

VEECO INSTRUMENTS INC  
Form 10-Q  
May 05, 2014  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended March 31, 2014**

**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 0-16244**

## VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of

Incorporation or Organization)

**11-2989601**  
(I.R.S. Employer

Identification Number)

**Terminal Drive**  
**Plainview, New York**  
(Address of Principal Executive Offices)

**11803**  
(Zip Code)

Registrant's telephone number, including area code: **(516) 677-0200**

Website: **www.veeco.com**

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

40,039,513 shares of common stock were outstanding as of the close of business on April 25, 2014.



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**Safe Harbor Statement**

This quarterly report on Form 10-Q (the Report ) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Discussions containing such forward-looking statements may be found in Part I. Items 2 and 3 hereof, as well as within this Report generally. In addition, when used in this Report, the words believes, anticipates, expects, estimates, plans, intends will and similar expressions are intended to identify forward-looking statements. Forward-looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from projected results. These risks and uncertainties include, without limitation, the following:

- Our operating results have been, and may continue to be, adversely affected by unfavorable market conditions;
- Timing of market adoption of light emitting diode ( LED ) technology for general lighting is uncertain;
- Our failure to successfully manage our outsourcing activities or failure of our outsourcing partners to perform as anticipated could adversely affect our results of operations and our ability to adapt to fluctuating order volumes;
- The further reduction or elimination of foreign government subsidies and economic incentives may adversely affect the future order rate for our metal organic chemical vapor deposition ( MOCVD ) equipment;
- Our operating results have been, and may continue to be, adversely affected by tightening credit markets;
- Our backlog is subject to customer cancellation or modification and such cancellation could result in decreased sales and increased provisions for excess and obsolete inventory and/or liabilities to our suppliers for products no longer needed;
- Our failure to estimate customer demand accurately could result in excess or obsolete inventory and/or liabilities to our suppliers for products no longer needed, while manufacturing interruptions or delays could affect our ability to meet customer demand;
- The cyclical nature of the industries we serve directly affects our business;
- We rely on a limited number of suppliers, some of whom are our sole source for particular components;
- Our sales to LED and data storage manufacturers are highly dependent on these manufacturers' sales for consumer electronics applications, which can experience significant volatility due to seasonal and other factors, which could materially adversely impact our future results of operations;
- We are exposed to the risks of operating a global business, including the need to obtain export licenses for certain of our shipments and political risks in the countries we operate;
- We may be exposed to liabilities under the Foreign Corrupt Practices Act and any determination that we violated these or similar laws could have a material adverse effect on our business;
- The timing of our orders, shipments, and revenue recognition may cause our quarterly operating results to fluctuate significantly;
- We operate in industries characterized by rapid technological change;

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- We face significant competition;
  - We depend on a limited number of customers, located primarily in a limited number of regions, which operate in highly concentrated industries;
  - Our sales cycle is long and unpredictable;
  - We are subject to internal control evaluations and attestation requirements of Section 404 of the Sarbanes-Oxley Act and any delays or difficulty in satisfying these requirements or negative reports concerning our internal controls could adversely affect our future results of operations and our stock price;
  - The price of our common shares may be volatile and could decline significantly;
  - Our inability to attract, retain, and motivate key employees could have a material adverse effect on our business;
  - We are subject to foreign currency exchange risks;
  - The enforcement and protection of our intellectual property rights may be expensive and could divert our limited resources;
  - We may be subject to claims of intellectual property infringement by others;
  - If we are subject to cyber-attacks we could incur substantial costs and, if such attacks are successful, could result in significant liabilities, reputational harm and disruption of our operations;
  - Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses;
  - We may be required to take additional impairment charges for goodwill and indefinite-lived intangible assets or definite-lived intangible and long-lived assets;
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- Changes in accounting pronouncements or taxation rules or practices may adversely affect our financial results;
- We are subject to risks of non-compliance with environmental, health and safety regulations;
- We have significant operations in locations which could be materially and adversely impacted in the event of a natural disaster or other significant disruption;
- We have adopted certain measures that may have anti-takeover effects which may make an acquisition of our Company by another company more difficult;
- New regulations related to conflict minerals will force us to incur additional expenses, may make our supply chain more complex, and may result in damage to our relationships with customers; and
- The matters set forth in this Report generally, including the risk factors set forth in Part II. Item 1A. Risk Factors.

Consequently, such forward looking statements should be regarded solely as the current plans, estimates and beliefs of Veeco Instruments Inc. (together with its consolidated subsidiaries, Veeco, the Company, we, us, and our, unless the context indicates otherwise). The Company does not undertake any obligation to update any forward looking statements to reflect future events or circumstances after the date of such statements.

**Available Information**

We file annual, quarterly and current reports, information statements and other information with the SEC. The public may obtain information by calling the SEC at 1-800-SEC-0330. The SEC also maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is [www.sec.gov](http://www.sec.gov).

**Internet Address**

We maintain a website where additional information concerning our business and various upcoming events can be found. The address of our website is [www.veeco.com](http://www.veeco.com). We provide a link on our website, under Investors Financial Information SEC Filings, through which investors can access our filings with the SEC, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to such reports. These filings are posted to our website as soon as reasonably practicable after we electronically file such material with the SEC.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****Veeco Instruments Inc. and Subsidiaries****Condensed Consolidated Statements of Operations****(In thousands, except per share data)  
(Unaudited)**

|                                      | <b>For the three months ended<br/>March 31,</b> |          |             |
|--------------------------------------|---|----------|-------------|
|                                      | <b>2014</b>                                     |          | <b>2013</b> |
| Net sales                            | \$  | 90,841   | \$ 61,781   |
| Cost of sales                        |   | 57,064   | 39,229      |
| Gross profit                         |   | 33,777   | 22,552      |
| Operating expenses:                  |   |          |             |
| Selling, general and administrative  |   | 21,667   | 19,648      |
| Research and development             |   | 19,768   | 20,737      |
| Amortization                         |   | 2,903    | 856         |
| Restructuring                        |   | 392      | 531         |
| Total operating expenses             |   | 44,730   | 41,772      |
| Other operating, net                 |   | (212)    | 404         |
| Changes in contingent consideration  |   | (29,368) |             |
| Operating income (loss)              |   | 18,627   | (19,624)    |
| Interest income (expense), net       |   | 164      | 192         |
| Income (loss) before income taxes    |   | 18,791   | (19,432)    |
| Income tax provision (benefit)       |   | (369)    | (9,361)     |
| Net income (loss)                    | \$  | 19,160   | \$ (10,071) |
| Income (loss) per common share:      |   |          |             |
| Basic:                               |   |          |             |
| Income (loss)                        | \$  | 0.49     | \$ (0.26)   |
| Diluted :                            |   |          |             |
| Income (loss)                        | \$  | 0.48     | \$ (0.26)   |
| Weighted average shares outstanding: |   |          |             |
| Basic                                |   | 39,177   | 38,716      |
| Diluted                              |   | 39,937   | 38,716      |

The accompanying notes are an integral part of these condensed consolidated financial statements.



