optical lithography continues to scale device capabilities at and below 90 nanometer. The Company has incurred research and development expenses of \$17.5 million, \$17.3 million and \$27.3 million in fiscal 2008, 2007 and 2006, respectively. The Company believes that it owns or controls valuable proprietary information necessary for its business as presently conducted. This includes trade secrets as well as patents. Recently, the Company has either applied for or been granted patents pertaining to its manufacturing processes. The Company believes that its intellectual property is and will continue to be important to the Company's technical leadership in the field of photomasks.

Patents and Trademarks

The Company has over 40 patents with ownership interest in the United States. The subject matter of these patents generally relates to the manufacture of photomasks themselves and the use of photomasks to manufacture other products. The expiration dates of these patents range from 2011 to 2027. Additionally, pursuant to the technology license agreement with Micron, the Company has access to certain technology of Micron and MP Mask. The Company also has a number of trademarks and trademark registrations in the United States and in other countries.

While the Company believes that its intellectual property is, and will continue to be, important to the Company's technical leadership in the field of photomasks, the Company's operations are not dependent on any one individual patent. The Company protects its intellectual property rights regarding products and manufacturing processes through patents and trade secrets. The Company also relies on non-disclosure agreements with employees and vendors to protect its intellectual property and proprietary processes.

Materials, Supplies and Equipment

Raw materials used by the Company generally include high precision quartz plates (including large area plates), which are used as photomask blanks, primarily obtained from Japanese and Korean suppliers; pellicles and electronic grade chemicals, which are used in the manufacturing process; and compacts, which are durable plastic containers in which photomasks are shipped. These materials are generally sourced from several suppliers and although the Company is not dependent on any one supplier for most of its raw materials, glass blanks used for the production of certain high-end photomasks are only available from one supplier. The Company believes that its utilization of a select group of strategic suppliers enables it to access the most technologically advanced materials available. On an ongoing basis, the Company continues to consider additional supply sources.

The Company relies on a limited number of equipment suppliers to develop and supply the equipment used in the photomask manufacturing process. Although the Company has been able to obtain equipment on a timely basis, the inability to obtain equipment when required could adversely affect the Company's business and results of operations. The Company also relies on these and additional suppliers to develop future generations of manufacturing systems to support the Company's requirements.

Backlog

The first several levels of a set of photomasks for a circuit pattern are often required to be shipped within 24 hours of receiving a customer's designs. Because of the short period between order and shipment dates (typically from 1 day to 2 weeks) for a significant amount of the Company's sales, the dollar amount of current backlog is not considered to be a reliable indicator of future sales volume.

International Operations

International sales were approximately 77%, 75% and 73% of the Company's sales in fiscal 2008, 2007 and 2006, respectively. The Company believes that maintaining significant international operations requires it to have, among other things, a local presence in the markets in which it operates. This requires a significant investment in financial, management, operational, and other resources.

Operations outside the United States are subject to inherent risks, including fluctuations in exchange rates, political and economic conditions in various countries, unexpected changes in regulatory requirements, tariffs and other trade barriers, difficulties in staffing and managing international operations, longer accounts receivable collection cycles and potentially adverse tax consequences. These factors may have a material adverse effect on the Company's ability to generate sales outside the United States and to deploy resources where they can be used to their greatest advantage, and consequently may adversely affect its financial conditions and results of operations.

Note 16 of the notes to the Company's consolidated financial statements reports net sales and long-lived assets by geographic region.

Competition

The photomask industry is highly competitive and most of the Company's customers utilize multiple photomask suppliers. The Company's ability to compete depends primarily upon its consistency of product quality and timeliness of delivery, as well as pricing, technical capability and service. The Company also believes that proximity to customers is an important factor in certain markets where cycle time from order to delivery is critical. Certain competitors have substantially greater financial, technical, sales, marketing and other resources than the Company. The Company believes that consistency of product quality, timeliness of delivery, and price are the principal factors considered by customers in selecting their photomask suppliers. The Company's inability to meet these requirements could adversely affect its sales. The Company believes that it is able to compete effectively because of its dedication to customer service, its investment in state-of-the-art photomask equipment and facilities, and its experienced technical employees.

The Company estimates that for the types of photomasks it manufactures (IC and FPD) the size of the total market (captive and merchant) is approximately \$3.5 billion. Competitors include Compugraphics, Inc., Dai Nippon Printing

Co., Ltd., Hoya Corporation, SK-Electronics Co. Ltd., Taiwan Mask Corporation, Toppan Printing Co., Ltd. and Toppan Chungwha Electronics. The Company also competes with semiconductor manufacturers' captive photomask manufacturing operations that supply photomasks for internal use and, in some instances, also for external customers and foundries. The Company expects to face continued competition which in the past has led to pressure to reduce prices. The Company believes the pressure to reduce prices has contributed to the decrease in the number of independent manufacturers, and that expects such pressure to continue in the future.

Employees

As of November 2, 2008, the Company and its majority-owned subsidiaries had approximately 1,440 employees. The Company believes it offers competitive compensation and other benefits and that its employee relations are good. Except for certain employees in the United Kingdom, none of the Company's employees are represented by a union.

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ITEM 1A. RISKS RELATING TO THE COMPANY'S BUSINESS

The Company is dependent on the semiconductor industry which as a whole is volatile and could have a negative material impact on its business.

The Company sells substantially all of its photomasks to semiconductor designers, manufacturers and foundries, as well as to other high performance electronics manufacturers. The Company believes that the demand for photomasks depends primarily on design activity rather than sales volume from products using photomask technology. Consequently, an increase in semiconductor sales does not necessarily result in a corresponding increase in photomask sales. In addition, the reduced use of customized ICs, a reduction in design complexity, other changes in the technology or methods of manufacturing or designing semiconductors or a slowdown in the introduction of new semiconductor designs could reduce demand for photomasks even if there is increased demand for semiconductors. Further, advances in design and production methods for semiconductors and other high performance electronics could reduce the demand for photomasks. Historically, the semiconductor industry has been volatile, with sharp periodic downturns and slowdowns. These downturns have been characterized by, among other things, diminished product demand, excess production capacity and accelerated erosion of selling prices. The semiconductor industry began to experience a downturn in fiscal 2008, which the Company believes could continue through fiscal 2009, which had an adverse impact on its 2008 operating results.

The Company's sales of photomasks for use in fabricating high performance electronic products such as FPDs increased in fiscal 2008 as compared to fiscal 2007. The Company's results may suffer if the FPD photomask market does not grow or if the Company is unable to serve this market successfully. As is the case with semiconductor photomask demand, the Company believes that demand for photomasks for FPDs depends primarily on design activity and, to a lesser extent upon an increase in the number of production facilities used to manufacture FPDs. As a result, an increase in FPD sales will not necessarily lead to a corresponding increase in photomask sales. The technology for fabricating FPDs continues to develop in order to increase the size and improve the resolution of FPDs. A slowdown in the development of new technologies for fabricating FPDs could reduce the demand for related photomasks even if demand for FPDs increases.

The Company's quarterly operating results fluctuate significantly and may continue to do so in the future which could adversely impact the Company's business.

The Company has experienced fluctuations in its quarterly operating results and anticipates that such fluctuations will continue and could intensify in the future. Fluctuations in operating results may result in volatility in the prices of the Company's securities, particularly its common stock and securities linked to the value of the Company's common stock. Operating results may fluctuate as a result of many factors, including size and timing of orders and shipments, loss of significant customers, product mix, technological change, fluctuations in manufacturing yields, competition and general economic conditions. The Company operates in a high fixed cost environment and to the extent its revenues and asset utilization increase or decrease, operating margins will be positively or negatively impacted. The Company's customers generally order photomasks on an as-needed basis, and substantially all of the Company's net sales in any quarter are dependent on orders received during that quarter. Since the Company operates with little backlog and the rate of new orders may vary significantly from month-to-month, the Company's capital expenditures and expense levels are based primarily on sales forecasts. Consequently, if anticipated sales in any quarter do not occur when expected, capital expenditures and expense levels could be disproportionately high, and the Company's operating results would be adversely affected. Due to the foregoing factors, the Company believes that period-to-period comparisons of its operating results are not necessarily meaningful and that these comparisons cannot be relied upon as indicators of future performance. In addition, in future quarters the Company's operating results could be below the expectations of public market analysts and investors, which, in turn, could materially adversely affect the market prices of the Company's common stock.

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The Company's industry is subject to rapid technological change and the Company might fail to remain competitive, which could have a material adverse effect on the Company's business and results of operations.

The photomask industry has been, and is expected to continue to be characterized by technological change and evolving industry standards. In order to remain competitive, the Company will be required to continually anticipate, respond to and utilize changing technologies of increasing complexity in both traditional and emerging markets that it serves. In particular, the Company believes that, as semiconductor geometries continue to become smaller and FPDs become larger with improved performance, it will be required to manufacture increasingly complex photomasks. Additionally, demand for photomasks has been, and could in the future be, adversely affected by changes in methods of fabricating semiconductors and high performance electronics (that could affect the type or quantity of photomasks utilized), such as changes in semiconductor demand that favor field programmable gate arrays and other semiconductor designs that replace application-specific ICs. Additionally, increased market acceptance of alternative methods of IC designs onto semiconductor wafers, such as direct-write lithography, could reduce or eliminate the need for photomasks entirely in the production of semiconductors. Through fiscal 2008, direct-write lithography has not been proven to be a commercially viable alternative to photomasks, as it is considered too slow for high volume semiconductor wafer production. However, should direct-write or any other alternative methods of transferring IC designs to semiconductor wafers without the use of photomasks achieve market acceptance, the Company's business and results of operations would be materially adversely affected. If the Company is unable to anticipate, respond to or utilize these or other changing technologies, due to resource, technological or other constraints, its business and results of operations could be materially adversely affected.

Further, should sales volumes decrease based upon the flow of design releases from the Company's customers, the Company may have excess or underutilized production capacity that could significantly impact operating margins, or result in write-offs from asset impairments.

The Company's operations will continue to require substantial capital, which it may be unable to obtain.

The manufacture of photomasks requires substantial investments in high-end manufacturing capability at existing and new facilities. The Company expects that it will be required to continue to make substantial capital expenditures to meet the technological demands of its customers and to position it for future growth. The Company's capital expenditure payments for fiscal 2009 are expected to be in the range of \$40 million to \$50 million, of which \$24 million was accrued as of November 2, 2008. Further, the Company's credit facility has a limitation on capital expenditure payments. The Company cannot provide assurance that it will be able to obtain the additional capital required in connection with its operations on reasonable terms, if at all, or that any such expenditure will not have a material adverse effect on its business and results of operations.

The Company's agreements with Micron have several risks; should either company not comply or execute under these agreements it could significantly disrupt the Company's business and technology activities which could have a material effect on the Company's operations or cash flows.

On May 5, 2006, Photronics and Micron entered into a joint venture known as MP Mask. The joint venture develops and produces photomasks for leading-edge and advanced next generation semiconductors. As part of the formation of the joint venture, Micron contributed its existing photomask technology center located at its Boise, Idaho, headquarters to MP Mask and Photronics paid Micron \$135.0 million in exchange for a 49.99% interest in MP Mask, a license for photomask technology of Micron and certain supply agreements. The Company invested an additional \$2.6 million in 2008 and \$3.5 million in 2007 in MP Mask for capital expenditure and working capital purposes, and received a distribution from MP Mask of \$5.0 million in 2008.

In the first quarter of fiscal 2008, a capital lease agreement commenced with Micron for the U.S. Nanofab for \$61.7 million principal amount. Photronics' total investment to date in the purchase and equipping of its U.S. Nanofab is approximately \$186 million. The U.S. Nanofab began production in the Company's second fiscal quarter.

Failure by Photronics or Micron to comply or execute under any of these agreements, to capitalize on the use of existing technology or to further develop technology could result in a significant disruption to the Company's business and technology activities, and could adversely affect the Company's operations and cash flows.

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The Company has been dependent on sales to a limited number of large customers; the loss of any of these customers or any reduction in orders from these customers could have a material adverse effect on its sales and results of operations.

Historically, the Company has sold a significant proportion of photomasks to a limited number of IC and FPD manufacturers. During fiscal 2008, one customer, Samsung Electronics Co., Ltd., accounted for approximately 25% of the Company's net sales. The Company's five largest customers, in the aggregate, accounted for 44% of net sales in fiscal 2008, 43% in fiscal 2007, and 46% in fiscal 2006. None of the Company's customers has entered into a long-term agreement with the Company requiring them to purchase the Company's products. The loss of a significant customer or any reduction or delay in orders from any significant customer, including reductions or delays due to customer departures from recent buying patterns, or market, economic, or competitive conditions in the semiconductor or FPD industries, could have a material adverse effect on the Company's financial performance and business prospects. The continuing consolidation of semiconductor manufacturers and economic downturn in the semiconductor industry may increase the likelihood of losing a significant customer and have an adverse effect on the Company's financial performance and business prospects.

The Company depends on a small number of suppliers for equipment and raw materials and, if the Company's suppliers do not deliver their products to them, the Company may be unable to deliver its products to its

customers, which could adversely affect its business and results of operations.

The Company relies on a limited number of photomask equipment manufacturers to develop and supply the equipment it uses. These equipment manufacturers currently require lead times of up to 12 months between the order and the delivery of certain photomask imaging and inspection equipment. The failure of such manufacturers to develop or deliver such equipment on a timely basis could have a material adverse effect on the Company's business and results of operations. Further, the Company relies on equipment manufacturers to develop future generations of manufacturing equipment to meet its requirements. In addition, the manufacturing equipment necessary to produce advanced photomasks could become prohibitively expensive.

The Company uses high precision quartz photomask blanks, pellicles, and electronic grade chemicals in its manufacturing processes. There are a limited number of suppliers of these raw materials, and for production of certain high-end photomasks there is only one available supplier, and the Company has no long-term contract for the supply of these raw materials. Any delays or quality problems in connection with significant raw materials, particularly photomask blanks, could cause delays in shipments of photomasks, which could have a material adverse effect on the Company's business and results of operations. The fluctuation of foreign currency exchange rates with respect to prices of equipment and raw materials used in manufacturing also could have a material adverse effect on the Company's business and results of operations, although they have not been material to date.

The Company faces risks associated with complex manufacturing processes, including the use of sophisticated equipment and manufacturing processes with complex technologies; should the Company be unable to effectively utilize such processes and technologies it could have a material adverse effect on its business and results of operations.

The Company's complex manufacturing processes require the use of expensive and technologically sophisticated equipment and materials, and are continuously modified in an effort to improve manufacturing yields and product quality. Minute impurities, defects or other difficulties in the manufacturing process can lower manufacturing yields and make products unmarketable. Moreover, manufacturing leading-edge photomasks is more complex and time consuming than manufacturing less advanced photomasks, and may lead to delays in the manufacturing of all levels of photomasks. The Company has, on occasion, experienced manufacturing difficulties and capacity limitations that have delayed the Company's ability to deliver products within the time frames contracted for by its customers. The Company cannot provide assurance that it will not experience these or other manufacturing difficulties, or be subject to increased costs or production capacity constraints in the future, any of which could result in a loss of customers or could otherwise have a material adverse effect on its business and results of operations.

In the first quarter of fiscal 2008, a capital lease agreement commenced with Micron for the U.S. Nanofab. The Company cannot provide assurance that this facility will ramp up to anticipated production levels or that it will not experience any production or other difficulties.

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Covenants in the Company's debt agreements limit its ability to obtain financing and obligate it to repay debt.

The Company's ability to comply with the financial and other covenants in its debt agreements may be affected by economic or business conditions or other events. As of November 2, 2008, the Company had a revolving credit facility with \$122.5 million outstanding, and foreign loans with \$30.5 million outstanding, that were subject to various financial and other covenants, which were last amended on December 12, 2008. The financial covenants include, among others, the Senior Leverage Ratio, Total Leverage Ratio, Minimum Fixed Charge Ratio and minimum quarterly EBITDA levels. Existing covenant restrictions limit the Company's ability to obtain additional debt

financing and should the Company be unable to meet one or more of these covenants the bank may require the Company to repay its outstanding balances prior to the expiration date of the agreements. The Company cannot assure that additional sources of financing would be available to the Company to pay off the Company's long-term borrowings to avoid default.

On October 31, 2008, the Company's credit agreement was amended to change the minimum senior leverage ratio covenant, as defined, and to extend the date that the Company was required to obtain at least \$75 million in permanent long-term capital from November 2, 2008 to December 5, 2008. The credit agreement was further amended on December 5, 2008 to extend the date to obtain at least \$75 million in permanent long-term capital to December 12, 2008, at which date the credit agreement was last amended and, among other items, eliminated the requirement to obtain such permanent long-term capital.

Should the Company default on any of its long-term borrowings, a cross default would occur on its other long-term borrowings, unless amended or waived.

The Company's prior and future acquisitions may entail certain operational and financial risks.

The Company has made significant acquisitions throughout its history. Acquisitions have focused on increasing its manufacturing presence in Asia, including its acquisition of Photronics Semiconductor Mask Corporation ("PSMC"), a Taiwanese photomask manufacturer, in 2000 and PKL, a Korean photomask manufacturer, in 2001 and increasing the technology base through the MP Mask joint venture between Photronics and Micron in 2006. The Company may make additional acquisitions in the future. Acquisitions place significant demands on the Company's administrative, operational and financial personnel and systems. Managing acquired operations entails numerous operational and financial risks, including difficulties in the assimilation of acquired operations, diversion of management's attention from other business concerns, managing assets in multiple geographic regions, amortization of acquired intangible assets and potential loss of key employees of acquired operations. Sales of acquired operations also may decline following an acquisition, particularly if there is an overlap of customers served by the Company and the acquired operation, and these customers transition to another vendor in order to ensure a second source of supply. Furthermore, the Company may be required to utilize its cash reserves and/or issue new securities for future acquisitions, which could have a dilutive effect on its earnings per share.

The Company may incur unforeseen charges related to its intended restructuring of its European infrastructure or, it may fail to realize projected benefits related to the restructure.

In the fourth quarter of fiscal 2008, the Company announced its intention to streamline its European operations by ceasing the manufacture of photomasks at its facility in Manchester, United Kingdom. The Company expects this action to lower its operating costs and increase its manufacturing efficiencies. However, the Company cannot assure that this action will not result in unforeseen costs, disruptions in its operations, or other negative events that could result in the Company failing to realize the projected benefits of the restructure.

The Company operates in a highly competitive industry; should the Company be unable to meet its customers requirements for product quality, timelines of delivery or technical capabilities, it could adversely affect its sales.

The photomask industry is highly competitive, and most of the Company's customers utilize more than one photomask supplier. The Company's competitors include Compugraphics, Inc., Dai Nippon Printing Co., Ltd., Hoya Corporation, Taiwan Mask Corporation, Toppan Printing Co., Ltd. and Toppan Chungwha Electronics. The Company also competes with semiconductor manufacturers' captive photomask manufacturing operations. The Company expects to face continued competition from these and other suppliers in the future. Many of the Company's competitors have substantially greater financial, technical, sales, marketing and other resources than it does. Also, when producing smaller geometry photomasks, some of the Company's competitors may be able to more rapidly

develop, produce, and achieve higher manufacturing yields than the Company. The Company believes that consistency of product quality and timeliness of delivery, as well as price, technical capability, and service, are the principal factors considered by customers in selecting their photomask suppliers. The Company's inability to meet these requirements could adversely affect its sales which

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could have a material adverse effect on its business and results of operations. In the past, competition led to pressure to reduce prices which, the Company believes, contributed to the decrease in the number of independent manufacturers. This pressure to reduce prices may continue in the future. In addition, certain semiconductor manufacturers possess their own captive facilities for manufacturing photomasks, some of which market their photomask manufacturing services to outside customers as well as to their internal organizations.

The Company's substantial international operations are subject to additional risks.

International sales accounted for approximately 77% of the Company's net sales for fiscal 2008, 75% in fiscal 2007, and 73% in fiscal 2006. The Company believes that maintaining significant international operations requires it to have, among other things, a local presence in the markets in which it operates. This requires a significant investment of financial, managerial, operational, and other resources. Since 1996, the Company has significantly expanded its operations in international markets by acquiring existing businesses in Europe, establishing manufacturing operations in Singapore, acquiring majority equity interests in photomask manufacturing operations in Korea and Taiwan and building a new manufacturing facility for FPD photomasks in Taiwan and a new photomask manufacturing facility in Shanghai, China. As the served market continues to shift to Asia, the Company will continue to assess its manufacturing base and may close or open new facilities to adapt to these market conditions.

Operations outside the United States are subject to inherent risks, including fluctuations in exchange rates, political and economic conditions in various countries, unexpected changes in regulatory requirements, tariffs and other trade barriers, difficulties in staffing and managing international operations, longer accounts receivable payment cycles and potentially adverse tax consequences. These factors may have a material adverse effect on the Company's ability to generate sales outside the United States and, consequently, on its business and results of operations.

Changes in foreign currency exchange rates could materially adversely affect the Company's business, results of operations, or financial condition.

The Company's financial statements are prepared in accordance with U.S. GAAP and are reported in U.S. dollars. The Company's international operations have transactions and balances denominated in currencies other than the U.S. dollar, primarily the Korean won, New Taiwan dollar, Chinese renminbi, Japanese yen, Singapore dollar, euro and British pound. In fiscal 2008, the Company recorded a net gain of \$3.8 million in its statement of operations from changes in foreign currency rates, while its net assets were reduced by \$62.2 million as a result of the translation of foreign currency financial statements to U.S. dollars. In the event of significant foreign currency fluctuations, the Company's results of operations, financial condition or cash flows may be adversely affected.