Table of Contents**Veeco Instruments Inc. and Subsidiaries****Condensed Consolidated Statements of Comprehensive Income (Loss)****(In thousands)****(Unaudited)**

|  | <b>For the three months ended</b> |             |
|--|-----------------------------------|-------------|
|  | <b>March 31,</b>                  |             |
|  | <b>2014</b>                       | <b>2013</b> |
| Net income (loss)  | \$ 19,160                         | \$ (10,071) |
| Other comprehensive income (loss), net of tax                              |                                   |             |
| Available-for-sale securities  |                                   |             |
| Unrealized gain (loss) on available-for-sale securities                    | 50                                | 27          |
| Benefit (provision) for income taxes                                       |                                   | 16          |
| Less: Reclassification adjustments for gains included in net income (loss) |                                   | (59)        |
| Net unrealized gain (loss) on available-for-sale securities                | 50                                | (16)        |
| Foreign currency translation   |                                   |             |
| Foreign currency translation   | 133                               | (750)       |
| Benefit (provision) for income taxes                                       |                                   | (13)        |
| Net foreign currency translation   | 133                               | (763)       |
| Other comprehensive income (loss), net of tax                              | 183                               | (779)       |
| Comprehensive income (loss)  | \$ 19,343                         | \$ (10,850) |

The accompanying notes are an integral part of these condensed consolidated financial statements.

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## Veeco Instruments Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(In thousands, except share data)

|  | March 31,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--|----------------------------------|----------------------|
| <b>Assets</b>  |                                  |                      |
| Current assets:  |                                  |                      |
| Cash and cash equivalents  | \$ 214,682                       | \$ 210,799           |
| Short-term investments   | 267,402                          | 281,538              |
| Restricted cash  | 764                              | 2,738                |
| Accounts receivable, net   | 50,720                           | 23,823               |
| Inventories  | 52,073                           | 59,726               |
| Deferred cost of sales   | 2,646                            | 724                  |
| Prepaid expenses and other current assets  | 26,121                           | 22,579               |
| Deferred income taxes  | 10,796                           | 11,716               |
| <b>Total current assets</b>  | <b>625,204</b>                   | <b>613,643</b>       |
| Property, plant and equipment at cost, net   | 86,912                           | 89,139               |
| Goodwill   | 91,348                           | 91,348               |
| Deferred income taxes  | 397                              | 397                  |
| Intangible assets, net   | 111,814                          | 114,716              |
| Other assets   | 38,882                           | 38,726               |
| <b>Total assets</b>  | <b>\$ 954,557</b>                | <b>\$ 947,969</b>    |
| <b>Liabilities and equity</b>  |                                  |                      |
| Current liabilities:   |                                  |                      |
| Accounts payable   | \$ 28,293                        | \$ 35,755            |
| Accrued expenses and other current liabilities   | 38,065                           | 51,084               |
| Customer deposits and deferred revenue   | 41,171                           | 34,754               |
| Income taxes payable   | 5,538                            | 6,149                |
| Deferred income taxes  | 159                              | 159                  |
| Current portion of long-term debt  | 296                              | 290                  |
| <b>Total current liabilities</b>   | <b>113,522</b>                   | <b>128,191</b>       |
| Deferred income taxes  | 26,325                           | 28,052               |
| Long-term debt   | 1,771                            | 1,847                |
| Other liabilities  | 498                              | 9,649                |
| <b>Total liabilities</b>   | <b>142,116</b>                   | <b>167,739</b>       |
| Equity:  |                                  |                      |
| Preferred stock, 500,000 shares authorized; no shares issued and outstanding   |                                  |                      |
| Common stock; \$.01 par value; authorized 120,000,000 shares; 40,015,173 and 39,666,195 shares issued and outstanding in 2014 and 2013, respectively | 400                              | 397                  |
| Additional paid-in capital   | 734,217                          | 721,352              |
| Retained earnings  | 73,020                           | 53,860               |
| Accumulated other comprehensive income   | 4,804                            | 4,621                |
| <b>Total equity</b>  | <b>812,441</b>                   | <b>780,230</b>       |
| <b>Total liabilities and equity</b>  | <b>\$ 954,557</b>                | <b>\$ 947,969</b>    |

The accompanying notes are an integral part of these condensed consolidated financial statements.



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## Veeco Instruments Inc. and Subsidiaries

## Condensed Consolidated Statements of Cash Flows

(In thousands)  
(Unaudited)

|   | Three months ended<br>March 31, |             |
|---|---------------------------------|-------------|
|   | 2014                            | 2013        |
| <b>Cash Flows from Operating Activities</b>   |                                 |             |
| Net income (loss)   | \$ 19,160                       | \$ (10,071) |
| Adjustments to reconcile net income (loss) to net cash from operating activities:   |                                 |             |
| Depreciation and amortization   | 5,771                           | 3,927       |
| Deferred income taxes   | (798)                           | (6,215)     |
| Non-cash equity-based compensation  | 4,722                           | 2,579       |
| Provision for bad debt  | (42)                            | 16          |
| Gross profit from sales of lab tools  | (920)                           |             |
| Change in contingent consideration  | (29,368)                        |             |
| Excess tax benefits from equity-based compensation                                  |                                 | (31)        |
| Changes in operating assets and liabilities:  |                                 |             |
| Accounts receivable   | (26,939)                        | 20,004      |
| Restricted cash   | 1,974                           |             |
| Inventories   | 8,150                           | (8,395)     |
| Prepaid expenses and other current assets   | (3,410)                         | (6,501)     |
| Accounts payable  | (7,432)                         | 6,458       |
| Accrued expenses, customer deposits, deferred revenue and other current liabilities | 11,608                          | 1,764       |
| Income taxes payable  | (612)                           | (1,555)     |
| Other, net  | (265)                           | 8,506       |
| Net cash provided by (used in) operating activities                                 | (18,401)                        | 10,486      |
| <b>Cash Flows from Investing Activities</b>   |                                 |             |
| Capital expenditures  | (2,138)                         | (1,619)     |
| Proceeds from the liquidation of short-term investments                             | 32,030                          | 101,236     |
| Payments for purchases of short-term investments                                    | (17,989)                        | (271,713)   |
| Proceeds from sale of lab tools   | 2,340                           |             |
| Other   | (124)                           |             |
| Net cash provided by (used in) investing activities                                 | 14,119                          | (172,096)   |
| <b>Cash Flows from Financing Activities</b>   |                                 |             |
| Proceeds from stock option exercises  | 8,316                           | 280         |
| Restricted stock tax withholdings   | (170)                           | (132)       |
| Excess tax benefits from equity-based compensation                                  |                                 | 31          |
| Repayments of long-term debt  | (70)                            | (65)        |
| Net cash provided by (used in) financing activities                                 | 8,076                           | 114         |
| Effect of exchange rate changes on cash and cash equivalents                        | 89                              | 60          |
| Net increase (decrease) in cash and cash equivalents                                | 3,883                           | (161,436)   |
| Cash and cash equivalents as of beginning of period                                 | 210,799                         | 384,557     |
| Cash and cash equivalents as of end of period                                       | \$ 214,682                      | \$ 223,121  |

The accompanying notes are an integral part of these condensed consolidated financial statements.