The Company's business depends on management and technical personnel, who are in great demand, and its inability to attract and retain qualified employees could adversely affect the Company's business and results of operations.

The Company's success, in part, depends upon key managerial, engineering and technical personnel, as well as its ability to continue to attract and retain additional personnel. The loss of certain key personnel could have a material adverse effect upon the Company's business and results of operations. There can be no assurance that the Company

can retain its key managerial, engineering and technical employees, or that it can attract similar additional employees in the future. The Company believes that it provides competitive compensation and incentive packages to its employees.

The Company may be unable to enforce or defend its ownership and use of proprietary technology, and the utilization of unprotected Company developed technology by its competitors could adversely affect the Company's business, results of operations and financial position.

The Company believes that the success of its business depends more on its proprietary technology, information and processes and know-how than on its patents or trademarks. Much of its proprietary information and technology relating to manufacturing processes is not patented and may not be patentable. The Company cannot offer assurance that:

- * it will be able to adequately protect its technology;
- * competitors will not independently develop similar technology; or
- * international intellectual property laws will adequately protect its intellectual property rights.

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The Company may become the subject of infringement claims or legal proceedings by third parties with respect to current or future products or processes. Any such claims or litigation, with or without merit, to enforce or protect its intellectual property rights or to defend itself against claimed infringement of the rights of others could result in substantial costs, diversion of resources and product shipment delays or could force the Company to enter into royalty or license agreements rather than dispute the merits of these claims. Any of the foregoing could have a material adverse effect on the Company's business, results of operations and financial position.

The Company may be unprepared for changes to environmental laws and regulations and may have liabilities arising from environmental matters.

The Company is subject to numerous environmental laws and regulations that impose various environmental controls on, among other things, the discharge of pollutants into the air and water and the handling, use, storage, disposal and clean-up of solid and hazardous wastes. Changes in these laws and regulations may have a material adverse effect on the Company's financial position and results of operations. Any failure by the Company to adequately comply with these laws and regulations could subject it to significant future liabilities.

In addition, these laws and regulations may impose clean-up liabilities on current and former owners and operators of real property without regard to fault and these liabilities may be joint and several with other parties. In the past, the Company has been involved in remediation activities relating to its properties. The Company believes, based upon current information, that environmental liabilities relating to these activities or other matters are not material to its financial statements. However, there can be no assurances that the Company will not incur any material environmental liabilities in the future.

The Company's production facilities could be damaged or disrupted by a natural disaster or labor strike, either of which could adversely affect its financial position, results of operations and cash flows.

The Company's facilities in Taiwan are located in a seismically active area. In addition, a major catastrophe such as an earthquake or other natural disaster, labor strikes, or work stoppage at any of the Company's manufacturing

facilities could result in a prolonged interruption of its business. Any disruption resulting from these events could cause significant delays in shipments of the Company's products and the loss of sales and customers, which could have a material adverse effect on the Company's financial position and results of operations, and cash flows.

The Company's sales can be impacted by the health and stability of the general economy, which could adversely affect its operations and cash flows.

Unfavorable changes in general economic conditions, including Asia, such as a recession or economic slowdown in the U.S. or other countries in which the Company does business, may have the effect of reducing the demand for photomasks. For example, an economic downturn may lead to a decrease in demand for end products whose manufacturing process involves the use of photomasks, which may result in a reduction in new product design and development by semiconductor manufacturers, which could adversely affect the Company's operations and cash flows.

Changes in the Company's credit rating could adversely affect its financial position.

The Company's credit rating can be materially influenced by acquisitions, dispositions, other investment decisions, and the results of its operations in the near-term. Should the Company's credit rating be downgraded, its cost and ability to raise needed working and investment capital could adversely affect its results of operations and cash flows.

Additional taxes could adversely effect the Company's financial results.

The Company's tax filings are subjected to audit by tax authorities in the various jurisdictions in which it does business. These audits may result in assessments of additional taxes that are subsequently resolved with the authorities or through the courts. Currently, the Company believes there are no outstanding assessments whose resolution would result in a material adverse financial result. However, the Company cannot offer assurances that unasserted or potential future assessments would not have a material adverse effect on its financial condition or results of operations.

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The Company's business could be adversely impacted by global or regional catastrophic events.

The Company's business could be adversely affected by terrorist acts, the outbreak or escalation of wars, major natural disasters; or widespread outbreaks of infectious diseases. Such events in the geographic regions in which the Company does business could have material adverse impacts on its sales volume, cost of raw materials, earnings, cash flows and financial condition.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. DESCRIPTION OF PROPERTY

The following table presents certain information about the Company's photomask manufacturing facilities:

| Location | Type of Interest |
|-----------------|-------------------------|
|-----------------|-------------------------|

| | |
|---------------------------------------|-----------|
| Allen, Texas | Owned |
| Boise, Idaho | Leased |
| Brookfield, Connecticut (Building #1) | Owned |
| Brookfield, Connecticut (Building #2) | Owned |
| Bridgend, South Wales | Leased |
| Cheonan, Korea | Owned |
| Dresden, Germany | Leased |
| Hsinchu, Taiwan | Leased |
| Manchester, England | Owned (1) |
| Shanghai, China | Owned (2) |
| Singapore | Leased |
| Taichung, Taiwan | Owned (2) |

- (1) Production at the Manchester, United Kingdom manufacturing facility ceased in January 2009.
- (2) The Company owns its manufacturing facilities in Shanghai and Taichung, however, it leases the related land.

The Company believes that its existing manufacturing facilities are suitable and adequate for its present purposes. The Company also leases various sales offices. The Company's administrative headquarters are located in Brookfield, Connecticut in a building that it owns.

ITEM 3. LEGAL PROCEEDINGS

The Company is subject to various claims that arise in the ordinary course of business. The Company believes such claims, individually or in the aggregate, will not have a material adverse effect on the business of the Company.

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

No matters were submitted to a vote of the Company's security holders during the fourth quarter of fiscal 2008.

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PART II

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

The Common Stock of the Company is traded on the NASDAQ Stock Market, Inc. ("NASDAQ") under the symbol PLAB. The table below shows the range of high and low sale prices per share for each quarter for fiscal year 2008 and 2007, as reported on the NASDAQ.

| | <u>High</u> | <u>Low</u> |
|--|-------------|------------|
| Fiscal Year Ended November 2, 2008: | | |
| Quarter Ended January 27, 2008 | \$13.10 | \$8.91 |

| | | |
|--------------------------------|-------|------|
| Quarter Ended April 27, 2008 | 12.87 | 8.44 |
| Quarter Ended July 27, 2008 | 11.16 | 4.40 |
| Quarter Ended November 2, 2008 | 4.74 | 0.39 |

Fiscal Year Ended October 28, 2007:

| | | |
|--------------------------------|---------|---------|
| Quarter Ended January 28, 2007 | \$16.97 | \$13.68 |
| Quarter Ended April 29, 2007 | 16.88 | 15.00 |
| Quarter Ended July 29, 2007 | 15.96 | 14.14 |
| Quarter Ended October 28, 2007 | 14.54 | 10.38 |

On December 31, 2008, the closing sale price for the Common Stock as reported by NASDAQ was \$1.95. Based on information available to the Company, the Company believes it has approximately 9,500 shareholders.

The Company has not paid any cash dividends to date and, for the foreseeable future, anticipates that earnings will continue to be retained for use in its business. Further, the Company's revolving credit facility ("credit facility") precludes it from paying cash dividends.

The information regarding the Company's equity compensation required to be disclosed by Item 201(d) of Regulation S-K is incorporated by reference from the Company's 2009 definitive Proxy Statement into Item 12 of Part III of this report.

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ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data is derived from the Company's audited consolidated financial statements. The data should be read in conjunction with the audited consolidated financial statements and notes thereto and other financial information included elsewhere in this Form 10-K (in thousands, except per share amounts):

| | Year Ended | | | | |
|-------------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 | October 30, 2005 | October 30, 2004 |
| OPERATING DATA: | | | | | |
| Net sales | \$422,548 | \$421,479 | \$454,875 | \$440,770 | \$399,875 |
| Cost and expenses: | | | | | |
| Cost of sales | (349,841) | (321,958) | (307,851) | (295,649) | (260,841) |
| Selling, general and administrative | (55,167) | (61,507) | (62,215) | (54,295) | (53,167) |
| Research and development | (17,475) | (17,300) | (27,337) | (32,152) | (30,167) |

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| | | | | | |
|---|---------------------------------|------------------|----------------------|----------------------|-------------|
| Impairment of goodwill | (138,534) (a) | - | - | - | - |
| Impairment of long-lived assets | (66,874) (b) | - | - | - | - |
| Consolidation, restructuring and related charges | (510) (c) | - | (15,639) (d) | - | - |
| Gain on sale of facility | - | 2,254 | - | - | - |
| Operating income (loss) | (205,853) | 22,968 | 41,833 | 58,674 | 5 |
| Other income (expense): | | | | | |
| Interest expense | (11,878) | (5,928) | (11,916) | (10,885) | (14) |
| Investment and other income, net | 5,562 | 6,844 | 15,469 | 7,556 (e) | 4 |
| Income (loss) before income tax benefit (provision) and minority interest | (212,169) | 23,884 | 45,386 | 55,345 | 4 |
| Income tax benefit (provision) | 2,778 | 3,178 | (10,462) | (10,058) | (5) |
| Minority interest in income of consolidated subsidiaries | (1,374) | (2,539) | (5,592) | (6,634) | (10) |
| Net income (loss) | <u>\$ (210,765) (a) (b) (c)</u> | <u>\$ 24,523</u> | <u>\$ 29,332 (d)</u> | <u>\$ 38,653 (e)</u> | <u>\$ 2</u> |
| Earnings (loss) per share: | | | | | |
| Basic | <u>\$(5.06) (a) (b) (c)</u> | <u>\$0.59</u> | <u>\$0.71 (d)</u> | <u>\$1.09 (e)</u> | <u>9</u> |
| Diluted | <u>\$(5.06) (a) (b) (c)</u> | <u>\$0.56</u> | <u>\$0.66 (d)</u> | <u>\$0.95 (e)</u> | <u>9</u> |
| Weighted average number of common shares outstanding: | | | | | |
| Basic | <u>41,658</u> | <u>41,539</u> | <u>41,369</u> | <u>35,519</u> | <u>32</u> |
| Diluted | <u>41,658</u> | <u>51,282</u> | <u>51,072</u> | <u>45,256</u> | <u>42</u> |

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BALANCE SHEET DATA:

As of

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| | November 2, 2008 | October 28, 2007 | October 29, 2006 | October 30, 2005 | October 31, 2004 |
|------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Working capital | \$66,419 | \$96,606 | \$127,691 | \$300,557 | \$240,401 |
| Property, plant and equipment, net | 436,528 | 531,578 | 443,637 | 412,429 | 396,461 |
| Total assets | 758,007 | 1,059,780 | 1,045,683 | 945,729 | 858,210 |
| Long-term debt | 202,979 | 191,253 | 170,288 | 238,949 | 315,888 |
| Shareholders' equity | 382,782 | 654,284 | 614,282 | 561,875 | 349,473 |

- (a) Includes impairment of goodwill charge of \$138.5 million (\$137.3 million net of tax).
- (b) Includes impairment charge of \$66.9 million for certain long-lived assets in Asia and Europe (\$60.9 million net of tax).
- (c) Includes consolidation and restructuring charges of \$0.5 million (\$0.4 million net of tax) in connection with the closure of the Company's Manchester, United Kingdom manufacturing facility.
- (d) Includes consolidation and restructuring charges of \$15.6 million net of tax in connection with the closure of the Company's Austin, Texas manufacturing and research and development facility.
- (e) Includes early extinguishment charge of \$1.7 million in connection with the early redemption of \$64.4 million of the Company's 4.75% convertible notes.
- (f) Includes early extinguishment charge of \$1.2 million in connection with the early redemption of \$48.5 million of the Company's 4.75% convertible notes.

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

Results of Operations for the Years Ended November 2, 2008, October 28, 2007 and October 29, 2006

Overview

The Company sells substantially all of its photomasks to semiconductor designers and manufacturers, and manufacturers of FPDs. Photomask technology is also being applied to the fabrication of other higher performance electronic products such as photonics, micro-electronic mechanical systems and certain nanotechnology applications. Thus, the Company's selling cycle is tightly interwoven with the development and release of new semiconductor designs and flat panel applications, particularly as it relates to the semiconductor industry's migration to more advanced design methodologies and fabrication processes. The Company believes that the demand for photomasks primarily depends on design activity rather than sales volumes from products produced using photomask technologies. Consequently, an increase in semiconductor or FPD sales does not necessarily result in a corresponding increase in photomask sales. In addition, the reduced use of customized ICs, reductions in design complexity, other changes in the technology or methods of manufacturing semiconductors, or a slowdown in the introduction of new semiconductor or FPD designs could reduce demand for photomasks even if demand for semiconductors and FPDs increases. Advances in semiconductor and photomask design and semiconductor production methods could reduce the demand for photomasks. Historically, the semiconductor industry has been volatile, with sharp periodic downturns and slowdowns. These downturns have been characterized by, among other things, diminished product demand, excess production capacity and accelerated erosion of selling prices. The semiconductor industry began to experience a

downturn in fiscal 2008, which the Company believes could continue through fiscal 2009, which had an adverse impact on its 2008 operating results.

The global semiconductor industry is driven by end markets which have been closely tied to consumer driven applications of high performance semiconductor devices including, but not limited to, communications and mobile computing solutions. The Company is typically required to fulfill its customer orders within a short period of time, sometimes within 24 hours. This results in the Company having a minimal level of back-log orders, typically one to two weeks. The Company cannot predict the timing of the industry's transition to volume production of next generation technology nodes or the timing of up and down cycles with precise accuracy, but believes that such transitions and cycles will continue into the future, beneficially and adversely affecting its business, financial condition and operating results in the near term. The Company's ability to remain successful in these environments is based upon achieving its goals of being a service and technology leader, an efficient solutions supplier, and a company able to continually reinvest in its global infrastructure.

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The effects of the worsening global economy and the tightening credit market are also making it increasingly difficult for the Company to obtain external sources of financing to fund its operations. The Company faces challenges in the current and near term that require it to continue to make significant improvements in its competitiveness. The Company continues to evaluate financing alternatives, delay capital expenditures and evaluate further cost reduction initiatives.

The Company is focused on improving its competitiveness by advancing its technology and reducing costs. In addition, the Company increased its high-end manufacturing capability in 2008 with the commencement of production at its state-of-the-art nanofab facility ("U.S. Nanofab") in Boise, Idaho. To reduce costs, in the first quarter of fiscal 2009 the Company implemented a restructure initiative in Europe to reduce manufacturing and overhead costs, and reduce its workforce.

As of December 2008, state-of-the-art production for semiconductor masks is considered to be 45 nanometer and lower for ICs, and Generation 8 and above process technologies for FPDs, while 65 nanometer has moved into volume production. 90 nanometer and above geometries and Generation 7 and below process technologies for FPDs constitute the majority of designs being fabricated in volume today. The Company expects there to be an increase in 65 nanometer designs moving to wafer fabrication throughout fiscal 2009 and believes it is well positioned to service an increasing volume of this business through investments in manufacturing processes and technology in the global regions where its customers are located.

The photomask industry has been, and is expected to continue to be, characterized by technological change and evolving industry standards. In order to remain competitive, the Company will be required to continually anticipate, respond to, and utilize changing technologies. In particular, the Company believes that, as semiconductor geometries continue to become smaller, it will be required to manufacture even more complex optically-enhanced reticles, including optical proximity correction and phase-shift photomasks. Additionally, demand for photomasks has been, and could in the future be, adversely affected by changes in methods of semiconductor manufacturing (which could affect the type or quantity of photomasks utilized), such as changes in semiconductor demand that favor field-programmable gate arrays and other semiconductor designs that replace application-specific ICs. Through fiscal 2008, the Company has not experienced a significant loss of revenue as a result of alternative semiconductor design methodologies. Additionally, increased market acceptance of alternative methods of transferring circuit designs onto semiconductor wafers, such as direct-write lithography, could reduce or eliminate the need for photomasks. Through fiscal 2008, direct-write lithography has not been proven to be a commercially viable alternative to photomasks, as it is considered too slow for high volume semiconductor wafer production. However, should direct-write or any other

alternative methods of transferring IC designs to semiconductor wafers be done without the use of photomasks, the Company's business and results of operations would be materially adversely affected. If the Company is unable to anticipate, respond to, or utilize these or other changing technologies due to resource, technological or other constraints, its business and results of operations could be materially adversely affected.

Both revenues and costs have been affected by the increased demand for high-end technology photomasks that require more advanced manufacturing capabilities but generally command higher average selling prices ("ASPs"). The Company's capital expenditure payments for new facilities and equipment aggregated approximately \$294 million for the three fiscal years ended November 2, 2008, resulting in significant increases in operating expenses. While the Company intends to continue to make the required investments to support the technological demands of its customers and position itself for future growth, it expects that its level of capital expenditures will decrease for the next several years. In 2006, the Company invested \$135 million in the MP Mask joint venture, and technology license and related agreements.

The manufacture of photomasks for use in fabricating ICs and other related products built using comparable photomask-based process technologies has been, and continues to be, capital intensive due to the need to maintain a technology-based infrastructure. The Company's integrated global manufacturing network and employees, which consist of ten current manufacturing sites (the Manchester, United Kingdom facility ceased production in January 2009), represent a significant portion of its fixed operating cost base. Should sales volumes decrease based upon the flow of design releases from the Company's customers, the Company may have excess or underutilized production capacity that could significantly impact operating margins, or result in write-offs from asset impairments.

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The vast majority of photomask units produced for the semiconductor industry employ geometries of 90 nanometers or larger for ICs, and Generation 7 technologies or lower for FPDs. At these geometries, the Company can produce full lines of photomasks and there is no significant technology employed by the Company's competitors that is not available to the Company. Semiconductor fabrication also occurs below 90 nanometer for ICs, and Generation 8 and above for FPDs. The Company is currently capable of producing a selective range of photomasks at these smaller geometries, and has begun accelerating its efforts to support the development and production of photomasks for 65, 45 and 32 nanometer technology nodes in semiconductors and Generation 8 in FPD. However, as is typical of industries in the midst of technological change, some of the Company's competitors may be able to achieve higher manufacturing yields than the Company when producing these smaller geometry photomasks, in part because these competitors may have completed more cycles of learning than the Company in this area and in part because of the Company's need to replicate production of these complex photomasks at its world-wide advanced technology locations.

In March of 2006, the Company further streamlined its operating infrastructure in North America by closing the Austin, Texas manufacturing and research and development center and relocating certain development and manufacturing work to other facilities within the global network. The Company incurred total restructuring charges of \$15.6 million in its fiscal year ended October 29, 2006. In January 2007, the Company sold its Austin, Texas manufacturing and research and development facility for proceeds of \$5.0 million and realized a gain of \$2.3 million.

On May 5, 2006, Photronics and Micron entered into the MP Mask joint venture, which develops and produces photomasks for leading-edge and advanced next generation semiconductors. As part of the formation of the joint venture, Micron contributed its existing photomask technology center located at its Boise, Idaho, headquarters to MP Mask and Photronics paid Micron \$135.0 million in exchange for a 49.99% interest in MP Mask and a license for photomask technology of Micron and certain supply agreements. The Company subsequently invested an additional \$6.1 million in MP Mask for capital expenditure and working capital purposes, and received a return of investment

from MP Mask of \$5 million (see Note 3 to the consolidated financial statements).

In the first quarter of fiscal 2008, a capital lease agreement commenced with Micron for the U.S. Nanofab for a total cost of \$61.7 million. The Company's total investment through fiscal 2008 in the purchase and equipping of its U.S. Nanofab was approximately \$186 million. The U.S. Nanofab began production during the second quarter of fiscal 2008.

In the third quarter of fiscal 2008, the Company recorded impairment charges for certain of its long-lived assets and wrote off all \$138.5 million of its goodwill (see Note 2 to the consolidated financial statements). In the fourth quarter of fiscal 2008, the Company announced its intention to cease the manufacture of photomasks at its Manchester, United Kingdom facility (see Note 18 to the consolidated financial statements).

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Results of Operations

The following table represents selected operating information expressed as a percentage of net sales:

| | Year Ended | | |
|--|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Net sales | 100.0% | 100.0% | 100.0% |
| Cost of sales | (82.8) | (76.4) | (67.7) |
| Gross margin | 17.2 | 23.6 | 32.3 |
| Selling, general and administrative expenses | (13.1) | (14.6) | (13.7) |
| Research and development expenses | (4.1) | (4.1) | (6.0) |
| Impairment of goodwill | (32.8) | - | - |
| Impairment of long-lived assets | (15.8) | - | - |
| Consolidation, restructuring and related charges | (0.1) | - | (3.4) |
| Gain on sale of facility | - | 0.5 | - |
| Operating income (loss) | (48.7) | 5.4 | 9.2 |
| Interest expense | (2.8) | (1.4) | (2.6) |
| Investment and other income, net | 1.3 | 1.6 | 3.4 |
| Income (loss) before income tax benefit (provision) and minority interest | (50.2) | 5.6 | 10.0 |
| Income tax benefit (provision) | 0.6 | 0.8 | (2.3) |
| Minority interest | (0.3) | (0.6) | (1.3) |
| Net income (loss) | (49.9)% | 5.8% | 6.4% |

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Note: All the following tabular comparisons, unless otherwise indicated, are for the fiscal years ended November 2, 2008 (2008), October 28, 2007 (2007) and October 29, 2006 (2006), in millions of dollars.