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**Veeco Instruments Inc. and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements of Veeco Instruments Inc. (together with its consolidated subsidiaries, Veeco, the Company, we, us, and our, unless the context indicates otherwise) have been prepared in accordance with accounting principles generally accepted in the United States ( U.S. ) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S generally accepted accounting principles ( U.S. GAAP ) for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. Operating results for the three months ended March 31, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended December 31, 2013.

Consistent with prior years, we report interim quarters, other than fourth quarters which always end on December 31, on a 13-week basis ending on the last Sunday of each period. The interim quarter ends are determined at the beginning of each year based on the 13-week quarters. The 2014 interim quarter ends are March 30, June 29 and September 28. The 2013 interim quarter ends were March 31, June 30 and September 29. For ease of reference, we report these interim quarter ends as March 31, June 30 and September 30 in our interim condensed consolidated financial statements. We have reclassified certain amounts previously reported in our financial statements to conform to the current presentation.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made by management include: the best estimate of selling price for our products and services; allowance for doubtful accounts; inventory obsolescence; recoverability and useful lives of property, plant and equipment and identifiable intangible assets; investment valuations; fair value of derivatives; recoverability of goodwill and long lived assets; recoverability of deferred tax assets; liabilities for product warranty; accounting for acquisitions; accruals for contingencies; equity-based payments, including forfeitures and performance based vesting; and liabilities for tax uncertainties. Actual results could differ from those estimates.

*Income (Loss) Per Common Share*

The following table sets forth the reconciliation of basic weighted average shares outstanding and diluted weighted average shares outstanding (in thousands):

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|   | Three months ended<br>March 31, |        |
|---|---------------------------------|--------|
|   | 2014                            | 2013   |
| Basic weighted average shares outstanding             | 39,177                          | 38,716 |
| Dilutive effect of stock options and restricted stock | 760                             |        |
| Diluted weighted average shares outstanding           | 39,937                          | 38,716 |

Basic income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is computed using the weighted average number of common shares and common equivalent shares outstanding during the period. For the three months ended March 31, 2013, we reported a net loss applicable to common shareholders, and accordingly, the basic and diluted weighted average shares outstanding are equal because any increase to basic weighted average shares outstanding would be antidilutive. As a result, for the three months ended March 31, 2013, we excluded 0.5 million common equivalent shares that would have otherwise been dilutive.

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Additionally, not included above, were additional stock options and restricted stock outstanding that had exercise or grant prices in excess of the average market value of our common stock during the period and are therefore antidilutive. There were 1.4 million of such underlying shares for the three months ended March 31, 2014 and 2013, respectively.

*Revenue Recognition*

We recognize revenue when all of the following criteria have been met: persuasive evidence of an arrangement exists with a customer; delivery of the specified products has occurred or services have been rendered; prices are contractually fixed or determinable; and collectability is reasonably assured. Revenue is recorded including shipping and handling costs and excluding applicable taxes related to sales. A significant portion of our revenue is derived from contractual arrangements with customers that have multiple elements, such as systems, upgrades, components, spare parts, maintenance and service plans. For sales arrangements that contain multiple elements, we split the arrangement into separate units of accounting if the individually delivered elements have value to the customer on a standalone basis. We also evaluate whether multiple transactions with the same customer or related party should be considered part of a multiple element arrangement, whereby we assess, among other factors, whether the contracts or agreements are negotiated or executed within a short time frame of each other or if there are indicators that the contracts are negotiated in contemplation of each other. When we have separate units of accounting, we allocate revenue to each element based on the following selling price hierarchy: vendor-specific objective evidence ( VSOE ) if available; third party evidence ( TPE ) if VSOE is not available; or our best estimate of selling price ( BEBP ) if neither VSOE nor TPE is available. We utilize BEBP for the majority of the elements in our arrangements. The accounting guidance for selling price hierarchy did not include BEBP for arrangements entered into prior to January 1, 2011, and as such we recognized revenue for those arrangements as described below.

We consider many facts when evaluating each of our sales arrangements to determine the timing of revenue recognition, including the contractual obligations, the customer's creditworthiness and the nature of the customer's post-delivery acceptance provisions. Our system sales arrangements, including certain upgrades, generally include field acceptance provisions that may include functional or mechanical test procedures. For the majority of our arrangements, a customer source inspection of the system is performed in our facility or test data is sent to the customer documenting that the system is functioning to the agreed upon specifications prior to delivery. Historically, such source inspection or test data replicates the field acceptance provisions that will be performed at the customer's site prior to final acceptance of the system. As such, we objectively demonstrate that the criteria specified in the contractual acceptance provisions are achieved prior to delivery and, therefore, we recognize revenue upon delivery since there is no substantive contingency remaining related to the acceptance provisions at that date, subject to the retention amount constraint described below. For new products, new applications of existing products or for products with substantive customer acceptance provisions where we cannot objectively demonstrate that the criteria specified in the contractual acceptance provisions have been achieved prior to delivery, revenue and the associated costs are deferred and fully recognized upon the receipt of final customer acceptance, assuming all other revenue recognition criteria have been met.

Our system sales arrangements, including certain upgrades, generally do not contain provisions for right of return or forfeiture, refund, or other purchase price concessions. In the rare instances where such provisions are included, we defer all revenue until such rights expire. In many cases our products are sold with a billing retention, typically 10% of the sales price (the retention amount), which is typically payable by the customer when field acceptance provisions are completed. The amount of revenue recognized upon delivery of a system or upgrade, if any, is limited to the lower of i) the amount billed that is not contingent upon acceptance provisions or ii) the value of the arrangement consideration allocated to the delivered elements, if such sale is part of a multiple-element arrangement.

For transactions entered into prior to January 1, 2011, under the accounting rules for multiple-element arrangements in place at that time, we deferred the greater of the retention amount or the relative fair value of the undelivered elements based on VSOE. When we could not establish VSOE or TPE for all undelivered elements of an arrangement, revenue on the entire arrangement was deferred until the earlier of the point when we did have VSOE for all undelivered elements or the delivery of all elements of the arrangement.



Our sales arrangements, including certain upgrades, generally include installation. The installation process is not deemed essential to the functionality of the equipment since it is not complex; that is, it does not require significant changes to the features or capabilities of the equipment or involve building elaborate interfaces or connections subsequent to factory acceptance. We have a demonstrated history of consistently completing installations in a timely manner and can reliably estimate the costs of such activities. Most customers engage us to perform the installation services, although there are other

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third-party providers with sufficient knowledge who could complete these services. Based on these factors, we deem the installation of our systems to be inconsequential or perfunctory relative to the system as a whole, and as a result, do not consider such services to be a separate element of the arrangement. As such, we accrue the cost of the installation at the time of revenue recognition for the system.