Net Sales

| | Percent Change | | | | |
|-----------------|-----------------------|-------------|-------------|-------------------------|-------------------------|
| | 2008 | 2007 | 2006 | 2008 to 2007 | 2007 to 2006 |
| FPD | \$107.6 | \$ 82.1 | \$ 99.8 | 31.1% | (17.7)% |
| IC | 314.9 | 339.4 | 355.1 | (7.2) | (4.4) |
| Total net sales | \$422.5 | \$421.5 | \$454.9 | 0.3% | (7.3)% |

Net sales for 2008 increased 0.3% to \$422.5 million as compared to \$421.5 million for 2007. The increase is related to increased sales of FPD photomasks of \$25.5 million, primarily related to increased sales of high-end FPD photomasks; substantially offset by reduced sales of IC photomasks of \$24.5 million associated with decreased ASPs, primarily for mainstream photomasks. High-end photomask applications, which typically have higher ASPs, include photomask sets for FPD products using G6 and above technologies and IC products using 90 nanometer and below technologies. During 2008, sales of high-end photomasks totaled \$115 million as compared to \$92 million in 2007. Total sales of high-end FPD photomasks increased by \$20 million, and sales of high-end IC photomasks increased by \$3.0 million. By geographic area, net sales in 2008 as compared to 2007 increased by \$16.5 million or 6.8% in Asia, decreased by \$10.4 million or 9.7% in North America, and decreased by \$5.0 million or 7.0% in Europe. As a percent of total sales in 2008, sales were 61% in Asia, 23% in North America and 16% in Europe.

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Net sales for 2007 decreased 7.3% to \$421.5 million as compared to \$454.9 million for 2006. The decrease is related to reduced sales of FPD photomasks of \$17.7 million associated with decreased ASPs primarily for high-end FPD photomasks; and reduced sales of IC photomasks of \$15.7 million as a result of a decline in ASPs, primarily from mainstream products. During 2007, sales of high-end photomasks totaled \$92 million as compared to \$91 million in 2006. Total sales of high-end FPD masks decreased by \$18 million, while sales of high-end IC photomasks increased by \$19 million. By geographic area, net sales in 2007 as compared to 2006 decreased by \$9.8 million or 3.9% in Asia, by \$15.2 million or 12.4% in North America, and by \$8.4 million or 10.5% in Europe. As a percent of total sales in 2007, sales were 58% in Asia, 25% in North America, and 17% in Europe.

Gross Margin

| | Percent Change | | | | |
|--|-----------------------|-------------|-------------|-------------------------|-------------------------|
| | 2008 | 2007 | 2006 | 2008 to 2007 | 2007 to 2006 |

| | | | | | |
|----------------|--------|--------|---------|---------|---------|
| Gross margin | \$72.7 | \$99.5 | \$147.0 | (26.9)% | (32.3)% |
| Gross margin % | 17.2% | 23.6% | 32.3% | - | - |

Gross margin decreased to 17.2% in 2008 from 23.6% in 2007 primarily due to costs relating to the Company's increased manufacturing base, including costs associated with the U.S. Nanofab which commenced operations in the second fiscal quarter of 2008, and reduced ASPs for IC photomasks, principally mainstream. The decreased gross margin was partially mitigated by increased high-end revenues, primarily for FPD photomasks. The Company operates in a high fixed cost environment and to the extent that the Company's revenues and utilization increase or decrease, gross margin will be positively or negatively impacted. The gross margin percentage in fiscal 2009 could be negatively impacted by decreased ASPs and units, and increased depreciation expense and costs associated with the Company's increased fixed cost manufacturing base.

Gross margin decreased to 23.6% in 2007 from 32.3% in 2006 primarily due to decreased ASPs for both IC and FPD photomasks and the Company's increased manufacturing base in Asia.

Selling, General and Administrative Expenses

| | <u>2008</u> | <u>2007</u> | <u>2006</u> | <u>Percent Change</u> | |
|----------------|-------------|-------------|-------------|-----------------------|---------------------|
| | | | | <u>2008 to 2007</u> | <u>2007 to 2006</u> |
| S,G&A expense | \$55.2 | \$61.5 | \$62.2 | (10.3)% | (1.1)% |
| % of net sales | 13.1% | 14.6% | 13.7% | - | - |

Selling, general and administrative expenses decreased by \$6.3 million or 10.3% to \$55.2 million in 2008, as compared to \$61.5 million in 2007. The decrease was related to certain U.S. Nanofab costs reported in costs of sales since production commenced in the second quarter of fiscal 2008, and reduced compensation expense, due in part to reduced headcount and cost reduction programs.

Selling, general and administrative expenses decreased by \$0.7 million or 1.1% to \$61.5 million in 2007 from \$62.2 million in 2006. The decrease was primarily due to decreased compensation expense, which was partially offset by start-up expenses related to the U.S. Nanofab.

Research and Development

| | <u>2008</u> | <u>2007</u> | <u>2006</u> | <u>Percent Change</u> | |
|----------------|-------------|-------------|-------------|-----------------------|---------------------|
| | | | | <u>2008 to 2007</u> | <u>2007 to 2006</u> |
| R&D expense | \$17.5 | \$17.3 | \$27.3 | 1.0% | (36.7)% |
| % of net sales | 4.1% | 4.1% | 6.0% | - | - |

Research and development expenditures consist primarily of global development efforts of high-end process technologies for advanced sub-wavelength reticle solutions for IC and FPD technologies. Research and development expenses decreased in both 2008 and 2007 as compared to 2006 as a result of cost savings associated with the 2006 closure of the Company's Austin, Texas research and development operations, which were in part offset by amortization expenses of the fair value of the agreement to license technology from Micron.

Impairment of Goodwill

Through the third quarter of fiscal 2008, the Company experienced a sustained, significant decline in its stock price. As a result of the decline in stock price, the Company's market capitalization fell significantly below the recorded value of its consolidated net assets during the third quarter of fiscal 2008. Due to the decrease in its market capitalization and quarterly net losses incurred through the third quarter of fiscal 2008, management tested goodwill for impairment in accordance with the requirements of Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*. The results of the analysis indicated that there would be no remaining implied value attributable to the Company's goodwill and, accordingly, the Company wrote off all \$138.5 million of its goodwill in fiscal 2008 (see Note 2 to the consolidated financial statements).

Impairment of Long-Lived Assets

As a result of the Company's projected undiscounted future cash flows related to certain of its asset groups (located in Europe and Asia) being less than the carrying value of those assets, the Company recorded an impairment charge of \$66.9 million in the third quarter of fiscal 2008. As required by SFAS No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* the carrying value of the assets determined to be impaired were reduced to their fair values (see Note 2 to the consolidated financial statement).

Consolidation, Restructuring and Related Charges

In the fourth quarter of fiscal 2008 the Company announced its intention to streamline its European operations by ceasing the manufacturing of photomasks at its facility in Manchester, United Kingdom. The Company expects to record an after tax charge in the range of \$3.0 million to \$5.0 million through fiscal 2009 (including \$0.4 million after tax recorded in fiscal 2008), approximately 25% of which will be for non-cash items. The Company expects to recover all related charges within a one year period through lower operating costs and increased manufacturing efficiencies. The Company estimates that approximately 85 employees will be affected by the planned closure. Production ceased at the Manchester, United Kingdom facility in January 2009.

In the second quarter of 2006, the Company streamlined its operating infrastructure in North America by ceasing the manufacture and research and development of photomasks at its Austin, Texas facility. The Company recorded total restructuring charges of \$15.6 million in 2006, primarily comprised of \$14.3 million related to the impairment of facilities and equipment and \$1.3 million relating to workforce reductions of approximately 95 employees in the United States.

The Company continues to assess its global manufacturing strategy as its sales volume continues to grow in Asia. This ongoing assessment could result, in the future, in facilities closures, asset redeployment, workforce reductions, and the addition of increased manufacturing facilities, all of which would be predicated by market conditions and customer requirements.

Gain on Sale of Facility

In January 2007, the Company sold its Austin, Texas manufacturing and research and development facility for proceeds of \$5.0 million and realized a gain of \$2.3 million.

Other Income (Expense)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|----------------------------------|-----------------|---------------|---------------|
| Interest expense | \$(11.9) | \$(5.9) | \$(11.9) |
| Investment and other income, net | 5.6 | 6.8 | 15.5 |
| Total other income (expense) | <u>\$ (6.3)</u> | <u>\$ 0.9</u> | <u>\$ 3.6</u> |

Interest expense increased in 2008 as compared to 2007, primarily as a result of increased interest rates and increased outstanding debt balances. Investment and other income net, decreased in 2008 as compared to 2007, primarily due to reduced interest income associated with lower cash and investment balances, which were offset by increased foreign currency gains.

Interest expense decreased in 2007 as compared to 2006, primarily as a result of the Company's repaying the remaining outstanding balance of its \$87.1 million, 4.75% convertible subordinated notes upon maturity on December 15, 2006. Investment and other income net, for 2007, decreased as compared to 2006, primarily due to reduced foreign currency gains and reduced investment income associated with reduced investment balances. Further, realized gains on the sales of investments and other assets were \$0.9 million in 2007 as compared to \$3.6 million in 2006.

Income Tax Benefit (Provision)

| | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|--------------------------------|-------------|-------------|-------------|
| Income tax benefit (provision) | \$2.8 | \$3.2 | \$(10.5) |
| Effective income tax rate | 1.3% | 13.3% | (23.1)% |

The Company's operations have followed the recent migration of semiconductor industry fabrication to Asia, where the Company operates in countries where it is accorded favorable tax treatments. PKLT, the Company's FPD manufacturing facility in Taiwan, is accorded a tax holiday which expires in December 2012. In addition, the Company has been accorded a tax holiday in China which is expected to expire in 2011. In Korea, various investment tax credits have been utilized to reduce the Company's effective income tax rate. The Company's tax returns are subject to periodic examination by the tax authorities in the various jurisdictions in which it operates. The Company regularly assesses the potential outcomes of ongoing and future examinations and has provided accruals for tax contingencies in accordance with FASB Interpretation Number 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* ("SFAS 109").

The income tax benefit for the fiscal year ended November 2, 2008 was \$2.8 million or 1.3% of loss before income taxes. The income tax benefit differs from the amount that would result from applying the federal statutory income tax rate of 35% to the Company's loss before income taxes, primarily due to the Company's inability to record a full income tax benefit for the impairments of the goodwill and long-lived assets, additional valuation allowances in taxable jurisdictions and available tax credits in Korea.

The income tax benefit for the fiscal year ended October 28, 2007 was \$3.2 million or 13.3% of income before income taxes, which differs from the federal statutory income tax rate of 35%, primarily as a result of a recognized tax benefit of \$7.4 million and to a lesser extent available tax credits in Korea. During the fiscal year ended October 28, 2007, the Company recorded a tax benefit in the amount of \$7.4 million related to the resolution and settlement of U.S. and foreign tax matters that were associated with certain tax positions in prior years.

The Company evaluates the recoverability of deferred tax assets from future taxable income and establishes valuation allowances if recovery is deemed not likely. The valuation allowance increased \$8.8 million and \$2.4 million in fiscal 2008 and 2007, respectively.

The availability of tax holidays in some Asian jurisdictions did not have a significant impact on the Company's decision to close some of its North American facilities nor in the Company's increased Asian presence which is in response to fundamental changes taking place in the semiconductor industry that the Company serves. These tax holidays had no dollar or per share effect on the 2008, 2007 or 2006 fiscal years. As semiconductor fabrication has migrated to Asia, in large part from the United States, the Company has followed, in order to avoid a severe loss of business.

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In June 2006, the FASB issued FIN 48, which contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109, *Accounting for Income Taxes*. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is more than 50% likely of being realized upon ultimate settlement. The Company adopted FIN 48 as of the beginning of its 2008 fiscal year. Prior to adoption, the Company's pre-existing policy was to establish reserves, including interest and penalties, for uncertain tax positions that reflected the probable outcome of known tax contingencies. As of the date of adoption of FIN 48, the Company has elected to recognize interest, and penalties if applicable, related to uncertain tax positions in the income tax provision in its condensed consolidated statements of operations. As compared to the Company's historical approach, the application of FIN 48 resulted in a net increase to accrued income taxes payable of approximately \$1.0 million (including interest and penalties of approximately \$0.2 million), and a decrease to retained earnings of the same amount. There were no significant changes to the liability for uncertain tax positions during the fiscal year ended November 2, 2008.

Minority Interest in Consolidated Subsidiaries

Minority interest in consolidated subsidiaries, which represents the minority interest in earnings of the Company's non-wholly owned subsidiaries in Taiwan and Korea, was \$1.4 million in fiscal year 2008 as compared to \$2.5 million in fiscal year 2007. The decrease in minority interest expense is due to decreased net income of the Company's non-wholly owned subsidiary in Taiwan. The Company's ownership in its subsidiary in Korea was 99.7% at November 2, 2008, October 28, 2007 and October 29, 2006. The Company's ownership in its subsidiary in Taiwan was 58% at November 2, 2008, October 28, 2007 and October 29, 2006. The Company increased its ownership in its subsidiary in Korea from 96.5% to 99.7% during fiscal 2006 for cash of approximately \$8.5 million.

Liquidity and Capital Resources

| November 2, 2008 | October 28, 2007 | October 29, 2006 |
|-----------------------------|-----------------------------|-----------------------------|
|-----------------------------|-----------------------------|-----------------------------|

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| | <i>(in millions)</i> | <i>(in millions)</i> | <i>(in millions)</i> |
|---|----------------------|----------------------|----------------------|
| Cash and cash equivalents | \$ 83.8 | \$146.0 | \$129.4 |
| Short-term investments | 1.3 | 5.7 | 69.9 |
| | <hr/> | <hr/> | <hr/> |
| Total | \$ 85.1 | \$151.7 | \$199.3 |
| | <hr/> | <hr/> | <hr/> |
| Net cash provided by operating activities | \$ 92.1 | \$134.7 | \$ 116.2 |
| Net cash used in investing activities | \$(99.2) | \$(29.7) | \$(201.2) |
| Net cash (used in) provided by financing activities | \$(47.7) | \$(89.8) | \$ 13.5 |

As of November 2, 2008 the Company had cash and equivalents and short-term investments of \$85 million compared to \$152 million as of October 28, 2007.

The Company's working capital decreased \$30.2 million to \$66.4 million at the end of fiscal 2008, as compared to \$96.6 million at the end of fiscal 2007. The decrease was primarily related to a decrease in cash and short-term investments used for capital expenditure payments and to an increase in the current portion of outstanding long-term borrowings due primarily to capital lease obligations.

Cash provided by operating activities was \$92.1 million for fiscal 2008, as compared to \$134.7 million for fiscal 2007. This decrease was primarily due to a net loss incurred in fiscal 2008 as compared to net income in fiscal 2007, and lower year-over-year accounts payable and accrued liability balances. Cash provided by operating activities was \$134.7 million for fiscal 2007, as compared to \$116.2 million for fiscal 2006. This increase was primarily due to lower accounts receivable balances associated with decreased 2007 sales as well as increases in accounts payable partially offset by decreased accrued liabilities.

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Cash used in investing activities in fiscal 2008 increased to \$99.2 million, as compared to \$29.7 million in 2007, primarily due to proceeds from the sale of short-term investments decreased year-over-year by \$62.5 million. Capital expenditures for the fiscal years ended 2008, 2007, and 2006 were \$105.1 million, \$94.1 million and \$94.6 million, respectively. The Company expects capital expenditure payments for fiscal 2009 to be approximately \$40 million to \$50 million, primarily related to investment in high-end IC manufacturing capability. Cash used in investing activities in fiscal 2007 decreased to \$29.7 million, as compared to \$201.2 million in 2006, primarily as a result of the initial payment of \$120 million to Micron for the investment in MP Mask and related technology license and supply agreements having been made in fiscal 2006 and a decrease in the purchase of short-term investments from \$82.6 million in 2006 to \$4.2 million in 2007.

Cash used in financing activities was \$47.7 million in fiscal 2008, a decrease of \$42.1 million compared to \$89.8 million in fiscal 2007. Cash used in financing activities in 2008 was primarily related to the Company's redemptions of its \$150.0 million outstanding 2.25% convertible subordinated notes on April 15, 2008, offset in part by \$122.5 million net borrowings on its revolver. Cash used in financing activities in 2007 was primarily related to the Company's redeeming its \$87.1 million outstanding 4.75% convertible subordinated notes in December 2006.

On June 6, 2007, the Company and a group of financial institutions entered into a credit agreement, which allows

for borrowings under various currencies. On October 31, 2008, the Company's credit agreement was amended to change the minimum Senior Leverage Ratio covenant, as defined, and to extend the date it was required to obtain at least \$75 million in permanent long-term capital from November 2, 2008 to December 5, 2008. The credit agreement was further amended on December 5, 2008 to extend the date to obtain at least \$75 million in permanent long-term capital to December 12, 2008, at which date the credit agreement was last amended and, among other items, eliminated the requirement to obtain such permanent long-term capital. The credit agreement was last amended on December 12, 2008. Among other items, the last amendment provided for the following: the maturity date of the credit agreement was changed from June 6, 2012 to July 30, 2010; the aggregate commitment was reduced from \$155 million to \$135 million, and is further reduced to \$120 million on October 31, 2009 and \$100 million on January 31, 2010; substantially all of the Company's assets in the United States were pledged as collateral; financial covenants were modified and include, among other items as defined, a Senior Leverage Ratio, Total Leverage Ratio, Minimum Fixed Charge Ratio, and a quarterly minimum EBITDA covenant, as defined. Additionally, cash received as a result of certain events, as defined, is required to be used to pay down the outstanding loan balance and reduce the available credit facility by the same amount; and there is a capital expenditure payment limitation. The credit agreement also continues to provide for Minimum Unrestricted Cash Balances of \$50 million, as defined, and limits the amount of both secured and unsecured debt. The credit facility is also secured by a pledge of the Company's stock in certain of its subsidiaries. As of November 2, 2008, \$122.5 million was outstanding under the credit facility, \$3.6 million was utilized for a standby letter of credit, and the remaining balance of \$8.9 million was available to the Company based upon the subsequently amended aggregate commitment of \$135 million.

In addition to the credit agreement discussed above, on December 12, 2008, the maturity date of the foreign revolving loan and term loan was amended from October 11, 2010 to January 31, 2010. Further, the interest rate on these foreign loans was amended and is currently based on the Peoples Bank of China base rate, plus a spread (as defined), and the lenders have the right to secure the Company's assets in China.

The Company's liquidity is highly dependent on its ability to receive orders as it operates in a high fixed cost environment and the timing of capital expenditures, both of which can vary significantly from period to period. Depending on conditions in the IC semiconductor and FPD market, the Company's cash flows from operations and current holdings of cash and investments may not be adequate to meet the Company's current and long-term needs for capital expenditures and operations. Historically, in certain years the Company has used external financing to fund these needs. Due to conditions in the credit markets, some financing instruments used by the Company in the past are currently not available to the Company. The Company is evaluating financing alternatives, delaying capital expenditures and evaluating further cost reduction initiatives. However, the Company cannot assure that additional sources of financing would be available to the Company on commercially favorable terms should the Company's capital requirements exceed cash available from operations and existing cash, short-term investments and cash available under its credit facility.

At November 2, 2008, the Company had outstanding purchase commitments of approximately \$46 million, which include approximately \$31 million related to capital expenditures, primarily related to investment in high-end IC manufacturing capability. The Company will use its working capital and cash generated from operations to finance its capital expenditures.

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Cash Requirements

The Company's cash requirements in fiscal 2009 will be primarily to fund operations, including capital spending and debt service. The Company believes that its cash on hand, cash generated from operations and amounts available under its credit facility will be sufficient to meet its cash requirements for the next 12 months. The Company regularly

reviews the availability and terms on which it might issue additional equity or debt securities in the public or private markets. However, the Company cannot assure that additional sources of financing would be available to the Company on commercially favorable terms should the Company's capital requirements exceed cash available from operations and existing cash, short-term investments and cash available under its credit facility.

Contractual Cash Obligations

The following table quantifies the Company's future contractual obligations as of November 2, 2008:

| | Payments Due | | | | |
|------------------------------------|---------------------|---------------------------------|------------------------|------------------------|----------------------------------|
| | Total | Less Than 1 Year | 1 - 3 Years | 3 - 5 Years | More Than 5 Years |
| Long-term borrowings | \$153.0 | \$ 5.8 | \$147.2 | \$ - | \$ - |
| Operating leases | 10.7 | 2.8 | 3.5 | 2.1 | 2.3 |
| Capital leases | 70.6 | 14.8 | 33.2 | 22.6 | - |
| Unconditional purchase obligations | 45.6 | 15.8 | 29.8 | - | - |
| Interest | 32.5 | 16.8 | 14.5 | 1.2 | - |
| Total | \$312.4 | \$56.0 | \$228.2 | \$25.9 | \$2.3 |

As of November 2, 2008, the Company had FIN 48 liabilities of \$3.1 million which were not included in the above table due to the high degree of uncertainty regarding the timing of future payments relating to such liabilities, and it was not practical to determine a reasonably reliable estimate of the amount and period when such liabilities might be paid.

Off-Balance Sheet Arrangements

Under the Operating Agreement relating to the MP Mask joint venture, through May 5, 2010, the Company may be required to make additional capital contributions to the joint venture of up to a maximum amount as defined in the Operating Agreement. Through the end of fiscal year 2008, the Company has contributed \$6.1 million to the joint venture, and has received a distribution from the joint venture of \$5.0 million.

Stock-based Compensation

Total stock-based compensation expense for the year ended November 2, 2008 was \$2.6 million, as compared to \$2.9 million for the year ended October 28, 2007, substantially all of which is in selling, general and administrative expenses. No compensation cost was capitalized as part of inventory, and no income tax benefit has been recorded. As of November 2, 2008, total unrecognized compensation cost of \$6.0 million is expected to be recognized over a weighted-average amortization period of 3.5 years.

Business Outlook

A majority of the Company's revenue growth has come from, and is expected to continue to come from, the Asian region as customers increase their use of manufacturing foundries located outside of North America and Europe. Additional revenue growth is also anticipated from North America and Europe as a result of utilizing technology licensed under the Company's technology license with Micron. The Company's Korean and Taiwanese operations are non-wholly owned subsidiaries; therefore a portion of earnings generated at each location is allocated to the minority shareholders.

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The Company continues to assess its global manufacturing strategy and monitor its market capitalization, sales volume and related cash flows from operations. This ongoing assessment could result in future facilities closures, asset redeployments, additional impairments of intangible or long-lived assets, workforce reductions, or the addition of increased manufacturing facilities, all of which would be based on market conditions and customer requirements.

The Company's future results of operations and the other forward-looking statements contained in this filing involve a number of risks and uncertainties. While various risks and uncertainties have been discussed, a number of other factors could cause actual results to differ materially from the Company's expectations.

Application of Critical Accounting Procedures

The Company's consolidated financial statements are based on the selection and application of significant accounting policies, which require management to make significant estimates and assumptions. The Company believes that the following are some of the more critical judgment areas in the application of the Company's accounting policies that affect its financial condition and results of operations.

Estimates and Assumptions

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in them. Management bases its estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances. Significant accounting estimates include those used in the testing of long-lived assets and goodwill for potential impairment, and those used in developing income tax provisions, allowances for uncollectible accounts receivable, inventory valuation allowances, and restructuring reserves. The Company's estimates are based on the facts and circumstances available at the time and different reasonable estimates could have been used in the current period. Changes in accounting estimates used are likely to occur from period to period, which may have a material impact on the presentation of the Company's financial condition and results of operations. Actual results reported by the Company may differ from such estimates. The Company reviews these estimates periodically and reflects the effect of revisions in the period in which they are determined.

Derivative Instruments and Hedging Activities

The Company records derivatives in the condensed consolidated balance sheet as assets or liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives are reported in the condensed consolidated statements of income or as accumulated other comprehensive income, a separate component of shareholders' equity, depending on the use of the derivatives and whether they qualify for hedge accounting. Among other criteria, in order to qualify for hedge accounting, the derivative must be a hedge for an interest rate, price, foreign currency exchange rate, or credit risk; expected to be highly effective at the inception of the hedge and be

highly effective in achieving offsetting changes in the fair value or cash flows of the hedged items during the term of the hedge, and formally documented at the inception of the hedge. The Company uses judgment in assessing the fair value of derivatives and related financial instruments, including assumptions utilized in derivative fair value models in areas such as projected interest and foreign currency exchange rates during the contract term. At times, the Company manages a portion of its foreign currency exchange and interest rate risks through these derivative instruments.

Property, Plant and Equipment

Property, plant and equipment, except as explained below under "Impairment of Long-Lived Assets," are stated at cost less accumulated depreciation and amortization. Repairs and maintenance, as well as renewals and replacements of a routine nature are charged to operations as incurred, while those which improve or extend the lives of existing assets are capitalized. Upon sale or other disposition, the cost of the asset and accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in operations.

Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the related assets. Buildings and improvements are depreciated over 15 to 40 years, machinery and equipment over 3 to 10 years and furniture, fixtures and office equipment over 3 to 5 years. Leasehold improvements are amortized over the life of the lease or the estimated useful life of the improvement, whichever is less. Judgment and assumptions are used in establishing estimated useful lives and depreciation periods. The Company also uses judgment and assumptions as it periodically

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reviews property, plant and equipment for any potential impairment in carrying values whenever events such as a significant industry downturn, plant closures, technological obsolescence or other changes in circumstances indicate that their carrying amount may not be recoverable. Fair value amounts used in these analyses represent management's best estimate of fair values.

Goodwill and Other Intangible Assets

Intangible assets consist primarily of a technology license agreement, a supply agreement, acquisition-related intangibles, and prior to July 27, 2008, goodwill. These assets, except as explained below, are stated at fair value as of the date acquired less accumulated amortization. Amortization is calculated on a straight-line basis or another method that more fairly represents the utilization of the assets. The future economic benefit of the carrying values of intangible assets that are subject to amortization are tested for recoverability whenever events or changes in circumstances indicate the carrying value of an intangible asset may not be recoverable based on discounted cash flows or market factors and an impairment loss would be recorded in the period so determined.

In accordance with SFAS No. 142, the Company tests goodwill for impairment annually and when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Goodwill is tested for impairment using a two-step process. In the first step, the fair value of the reporting unit is compared to its carrying value. For purposes of testing impairment under SFAS No. 142, the Company is a single reporting unit. If the fair value of the reporting unit exceeds the carrying value of its net assets, goodwill is considered not impaired and no further testing is required. If the carrying value of the net assets exceeds the fair value of the reporting unit, a second step of the impairment test is performed in order to determine the implied fair value of a reporting unit's goodwill. Determining the implied fair value of goodwill requires a valuation of the reporting unit's tangible and intangible assets and liabilities in a manner similar to the allocation of purchase price in a business combination. If the carrying value of the reporting unit's goodwill exceeds the implied fair value of its goodwill, goodwill is deemed impaired and is written down to the extent of the difference.

In performing the goodwill assessment, the Company uses current market capitalization, discounted cash flows and other factors as the best evidence of fair value. There are inherent uncertainties and management judgment required in an analysis of goodwill impairment (see Note 2 to the consolidated financial statements).

Impairment of Long-Lived Assets

As required by SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on the Company's judgment and estimates of undiscounted future cash flows resulting from the use of the assets and their eventual disposition. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset.

The carrying values of the assets determined to be impaired are reduced to their estimated fair values. The fair values of the impaired assets are determined based on market conditions, the income approach which utilizes cash flow projections, and other factors (see Note 2 to the consolidated financial statements).

Investment in Joint Venture

Investments in joint ventures over which the Company has the ability to exercise significant influence and that, in general, are at least 20 percent owned are stated at cost plus equity in undistributed net income (loss) of the joint venture. These investments are evaluated for impairment in accordance with the requirements of Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. An impairment loss would be recorded whenever a decline in the value of an equity investment below its carrying amount is determined to be other than temporary. In judging "other than temporary," the Company would consider the length of time and extent to which the fair value of the investment has been less than the carrying amount of the investment, the near-term and longer-term operating and financial prospects of the investee, and the Company's longer-term intent of retaining the investment in the investee.

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Income Taxes

The income tax (provision) benefit is computed on the basis of the various tax jurisdictions' financial statements income or loss before income taxes. Deferred income taxes reflect the tax effects of differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company uses judgment and assumptions to determine if valuation allowances for deferred income tax assets are required if realization is not likely by considering future market growth, forecasted operations, future taxable income, and the mix of earnings in the tax jurisdictions in which it operates.

The Company considers income taxes in each of the tax jurisdictions in which it operates in order to determine its effective income tax rate. Current income tax exposure is identified and temporary differences resulting from differing treatments of items for tax and financial reporting purposes are assessed. These differences result in deferred tax assets and liabilities, which are included in the Company's consolidated balance sheets. Additionally, the Company evaluates the recoverability of deferred income tax assets from future taxable income and establishes valuation allowances if recovery is deemed not likely. Accordingly, the income tax provision in the consolidated statements of operations is impacted by changes in the valuation allowance. Significant management estimates and judgment are required in determining any valuation allowance recorded against net deferred tax assets.

Revenue Recognition

The Company recognizes revenue when there is persuasive evidence that an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. The Company uses judgment when estimating the effect on revenue of discounts and product warranty obligations, both of which are accrued when the related revenue is recognized.

Product Returns - Customer returns have historically been insignificant. However, the Company does record a liability for the insignificant amount of estimated sales returns based upon historical experience.

Warranties and Other Post Shipment Obligations - For a 30-day period, the Company warrants that items sold will conform to customer specification. However, the Company's liability is limited to repair or replacement of the photomasks at its sole option. The Company inspects photomasks for conformity to customer specifications prior to shipment. Accordingly, customer returns of items under warranty have historically been insignificant. However, the Company records a liability for the insignificant amount of estimated warranty returns based on historical experience. The Company's specific return policies include accepting returns for products with defects, or products that have not been produced to precise customer specifications. At the time of revenue recognition, a liability is established for these items.

Sales Taxes - The Company presents its revenues in the consolidated statements of operations net of sales taxes, if any (excluded from revenues).

Stock-based Compensation

The Company adopted SFAS No. 123(R) *Share-Based Payment* on October 31, 2005, using the modified prospective method. Subsequently, compensation expense is recognized in the Company's consolidated statements of income, over the service period that the awards are expected to vest. The Company recognizes expense for all stock-based compensation with graded vesting granted on or after October 31, 2005 on a straight-line basis over the vesting period of the entire award. For awards with graded vesting granted prior to October 31, 2005, the Company continues to recognize compensation cost over the vesting period following accelerated recognition as if each underlying vesting date represented a separate award. Stock-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and will also impact the amount of expense to be recognized in future periods. The Company adopted the alternative transition method provided in FASB Staff Position No. 123(R)-3 for calculating the tax effects of share-based compensation. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates.

As a result of adopting SFAS No. 123(R) on October 31, 2005, the Company's income before income taxes and net income for the year ended October 29, 2006 was \$1.3 million, or \$0.03 per basic and diluted share less than if it had

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continued to account for share-based compensation under APB Opinion No. 25. There was no change in the statement of cash flows as a result of adoption of SFAS No. 123(R).

The Company uses the Black-Scholes option valuation model to value employee stock awards. The Company estimates stock price volatility based on weekly averages of its historical volatility over a term approximately equal to

the grant's estimated option life. Estimated option life and forfeiture rate assumptions are derived from historical data.

Effect of New Accounting Standards

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." FSP No. APB 14-1 requires that issuers of convertible debt instruments that may be settled in cash upon conversion separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP No. APB 14-1 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years, and is required to be retrospectively applied. The Company is evaluating the impact, if any, that the adoption of FSP No. APB 14-1 will have on its consolidated financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS No. 162 became effective in November 2008. Its adoption is not expected to have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB No. 133." SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities by requiring entities to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company is evaluating the impact, if any, SFAS No. 161 will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51." SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. The Company is currently evaluating the impact SFAS No. 160 will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." SFAS No. 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and, therefore will not impact the Company's consolidated financial statements upon adoption.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an Amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, and is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" which provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. SFAS No. 157 requires expanded disclosures about fair value measurements and

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establishes a three-level hierarchy for fair value measurements based on the transparency of inputs to the valuation of an asset or liability as of the measurement date. The standard also requires that a company use its own nonperformance risk when measuring liabilities carried at fair value, including derivatives. In February 2008, the FASB approved a FASB Staff Position ("FSP") that permits companies to partially defer the effective date of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The FSP did not permit companies to defer recognition and disclosure requirements for financial assets and financial liabilities or for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually. SFAS No. 157 is effective for financial assets and financial liabilities and for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions of SFAS No. 157 will be applied prospectively. The Company intends to defer adoption of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company is currently evaluating the effects, if any, that SFAS No. 157 may have on its consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company records derivatives on the balance sheet as assets or liabilities, measured at fair value. The Company does not engage in derivative instruments for speculative purposes. Gains or losses resulting from changes in the values of those derivatives are reported in the condensed consolidated statement of operations, or as accumulated other comprehensive income, a separate component of shareholders' equity, depending on the use of the derivatives and whether they qualify for hedge accounting. In order to qualify for hedge accounting, among other criteria, the derivative must be a hedge for an interest rate, price, foreign currency exchange rate, or credit risk, expected to be highly effective at the inception of the hedge and be highly effective in achieving offsetting changes in the fair value or cash flows of the hedged item during the term of the hedge, and formally documented at the inception of the hedge. In general, the types of risks hedged are those relating to the variability of future cash flows caused by movements in foreign currency exchange and interest rates. The Company documents its risk management strategy and hedge effectiveness at the inception of, and during the term of each hedge.

Foreign Currency Exchange Rate Risk

The Company conducts business in several major international currencies through its worldwide operations and is subject to changes in foreign exchange rates of such currencies. Changes in exchange rates can positively or negatively affect the Company's sales, operating margins and retained earnings. The functional currencies of the Company's Asian subsidiaries are the Korean won, New Taiwan dollar, Chinese renminbi, and Singapore dollar. The functional currencies of the Company's European subsidiaries are the British pound and the euro.

The Company attempts to minimize its risk of foreign currency transaction losses by producing its products in the same country in which the products are sold and thereby generating revenues and incurring expenses in the same currency, and by managing its working capital. In some instances, the Company may sell or purchase products in a currency other than the functional currency of the country where it was produced. There can be no assurance that this approach will continue to be successful, especially in the event of a significant adverse movement in the value of any

foreign currencies against the U.S. dollar. For the past several years the Company has not experienced a significant foreign exchange loss on these transactions in its statement of operations. The Company does not engage in purchasing forward exchange contracts for speculative purposes.

The Company's primary net foreign currency exposures as of November 2, 2008 included the Korean won, the Japanese yen, the Singapore dollar, the New Taiwan dollar, the Chinese renminbi, the British pound, and the euro. As of November 2, 2008, a 10% adverse movement in the value of these currencies against the U.S. dollar would have resulted in a net unrealized pre-tax loss of \$4.6 million. The Company does not believe that a 10% change in the exchange rates of other non-U.S. dollar currencies would have a material effect on its consolidated financial position, results of operations, or cash flows.

In April, 2006, the Company's Korean subsidiary entered into a foreign currency rate swap contract which, under the terms of the contract, effectively converted a \$50 million interest bearing intercompany loan denominated in U.S. dollars to Korean won. The intercompany loan was repaid and related swap settled during the nine month period ended July 27, 2008, including a final payment of \$5.0 million during the three month period ended July 27, 2008.

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In accordance with SFAS No. 133, "Accounting for Derivatives and Hedging Activities," hedges related to anticipated transactions are designated and documented at their inception as cash flow hedges and are evaluated for effectiveness. In September, 2006, the Company entered into forward contracts to convert the fixed yen purchase price of certain equipment into fixed U.S. dollar amounts, which were designated as cash flow hedges. The Company records these derivative instruments in either current assets, noncurrent assets, or accrued liabilities, depending on their net position, at fair value regardless of the purpose or intent for holding the instrument. Changes in the fair value of derivative financial instruments are recognized in earnings for the ineffective portion of hedges, or in shareholders equity as a component of accumulated other comprehensive income or loss for the effective portion. As of November 2, 2008, all of the Company's forward contracts were settled.

In April 2008, the Company's Korean and Taiwanese subsidiaries each entered into separate foreign currency exchange rate swap contracts that effectively converted a \$12 million interest bearing intercompany loan denominated in U.S. dollars into their respective local currencies. Both contracts expire in conjunction with the April 2009 maturity date of the intercompany loan. The Company did not elect to designate either contract as a fair value hedge.

Interest Rate Risk

The majority of the Company's borrowings at November 2, 2008 was in the form of borrowings under the Company's credit facility, last amended on December 12, 2008, and certain foreign loans payable with variable interest rates. The \$86.9 million net carrying value of its 4.75% convertible subordinated note was repaid by the Company in December 2006. At November 2, 2008 and October 28, 2007, the Company had approximately \$72 million and \$97 million, respectively, in net variable rate financial instruments which were sensitive to interest rate risk. A 10% change in interest rates would not have a material effect on the Company's consolidated financial position, results of operations, or cash flows in either 2008 or 2007.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders Photronics, Inc. Brookfield, Connecticut

We have audited the accompanying consolidated balance sheets of Photronics, Inc. and subsidiaries (the "Company") as of November 2, 2008 and October 28, 2007 and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three fiscal years in the period ended November 2, 2008. We also have audited the Company's internal control over financial reporting as of November 2, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting in Item 9A. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our

audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Photronics, Inc. and subsidiaries as of November 2, 2008 and October 28, 2007, and the results of their operations and their cash flows for each of the three fiscal years in the period ended November 2, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of November 2, 2008, based on the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ Deloitte & Touche LLP
Stamford, Connecticut
January 14, 2009

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PHOTRONICS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(in thousands, except per share amounts)

| | November 2, 2008 | October 28, 2007 |
|--|-----------------------------|-----------------------------|
|--|-----------------------------|-----------------------------|

ASSETS

Current assets:

| | | |
|---|-----------|-------------|
| Cash and cash equivalents | \$ 83,763 | \$ 146,049 |
| Short-term investments | 1,343 | 5,657 |
| Accounts receivable, net of allowance of \$2,788 in 2008 and \$3,721 in 2007 | 68,095 | 68,248 |
| Inventories | 17,548 | 17,716 |
| Deferred income taxes | 2,843 | 3,071 |
| Other current assets | 8,905 | 6,244 |
| | <hr/> | <hr/> |
| Total current assets | 182,497 | 246,985 |
| Property, plant and equipment, net | 436,528 | 531,578 |
| Goodwill | - | 138,534 |
| Investment in joint venture | 65,737 | 67,900 |
| Other intangibles, net | 62,386 | 68,835 |
| Other assets | 10,859 | 5,948 |
| | <hr/> | <hr/> |
| | \$758,007 | \$1,059,780 |
| | <hr/> | <hr/> |

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

| | | |
|---|-----------|----------|
| Current portion of long-term borrowings | \$ 20,630 | \$ 4,482 |
| Accounts payable | 69,791 | 114,221 |
| Accrued liabilities | 25,657 | 31,676 |
| | <hr/> | <hr/> |
| Total current liabilities | 116,078 | 150,379 |
| Long-term borrowings | 202,979 | 191,253 |
| Deferred income taxes | 1,813 | 8,143 |
| Other liabilities | 4,739 | 6,256 |
| | <hr/> | <hr/> |
| Total liabilities | 325,609 | 356,031 |
| Minority interest | 49,616 | 49,465 |
| Commitments and contingencies | - | - |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value, 2,000 shares authorized, none issued and outstanding | - | - |
| Common stock, \$0.01 par value, 150,000 shares authorized, 41,712 shares issued and outstanding at November 2, 2008 and 41,635 shares issued and outstanding at October 28, 2007 | 417 | 416 |
| Additional paid-in capital | 384,502 | 381,876 |
| Retained earnings | 15,364 | 227,175 |

| | | |
|---|------------------|--------------------|
| Accumulated other comprehensive income (loss) | (17,501) | 44,817 |
| | <u>382,782</u> | <u>654,284</u> |
| Total shareholders' equity | <u>\$758,007</u> | <u>\$1,059,780</u> |

See accompanying notes to consolidated financial statements.

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PHOTRONICS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(in thousands, except per share amounts)

| | Year Ended | | |
|--|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Net sales | \$ 422,548 | \$421,479 | \$454,875 |
| Cost and expenses: | | | |
| Cost of sales | (349,841) | (321,958) | (307,851) |
| Selling, general and administrative | (55,167) | (61,507) | (62,215) |
| Research and development | (17,475) | (17,300) | (27,337) |
| Impairment of goodwill | (138,534) | - | - |
| Impairment of long-lived assets | (66,874) | - | - |
| Consolidation, restructuring and related charges | (510) | - | (15,639) |
| Gain on sale of facility | - | 2,254 | - |
| Operating income (loss) | <u>(205,853)</u> | <u>22,968</u> | <u>41,833</u> |
| Other income (expense): | | | |
| Interest expense | (11,878) | (5,928) | (11,916) |
| Investment and other income, net | 5,562 | 6,844 | 15,469 |

| | | | |
|---|--------------------|------------------|------------------|
| Income (loss) before income tax benefit (provision) and minority interest | (212,169) | 23,884 | 45,386 |
| Income tax benefit (provision) | 2,778 | 3,178 | (10,462) |
| Income (loss) before minority interest | (209,391) | 27,062 | 34,924 |
| Minority interest in income of consolidated subsidiaries | (1,374) | (2,539) | (5,592) |
| Net income (loss) | <u>\$(210,765)</u> | <u>\$ 24,523</u> | <u>\$ 29,332</u> |
| Income (loss) per share: | | | |
| Basic | <u>\$(5.06)</u> | <u>\$0.59</u> | <u>\$0.71</u> |
| Diluted | <u>\$(5.06)</u> | <u>\$0.56</u> | <u>\$0.66</u> |
| Weighted average number of common shares outstanding: | | | |
| Basic | <u>41,658</u> | <u>41,539</u> | <u>41,369</u> |
| Diluted | <u>41,658</u> | <u>51,282</u> | <u>51,072</u> |

See accompanying notes to consolidated financial statements.