In Japan, where our contractual terms with customers generally specify title and risk and rewards of ownership transfer upon customer acceptance, revenue is recognized and the customer is billed upon the receipt of written customer acceptance. During the fourth quarter of fiscal 2013, we began using a distributor for almost all of our product and service sales to customers in Japan. Title and risk and rewards of ownership of our system sales still transfer to our end-customers upon their acceptance. As such, there is no impact to our policy of recognizing revenue upon receipt of written acceptance from the end customer.

Revenue related to maintenance and service contracts is recognized ratably over the applicable contract term. Component and spare part revenue are recognized at the time of delivery in accordance with the terms of the applicable sales arrangement.

*Recent Accounting Pronouncements*

*Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.* In April 2014, the FASB issued ASU No. 2014-08 that changes the threshold for reporting discontinued operations and adds new disclosures. The new guidance defines a discontinued operation as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. For disposals of individually significant components that do not qualify as discontinued operations, an entity must disclose pre-tax earnings of the disposed component. For public business entities, this guidance is effective prospectively for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

*Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or Tax Credit Carryforward Exists:* In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or Tax Credit Carryforward Exists.* ASU 2013-11 requires entities to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward when settlement in this manner is available under the tax law. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. We adopted this as of January 1, 2014 and it did not have a material impact on our consolidated financial statements.

*Presentation of Financial Statements:* In April 2013, the FASB issued ASU No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting.* The objective of ASU 2013-07 is to clarify when an entity should apply the liquidation basis of accounting. The update provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. We adopted this as of January 1, 2014 and will evaluate the materiality of its impact on our consolidated financial statements when there are any indications that liquidation is imminent.

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*Parent's Accounting for the Cumulative Translation Adjustment:* In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This new standard is intended to resolve diversity in practice regarding the release into net income of a cumulative translation adjustment (CTA) upon derecognition of a subsidiary or group of assets within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. We have adopted this as of January 1, 2014 and currently anticipate that it could have an impact on our consolidated financial statements, in the event of derecognition of a foreign subsidiary in 2014 or subsequently. We cannot currently estimate the amount of CTA to be released into income from any potential derecognition.

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**Note 2 Business Combinations**

On October 1, 2013 ( the Acquisition Date ), Veeco acquired 100% of the outstanding common shares and voting interest of Synos Technology, Inc. ( Synos ). The results of Synos operations have been included in the consolidated financial statements since that date. Synos is an early stage manufacturer of fast array scanning atomic layer deposition ( FAST-ALD ) tools for OLED and other applications. As a result of the acquisition, the Company has entered the ALD market which is complimentary to the Company s MOCVD LED offerings. The purchase price allocation is still preliminary.

As part of Veeco s acquisition agreement with Synos, there were certain contingent payments due to the selling shareholders of Synos dependent on the achievement of certain milestones. The aggregate fair value of the contingent consideration arrangement as of December 31, 2013 was \$29.4 million.

We estimate the fair value of acquisition-related contingent consideration based on management s probability-weighted present value of the consideration expected to be transferred during the remainder of the earn-out period, based on the forecast related to the milestones. The fair value of the contingent consideration is reassessed by us on a quarterly basis based on a collaborative effort of our operations, finance and accounting groups using additional information as it becomes available. Any change in the fair value of an acquisition s contingent consideration liability results in a remeasurement gain or loss that is recorded in the earnings of that period. As of March 31, 2014, we determined that the agreed upon post-closing milestones were not met or are not expected to be achieved and therefore reversed the remaining \$29.4 million liability of the contingent consideration and recorded it as a change in contingent consideration in the Condensed Consolidated Statement of Operations.

The post-closing milestones are divided into two contingencies. The first, tied to receipt of certain purchase orders, had an evaluation date of March 31, 2014, which, was not met and accounted for \$20.2 million of the reversed liability. The second is based on achieving certain full year 2014 revenue and gross margin thresholds, which are unlikely to be met and accounted for \$9.2 million of the reversed liability. As of March 31, 2014 the second contingency, with a maximum potential value of \$75.0 million, remains contractually outstanding.

**Note 3 Income Taxes**

At the end of each interim reporting period, we estimate the effective income tax rate expected to be applicable for the full year. This estimate is used to determine the income tax provision or benefit on a year-to-date basis and may change in subsequent interim periods.

Our effective tax rate for the three months ended March 31, 2014 was a benefit of 2.0% compared to a benefit of 48.2% during the three months ended March 31, 2013. A tax benefit for each period was provided to the extent of future reversals of taxable temporary differences which relate primarily to tax deductible intangibles. Our effective tax rate for 2014 differed from the expected net operating loss carry forward benefit at the U.S. federal statutory rate of 35% primarily because of the inability to recognize such benefit due to uncertainties relating to future taxable income in terms of both its timing and its sufficiency, which would enable us to realize the federal carry forward benefit. The effective tax rate was also impacted because we did not provide a tax provision on the gain from the settlement of the contingent consideration related to the Synos acquisition. Our effective tax rate for 2013 differed from the U.S. federal statutory rate as a result of the jurisdictional mix of earnings in our foreign locations, an income tax benefit related to the generation of current year research and development tax credits, and legislation enacted in the first quarter of 2013 which extended the Federal Research and Development Credit for both the 2012 and 2013 tax years.

**Note 4 Balance Sheet Information**

*Cash and Cash Equivalents*

Cash and cash equivalents include cash and certain highly liquid investments. Highly liquid investments with maturities of three months or less when purchased may be classified as cash equivalents. Such items may include liquid money market accounts, U.S. treasuries, government agency securities and corporate debt. The investments that are classified as cash equivalents are carried at cost, which approximates fair value.

Table of Contents*Short-Term Investments*

Total available-for-sale securities and gains and losses in accumulated other comprehensive income (loss) consist of the following (*in thousands*):

|                                     | March 31, 2014    |   |  |                         |
|-------------------------------------|-------------------|---|--|-------------------------|
|                                     | Amortized<br>Cost | Gains in<br>Accumulated<br>Other<br>Comprehensive<br>Income | Losses in<br>Accumulated<br>Other<br>Comprehensive<br>Income | Estimated Fair<br>Value |
| U.S. treasuries                     | \$ 130,889        | \$ 25   | \$   | \$ 130,914              |
| Corporate debt                      | 73,410            | 76  | (13)   | 73,473                  |
| Government agency securities        | 59,004            | 11  |  | 59,015                  |
| Commercial paper                    | 4,000             |   |  | 4,000                   |
| Total available-for-sale securities | \$ 267,303        | \$ 112  | \$ (13)  | \$ 267,402              |

|                                     | December 31, 2013 |   |  |                         |
|-------------------------------------|-------------------|---|--|-------------------------|
|                                     | Amortized<br>Cost | Gains in<br>Accumulated<br>Other<br>Comprehensive<br>Income | Losses in<br>Accumulated<br>Other<br>Comprehensive<br>Income | Estimated Fair<br>Value |
| U.S. treasuries                     | \$ 130,956        | \$ 22   | \$ (1)   | \$ 130,977              |
| Corporate debt                      | 77,582            | 55  | (36)   | 77,601                  |
| Government agency securities        | 61,004            | 9   |  | 61,013                  |
| Commercial paper                    | 11,947            |   |  | 11,947                  |
| Total available-for-sale securities | \$ 281,489        | \$ 86   | \$ (37)  | \$ 281,538              |

During the three months ended March 31, 2014 and 2013, available-for-sale securities were liquidated for total proceeds of \$32.0 million and \$101.2 million, respectively. For the three months ended March 31, 2014 there were no realized gains on these liquidations, which were all maturities of investments. For the three months ended March 31, 2013 the gross realized gains on these sales were \$0.1 million. The cost of securities sold is based on specific identification.