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PHOTRONICS, INC. AND SUBSIDIARIES
Consolidated Statements of Shareholders' Equity
Years Ended November 2, 2008, October 28, 2007 and October 29, 2006
(in thousands)

| | <u>Accumulated Other Comprehensive Income</u> | | | | | | | | Compe sation On Restrict Stock | |
|------------------|---|---------------|--------------------------------------|------------------------------|--|---------------------------------|---|--------------|--|--------------|
| | <u>Common Stock Shares</u> | <u>Amount</u> | <u>Add'l Paid-In Capital</u> | <u>Retained Earnings</u> | <u>Unrealized Investment Gains</u> | <u>Cash Flow Hedges</u> | <u>Foreign Currency Translation</u> | <u>Other</u> | | <u>Total</u> |
| October 30, 2005 | 41,304 | \$413 | \$374,326 | \$173,320 | \$1,784 | \$(786) | \$12,852 | \$ - | \$13,850 | \$(34) |

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| | | | | | | | | | | |
|----------------------------------|---------------|------------|----------------|----------------|------------|----------------|---------------|--------------|---------------|----------|
| Net income: | - | - | - | 29,332 | - | - | - | - | - | - |
| Non-holding gains | - | - | - | - | 1,188 | - | - | - | 1,188 | - |
| Amortification adjustments | - | - | - | - | (2,297) | - | - | - | (2,297) | - |
| Change in fair value of cash | - | - | - | - | - | (35) | - | - | (35) | - |
| Foreign currency translation | - | - | - | - | - | - | 20,366 | - | 20,366 | - |
| Comprehensive income | - | - | - | - | - | - | - | - | - | - |
| Change in stock through | - | - | - | - | - | - | - | - | - | - |
| Exercise of stock option and | 151 | 2 | 2,078 | - | - | - | - | - | - | - |
| Restricted stock awards, | - | - | - | - | - | - | - | - | - | - |
| Share repurchase | 30 | - | 399 | - | - | - | - | - | - | 34 |
| Share-based compensation | - | - | 1,340 | - | - | - | - | - | - | - |
| October 29, 2006 | 41,485 | 415 | 378,143 | 202,652 | 675 | (821) | 33,218 | - | 33,072 | - |
| Net income: | - | - | - | 24,523 | - | - | - | - | - | - |
| Non-holding gains | - | - | - | - | 142 | - | - | - | 142 | - |
| Amortification adjustments | - | - | - | - | (600) | - | - | - | (600) | - |
| Change in fair value of cash | - | - | - | - | - | (1,024) | - | - | (1,024) | - |
| Foreign currency translation | - | - | - | - | - | - | 13,496 | - | 13,496 | - |
| Comprehensive income | - | - | - | - | - | - | - | (269) | (269) | - |
| Change in stock through | - | - | - | - | - | - | - | - | - | - |
| Exercise of stock option and | 80 | 1 | 972 | - | - | - | - | - | - | - |
| Restricted stock awards, | - | - | - | - | - | - | - | - | - | - |
| Share repurchase | 70 | - | 730 | - | - | - | - | - | - | - |
| Share-based compensation expense | - | - | 2,031 | - | - | - | - | - | - | - |
| October 28, 2007 | 41,635 | 416 | 381,876 | 227,175 | 217 | (1,845) | 46,714 | (269) | 44,817 | - |
| Net income: | - | - | - | (210,765) | - | - | - | - | - | - |
| Non-holding losses | - | - | - | - | (340) | - | - | - | (340) | - |
| Amortification adjustments | - | - | - | - | 61 | - | - | - | 61 | - |
| Change in fair value of cash | - | - | - | - | - | 193 | - | - | 193 | - |
| Foreign currency translation | - | - | - | - | - | - | (62,234) | - | (62,234) | - |

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| | | | | | | | | | | |
|-------------------------|---------------|--------------|------------------|-----------------|---------------|------------------|-------------------|----------------|-------------------|-------------|
| | - | - | - | - | - | - | - | 2 | 2 | - |
| prehensive loss | - | - | - | - | - | - | - | - | - | - |
| on stock through | | | | | | | | | | |
| ck option and | | | | | | | | | | |
| n | 25 | - | 162 | - | - | - | - | - | - | - |
| ck awards, | | | | | | | | | | |
| zation to | | | | | | | | | | |
| n expense | 52 | 1 | 1,167 | - | - | - | - | - | - | - |
| ompensation expense | - | - | 1,297 | | | | | | | |
| FIN 48 adjustment | - | - | - | (1,046) | - | - | - | - | - | - |
| November 2, 2008 | <u>41,712</u> | <u>\$417</u> | <u>\$384,502</u> | <u>\$15,364</u> | <u>\$(62)</u> | <u>\$(1,652)</u> | <u>\$(15,520)</u> | <u>\$(267)</u> | <u>\$(17,501)</u> | <u>\$ -</u> |

aying notes to consolidated financial statements.

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PHOTRONICS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(in thousands)

| | Year Ended | | |
|---|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Cash flows from operating activities: | | | |
| Net income (loss) | \$(210,765) | \$ 24,523 | \$ 29,332 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation and amortization of property, plant and equipment | 95,931 | 89,752 | 85,409 |
| Amortization of deferred financing fees and intangible assets | 8,001 | 8,266 | 5,269 |
| Impairment of goodwill | 138,534 | - | - |
| Impairment of long-lived assets | 66,874 | - | - |
| Stock-based compensation | 2,622 | 2,890 | 1,970 |
| Minority interest in income of consolidated subsidiaries | 1,374 | 2,539 | 5,592 |
| Gain on sale of facility | - | (2,254) | - |
| Deferred income taxes | (1,944) | (961) | 965 |
| Consolidation, restructuring and related charges | 510 | - | 15,639 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (7,310) | 18,370 | (9,161) |
| Inventories | (2,622) | 2,008 | 3,302 |
| Other current assets | (4,410) | 7,528 | (7,272) |

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| | | | |
|---|------------|-----------|-----------|
| Accounts payable, accrued liabilities and other | 5,285 | (17,968) | (14,846) |
| Net cash provided by operating activities | 92,080 | 134,693 | 116,199 |
| Cash flows from investing activities: | | | |
| Purchases of property, plant and equipment | (105,125) | (94,132) | (94,646) |
| Purchases of short-term investments and other | (327) | (4,151) | (82,582) |
| Proceeds from sales of short-term investments and other | 3,815 | 66,304 | 104,962 |
| Investment in joint venture, technology and supply agreements | (2,598) | (3,499) | (120,505) |
| Return of investment from joint venture | 5,000 | - | - |
| Proceeds from sale of facility and other | - | 5,784 | - |
| Acquisition of additional interest in PK, Ltd. | - | - | (8,432) |
| Net cash used in investing activities | (99,235) | (29,694) | (201,203) |
| Cash flows from financing activities: | | | |
| Proceeds from long-term borrowings | 139,640 | 4,303 | 20,303 |
| Repayments of long-term borrowings | (176,009) | (87,084) | (8,566) |
| Payments to Micron Technology, Inc. | (7,500) | (7,500) | - |
| Proceeds from exercised stock options and other | - | 988 | 1,809 |
| Other | (3,790) | (527) | - |
| Net cash (used in) provided by financing activities | (47,659) | (89,820) | 13,546 |
| Effect of exchange rate changes on cash | (7,472) | 1,445 | 4,834 |
| Net increase (decrease) in cash and cash equivalents | (62,286) | 16,624 | (66,624) |
| Cash and cash equivalents at beginning of year | 146,049 | 129,425 | 196,049 |
| Cash and cash equivalents at end of year | \$ 83,763 | \$146,049 | \$129,425 |
| Supplemental disclosure of cash flow information: | | | |
| Change in accrual for purchases of property, plant and equipment | \$(46,769) | \$ 51,582 | \$ 18,692 |
| Capital lease obligation for purchases of property, plant and equipment | \$ 61,662 | \$ 19,912 | \$ - |

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

Photronics, Inc. and its subsidiaries (the "Company" or "Photronics") is one of the world's leading manufacturers of photomasks, which are high precision photographic quartz plates containing microscopic images of electronic circuits. Photomasks are a key element in the manufacture of semiconductors and flat panel displays ("FPDs"), and are used as masters to transfer circuit patterns onto semiconductor wafers and flat panel substrates during the fabrication of integrated circuits ("IC") and a variety of FPDs and, to a lesser extent, other types of electrical and optical components. The Company currently operates principally from ten manufacturing facilities; two of which are located in Europe, two in Taiwan, one each in Korea, Singapore, and China; and three in the United States, including a state-of-the-art nanofab facility ("U.S. Nanofab") in Boise, Idaho, which commenced production during the second quarter of fiscal 2008. In the fourth quarter of fiscal 2008, the Company announced its intention to streamline its European operations and close its photomask manufacturing facility in Manchester, United Kingdom, which ceased production in January 2009.

Consolidation

The accompanying consolidated financial statements include the accounts of Photronics and its majority-owned subsidiaries, in which the Company exercises control. All significant intercompany balances and transactions have been eliminated in consolidation.

Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in them. Actual results may differ from such estimates.

Fair Value of Financial Instruments

The fair value of the Company's short-term and long-term investments is estimated by management based upon reference to quoted market prices and other available market information. The fair values of the Company's other financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and certain other current assets and current liabilities, and variable rate borrowings approximate their carrying value due to their short-term maturities.

Derivative Instruments and Hedging Activities

The Company records derivatives on the balance sheet as assets or liabilities, measured at fair value. The Company does not engage in derivative instruments for speculative purposes. Gains or losses resulting from changes in the values of those derivatives are reported in the consolidated statement of operations, or as accumulated other comprehensive income, a separate component of shareholders' equity, depending on the use of the derivatives and whether they qualify for hedge accounting. In order to qualify for hedge accounting, among other criteria, the derivative must be a hedge for an interest rate, price, foreign currency exchange rate, or credit risk, expected to be highly effective at the inception of the hedge and be highly effective in achieving offsetting changes in the fair value or cash flows of the hedged item during the term of the hedge, and formally documented at the inception of the hedge. In general, the types of risks hedged are those relating to the variability of future cash flows caused by movements in foreign currency exchange and interest rates. The Company documents its risk management strategy and hedge effectiveness at the inception of, and during the term of each hedge.

Fiscal Year

The Company's fiscal year ends on the Sunday closest to October thirty-first, and, as a result, a 53-week year occurs every 5 to 6 years. Fiscal years 2006, and 2007 included 52 weeks; while fiscal year 2008 included 53 weeks. Fiscal year 2009 will include 52 weeks.

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Cash and Cash Equivalents

Cash and cash equivalents include cash and highly liquid investments purchased with an original maturity of 3 months or less. The carrying values of cash equivalents approximate fair values based on the short maturity of these instruments.

Investments

The Company's investments, comprised of marketable equity securities and fixed income bonds, are classified as available-for-sale, and are carried at fair value. Investments available for current operations are classified in the consolidated balance sheets as current assets; investments held for long-term purposes are classified as non-current assets. Unrealized gains and losses, net of tax, are reported in other comprehensive income ("OCI") as a separate component of shareholders' equity. Gains and losses are reported in the consolidated statements of operations when realized, determined based on the disposition of specifically identified investments.

Investments identified by the Company as being potentially impaired are subject to further analysis to determine if the impairment is other than temporary. Other than temporary declines in market value from original costs are charged to investment and other income, net, in the period in which the loss occurs. In determining whether investment holdings are other than temporarily impaired, the Company considers the nature, cause, severity and duration of the impairment. The Company and its investment advisors used analyst reports, credit ratings or other items as part of its review.

Inventories

Inventories, principally raw materials, are stated at the lower of cost, determined under the first-in, first-out ("FIFO") method, or market.

Property, Plant and Equipment

Property, plant and equipment, except as explained below under "Impairment of Long-Lived Assets," are stated at cost less accumulated depreciation and amortization. Repairs and maintenance, as well as renewals and replacements of a routine nature are charged to operations as incurred, while those which improve or extend the lives of existing assets are capitalized. Upon sale or other disposition, the cost of the asset and accumulated depreciation are removed from the accounts, and any resulting gain or loss is reflected in operations.

Depreciation and amortization are computed using the straight line method over the estimated useful lives of the related assets. Buildings and improvements are depreciated over 15 to 40 years, machinery and equipment over 3 to 10 years and, furniture, fixtures and office equipment over 3 to 5 years. Leasehold improvements are amortized over the life of the lease or the estimated useful life of the improvement, whichever is less. Judgment and assumptions are used in establishing estimated useful lives and depreciation periods. The Company also uses judgment and assumptions as it periodically reviews property, plant and equipment for any potential impairment in carrying values

whenever events such as a significant industry downturn, plant closure, technological obsolescence, or other change in circumstances indicate that their carrying amount may not be recoverable.

Goodwill and Other Intangible Assets

Intangible assets consist primarily of a technology license agreement, a supply agreement, acquisition-related intangibles, and prior to July 27, 2008, goodwill. These assets are stated at fair value as of the date acquired less accumulated amortization. Amortization is calculated on a straight-line basis or another method that more fairly represents the utilization of the assets. The future economic benefit of the carrying value of intangible assets is reviewed annually and the Company uses judgment whenever events or changes in circumstances indicate the carrying value of an intangible asset may not be recoverable based on discounted cash flows or market factors and an impairment loss would be recorded in the period so determined. Refer to Note 2 for further discussion of impairment charges recognized in fiscal 2008.

In performing the annual review and assessment, the Company considers current market capitalization, discounted cash flows and other factors as the best evidence of fair value. There are inherent uncertainties and management judgment required in these analyses.

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Impairment of Long-Lived Assets

As required by Statement of Financial Accounting Standard (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on the Company's judgment and estimates of undiscounted future cash flows resulting from the use of the assets and their eventual disposition. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset.

The fair values of the impaired long-lived assets are determined based on market conditions, the income approach utilizing cash flow projections, and other factors (see Note 2).

Investment in Joint Venture

Investments in joint ventures over which the Company has the ability to exercise significant influence and that, in general, are at least 20 percent owned are stated at cost plus equity in undistributed net income (loss) of the joint venture. These investments are evaluated for impairment in accordance with the requirements of Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. An impairment loss would be recorded whenever a decline in the value of an equity investment below its carrying amount is determined to be other than temporary. In judging "other than temporary," the Company would consider the length of time and extent to which the fair value of the investment has been less than the carrying amount of the investment, the near-term and longer-term operating and financial prospects of the investee, and the Company's longer-term intent of retaining the investment in the investee.

Income Taxes

The income tax (provision) benefit is computed on the basis of the various tax jurisdictions' financial statements income or loss before income taxes. Deferred income taxes reflect the tax effects of differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The

Company uses judgment and assumptions to determine if valuation allowances for deferred income tax assets are required if realization is not likely by considering future market growth, forecasted operations, future taxable income, and the mix of earnings in the tax jurisdictions in which it operates.

The Company considers income taxes in each of the tax jurisdictions in which it operates in order to determine its effective income tax rate. Current income tax exposure is identified and temporary differences resulting from differing treatments of items for tax and financial reporting purposes are assessed. These differences result in deferred tax assets and liabilities, which are included in the Company's consolidated balance sheets. Additionally, the Company evaluates the recoverability of deferred income tax assets from future taxable income and establishes valuation allowances if recovery is deemed not likely. Accordingly, the income tax provision in the consolidated statements of operations is impacted by changes in the valuation allowance. Significant management estimates and judgment are required in determining any valuation allowance recorded against net deferred tax assets.

Earnings Per Share

Basic earnings per share ("EPS") is based on the weighted average number of common shares outstanding for the period, excluding any dilutive common share equivalents. Diluted EPS reflects the potential dilution that could occur if certain securities or other contracts to issue common stock were exercised or converted.

Stock-Based Compensation

The Company adopted SFAS No. 123(R), *Share-Based Payment* on October 31, 2005, using the modified prospective method. Subsequently compensation expense is recognized in its consolidated statements of operations over the service period that the awards are expected to vest. The Company recognizes expense for all stock-based compensation with graded vesting granted on or after October 31, 2005 on a straight-line basis over the vesting period of the entire award. For awards with graded vesting granted prior to October 31, 2005, the Company continues to recognize compensation cost over the vesting period following accelerated recognition as if each underlying vesting date represented a separate award. Stock-based compensation expense includes the estimated effects of forfeitures, which will be adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures will be recognized in the period of change and will also impact the amount of expense to be recognized in

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future periods. The Company adopted the alternative transition method provided in Financial Accounting Standards Board ("FASB") Staff Position No. 123(R)-3 for calculating the tax effects of share-based compensation. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates.

As a result of adopting SFAS No. 123(R) on October 31, 2005, the Company's income before income taxes and net income for the year ended October 29, 2006 was \$1.3 million, or \$0.03 per basic and diluted share less than if it had continued to account for share-based compensation under APB Opinion No. 25. There was no change in the statement of cash flows as a result of adoption of SFAS No. 123(R).

The Company uses the Black-Scholes option valuation model to value employee stock awards. The Company estimates stock price volatility based on weekly averages of its historical volatility over a term approximately equal to the grant's estimated option life. Estimated option life and forfeiture rate assumptions are derived from historical data.

Research and Development

Research and development costs are expensed as incurred, and consist primarily of global development efforts of high-end process technologies for advanced sub-wavelength reticle solutions for IC and FPD photomask technologies.

Research and development expenses also include the amortization of the carrying value of a technology license agreement with Micron (see Note 3 and Note 6 to the consolidated financial statements). Under this technology license agreement, the Company has access to certain photomask technology developed by Micron.

Foreign Currency Translation

The Company's international subsidiaries maintain their accounts in their respective local currencies. Assets and liabilities of such subsidiaries are translated to U.S. dollars at year-end exchange rates. Income and expenses are translated at average rates of exchange prevailing during the year. Foreign currency translation adjustments are accumulated and reported as OCI as a separate component of shareholders' equity. The effects of changes in exchange rates on foreign currency transactions, which are included in investment and other income, net, were \$3.8 million, \$1.0 million and \$4.3 million in fiscal 2008, 2007 and 2006, respectively.

Minority Interest

Minority interest represents the minority shareholders' proportionate share in the equity of the Company's two majority-owned subsidiaries, PK, Ltd. ("PKL") in Korea, and Photronics Semiconductor Mask Corporation ("PSMC") in Taiwan, of which minority shareholders owned approximately 0.3% and 42%, respectively, as of November 2, 2008 and October 28, 2007.

Revenue Recognition

The Company recognizes revenue when there is persuasive evidence that an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. The Company uses judgment when estimating the effect on revenue of discounts and product warranty obligations, both of which are accrued when the related revenue is recognized.

Product Returns - Customer returns have historically been insignificant. However, the Company does record a liability for the insignificant amount of estimated sales returns based upon historical experience.

Warranties and Other Post Shipment Obligations - For a 30-day period, the Company warrants that items sold will conform to customer specifications. However, the Company's liability is limited to repair or replacement of the photomasks at its sole option. The Company inspects photomasks for conformity to customer specifications prior to shipment. Accordingly, customer returns of items under warranty have historically been insignificant. However, the Company records a liability for the insignificant amount of estimated warranty returns based on historical experience. The Company's specific return policies include accepting returns for products with defects, or products that have not been produced to precise customer specifications. At the time of revenue recognition, a liability is established for these items.

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Sales Taxes - The Company presents its revenues in the consolidated statements of income, net of sales taxes, if any (excluded from revenues).

NOTE 2 - IMPAIRMENTS OF GOODWILL AND LONG-LIVED ASSETS

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, as of July 27, 2008 the Company performed an interim impairment test of its goodwill and certain of its long-lived assets (principally machinery and equipment, and buildings and improvements) due to events and changes in circumstances through the third quarter of fiscal 2008 that indicated an impairment might have occurred.

Factors deemed by management to have collectively constituted an impairment triggering event included net losses in each of three quarters of fiscal 2008, and a significant decrease in the Company's market capitalization through the third quarter of fiscal 2008 which was significantly below its consolidated net assets. As a result of this impairment testing, the Company recorded the following impairment charges during fiscal 2008:

| | |
|---------------------------------|------------------|
| Impairment of goodwill | \$138,534 |
| Impairment of long-lived assets | 66,874 |
| | <hr/> |
| Total impairments | <u>\$205,408</u> |

Goodwill

In accordance with SFAS No. 142, the Company tests goodwill for impairment annually and when an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Goodwill is tested for impairment using a two-step process.

Through the third quarter of fiscal 2008, the Company experienced a sustained, significant decline in its stock price. As a result of the decline in stock price, the Company's market capitalization fell significantly below the recorded value of its consolidated net assets during the third quarter of fiscal 2008. Accordingly, in the third quarter of fiscal 2008, management performed an assessment of goodwill for impairment. The result of the analysis indicated that there would be no remaining implied value attributable to the Company's goodwill and accordingly, the Company wrote off all of its \$138.5 million of goodwill as of July 27, 2008.

In performing the goodwill assessment, the Company used current market capitalization, discounted cash flows and other factors as the best evidence of fair value. For purposes of testing impairment under SFAS No. 142, the Company is a single reporting unit. There are inherent uncertainties and management judgment required in an analysis of goodwill impairment.

Long-Lived Assets

In connection with the triggering events discussed above, during the third quarter of fiscal year 2008 the Company determined that long-lived assets were impaired for certain groups of its assets. The determination was based on reviewing estimated undiscounted cash flows for these groups of assets, which were less than their carrying values. The Company considers its asset groups to be the assets and liabilities at each of its locations, primarily consisting of machinery and equipment, and buildings and improvements. As a result, the Company recorded an impairment charge of \$66.9 million as of July 27, 2008, which represents the difference between the estimated fair values of these long-lived assets as compared to their carrying values for certain asset groups located in Asia and Europe. Fair values were determined based upon market conditions, the income approach which utilized cash flow projections, and other factors.

NOTE 3 - JOINT VENTURE, TECHNOLOGY LICENSE AND OTHER AGREEMENTS WITH MICRON TECHNOLOGY, INC.