The table below shows the fair value of short-term investments that have been in an unrealized loss position for less than 12 months (*in thousands*):

|                | March 31, 2014                                 |                            |                         | Total<br>Estimated Fair<br>Value | Total<br>Gross Unrealized<br>Losses |
|----------------|--|----------------------------|-------------------------|----------------------------------|-------------------------------------|
|                | Less than 12 months<br>Estimated<br>Fair Value | Gross Unrealized<br>Losses | Estimated Fair<br>Value |                                  |                                     |
| Corporate debt | \$ 25,916                                      | \$ (13)                    | \$ 25,916               | \$ (13)                          |                                     |
| Total          | \$ 25,916                                      | \$ (13)                    | \$ 25,916               | \$ (13)                          |                                     |

December 31, 2013

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|                  | Less than 12 months     |                            | Total                   |                            |
|------------------|-------------------------|----------------------------|-------------------------|----------------------------|
|                  | Estimated<br>Fair Value | Gross Unrealized<br>Losses | Estimated Fair<br>Value | Gross Unrealized<br>Losses |
| Corporate debt   | \$ 37,654               | \$ (36)                    | \$ 37,654               | \$ (36)                    |
| U. S. treasuries | 29,068                  | (1)                        | 29,068                  | (1)                        |
| Total            | \$ 66,722               | \$ (37)                    | \$ 66,722               | \$ (37)                    |

We did not hold any short-term investments that have been in an unrealized loss position for 12 months or longer for the periods noted in the tables above.

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The Company regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether an unrealized loss was considered to be temporary or other-than-temporary and therefore impaired include: the length of time and extent to which fair value has been lower than the cost basis; the financial condition and near-term prospects of the investee; and whether it is more likely than not that the Company will be required to sell the security prior to recovery. The Company believes the gross unrealized losses on the Company's short-term investments as of March 31, 2014 and December 31, 2013 were temporary in nature and therefore did not recognize any impairment.

Contractual maturities of available-for-sale debt securities are as follows (*in thousands*):

|                                     | <b>March 31, 2014</b>       |         |
|-------------------------------------|-----------------------------|---------|
|                                     | <b>Estimated Fair Value</b> |         |
| Due in one year or less             | \$                          | 207,913 |
| Due in 1 - 2 years                  |                             | 47,621  |
| Due in 2 - 3 years                  |                             | 11,868  |
| Total available-for-sale securities | \$                          | 267,402 |

Actual maturities may differ from contractual maturities because some borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

*Restricted Cash*

As of March 31, 2014 and December 31, 2013, restricted cash was \$0.8 million and \$2.7 million, respectively, which serves as collateral for bank guarantees that provide financial assurance that the Company will fulfill certain customer obligations. This cash is held in custody by the issuing bank and is restricted as to withdrawal or use while the related bank guarantees are outstanding.

*Accounts Receivable, Net*

Accounts receivable are presented net of allowance for doubtful accounts of \$2.7 million and \$2.4 million as of March 31, 2014 and December 31, 2013, respectively. We evaluate the collectability of accounts receivable based on a combination of factors. In cases where we become aware of circumstances that may impair a customer's ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize an allowance for doubtful accounts based on the length of time the receivables are past due and consideration of other factors such as industry conditions, the current business environment and its historical experience.

*Inventories*



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Inventories are stated at the lower of cost (principally first-in, first-out) or market. Inventories consist of (*in thousands*):

|                 | March 31,<br>2014 |        | December 31,<br>2013 |        |
|-----------------|-------------------|--------|----------------------|--------|
| Materials       | \$                | 27,486 | \$                   | 34,301 |
| Work in process |                   | 16,827 |                      | 12,900 |
| Finished goods  |                   | 7,760  |                      | 12,525 |
|                 | \$                | 52,073 | \$                   | 59,726 |

Table of Contents*Property, Plant and Equipment, Net*

As of March 31, 2014, we are holding \$5.8 million of tools, that were previously used in our laboratories, for sale. These tools are carried in machinery and equipment, as a component of property, plant and equipment, net in our Condensed Consolidated Balance Sheets. These tools are the same type of tools we sell to our customers in the ordinary course of our business. During the three months ended March 31, 2014, we converted and sold \$1.4 million of tools that we had previously used in our laboratories as Veeco Certified Equipment at an aggregate selling price of \$2.3 million which is included in revenue in our Condensed Consolidated Statements of Operations.

*Cost Method Investment*

On September 28, 2010, we completed a \$3.0 million investment in a rapidly developing organic light emitting diode (also known as OLED) equipment company (the Investment). We invested an additional \$10.3 million and \$1.2 million in the Investment during 2012 and 2011, respectively. In 2013, we invested an additional \$2.4 million in the Investment in the form of bridge notes bearing 4% interest. The bridge notes are payable in equity at the time of a liquidity event or a qualifying equity investment round, otherwise they are payable in cash one year from the date of issuance. During the three months ended March 31, 2014, we invested an additional \$0.2 million in the Investment in the form of additional bridge notes. Subsequent to quarter end, we invested an additional \$0.6 million in the bridge notes. As of March 31, 2014 and December 31, 2013, we have a 15.4% ownership of the preferred shares, and effectively hold a 11.0% ownership interest of the total company. Since we do not exert significant influence on the Investment, this investment is treated under the cost method in accordance with applicable accounting guidance. This investment is recorded in other assets in our Condensed Consolidated Balance Sheets as of March 31, 2014 and December 31, 2013.

*Customer Deposits and Deferred Revenue*

As of March 31, 2014 and December 31, 2013, we had customer deposits of \$31.3 million and \$27.5 million, respectively recorded as a component of customer deposits and deferred revenue.

*Accrued Warranty*

We estimate the costs that may be incurred under the warranties we provide and record a liability in the amount of such costs at the time the related revenue is recognized. Factors that affect our warranty liability include product failure rates, material usage and labor costs incurred in correcting product failures during the warranty period. This accrual is recorded in accrued expenses and other current liabilities in our Condensed Consolidated Balance Sheets. We periodically assess the adequacy of our recognized warranty liability and adjust the amount as necessary. Changes in our warranty liability during the period are as follows (*in thousands*):

|                                       | March 31, |          |
|---------------------------------------|-----------|----------|
|                                       | 2014      | 2013     |
| Balance as of the beginning of period | \$ 5,662  | \$ 4,942 |

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|                                       |          |          |
|---------------------------------------|----------|----------|
| Warranties issued during the period   | 643      | 478      |
| Settlements made during the period    | (1,195)  | (1,341)  |
| Changes in estimate during the period |          |          |
| Balance as of the end of period       | \$ 5,110 | \$ 4,079 |

*Mortgage Payable*

We have a mortgage payable with approximately \$2.1 million outstanding as of March 31, 2014 and December 31, 2013. The mortgage accrues interest at an annual rate of 7.91%, and the final payment is due on January 1, 2020. We estimate the fair value of the mortgage as of March 31, 2014 and December 31, 2013 was approximately \$2.2 million and \$2.3 million, respectively.

Table of Contents*Accumulated Other Comprehensive Income*

The components of accumulated other comprehensive income are (*in thousands*):

| <b>As of March 31, 2014</b>                      | <b>Gross</b> | <b>Taxes</b> | <b>Net</b> |
|--|--------------|--------------|------------|
| Translation adjustments                          | \$ 5,851     | \$ (392)     | \$ 5,459   |
| Minimum pension liability                        | (1,160)      | 424          | (736)      |
| Unrealized gain on available-for-sale securities | 99           | (18)         | 81         |
| Accumulated other comprehensive income           | \$ 4,790     | \$ 14        | \$ 4,804   |

| <b>As of December 31, 2013</b>                   | <b>Gross</b> | <b>Taxes</b> | <b>Net</b> |
|--|--------------|--------------|------------|
| Translation adjustments                          | \$ 5,718     | \$ (392)     | \$ 5,326   |
| Minimum pension liability                        | (1,160)      | 424          | (736)      |
| Unrealized gain on available-for-sale securities | 49           | (18)         | 31         |
| Accumulated other comprehensive income           | \$ 4,607     | \$ 14        | \$ 4,621   |

*Common Stock*

During the three months ended March 31, 2014, 355,930 shares of common stock were issued as a result of stock option exercises and 12,532 restricted stock awards vested, for which, 4,841 shares were withheld to cover taxes and cancelled.

**Note 5 Segment Information**

We have five identified operating segments that we aggregate into two reportable segments: the VIBE and Mechanical reporting units which are reported in our Data Storage segment; and the metal organic chemical vapor deposition ( MOCVD ), molecular beam epitaxy ( MBE ) and atomic layer deposition ( ALD ) reporting units are reported in our LED & Solar segment. We manage the business, review operating results and assess performance, as well as allocate resources, based upon our reporting units that reflect the market focus of each business. The LED & Solar segment consists of MOCVD systems, MBE systems, thermal deposition sources, ALD technology and other types of deposition systems. These systems are primarily sold to customers in the LED, OLED and solar industries, as well as to scientific research customers. This segment has product development and marketing sites in Somerset, New Jersey, Poughkeepsie, New York, St. Paul, Minnesota, Fremont, California, and Korea. The Data Storage segment consists of the ion beam etch, ion beam deposition, diamond-like carbon, physical vapor deposition, and dicing and slicing products sold primarily to customers in the data storage industry. This segment has product development and marketing sites in Plainview, New York, Ft. Collins, Colorado and Camarillo, California.

We evaluate the performance of our reportable segments based on income (loss) from operations before interest, income taxes, amortization and certain items ( segment profit (loss) ), which is the primary indicator used to plan and forecast future periods. The presentation of this financial measure facilitates meaningful comparison with prior periods, as management believes segment profit (loss) reports baseline performance and thus provides useful information. Certain items include restructuring expenses, asset impairment charges, equity-based compensation expense and other non-recurring items. The accounting policies of the reportable segments are the same as those described in the summary of critical accounting policies.



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The following tables present certain data pertaining to our reportable segments and a reconciliation of segment profit (loss) to income (loss) before income taxes for the three months ended March 31, 2014 and 2013, respectively, and goodwill and total assets as of March 31, 2014 and December 31, 2013 (*in thousands*):

|  | LED & Solar | Data Storage | Unallocated | Total       |
|--|-------------|--------------|-------------|-------------|
| <b>Three months ended March 31, 2014</b> |             |              |             |             |
| Net sales                                | \$ 70,755   | \$ 20,086    | \$          | \$ 90,841   |
| Segment profit (loss)                    | \$ 2,124    | \$ (648)     | \$ (4,200)  | \$ (2,724)  |
| Interest income (expense), net           |             |              | 164         | 164         |
| Amortization                             | (2,579)     | (324)        |             | (2,903)     |
| Equity-based compensation                | (2,173)     | (699)        | (1,850)     | (4,722)     |
| Restructuring                            | (164)       | (228)        |             | (392)       |
| Changes in contingent consideration      | 29,368      |              |             | 29,368      |
| Income (loss) before income taxes        | \$ 26,576   | \$ (1,899)   | \$ (5,886)  | \$ 18,791   |
| <b>Three months ended March 31, 2013</b> |             |              |             |             |
| Net sales                                | \$ 42,307   | \$ 19,474    | \$          | \$ 61,781   |
| Segment profit (loss)                    | \$ (11,222) | \$ 375       | \$ (4,811)  | \$ (15,658) |
| Interest income (expense), net           |             |              | 192         | 192         |
| Amortization                             | (532)       | (324)        |             | (856)       |
| Equity-based compensation                | (710)       | (130)        | (1,739)     | (2,579)     |
| Restructuring                            | (423)       | (50)         | (58)        | (531)       |
| Income (loss) before income taxes        | \$ (12,887) | \$ (129)     | \$ (6,416)  | \$ (19,432) |

| As of March 31, 2014 | LED & Solar | Data Storage | Unallocated | Total      |
|----------------------|-------------|--------------|-------------|------------|
| Goodwill             | \$ 91,348   | \$           | \$          | \$ 91,348  |
| Total assets         | \$ 373,022  | \$ 43,874    | \$ 537,661  | \$ 954,557 |

| As of December 31, 2013 | LED & Solar | Data Storage | Unallocated | Total      |
|-------------------------|-------------|--------------|-------------|------------|
| Goodwill                | \$ 91,348   | \$           | \$          | \$ 91,348  |
| Total assets            | \$ 359,464  | \$ 37,910    | \$ 550,595  | \$ 947,969 |

As of March 31, 2014 and December 31, 2013 unallocated assets were comprised principally of cash and cash equivalents, restricted cash and short-term investments.

**Note 6 Fair Value Measurements**

We have categorized our assets and liabilities recorded at fair value based upon the fair value hierarchy. The levels of fair value hierarchy are as follows:

- Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access.
- Level 2 inputs utilize other-than-quoted prices that are observable, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs such as interest rates and yield curves that are observable at commonly quoted

intervals.

- Level 3 inputs are unobservable and are typically based on our own assumptions, including situations where there is little, if any, market activity.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, we categorize such assets or liabilities based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset.