On May 5, 2006, Photronics and Micron entered into the MP Mask joint venture, which develops and produces photomasks for leading-edge and advanced next generation semiconductors. As part of the formation of the joint venture, Micron contributed its existing photomask technology center located at its Boise, Idaho, headquarters to MP Mask and Photronics invested \$135 million in exchange for a 49.99% interest in MP Mask, a license for photomask technology of Micron, and certain supply agreements. Of the total \$135 million investment, \$120 million was paid to Micron on May 6, 2006 and, as of that date, the remaining \$15 million was a non-cash financing activity, which was subsequently paid in two installments of \$7.5 million each in May 2007 and June 2008.

MP Mask is governed by a Board of Managers, appointed by Micron and the Company. Since MP Mask's inception, Micron, as a result of its majority ownership, has appointed the majority of the managers. The number of managers appointed by each party is subject to change as ownership interests change. Under the Operating Agreement relating to the MP Mask joint venture, through May 5, 2010, the Company may be required to make additional capital contributions to the joint venture of up to a maximum amount as defined in the Operating Agreement. The Company made additional investments in MP Mask of \$2.6 million in 2008 and \$3.5 million in 2007, which were used for working capital and capital expenditure purposes, and received a return of investment from MP Mask of \$5.0 million in 2008.

This joint venture is a variable interest entity as defined by Financial Accounting Standards Board Interpretation No. 46(R), "Consolidation of Variable Interest Entities" primarily because the holders of the equity interests are protected from the obligation to absorb expected losses that would result from the variability of the cash flows of the joint venture. The Company has determined that it is not the primary beneficiary and, therefore, accounts for its interest in the joint venture using the equity method of accounting.

In the first quarter of fiscal 2008, a capital lease agreement commenced with Micron for the U.S. Nanofab facility. The initial lease principal was \$61.7 million principal, payable by the Company to Micron over a 5-year period (see Note 8). The Company's total investment to date in the purchase and equipping of its U.S. Nanofab is approximately \$186 million. This U.S. Nanofab began production in the second fiscal quarter of 2008.

As of November 2, 2008, the Company owed MP Mask \$3.5 million and had a receivable from Micron of \$3.8 million, both primarily related to the supply agreements. The Company, in 2008, recorded \$2.7 million of commission revenue earned under the supply agreements it has with Micron and MP Mask. Amortization of \$1.5 million of the supply agreement intangible asset resulted in net earnings related to the supply agreements of \$1.2 million in 2008. The recorded commission revenue of \$2.7 million represents the excess of \$44.8 million in orders received from Micron over the Company's cost of \$42.1 million to fulfill the orders through MP Mask. For certain sales during 2008, the Company also recorded cost of sales in the amount of \$3.2 million for photomasks produced by MP Mask for the Company's customers and incurred outsourcing expenses of \$1.7 million from MP Mask for research and development activities purchased by the Company. The Company also purchased excess equipment from MP Mask for use in its U.S. Nanofab in the amount of \$4.1 million in 2008.

As of October 28, 2007, the Company owed MP Mask \$6.4 million and had a receivable from Micron of \$6.1 million, both primarily related to the supply agreements. The Company, in 2007, recorded \$3.9 million of commission revenue earned under the supply agreements it has with Micron and MP Mask. Amortization of \$1.8 million of the supply agreement intangible asset resulted in net earnings related to the supply agreements of \$2.1 million in 2007. The recorded commission revenue of \$3.9 million represents the excess of \$56.3 million in orders received from Micron over the Company's cost of \$52.4 million to fulfill the orders through MP Mask. The Company, during 2007, also recorded cost of sales in the amount of \$3.7 million for photomasks produced by MP Mask for its customers and

incurred outsourcing expenses of \$1.0 million from MP Mask for research and development activities purchased by the Company. The Company also purchased excess equipment from MP Mask for use in its U.S. Nanofab in the amount of \$4.0 million in 2007.

In 2006, the Company completed its analysis of fair value attributes of its total \$135.5 million investment through the use of management's estimates and other factors, and reallocated values that were preliminarily allocated to the investment in the MP Mask joint venture and related intangible assets. As a result of this analysis, the Company allocated \$64.2 million to the net fair value of tangible assets acquired, \$59.6 million to the technology agreement, which is being

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amortized over 15 years, \$7.0 million to the supply agreement which is being amortized over 10 years, and \$4.7 million to goodwill. The Company accounts for its interest in the joint venture using the equity method of accounting. The Company's proportionate share of income or losses from its investment in the joint venture (which was immaterial in 2008, 2007 and 2006) is recorded in other income and expense.

NOTE 4 - INVESTMENTS

Short-term investments at November 2, 2008 and October 28, 2007 consist of available-for-sale fixed income and marketable equity securities. Long-term investments are included in "Other Assets" and consist primarily of available-for-sale equity securities, for which fair values were determined based upon quoted market prices.

Available-for-sale investments at November 2, 2008 were as follows:

| | <u>Cost Basis</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Estimated Fair Value</u> |
|------------------------------|-------------------|---------------------------------------|--|---------------------------------|
| Short-term investments: | | | | |
| Foreign bond funds and other | \$1,439 | \$ - | \$(96) | \$1,343 |
| Total short-term investments | 1,439 | - | (96) | 1,343 |
| Long-term equity investments | 8 | 34 | - | 42 |
| | <u>\$1,447</u> | <u>\$34</u> | <u>\$(96)</u> | <u>\$1,385</u> |

Available-for-sale investments at October 28, 2007 were as follows:

| | <u>Cost Basis</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Estimated Fair Value</u> |
|-------------------------|-------------------|---------------------------------------|--|---------------------------------|
| Short-term investments: | | | | |

| | | | | |
|------------------------------|---------|-------|------|---------|
| Term deposit | \$3,260 | \$ - | \$ - | \$3,260 |
| Foreign bond funds and other | 2,289 | 108 | - | 2,397 |
| Total short-term investments | 5,549 | 108 | - | 5,657 |
| Long-term equity investments | 29 | 109 | - | 138 |
| | \$5,578 | \$217 | \$ - | \$5,795 |

In determining whether investment holdings are other than temporarily impaired, the Company considers the nature, cause, severity and duration of the impairment. The Company and its investment advisors used analyst reports, credit ratings or other items as part of its review. No investments were in a continuous unrealized loss position for more than twelve months.

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Gross realized gains and losses related to the Company's investments are as follows:

| | Year Ended | | |
|-----------------------------|---------------------|---------------------|---------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Gross realized gains | \$ - | \$851 | \$4,037 |
| Gross realized losses | (834) | (87) | (410) |
| Net realized gains (losses) | \$(834) | \$764 | \$3,627 |

Costs of securities sold and amounts reclassified from other accumulated comprehensive income into earnings are determined by specific identification.

NOTE 5 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

| | November 2, 2008 | October 28, 2007 |
|----------------------------|---------------------|---------------------|
| Land | \$ 8,393 | \$ 8,429 |
| Buildings and improvements | 120,808 | 103,010 |
| Machinery and equipment | 1,016,741 | 1,076,938 |

| | | |
|--|------------------|------------------|
| Leasehold improvements | 5,813 | 6,085 |
| Furniture, fixtures and office equipment | 17,528 | 20,700 |
| Construction in progress | 6,551 | 119,277 |
| | <u>1,175,834</u> | <u>1,334,439</u> |
| Less accumulated depreciation and amortization | 739,306 | 802,861 |
| | <u>\$436,528</u> | <u>\$531,578</u> |

Property, plant and equipment at November 2, 2008 includes an impairment charge (see Note 2) and foreign currency translation adjustments.

At November 2, 2008, buildings, machinery and equipment with a cost of \$81.6 million and accumulated amortization of \$3.5 million were recorded under capital leases. The Company capitalized interest expense of \$0.5 million during the fiscal year ended November 2, 2008.

At October 28, 2007, machinery and equipment with a cost of \$19.9 million was recorded under a capital lease with no accumulated amortization. The Company capitalized interest expense of \$0.2 million during the fiscal year ended October 28, 2007.

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NOTE 6 - GOODWILL AND OTHER INTANGIBLE ASSETS

As discussed in Note 2 to the consolidated financial statements, the Company wrote off all of its \$138.5 million of goodwill during the fiscal year ended November 2, 2008, which represented the carrying value of the Company's goodwill at October 28, 2007. Intangible assets that do not have indefinite lives are amortized based on average lives, which range from 3 to 15 years. Intangible asset amortization is forecasted to range from \$3.0 million to \$7.3 million per year for the next 5 years.

Other intangible assets include assets related to the purchase of additional shares of PKL and the investment to form the MP Mask joint venture. The following tables summarize the type, value and amortization periods of other intangible assets:

| As of November 2, 2008 | Gross Value | Accumulated Amortization | Net Value | Weighted Average Amortization Period |
|------------------------------|-------------------|--------------------------|-------------------|--------------------------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Technology license agreement | \$59,616 | \$ 9,605 | \$50,011 | 15 years |
| Customer lists | 7,210 | 1,490 | 5,720 | 10 years |
| Supply agreement | 6,959 | 4,016 | 2,943 | 10 years |
| Patents | 156 | 32 | 124 | 10 years |
| Software and other | 5,569 | 1,981 | 3,588 | 3 years |

| | | |
|-----------------|-----------------|-----------------|
| <u>\$79,510</u> | <u>\$17,124</u> | <u>\$62,386</u> |
|-----------------|-----------------|-----------------|

| As of October 28, 2007 | <u>Gross Value</u> | <u>Accumulated Amortization</u> | <u>Net Value</u> | <u>Weighted Average Amortization Period</u> |
|------------------------------|------------------------|-------------------------------------|----------------------|---|
| Technology license agreement | \$59,616 | \$ 5,630 | \$53,986 | 15 years |
| Customer lists | 7,210 | 1,321 | 5,889 | 10 years |
| Supply agreement | 6,959 | 2,461 | 4,498 | 10 years |
| Patents | 156 | 28 | 128 | 10 years |
| Software and other | 5,969 | 1,635 | 4,334 | 3 years |
| | <u>\$79,910</u> | <u>\$11,075</u> | <u>\$68,835</u> | |

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NOTE 7 - ACCRUED LIABILITIES

Accrued liabilities consist of the following:

| | <u>November 2, 2008</u> | <u>October 28, 2007</u> |
|--------------------------------------|-----------------------------|-----------------------------|
| Income taxes | \$ 8,586 | \$ 4,977 |
| Salaries, wages and related benefits | 5,967 | 7,466 |
| Restructuring | 1,134 | 1,687 |
| Interest | 984 | 309 |
| Property taxes | 1,507 | 919 |
| Payable to Micron Technology, Inc. | - | 7,500 |
| Other | 7,479 | 8,818 |
| | <u>\$25,657</u> | <u>\$31,676</u> |

NOTE 8 - LONG-TERM BORROWINGS

Long-term borrowings consist of the following:

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| | <u>November 2, 2008</u> | <u>October 28, 2007</u> |
|--|-----------------------------|-----------------------------|
| Borrowings under revolving credit facility, last amended on December 12, 2008, which bears interest at a variable rate, as defined (7.46% at December 12, 2008; 6.36% at November 2, 2008) | \$122,500 | \$ - |
| 2.25% convertible subordinated notes redeemed on April 15, 2008 | - | 150,000 |
| 8.0% capital lease obligation payable through January 2013 | 53,895 | - |
| 5.6% capital lease obligation payable through October 2012 | 16,669 | 19,912 |
| Foreign loans: | | |
| Revolving loan, which bears interest at a variable rate (7.47% at November 2, 2008; 6.70% at October 28, 2007) | 19,045 | 17,393 |
| Term loan, which bears interest at a variable rate (7.74% at November 2, 2008; 6.93% at October 28, 2007) | 8,204 | 7,493 |
| Short-term loan, which bears interest at a variable rate (6.72% at November 2, 2008; 5.83% at October 28, 2007) | 3,296 | 937 |
| | <u>223,609</u> | <u>195,735</u> |
| Less current portion | <u>20,630</u> | <u>4,482</u> |
| | <u>\$202,979</u> | <u>\$191,253</u> |

As of November 2, 2008, long-term borrowings, excluding capital lease obligations, mature as follows: \$5,796 in fiscal year 2009 and \$147,249 in fiscal year 2010.

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As of November 2, 2008, minimum lease payments under the Company's capital lease obligations were as follows:

Fiscal Year:

| | |
|------|----------|
| 2009 | \$19,666 |
|------|----------|

| | |
|---|-----------------|
| 2010 | 19,666 |
| 2011 | 19,666 |
| 2012 | 19,666 |
| 2013 | 4,153 |
| | <hr/> |
| | 82,817 |
| Less interest | 12,253 |
| | <hr/> |
| Net minimum lease payments under capital lease | 70,564 |
| Less current portion of net minimum lease payments | 14,834 |
| | <hr/> |
| Long-term portion of minimum lease payments | <u>\$55,730</u> |

On June 6, 2007, the Company and a group of financial institutions entered into a credit agreement, which allows for borrowings under various currencies. On October 31, 2008, the Company's credit agreement was amended to change the minimum Senior Leverage Ratio covenant, as defined, and to extend the date it was required to obtain at least \$75 million in permanent long-term capital from November 2, 2008 to December 5, 2008. The credit agreement was further amended on December 5, 2008 to extend the date to obtain at least \$75 million in permanent long-term capital to December 12, 2008, at which date the credit agreement was last amended and eliminated, among other items, the requirement to obtain such permanent long-term capital. The credit agreement was last amended on December 12, 2008. Among other items, the last amendment provided for the following: the maturity date of the credit agreement was changed from June 6, 2012 to July 30, 2010; the aggregate commitment was reduced from \$155 million to \$135 million, and is further reduced to \$120 million on October 31, 2009 and \$100 million on January 31, 2010; substantially all of the Company's assets in the United States were pledged as collateral; financial covenants were modified and include, among other items as defined, a Senior Leverage Ratio, Total Leverage Ratio, Minimum Fixed Charge Ratio, and a quarterly minimum EBITDA covenant, as defined. Additionally, cash received as a result of certain events, as defined, is required to be used to pay down the outstanding loan balance and reduce the available credit facility by the same amount; and there is a capital expenditure payment limitation. The credit agreement also continues to provide for Minimum Unrestricted Cash Balances of \$50 million, as defined, and limits the amount of both secured and unsecured debt. The credit facility is also secured by a pledge of the Company's stock in certain of its subsidiaries. As of November 2, 2008, \$122.5 million was outstanding under the credit facility, \$3.6 million was utilized for a standby letter of credit, and the remaining balance of \$8.9 million was available to the Company based upon the subsequently amended aggregate commitment of \$135 million.

In addition to the credit agreement discussed above, on December 12, 2008, the maturity date of the foreign revolving loan and term loan was amended from October 11, 2010 to January 31, 2010. Further, the interest rate on these foreign loans was amended and is currently based on the Peoples Bank of China base rate, plus a spread (as defined), and the lenders have the right to secure the Company's assets in China.

The Company's liquidity is highly dependent on its ability to receive orders as it operates in a high fixed cost environment and the timing of capital expenditures, both of which can vary significantly from period to period. Depending on conditions in the IC semiconductor and FPD market, the Company's cash flows from operations and current holdings of cash and investments may not be adequate to meet the Company's current and long-term needs for

capital expenditures and operations. Historically, in certain years the Company has used external financing to fund these needs. Due to conditions in the credit markets, some financing instruments used by the Company in the past are currently not available to the Company. The Company is evaluating financing alternatives, delaying capital expenditures and evaluating further cost reduction initiatives. However, the Company cannot assure that additional sources of financing would be available to the Company on commercially favorable terms should the Company's capital requirements exceed cash available from operations and existing cash, short-term investments and cash available under its credit facility.

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As of November 2, 2008, foreign loans were in China, and consist of a term and revolving debt credit facility and a short-term loan, which were fully outstanding, and amount to RMB 186 million (\$27.2 million) and RMB 22.5 million (\$3.3 million), respectively. Interest rates are subject to change based on the People's Bank of China base rate, plus a spread, as defined. The term and revolving debt credit facility is due in January 2010, and the short-term credit line is due in March 2009. The Company is subject to certain financial and other covenants similar to those of its credit facility described above.

On April 15, 2008, the Company redeemed its \$150.0 million 2.25% convertible subordinated notes. During 2008, a capital lease agreement commenced, as discussed below, for the U.S. Nanofab. Quarterly lease payments, which bear interest at 8%, are \$3.8 million through January 2013. As of November 2, 2008 total capital lease amounts payable were \$64.1 million of which \$53.9 million represents principal and \$10.2 million represents interest. At the end of the 5-year lease term, ownership of the property transfers to the Company.

In October 2007, the Company entered into a capital lease agreement in the amount of \$19.9 million associated with certain equipment. Under the capital lease agreement, the Company is required to maintain the equipment in good working condition, and is required to comply with certain non-financial covenants. Payments under the lease are \$0.4 million per month over a 5-year term at a 5.6% interest rate.

Cash paid for interest was \$10.9 million, \$7.6 million and \$9.9 million in fiscal 2008, 2007 and 2006, respectively.

NOTE 9 - EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is presented as follows:

| | Year Ended | | |
|---|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Net income (loss) | \$(210,765) | \$24,523 | \$29,332 |
| Effect of dilutive securities: | | | |
| Interest expense on convertible notes, net of related tax effect | - | 4,401 | 4,343 |
| Earnings for diluted earnings (loss) per share | \$(210,765) | \$28,924 | \$33,675 |

Weighted average common shares computations:

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| | | | |
|---|----------|--------|--------|
| Weighted average common shares used for basic earnings (loss) per share | 41,658 | 41,539 | 41,369 |
| Effect of dilutive securities: | | | |
| Convertible notes | - | 9,441 | 9,441 |
| Employee stock options | - | 302 | 262 |
| | <hr/> | <hr/> | <hr/> |
| Dilutive potential common shares | - | 9,743 | 9,703 |
| | <hr/> | <hr/> | <hr/> |
| Weighted average common shares used for diluted earnings (loss) per share | 41,658 | 51,282 | 51,072 |
| | <hr/> | <hr/> | <hr/> |
| Basic earnings per share | \$(5.06) | \$0.59 | \$0.71 |
| Diluted earnings per share | \$(5.06) | \$0.56 | \$0.66 |

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The effect of the potential conversion of some of the Company's convertible subordinated notes, stock options, and restricted stock awards and the exercise of certain stock options has been antidilutive. The following table shows the amount of incremental shares outstanding that would have been added if the assumed conversion of convertible subordinated notes, stock options, and restricted stock awards had been dilutive:

| | Year Ended | | |
|--|---------------------|---------------------|---------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| | <hr/> | <hr/> | <hr/> |
| Convertible notes | 4,409 | 304 | 2,354 |
| Share based payment awards | 2,360 | 2,040 | 1,412 |
| | <hr/> | <hr/> | <hr/> |
| Total potentially dilutive shares excluded | 6,769 | 2,344 | 3,766 |
| | <hr/> | <hr/> | <hr/> |

In the first quarter of fiscal year 2009, the Company awarded approximately 1.3 million stock options and 75 thousand non-vested shares to its employees and directors.

NOTE 10 - INCOME TAXES

The income tax (benefit) provision consists of the following:

| | Year Ended | | |
|--|---------------------|---------------------|---------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| | <hr/> | <hr/> | <hr/> |

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| | | | |
|-----------|------------------|------------------|-----------------|
| Current: | | | |
| Federal | \$ - | \$(8,430) | \$ - |
| State | - | - | - |
| Foreign | (834) | 6,213 | 9,497 |
| | <u>(834)</u> | <u>(2,217)</u> | <u>9,497</u> |
| Deferred: | | | |
| Federal | - | - | - |
| State | - | - | - |
| Foreign | (1,944) | (961) | 965 |
| | <u>(1,944)</u> | <u>(961)</u> | <u>965</u> |
| Total | <u>\$(2,778)</u> | <u>\$(3,178)</u> | <u>\$10,462</u> |

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The income tax (benefit) provision differs from the amount computed by applying the statutory U.S. federal income tax rate to the income before taxes as a result of the following:

| | Year Ended | | |
|--|---------------------|---------------------|---------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| U.S. federal income tax at statutory rate | \$(74,259) | \$ 8,359 | \$15,885 |
| Goodwill and other impairments | 42,416 | - | - |
| Distributions from foreign subsidiaries | 10,937 | - | - |
| State income taxes, net of federal benefit | (1,255) | 108 | (255) |
| Change in valuation allowance | 8,757 | 2,399 | 4,054 |
| Foreign tax rate differential | 9,982 | (6,973) | (9,272) |
| Resolution and settlement of tax matters | (192) | (7,394) | - |
| Other, net | 836 | 323 | 50 |
| | <u>\$ (2,778)</u> | <u>\$(3,178)</u> | <u>\$10,462</u> |

During the fiscal year ended October 28, 2007, the Company recorded a tax benefit in the amount of \$7.4 million relating to the resolution and settlement of U.S. and foreign tax matters that were associated with certain tax positions in prior years.

The net deferred income tax liability consists of the following:

| | November 2, 2008 | October 28, 2007 |
|--|-----------------------------|-----------------------------|
| | <hr/> | <hr/> |
| Deferred income tax assets: | | |
| Reserves not currently deductible | \$4,369 | \$ 3,873 |
| Net operating losses | 52,143 | 47,557 |
| Alternative minimum tax credits | 2,926 | 2,926 |
| Tax credit carryforwards | 10,051 | 9,097 |
| Other | 4,175 | 1,195 |
| | <hr/> | <hr/> |
| | 73,664 | 64,648 |
| Valuation allowance | (48,149) | (39,392) |
| | <hr/> | <hr/> |
| | 25,515 | 25,256 |
| Deferred income tax liabilities: | | |
| Property, plant and equipment | (15,921) | (25,093) |
| Investments and other | (1,139) | (1,139) |
| Other | (1,307) | (2,094) |
| | <hr/> | <hr/> |
| | (18,367) | (28,326) |
| | <hr/> | <hr/> |
| Net deferred income tax liability | \$7,148 | \$(3,070) |
| | <hr/> | <hr/> |
| Reported as: | | |
| Current deferred tax assets | \$2,843 | \$ 3,071 |
| Long-term deferred tax assets | 6,118 | 2,002 |
| Long-term deferred tax liabilities | (1,813) | (8,143) |
| | <hr/> | <hr/> |
| | \$7,148 | \$(3,070) |
| | <hr/> | <hr/> |

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The Company's operations have followed the migration of semiconductor industry fabrication to Asia, where the Company operates in countries where it is accorded favorable tax treatment. PKLT, the Company's FPD manufacturing facility in Taiwan, is accorded a tax holiday, which expires in December 2012. In addition, the Company has been accorded a tax holiday in China which is expected to expire in 2011. These tax holidays had no dollar or per share effect in the fiscal years ended November 2, 2008, October 28, 2007 and October 29, 2006. In Korea, various investment tax credits have been utilized to reduce the Company's effective income tax rate.

Income tax payments were \$4.4 million, \$12.8 million and \$9.8 million in fiscal 2008, 2007 and 2006, respectively. Cash received for refunds of income taxes paid in prior years amounted to \$1.3 million, \$0.1 million and \$0.2 million in fiscal 2008, 2007 and 2006, respectively.

On July 13, 2006, the FASB issued FASB Interpretation Number 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109 ("SFAS 109")*. The interpretation contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS 109. The Company adopted FIN 48 as of the beginning of its 2008 fiscal year. The total amount of the liability accrued for unrecognized tax benefits as of the adoption date was approximately \$3.9 million, which includes interest and penalties. As compared to the Company's historical approach, the application of FIN 48 resulted in a net increase to accrued income taxes payable of approximately \$1.0 million (including interest and penalties of approximately \$0.2 million), and a decrease to retained earnings of the same amount. In addition, the majority of the liability for unrecognized tax benefits was reclassified from accrued income taxes to other long-term liabilities on the Company's Consolidated Balance Sheet. As of the date of adoption of FIN 48 the Company has elected to include any applicable interest and penalties related to uncertain tax positions in its income tax provision in its consolidated statements of operations. At November 2, 2008, the gross unrecognized tax benefits for income taxes associated with uncertain tax positions totaled approximately \$3.1 million, including interest and penalties of approximately \$1.1 million. If recognized, the benefits would favorably affect the Company's effective tax rate in future periods. As of November 2, 2008, the Company believes it is reasonably possible that the total amounts of unrecognized benefits will significantly increase or decrease in the next twelve months. These potential changes relate to possible settlements in the U.K. Though the Company expects that these items may result in a net reduction of its unrecognized tax benefits, an estimate of the expected reduction and related income tax benefit cannot be made at this time. Currently, the statutes of limitations remain open subsequent to and including 2004 in the U.S., 2002 in the U.K., 2006 in Germany and 2004 in Korea.

A reconciliation of the gross amounts of unrecognized tax benefits, excluding interest and penalties, at the beginning and end of the year is as follows:

| | |
|---|----------------|
| Unrecognized tax benefits as of October 29, 2007 | \$2,280 |
| Gross increases and decreases for tax provisions in prior periods | (301) |
| Gross increases - current period tax position | 294 |
| Settlements | (194) |
| Lapse of statutes of limitations | (91) |
| Unrecognized tax benefits as of November 2, 2008 | <u>\$1,988</u> |

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As of November 2, 2008 the Company had available U.S. Federal tax operating loss and tax credit carryforwards subject to expiration as follows:

| <u>Year of Expiration</u> | <u>Operating Losses</u> | <u>Tax Credits</u> |
|---------------------------|-------------------------|--------------------|
|---------------------------|-------------------------|--------------------|

| | | |
|------|-----------------|----------------|
| 2018 | \$ - | \$1,272 |
| 2020 | - | - |
| 2022 | 7,800 | - |
| 2023 | 36,200 | - |
| 2024 | 22,300 | 300 |
| 2025 | 12,200 | 510 |
| 2026 | 4,900 | 378 |
| 2027 | 1,500 | 138 |
| 2028 | 7,500 | - |
| | <u>\$92,400</u> | <u>\$2,598</u> |

The Company has established a valuation allowance for a portion of its deferred tax assets, because it is more likely than not that a portion of its net operating loss carryforwards may expire prior to utilization. The valuation allowance increased by \$8.8 million, \$2.4 million and \$1.7 million in fiscal 2008, 2007 and 2006, respectively.

As of November 2, 2008, the Company had \$2.9 million of alternative minimum tax credit carryforwards that are available to offset future federal taxes payable. The Company also has tax credits available in international jurisdictions of \$5.9 million and state tax credits of \$1.5 million. Both the international and state tax credits began to expire in 2008.

As of November 2, 2008, the undistributed earnings of foreign subsidiaries included in consolidated retained earnings amounted to \$74.1 million. During 2008 a decision was made to not indefinitely reinvest earnings in certain foreign jurisdictions. For the year ended November 2, 2008, \$12 million of earnings that were previously considered to be permanently reinvested in foreign operations were determined to no longer be indefinitely reinvested. This decision resulted in no impact to the consolidated statement of operations since the Company has a full valuation allowance against its net U.S. deferred tax assets. The remaining undistributed earnings of foreign subsidiaries are considered to be permanently reinvested. Accordingly, no provision has been made for taxes due on the remittance of these earnings. Should the Company elect in the future to repatriate the foreign earnings so invested, the Company would incur additional income tax expense on those foreign earnings.

The Company has elected the alternative transition method provided in FASB Staff Position No. 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*, for calculating the tax effects of share-based compensation. As of November 2, 2008 the deferred income tax expenses resulting from this method amounted to \$0.9 million.

NOTE 11- STOCK-BASED COMPENSATION

In March 2007, shareholders approved a new stock-based compensation plan ("Plan"), under which options, restricted stock, restricted stock units, stock appreciation rights, performance stock, performance units, and other awards based on, or related to shares of the Company's common stock may be granted from shares authorized but unissued, shares previously issued and reacquired by the Company or both. A maximum of three million shares of common stock may be issued under the Plan. Awards may be granted to Company officers, employees and directors, non-employee directors, consultants, advisors and independent contractors of the Company or a subsidiary of the Company. The Plan prohibits further awards from being issued under prior plans. Aspects of the Plan are more fully described below. The Company incurred compensation cost under the Plan of \$2.6 million, \$2.9 million and \$2.0 million for fiscal 2008, 2007 and 2006, respectively. No compensation cost was capitalized as part of inventory, and no income tax benefit was recorded in those years. No equity awards were settled in cash during the periods presented.

Stock Options

Option awards generally vest in one to four years, and have a ten year contractual term. All incentive and non-qualified stock option grants must have an exercise price no less than the market value of the underlying common stock on the date of grant. The option and share awards provide for accelerated vesting if there is a change in control as defined in the Plan.

The fair value of option grants is determined based on the closing price on the date of grant using the Black-Scholes option pricing model. Expected volatility is based on the historical volatility of the Company's stock. The Company uses historical option exercise behavior and employee termination data to estimate expected term, which represents the period of time that the options granted are expected to remain outstanding. The risk-free rate of return for the estimated life of the option is based on the U.S. treasury yield curve in effect at the time of grant. The weighted average assumptions used for fiscal 2008, 2007 and 2006 are noted in the following table:

| | Year Ended | | |
|--------------------------|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Volatility | 43.1% | 52.4% | 55.0% |
| Risk-free rate of return | 2.99% | 4.5% | 4.8% |
| Dividend yield | 0.0% | 0.0% | 0.0% |
| Expected term | 4.7 years | 4.6 years | 4.5 years |

A summary of option activity under the Plan as of November 2, 2008 and changes during the year then ended is presented as follows:

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life |
|---------------------------------|---------------|--|--|
| Outstanding at October 28, 2007 | 2,337,303 | \$18.68 | |
| Granted | 98,500 | 4.62 | |
| Exercised | - | - | |
| Cancelled and forfeited | (263,596) | 17.30 | |
| | <hr/> | | |
| Outstanding at November 2, 2008 | 2,172,207 | 18.21 | 5.7 years |
| | <hr/> | | |
| Exercisable at November 2, 2008 | 1,753,444 | \$19.22 | 5.1 years |

The weighted average grant date fair value of options granted during the fiscal years 2008, 2007 and 2006 was \$1.86, \$7.15 and \$8.50 respectively. The total intrinsic value of options exercised during the fiscal years 2008, 2007 and 2006 was \$0.0 million, \$0.1 million and \$0.4 million, respectively. There was no aggregate intrinsic value of options outstanding or exercisable at November 2, 2008. A summary of the status of the Company's non-vested options as of November 2, 2008 is presented as follows:

| Non-vested Options | Shares | Weighted Average Fair Value at Grant Date |
|--------------------------------|---------------|--|
| Non-vested at October 28, 2007 | 578,746 | \$8.54 |
| Granted | 98,500 | 1.86 |
| Vested | (190,232) | 8.55 |
| Cancelled and forfeited | (68,251) | 8.29 |
| Non-vested at November 2, 2008 | 418,763 | \$6.92 |

As of November 2, 2008 the total compensation cost for non-vested option awards not yet recognized was approximately \$2.3 million. That cost is expected to be recognized over a weighted average amortization period of 2.2 years.

Restricted Stock

The Company also grants restricted stock awards periodically. The restrictions on these awards lapse over a service period that has ranged from less than one to eight years. The weighted average grant date fair value of restricted stock grants during the fiscal years 2008, 2007 and 2006 was \$11.72, \$13.75 and \$16.54, respectively. The total value of awards for which restrictions lapsed during fiscal years 2008, 2007 and 2006 was \$0.6 million, \$0.1 million and \$0.5 million, respectively. As of November 2, 2008, the total compensation cost for non-vested option awards not yet recognized was approximately \$3.7 million. That cost is expected to be recognized over a weighted average amortization period of 4.3 years. A summary of the status of the Company's non-vested restricted shares as of November 2, 2008 is presented as follows:

| Restricted Stock | Shares | Weighted Average Fair Value at Grant Date | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|-------------------------|---------------|--|--|--|
|-------------------------|---------------|--|--|--|

| | | | | |
|---------------------------------|----------------|----------------|------------------|--------------|
| Outstanding at October 28, 2007 | 242,503 | \$16.47 | | |
| Granted | 151,300 | 11.72 | | |
| Vested | (70,939) | 14.61 | | |
| Cancelled and forfeited | (30,189) | 15.14 | | |
| | <u>292,675</u> | <u>\$14.60</u> | <u>4.3 years</u> | <u>\$202</u> |

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Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plan ("ESPP") permits employees to purchase shares at 85% of the lower of the fair market value at the commencement of the offering or the last day of the payroll payment period. A total of 900,000 shares are available for purchase under the ESPP. The vesting period for the ESPP is approximately one year. Under the ESPP 744,723 shares had been issued through November 2, 2008 and an additional 57,474 shares are subject to outstanding subscriptions.

NOTE 12 - EMPLOYEE RETIREMENT PLANS

The Company maintains a 401(k) Savings and Profit Sharing Plan ("401(k) Plan") which covers all full-time domestic employees who have completed 3 months of service and are 18 years of age or older. Under the terms of the 401(k) Plan, employees may contribute up to 50% of their salary, subject to certain maximum amounts, which will be matched by the Company at 50% of the employee's contributions, which are not in excess of 4% of the employee's compensation. Employee and employer contributions vest fully upon contribution. Employer contributions amounted to \$0.5 million in fiscal 2008, \$0.4 million in fiscal 2007 and \$0.5 million in fiscal 2006.

The Company's international subsidiaries maintain retirement plans for their employees, which vary by country. The obligations and cost of these plans are not significant to the Company's consolidated financial statements.

NOTE 13 - OPERATING LEASES

The Company leases various real estate and equipment under non-cancelable operating leases. Rental expense under such leases amounted to \$3.1 million in fiscal 2008, \$3.4 million in fiscal 2007 and \$3.2 million in fiscal 2006.

Future minimum lease payments (excluding costs associated with facilities closed under restructuring plans) under non-cancelable operating leases with initial or remaining terms in excess of one year at November 2, 2008 follow:

| | |
|------------|--------------|
| 2009 | \$ 2,375 |
| 2010 | 1,936 |
| 2011 | 1,573 |
| 2012 | 1,431 |
| 2013 | 726 |
| Thereafter | <u>2,231</u> |

\$10,272

See Note 8 for disclosures relating to the Company's capital lease obligations.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

At November 2, 2008, the Company had outstanding purchase commitments of approximately \$46 million, which includes approximately \$31 million related to capital expenditures.

Financial instruments that potentially subject the Company to credit risk consist principally of trade accounts receivable and temporary cash investments. The Company sells its products primarily to manufacturers in the semiconductor and computer industries in North America, Europe and Asia. The Company believes that the concentration of credit risk in its trade receivables is substantially mitigated by the Company's ongoing credit evaluation process and relatively short collection terms. The Company does not generally require collateral from customers. The Company establishes an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information.

The Company is subject to various claims that arise in the ordinary course of business. The Company believes such claims, individually or in the aggregate, will not have a material adverse effect on the business of the Company.

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NOTE 15 - DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

On October 22, 2002, the Company entered into an interest rate swap contract, which effectively converted \$100 million of 4.75% fixed rate debt to a variable rate. Under the contract, payments are made on a LIBOR-based variable rate (6.69% at October 29, 2006). In August 2005, the Company reduced its 4.75% fixed rate debt to \$87.1 million and in December 2006 repaid the outstanding balance. The interest rate swap expired in December 2006.

The interest rate swap contract was used to adjust the proportion of total debt that is subject to fixed interest rates. This contract was considered to be a hedge against interest rate risk of the Company's fixed rate debt obligations. Accordingly, the interest rate swap contract is stated at fair value in the Company's consolidated balance sheets (in accrued liabilities at October 29, 2006) and the related portion of fixed rate debt being hedged is stated at an amount equal to the sum of its principal amount plus an adjustment representing the change in fair value of the debt obligation attributable to the interest rate risk being hedged. In addition, changes during any accounting period in the fair value of the interest rate swap contract, as well as offsetting changes in the adjusted carrying value of the related portion of fixed rate debt being hedged, are recognized as adjustments to interest expense in the Company's consolidated statements of operations. The net effect of this interest rate swap contract on the Company's consolidated statements of operations is that the interest expense portion of fixed rate debt being hedged is generally recorded based on variable rates.

In April 2006, the Company's Korean subsidiary entered into a foreign currency rate swap contract. Under the terms of the contract, the Company has effectively converted a \$50 million interest bearing intercompany loan denominated in U.S. dollars to Korean won. This contract, initially scheduled to expire in December 2006, was settled in November 2008. The Company elected not to designate the foreign currency rate swap contract as a hedge which resulted in mark-to-market adjustments in the statements of operations in the amounts of \$1.9 million, \$(0.9) million

and \$(0.7) million in 2008, 2007 and 2006, respectively.

In September 2006, the Company entered into forward contracts to convert the fixed yen purchase price of certain equipment into fixed U.S. dollar amounts. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, hedges related to anticipated transactions are designated and documented at the inception of the respective hedges as cash flow hedges and are evaluated for effectiveness. In the fiscal years ended October 28, 2007 and October 29, 2006, changes in the fair value of these derivative financial instruments of \$1.1 million and \$0.1 million, respectively, were recorded as charges to shareholders' equity as a component of accumulated other comprehensive income since they qualified for hedge accounting as defined by SFAS No. 133. Changes in the fair values of other forward contracts not designated as hedging instruments in the amount of \$0.3 million were charged to the statement of operations (included in investment and other income, net). These forward contracts were settled in November 2007 at a gain of \$0.1 million.

In April 2008, the Company's Korean and Taiwanese subsidiaries each entered into separate foreign currency exchange rate swap contracts that effectively converted a \$12 million interest bearing intercompany loan denominated in U.S. dollars into their respective local currencies. Both contracts expire in conjunction with the April 2009 maturity date of the intercompany loan. The Company did not elect to designate either contract as a fair value hedge.

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NOTE 16 - GEOGRAPHIC AND SIGNIFICANT CUSTOMER INFORMATION

The Company operates as a single operating segment as a manufacturer of photomasks, which are high precision quartz plates containing microscopic images of electronic circuits for use in the fabrication of semiconductors. Geographic net sales are based primarily on where the Company's selling facility is located. The Company's 2008, 2007 and 2006 net sales and total long-lived assets by geographic area were as follows:

| | Fiscal Year Ended | | |
|--------------------------|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Net sales | | | |
| Asia | \$259,293 | \$242,788 | \$252,630 |
| Europe | 66,398 | 71,421 | 79,782 |
| North America | 96,857 | 107,270 | 122,463 |
| | <u>\$422,548</u> | <u>\$421,479</u> | <u>\$454,875</u> |
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Long-lived assets | | | |
| Asia | \$228,009 | \$329,619 | \$331,270 |
| Europe | 14,134 | 67,084 | 70,592 |
| North America | 194,385 | 134,875 | 41,775 |

\$436,528\$531,578\$443,637

Samsung Electronics Co., Ltd. accounted for approximately 25% of the Company's net sales in fiscal years 2008, 2007 and 2006.

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NOTE 17 - COMPREHENSIVE INCOME

The Company's comprehensive income as reported in the consolidated statements of shareholders' equity consists of net earnings (losses) and all changes in equity during a period except those resulting from investments by owners and distributions to owners. The components of other comprehensive income for the last three fiscal years, net of tax, were as follows:

| | Fiscal Year Ended | | |
|--|-----------------------------|-----------------------------|-----------------------------|
| | November 2, 2008 | October 28, 2007 | October 29, 2006 |
| Foreign currency translation adjustment | \$(62,234) | \$13,496 | \$20,366 |
| Change in fair value and amortization of cash flow hedges | 193 | (1,024) | (35) |
| Change in unrealized gains on investments | (279) | (458) | (1,109) |
| Other | 2 | (269) | - |
| Other comprehensive income (loss) | <u>\$(62,318)</u> | <u>\$11,745</u> | <u>\$19,222</u> |

The foreign currency translation adjustment of \$62.2 million for the fiscal year ended November 2, 2008 was primarily due to the weakening of the Korean won against the U.S. dollar.

NOTE 18 - RESTRUCTURING

Since 2001, the Company has closed manufacturing facilities in North America and in Europe due in part to the migration of semiconductor manufacturing to Asia, excess capacity, competitive pricing pressures and weakened demand. Decisions regarding which facilities to close were based on sales volume projections, customer base and production qualifications. The Company continues to assess its global manufacturing strategy based on changes in market conditions. This ongoing assessment could result, in the future, in facilities closures, asset redeployment or workforce reductions, or the addition of increased manufacturing facilities, all of which would be predicated by market conditions and customer requirements.

In fiscal 2006, the Company recorded total restructuring charges of \$15.6 million, primarily related to ceasing operations at its manufacturing and research and development facility in Austin, Texas. During the first quarter of 2007, the Company sold this facility for proceeds of \$5.0 million and realized a gain of \$2.3 million.

In fiscal 2008, the Company announced its intentions to streamline its infrastructure in Europe by ceasing the manufacture of photomasks at its Manchester U.K. facility. This initiative began in the fourth quarter of 2008 with the recording of a \$0.5 million charge for the impairment of certain long-lived assets at the facility in the fourth quarter of fiscal 2008 and was designed to enable the Company to realize manufacturing efficiencies while reducing its cost structure. The Company expects the total after tax cost of the restructure to range between \$3 million to \$5 million through fiscal 2009 (including \$0.5 million recorded in fiscal 2008), of which, approximately 25% will be attributable to non-cash items.

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The following tables set forth the Company's restructuring reserves as of November 2, 2008, October 28, 2007 and October 29, 2006, and reflect activity affecting the reserves for the years then ended. As of November 2, 2008, the remaining liability of \$1.1 million primarily represents non-cancelable lease obligations that are due through August, 2009.

Year Ended November 2, 2008

| | October 28, 2007 Balance | Charges | Utilized | November 2, 2008 Balance |
|--|---|----------------|-----------------|---|
| Manufacturing capacity reduction and other | \$1,687 | \$ - | \$(553) | \$1,134 |
| Total | \$1,687 | \$ - | \$(553) | \$1,134 |

Year Ended October 28, 2007

| | October 29, 2006 Balance | Charges | Utilized | October 28, 2007 Balance |
|--|---|----------------|-----------------|---|
| Manufacturing capacity reduction and other | \$2,528 | \$ - | \$(841) | \$1,687 |
| Workforce reductions | 126 | - | (126) | - |
| Total | \$2,654 | \$ - | \$(967) | \$1,687 |

Year Ended October 29 2006

| | October 30, 2005 Balance | Charges | Utilized | October 29, 2006 Balance |
|--|---|----------------|-----------------|---|
|--|---|----------------|-----------------|---|

| | | | | |
|--|---------|----------|------------|---------|
| Manufacturing capacity reduction and other | \$2,245 | \$14,383 | \$(14,100) | \$2,528 |
| Workforce reductions | - | 1,256 | (1,130) | 126 |
| Total | \$2,245 | \$15,639 | \$(15,230) | \$2,654 |

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NOTE 19 - OTHER RELATED PARTY TRANSACTIONS

The Chairman of the Board of the Company is also the Chairman of the Board and majority shareholder of a company who is a provider of secure managed information technology services. Another director of the Company is also a shareholder, CEO and Executive Vice Chairman of this company. Since 2002, the Company has entered into various service contracts with this company to provide services to all of the Company's worldwide facilities. The Company incurred expenses of \$3.3 million in 2008, \$3.8 million in 2007, and \$4.3 million in 2006 related to services provided by the company, for which the amount owed to this company was \$0.6 million at October 28, 2007. In 2006, the Company signed a new 3-year service contract with this company for \$2.5 million per year.