Both observable and unobservable inputs may be used to determine the fair value of positions that are classified within the

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Level 3 category. As a result, the unrealized gains and losses for assets within the Level 3 category may include changes in fair value that were attributable to both observable (e.g., changes in market interest rates) and unobservable (e.g., changes in historical company data) inputs.

The major categories of assets and liabilities measured on a recurring basis, at fair value, as of March 31, 2014 and December 31, 2013, are as follows (*in thousands*):

|                              | March 31, 2014 |         |         | Total      |
|------------------------------|----------------|---------|---------|------------|
|                              | Level 1        | Level 2 | Level 3 |            |
| U.S. treasuries              | \$ 130,914     | \$      | \$      | \$ 130,914 |
| Corporate debt               |                | 73,473  |         | 73,473     |
| Government agency securities |                | 59,015  |         | 59,015     |
| Commercial paper             |                | 7,850   |         | 7,850      |
| Derivative instrument        |                | 573     |         | 573        |

|                              | December 31, 2013 |         |          | Total      |
|------------------------------|-------------------|---------|----------|------------|
|                              | Level 1           | Level 2 | Level 3  |            |
| U.S. treasuries              | \$ 130,977        | \$      | \$       | \$ 130,977 |
| Corporate debt               |                   | 77,601  |          | 77,601     |
| Government agency securities |                   | 61,013  |          | 61,013     |
| Commercial paper             |                   | 11,947  |          | 11,947     |
| Derivative instrument        |                   | 907     |          | 907        |
| Contingent consideration     |                   |         | (29,368) | (29,368)   |

Highly liquid investments with maturities of three months or less when purchased may be classified as cash equivalents. Such items may include liquid money market accounts, U.S. treasuries, government agency securities and corporate debt. The investments that are classified as cash equivalents are carried at cost, which approximates fair value. Accordingly, no gains or losses (realized/unrealized) have been incurred for cash equivalents. All investments classified as available-for-sale are recorded at fair value within short-term investments in the Condensed Consolidated Balance Sheets.

In determining the fair value of our investments and levels, through a third-party service provider, we use pricing information from pricing services that value securities based on quoted market prices in active markets and matrix pricing. Matrix pricing is a mathematical valuation technique that does not rely exclusively on quoted prices of specific investments, but on the investment's relationship to other benchmarked quoted securities. We have a process in place for investment valuations to facilitate identification and resolution of potentially erroneous prices. We review the information provided by the third-party service provider to record the fair value of its portfolio.

Consistent with Level 1 measurement principles, U.S. treasuries are priced using active market prices of identical securities. Consistent with Level 2 measurement principles, corporate debt, government agency securities, commercial paper, and derivative instruments are priced with matrix pricing.



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We estimate the fair value of acquisition-related contingent consideration based on management's probability-weighted present value of the consideration expected to be transferred during the remainder of the earn-out period, based on forecast related to the milestones. The fair value of the contingent consideration is reassessed by us on a quarterly basis based on a collaborative effort of our operations, finance and accounting groups using additional information as it becomes available. Any change in the fair value of an acquisition's contingent consideration liability results in a remeasurement gain or loss that is recorded in the earnings of that period. This fair value measure is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Fair value measurements characterized within Level 3 of the fair value hierarchy are measured based on unobservable inputs that are supported by little or no market activity and reflect our own assumptions in measuring fair value.

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The significant unobservable inputs used in the fair value measurements of our acquisition-related contingent consideration include our measures of the probability of the achievement of certain agreed upon milestones and may include future profitability and related cash flows of the acquired business or assets, impacted by appropriate discount rates. Significant increases (decreases) in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumptions used for the discount rates is accompanied by a directionally opposite change in the fair value measurement and a change in the assumptions used for the future cash flows is accompanied by a directionally similar change in the fair value measurement.

A reconciliation of the amount in Level 3 is as follows (*in thousands*):

|  | <b>Level 3</b> |
|--|----------------|
| Balance as of December 31, 2013                        | \$ (29,368)    |
| Addition of contingent consideration                   |                |
| Payment on contingent consideration, net of adjustment |                |
| Fair value adjustment of contingent consideration      | 29,368         |
| Balance as of March 31, 2014                           | \$             |

**Note 7 Derivative Financial Instruments**

We use derivative financial instruments to minimize the impact of foreign exchange rate changes on earnings and cash flows. In the normal course of business, our operations are exposed to fluctuations in foreign exchange rates. In order to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known foreign currency exposures, we enter into monthly forward contracts. We do not use derivative financial instruments for trading or speculative purposes. Our forward contracts are not expected to subject us to material risks due to exchange rate movements because gains and losses on these contracts are intended to offset exchange gains and losses on the underlying assets and liabilities. The forward contracts are marked-to-market through earnings. We conduct our derivative transactions with highly rated financial institutions in an effort to mitigate any material counterparty risk.

| (in thousands)                                | Component of                     | As of March 31, 2014<br>Fair Value | Maturity Dates | Notional Amount |
|---|----------------------------------|------------------------------------|----------------|-----------------|
| <u>Not Designated as Hedges under ASC 815</u> |                                  |                                    |                |                 |
| Foreign currency exchange forwards            | Prepaid and other current assets | \$                                 | April 2014     | \$ 6,400        |
| Foreign currency collar                       | Prepaid and other current assets | 573                                | October 2014   | 34,069          |
| Total Derivative Instruments                  |                                  | \$ 573                             |                | \$ 40,469       |

| (in thousands)                                | Component of                     | As of December 31, 2013<br>Fair Value | Maturity Dates | Notional Amount |
|---|----------------------------------|---------------------------------------|----------------|-----------------|
| <u>Not Designated as Hedges under ASC 815</u> |                                  |                                       |                |                 |
| Foreign currency exchange forwards            | Prepaid and other current assets | \$ 1                                  | January 2014   | \$ 4,700        |
| Foreign currency collar                       |                                  | 906                                   | October 2014   | 34,069          |

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|                              |                                  |        |           |
|------------------------------|----------------------------------|--------|-----------|
|                              | Prepaid and other current assets |        |           |
| Total Derivative Instruments |                                  | \$ 907 | \$ 38,769 |

| (in thousands)                     | Location of realized net gain (loss) and changes in the fair value of derivatives | Amount of realized net gain (loss) and changes in the fair value of derivatives |        |
|------------------------------------|---|---|--------|
|                                    |   | For the three months ended March 31,  |        |
|                                    |   | 2014  | 2013   |
| Foreign currency exchange forwards | Other operating, net  | \$ (95)   | \$ 228 |
| Foreign currency collar            | Other operating, net  | (333)   |        |

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These contracts were valued using market quotes in the secondary market for similar instruments (fair value Level 2, please see our footnote *Fair Value Measurements*).

The weighted average notional amount of derivative contracts outstanding during the three months ended March 31, 2014 and 2013 was approximately \$11.5 million and \$2.4 million, respectively.