The Company purchases photomask blanks from a company of which an officer of the Company is a significant shareholder. The Company purchased \$28.5 million, \$21.6 million, and \$16.8 million of photomask blanks from this company in 2008, 2007, and 2006, respectively, for which the amount owed to this company was \$6.8 million at November 2, 2008 and \$5.0 million at October 28, 2007.

The Company believes that the terms of the transactions described above with related parties were negotiated at arm's-length and were no less favorable to the Company than the Company could have obtained from unrelated third parties. See Note 3 for other related party transactions.

NOTE 20 - QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following table sets forth certain unaudited quarterly financial data:

| | <u>First</u> | <u>Second</u> | <u>Third</u> | <u>Fourth</u> | <u>Year</u> |
|----------------------------|--------------|---------------|--------------|---------------|-------------|
| Fiscal 2008: | | | (a) | (b) | (a) (b) |
| Net sales | \$103,215 | \$110,330 | \$105,697 | \$103,306 | \$422,548 |
| Gross margin | 20,596 | 20,274 | 13,884 | 17,953 | 72,707 |
| Net income (loss) | (3,340) | (2,069) | (205,592) | 236 | (210,765) |
| Earnings (loss) per share: | | | | | |
| Basic | \$(0.08) | \$(0.05) | \$(4.93) | \$0.01 | \$(5.06) |
| Diluted | \$(0.08) | \$(0.05) | \$(4.93) | \$0.01 | \$(5.06) |

Fiscal 2007:

| | | | | | |
|---------------------|-----------|-----------|-----------|-----------|-----------|
| Net sales | \$105,981 | \$109,626 | \$104,301 | \$101,571 | \$421,479 |
| Gross margin | 29,665 | 26,193 | 23,706 | 19,957 | 99,521 |
| Net income | 7,857 | 14,066 | 2,238 | 362 | 24,523 |
| Earnings per share: | | | | | |
| Basic | \$0.19 | \$0.34 | \$0.05 | \$0.01 | \$0.59 |
| Diluted | \$0.17 | \$0.30 | \$0.05 | \$0.01 | \$0.56 |

- (a) Includes a \$137.3 million net of income taxes impairment of all of the Company's goodwill and a \$60.9 million net of tax impairment of long-lived assets related to certain asset groups located in Europe and Asia.
- (b) Includes \$0.4 million net of income taxes restructuring charge related to the Company's Manchester, United Kingdom facility made in conjunction with its announced intention to cease the manufacture of photomasks at that facility.

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NOTE 21 - RECENT ACCOUNTING PRONOUNCEMENTS

In May 2008, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. APB 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." FSP No. APB 14-1 requires that issuers of convertible debt instruments that may be settled in cash upon conversion separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP No. APB 14-1 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years, and is required to be retrospectively applied. The Company is evaluating the impact that the adoption of FSP No. APB 14-1 will have on its consolidated financial statements.

In May 2008, The FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS No. 162 became effective in November 2008. Its adoption is not expected to have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133." SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities by requiring entities to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS No. 161 is effective for financial statements issued for fiscal years beginning after November 15, 2008 and interim periods within those fiscal years. The Company is evaluating the impact, if any, SFAS No. 161 will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51." SFAS No. 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim statements within those fiscal years. The Company is currently evaluating the impact SFAS No. 160 will have on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations." SFAS No. 141R establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statement to evaluate the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and, therefore will not impact the Company's consolidated financial statements upon adoption.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, and is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which provides a consistent definition of fair value which focuses on exit price and prioritizes, within a measurement of fair value, the use of market-based inputs over entity-specific inputs. SFAS No. 157 requires expanded disclosures about fair value measurements and establishes a three-level hierarchy for fair value measurements based on the transparency of inputs to the valuation of an asset or liability as of the measurement date. The standard also requires that a company use its own nonperformance risk when measuring liabilities carried at fair value, including derivatives. In February 2008, the FASB approved a FASB Staff Position ("FSP") that permits companies to partially defer the effective date of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The FSP did not permit companies to defer recognition and disclosure requirements for financial assets and financial liabilities or for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually.

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SFAS No. 157 is effective for financial assets and financial liabilities and for nonfinancial assets and nonfinancial liabilities that are remeasured at least annually for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The provisions of SFAS No. 157 will be applied prospectively. The Company intends to defer adoption of SFAS No. 157 for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company is currently evaluating the effects, if any, that SFAS No. 157 may have on its consolidated financial statements.

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

None

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company has established and currently maintains disclosure controls and procedures designed to ensure that information required to be disclosed in its reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to management, including the Company's chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

The Company's management, with the participation of the Company's chief executive officer and chief financial officer, evaluated the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures, as of the end of the period covered by this report, were designed and are functioning effectively to provide reasonable assurance that the information required to be disclosed by the Company in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (ii) accumulated and communicated to management, including the chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding disclosure.

Changes in Internal Control over Financial Reporting

There was no change in the Company's internal control over financial reporting during the fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Internal control over financial reporting is a process designed 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.

Management assessed the effectiveness of the Company's internal control over financial reporting as of November 2, 2008 based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control - Integrated Framework*. Management, under the supervision and with the participation of the Company's chief executive officer and chief financial officer, assessed the effectiveness of the Company's internal control over financial reporting was effective as of November 2, 2008.

The Company's independent registered public accounting firm, Deloitte & Touche LLP, has audited the effectiveness of the Company's internal control over financial reporting as of November 2, 2008, as stated in their attestation report on page 32 of this Form 10-K.

January 14, 2009

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information as to Directors required by Item 401, 405 and 407(c)(3)(d)(4) and (d)(5) of Regulation S-K is set forth in the Company's 2009 definitive Proxy Statement which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this Form 10-K under the caption "PROPOSAL 1 - ELECTION OF DIRECTORS," "SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE" and in paragraph three under the caption "MEETINGS AND COMMITTEES OF THE BOARD" and is incorporated in this report by reference. The information as to Executive Officers is included in the Company's 2009 definitive Proxy Statement under the caption "EXECUTIVE OFFICERS" and is incorporated in this report by reference.

The Company has adopted a code of ethics that applies to its principal executive officer, principal financial officer and principal accounting officer or controller. A copy of the code of ethics may be obtained, free of charge, by writing to the General Counsel of Photronics, Inc., at 15 Secor Road, Brookfield, Connecticut 06804.

ITEM 11. EXECUTIVE COMPENSATION

The information required by Item 402 of Regulation S-K and paragraph (e)(4) and (e)(5) of Item 407 is set forth in the Company's 2009 definitive Proxy Statement under the captions "EXECUTIVE COMPENSATION," "STOCK OPTIONS", "CERTAIN AGREEMENTS", "DIRECTORS' COMPENSATION", "COMPENSATION COMMITTEE INTERLOCKS AND INSIDE PARTICIPATION" and "COMPENSATION COMMITTEE REPORT," respectively, and is incorporated in this report by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information required by Items 403 and 201(d) of Regulation S-K is set forth in the Company's 2009 definitive Proxy Statement under the captions "Ownership of Common Stock by Directors, Nominees, Officers and Certain Beneficial Owners" and "Equity Compensation Plan Information," respectively, and is incorporated in this report by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 404 of Regulation S-K and Item 407(a) of Regulation S-K is set forth in the Company's 2009 definitive Proxy Statement under the captions "MEETINGS AND COMMITTEES OF THE BOARD" and "CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS" and is incorporated in this report by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 9(e) of Schedule 14A is set forth in the Company's 2009 definitive Proxy Statement under the captions "FEES PAID TO THE INDEPENDENT AUDITORS" and "AUDIT COMMITTEE REPORT," respectively, and is incorporated in this report by reference.

PART IV**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

The following documents are filed as part of this report:

| | Page No. |
|--|---------------------|
| 1. Financial Statements: | |
| Report of Independent Registered Public Accounting Firm | 32 |
| Consolidated Balance Sheets at November 2, 2008 and October 28, 2007 | 33 |
| Consolidated Statements of Operations for the years ended November 2, 2008, October 28, 2007 and October 29, 2006 | 34 |
| Consolidated Statements of Shareholders' Equity for the years ended November 2, 2008, October 28, 2007 and October 29, 2006 | 35 |
| Consolidated Statements of Cash Flows for the years ended November 2, 2008, October 28, 2007 and October 29, 2006 | 36 |
| Notes to Consolidated Financial Statements | 37 |
| 2. Financial Statement Schedules: | |
| Report of Independent Registered Public Accounting Firm on Financial Statement Schedule for the years ended November 2, 2008, October 28, 2007 and October 29, 2006 | 68 |
| Schedule II, Valuation Account - Valuation and Qualifying Accounts for the years ended November 2, 2008, October 28, 2007 and October 29, 2006 | 68 |
| All other schedules are omitted because they are not applicable. | |
| 3. Exhibits | |

| <u>Exhibit Number</u> | <u>Description</u> |
|------------------------------|---|
| 3.1 | Certificate of Incorporation as amended July 9, 1986, April 9, 1990, March 16, 1995, November 13, 1997, April 15, 2002 and June 20, 2005 (incorporated by reference to Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended October 28, 2007). |
| 3.2 | By-laws of the Company, (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1, File Number 33-11694, which was declared effective by the Commission on March 10, 1987). |
| 4.1 | The Company will furnish to the Commission upon request any other debt instrument referred to in Item 601(b)(4)(iii)(A) of Regulation S-K. |
| 10.1 | Master Service Agreement dated January 11, 2002 between the Company and RagingWire Telecommunications, Inc. (incorporated by reference to Exhibit 10.2 to the Company's Annual Report on Form 10-K for the fiscal year ended November 3, 2002 (Commission File No. 0-15451)). |
| 10.2 | The Company's 1992 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.24 to the Company's Registration Statement on Form S-8, File Number 33-47446 which was filed on April 24, 1994). ⁺ |
| 10.3 | Amendment to the Employee Stock Purchase Plan as of April 1, 1998 (incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2004 (Commission File Number 0-15451)). ⁺ |
| 10.4 | Amendment to the Employee Stock Purchase Plan as of March 24, 2004 (incorporated by reference to Exhibit 10.10 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2004 (Commission File Number 0-15451)). ⁺ |
| 10.5 | The Company's 1994 Stock Option Plan (incorporated by reference to Exhibit 10.25 to the Company's Registration Statement on Form S-8, Commission File Number 33-78102 which was filed on April 22, 1994). ⁺ |
| 10.6 | The Company's 1996 Stock Option Plan, as amended and restated March 13, 2003 (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2004 (Commission File Number 0-15451)). ⁺ |
| 10.7 | The Company's 1998 Stock Option Plan, as amended and restated March 13, 2003 (incorporated by reference to Exhibit 10.15 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2004 (Commission File Number 0-15451)). ⁺ |
| 10.8 | The Company's 2000 Stock Option Plan, as amended and restated March 13, 2003 (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2004 (Commission File Number 0-15451)). ⁺ |
| 10.9 | 2007 Long-Term Equity Incentive Plan (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8, Registration No. 333). |
| 10.10 | |

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Consulting Agreement between the Company and Constantine S. Macricostas, dated July 11, 2005 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 13, 2005 (Commission File Number 0-15451)).⁺

- 10.11 Amendment No. 1 to the Consulting Agreement between Constantine S. Macricostas and the Company dated November 10, 2008.^{+,*}
- 10.12 Separation and Consulting Agreement between the Company and Michal J. Luttati dated July 12, 2008 (incorporated by reference to Exhibit 10.30 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 27, 2008 (Commission File No. 0-15451)).
- 10.13 Executive Employment Agreement between the Company and Sean T. Smith dated February 20, 2003 (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the quarter ended February 2, 2003 (Commission File No. 0-15451)).⁺

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- 10.14 Limited Liability Company Operating Agreement of MP Mask Technology Center, LLC between Micron Technology, Inc. ("Micron") and Photronics, Inc. ("Photronics") dated May 5, 2006 (incorporated by reference to Exhibit 10.17 to the Company's Quarterly Report on Form 10-Q filed on June 8, 2006 (Commission File No. 0-15451)).[#]
- 10.15 Contribution and Units Purchase Agreement between Micron, Photronics and MP Mask Technology Center, LLC ("MP Mask") dated May 5, 2006 (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q filed on June 8, 2006 (Commission File No. 0-15451)).[#]
- 10.16 Technology License Agreement among Micron, Photronics and MP Mask dated May 5, 2006 (incorporated by reference to Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q filed on June 8, 2006 (Commission File No. 0-15451)).[#]
- 10.17 Build to Suit Lease between Micron and Photronics dated May 5, 2006 (incorporated by reference to Exhibit 10.20 to the Company's Quarterly Report on Form 10-Q filed on June 8, 2006 (Commission File No. 0-15451)).[#]
- 10.18 Photronics to Micron Supply Agreement between Micron and Photronics dated May 5, 2006 (incorporated by reference to Exhibit 10.21 to the Company's Quarterly Report on Form 10-Q filed on June 8, 2006 (Commission File No. 0-15451)).[#]
- 10.19 Company to Photronics Supply Agreement between MP Mask and Photronics dated May 5, 2006 (incorporated by reference to Exhibit 10.22 to the Company's Quarterly Report on Form 10-Q filed on June 8, 2006 (Commission File No. 0-15451)).[#]
- 10.20 Supplemental Agreement entered into as of January 1, 2008 by and between Micron and Photronics in connection with the Build to Suit Lease (incorporated by reference to Exhibit 10.28 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 27, 2008 (Commission File No 0-15451)).[#]
- 10.21

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First Amendment to Build to Suit Lease entered into as of January 15, 2008 between Micron and Photronics in connection with the Build to Suit Lease (incorporated by reference to Exhibit 10.29 to the Company's Quarterly Report on Form 10-Q for the quarter ended July 27, 2008 (Commission File No. 0-15451)).#

- 10.22 Executive Employment Agreement between the Company and Soo Hong Jeong dated August 24, 2001, as amended March 18, 2004, November 28, 2005 and June 9, 2006 (incorporated by reference to Exhibit 10.23 to the Company's Current Report on Form 10-Q filed on September 7, 2006 (Commission File No. 0-15451)).
- 10.23 Extension of Executive Employment Agreement between the Company and Soo Hong Jeong effective October 29, 2006 and ending on October 28, 2007 (incorporated by reference to Exhibit 1.01 to the Company's Current Report on Form 8-K filed on January 3, 2007 (Commission File No. 0-15451)).
- 10.24 Extension of Executive Employment Agreement between the Company and Soo Hong Jeong effective October 28, 2007 and ending October 27, 2008 (incorporated by reference to Exhibit 1.01 to the Company's Current Report on Form 8-K Filed on November 8, 2007 (Commission File No. 0-15451)).
- 10.25 Extension of Executive Employment Agreement between the Company and Soo Hong Jeong effective October 28, 2008 and ending October 27, 2009 (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on November 17, 2008 (Commission File No. 0-15451)).
- 10.26 Executive Employment Agreement between the Company and Christopher J. Progler, Vice President, Chief Technology Officer dated September 10, 2007 (incorporated by reference to Exhibit 10.24 to the Company's Current Report on Form 10-K filed on January 11, 2008 (Commission File No. 0-15451)).+
- 10.27 Credit Agreement dated as of June 6, 2007 among Photronics, Inc., the foreign subsidiary borrowers party thereto, the lenders party thereto and JPMorgan Chase Bank, National Association (as Administrative Agent), Citizens Bank of Massachusetts, HSBC Bank USA, National Association and Citibank, N.A. and JPMorgan Securities, Inc. as Sole Bookrunner and Sole Lead Arranger (incorporated by reference to Exhibit 10.27 to the Company's Form 10-Q for the quarter ended July 29, 2007 (Commission File No. 0-15451)).
- 10.28 Amendment No. 1 to the Credit Agreement dated April 25, 2008 (incorporated by reference to Exhibit 9.01 of the Company's Form 8-K filed on April 30, 2008 (Commission File No. 0-15451)).
- 10.29 Amendment No. 2 to the Credit Agreement dated October 31, 2008.*

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- 10.30 Amendment No. 3 to the Credit Agreement dated December 4, 2008.*
- 10.31 Amendment No. 4 to the Credit Agreement dated December 12, 2008.*
- 10.32 Amended and Restated Agreement RMB 186,000,000 Credit Facility for Photronics Imaging Technologies (Shanghai) Co., Ltd. with JPMorgan Chase Bank (China) Company Limited, Shanghai Branch, as Administrative Agent (incorporated by reference to Exhibit 10.28 to the Company's Form 10-Q for the quarter ended July 29, 2007 (Commission File No. 0-15451)).
- 10.33

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Amendment Agreement dated December 12, 2008 between Photronics imaging Technologies (Shanghai) Co., Ltd. and JPMorgan Chase Bank (China) Company Limited, Shanghai Branch, as Administrative Agent.*

- 10.34 Amended and Restated Guarantee Agreement by Photronics, Inc. relating to RMB 186,000,000 Credit Facility for Photronics Imaging Technologies (Shanghai) Co., Ltd. dated August 23, 2007 (incorporated by reference to Exhibit 10.29 to the Company's Form 10-Q for the quarter ended July 29, 2007 (Commission File No. 0-15451)).
- 10.35 Amendment No. 1 to the Amended and Restated Guarantee Agreement dated April 25, 2008 (incorporated by reference to Exhibit 9.01 of the Company's Form 8-K filed on April 30, 2008 (Commission File No. 0-15451)).
- 10.36 Amendment No. 2 to the Amended and Restated Guarantee Agreement dated October 31, 2008.*
- 10.37 Confirmation of Guaranty and Amendment No. 3 dated as of December 12, 2008 to the Amended and Restated Guarantee Agreement dated as of August 23, 2007.*
- 21 List of Subsidiaries of the Company.*
- 23 Consent of Deloitte & Touche LLP.*
- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

+ Represents a management contract or compensatory plan or arrangement.

Portions of this exhibit have been omitted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission.

* Represents an exhibit that is filed with this Annual Report on Form 10-K.

The Company will provide a copy of any exhibit upon receipt of a written request for the particular exhibit or exhibits desired. All requests should be addressed to the Company's vice president of corporate communications at the address of the Company's principal executive offices.

Board of Directors and Shareholders
 Photronics, Inc.
 Brookfield, Connecticut

We have audited the consolidated financial statements of Photronics, Inc. and subsidiaries (the "Company") as of November 2, 2008 and October 28, 2007, and for each of the three fiscal years in the period ended November 2, 2008 and the Company's internal control over financial reporting as of November 2, 2008, and have issued our report thereon dated January 14, 2009; such consolidated financial statements and report are included elsewhere in this Form 10-K. Our audits also included the consolidated financial statement schedule of the Company listed in Item 15. This consolidated financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such consolidated financial statement schedule, 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/ Deloitte & Touche LLP
 Stamford, Connecticut
 January 14, 2009

Schedule II

Valuation and Qualifying Accounts for the Years Ended November 2, 2008, October 28, 2007 and October 29, 2006 (in thousands)

| | <u>Balance at Beginning of Year</u> | <u>Charge to Costs and Expenses</u> | <u>Deductions</u> | <u>Balance at End of Year</u> |
|--|---|---|-------------------|---------------------------------------|
| Allowance for Doubtful Accounts | | | | |
| Year ended November 2, 2008 | \$ 3,721 | \$ (481) | \$(452) (a) | \$ 2,788 |
| Year ended October 28, 2007 | \$ 4,471 | \$ (25) | \$(725) (a) | \$ 3,721 |
| Year ended October 29, 2006 | \$ 2,475 | \$2,158 | \$(162) (a) | \$ 4,471 |
| Deferred Income Tax Valuation Allowance | | | | |
| Year ended November 2, 2008 | \$39,392 | \$8,757 | \$ - | \$48,149 |
| Year ended October 28, 2007 | \$36,993 | \$2,399 | \$ - | \$39,392 |
| Year ended October 29, 2006 | \$35,245 | \$1,748 | \$ - | \$36,993 |

(a) Uncollectible accounts written off

SIGNATURES

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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.

PHOTRONICS, INC.
(Registrant)

By/s/ SEAN T. SMITH

January 14, 2009

Sean T. Smith
Senior Vice President
Chief Financial Officer
(Principal Accounting Officer)

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.

By/s/ CONSTANTINE S. MACRICOSTAS

January 14, 2009

Constantine S. Macricostas
Chairman of the Board
Interim Chief Executive Officer

By/s/ SEAN T. SMITH

January 14, 2009

Sean T. Smith
Senior Vice President
Chief Financial Officer
(Principal Accounting Officer)

By/s/ WALTER M. FIEDEROWICZ

January 14, 2009

Walter M. Fiederowicz
Director

By/s/ JOSEPH A. FIORITA, JR.

January 14, 2009

Joseph A. Fiorita, Jr.
Director

By/s/ GEORGE C. MACRICOSTAS

January 14, 2009

George C. Macricostas
Director

By/s/ WILLEM D. MARIS

January 14, 2009

Willem D. Maris
Director

By/s/ MITCHELL G. TYSON

January 14, 2009

Mitchell G. Tyson
Director

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