**Note 8 Commitments, Contingencies and Other Matters***Restructuring and Other Charges*

During the three months ended March 31, 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. We expect to substantially complete the consolidation by the end of 2014. We recorded restructuring charges of \$0.4 million and notified approximately 49 employees of their termination from the Company. These charges consisted of personnel severance and related costs. We expect to incur approximately \$1.3 million of additional restructuring charges in our Data Storage segment throughout the remainder of 2014 related to these actions. The reductions in head count principally relate to our Data Storage and MBE businesses.

During the three months ended March 31, 2013, we took measures to improve profitability in a challenging business environment and notified approximately 20 employees of their termination from the Company. As a result, we recorded restructuring charges of \$0.5 million consisting of personnel severance and related costs.

*Restructuring Liability*

The following is a reconciliation of the restructuring liability through March 31, 2014 (*in thousands*):

|                    | Balance as of<br>January 1, 2014 | Rollforward of Restructuring Liability<br>For the three months ended March 31, 2014 |               |             | Balance as of<br>March 31, 2014 | Short-term<br>portion |
|--------------------|----------------------------------|---|---------------|-------------|---------------------------------|-----------------------|
|                    |                                  | Expense Incurred  | Cash Payments | Adjustments |                                 |                       |
| 2012 Restructuring | \$ 195                           | \$  | \$ (109)      | \$          | \$ 86                           | \$ 86                 |
| 2013 Restructuring | 338                              |   | (125)         |             | 213                             | 213                   |
| 2014 Restructuring |                                  | 392   | (20)          |             | 372                             | 372                   |
| Total              | \$ 533                           | \$ 392  | \$ (254)      | \$          | \$ 671                          | \$ 671                |

The balance of the short-term liability will be paid over the next 12 months.

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The following is a reconciliation of the restructuring liability through December 31, 2013 (*in thousands*):

|                    | Balance as of   |                  | Rollforward of Restructuring Liability |             |        | Balance as of     |     | Short-term portion |
|--------------------|-----------------|------------------|--|-------------|--------|-------------------|-----|--------------------|
|                    | January 1, 2013 |                  | For the year ended December 31, 2013   |             |        | December 31, 2013 |     |                    |
|                    |                 | Expense Incurred | Cash Payments                          | Adjustments |        |                   |     |                    |
| 2012 Restructuring | \$ 1,875        | \$               | \$ (1,680)                             | \$          | \$ 195 | \$                | 195 |                    |
| 2013 Restructuring |                 | 1,485            | (1,147)                                |             | 338    |                   | 338 |                    |
| Total              | \$ 1,875        | \$ 1,485         | \$ (2,827)                             | \$          | \$ 533 | \$                | 533 |                    |

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

**Executive Summary**

Veeco Instruments Inc. (together with its consolidated subsidiaries, Veeco, the Company, we, us, and our, unless the context indicates otherwise) creates process equipment that enables technologies for a cleaner and more productive world. We design, manufacture and market equipment primarily sold to make LEDs and hard-disk drives, as well as for solar cells, power semiconductors, wireless components, and micro-electro-mechanical systems ( MEMS ).

Veeco develops highly differentiated, best-in-class process equipment for critical performance steps. Our products feature leading technology, low cost-of-ownership and high throughput. Core competencies in advanced thin film technologies, over 300 patents, and decades of specialized process know-how help us to stay at the forefront of these demanding industries.

*Veeco's LED & Solar segment* designs and manufactures metal organic chemical vapor deposition ( MOCVD ) and molecular beam epitaxy ( MBE ) systems and components sold to manufacturers of LEDs, wireless components, power semiconductors, and solar cells, as well as for R&D applications. Our atomic layer deposition ( ALD ) technology is used by manufacturers of flexible OLED displays and has further applications in the semiconductor and solar markets.

*Veeco's Data Storage segment* designs and manufactures systems used to create thin film magnetic heads ( TFMH s ) that read and write data in hard disk drives. These include ion beam etch, ion beam deposition, diamond-like carbon, physical vapor deposition, chemical vapor deposition, and slicing, dicing and lapping systems. While our systems are primarily sold to hard drive customers, they also have applications in optical coatings, MEMS and magnetic sensors, and extreme ultraviolet ( EUV ) lithography.

As of March 31, 2014, Veeco had approximately 800 employees to support our customers through product and process development, training, manufacturing, and sales and service sites in the U.S., South Korea, Taiwan, China, Singapore, Japan, Europe and other locations.

Veeco Instruments Inc. was organized as a Delaware corporation in 1989.

**Highlights of the First Quarter of 2014**

Selected financial highlights include:

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- Revenue increased 47.0% to \$90.8 million in 2014 from \$61.8 million in 2013. LED & Solar revenues increased 67.2% to \$70.7 million from \$42.3 million in 2013. Data Storage revenues increased 3.1% to \$20.1 million from \$19.5 million in 2013;
- Orders increased 45.7% to \$102.6 million in 2014, compared to \$70.4 million in 2013;
- Our gross margin increased to 37.2% in 2014 from 36.5% in 2013. Gross margins in LED & Solar increased from 33.1% in 2013 to 37.4%. Data Storage gross margins decreased from 44.0% in 2013 to 36.5%.
- Our selling, general and administrative expenses increased to \$21.7 million from \$19.6 million in 2013. Selling, general and administrative expenses were 23.9% of net sales in 2014 compared to 31.8% in 2013;
- Our research and development expenses decreased to \$19.8 million from \$20.7 million in 2013. Research and development expenses were 21.8% of net sales in 2014, compared to 33.6% in 2013;
- Net income (loss) in 2014 was \$19.2 million compared to (\$10.1) million in 2013;
- Diluted net income (loss) per share in 2014 was \$0.48 compared to (\$0.26) in 2013.

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**Outlook**

After a long downturn in our MOCVD business, LED fab utilization rates have improved to high levels at most key accounts and LED adoption is happening faster than many had expected. Our customers are also reporting better market demand for LED backlighting products. It is encouraging to see that our leading customers are beginning to place orders for capacity expansions. We currently anticipate that Veeco's second quarter 2014 orders will be similar to or better than first quarter orders. Yet, the timing and magnitude of key customer expansions could cause MOCVD orders to be lumpy and somewhat unpredictable on a quarterly basis, and we lack the visibility to see into the second half of the year. We continue to invest in MOCVD product and technology development to further improve our customers' cost of ownership and manufacturing capability. Competitive pricing pressure, which had a dramatic effect on our gross margins in 2013, is also difficult to predict.

Our new ALD business was acquired as a pre-revenue business and thus decreased our earnings in 2013 and is currently expected to negatively impact our financial performance this year as well. The timing of production ALD orders from our key customer could have a significant impact on our expected revenue growth and potential return to profitability. We did not receive any ALD orders from our key customer in the first quarter.

Our Data Storage orders were very low in the first quarter. Low growth is expected to continue in the hard drive industry; our customers have excess manufacturing capacity and they have only been making select technology purchases. Future demand for our Data Storage products is unclear and orders are expected to be lumpy.

We remain focused on our strategy to turn around our financial performance and transition the Company back to profitable growth by: 1) developing and launching game-changing new products that enable cost effective LED lighting, flexible OLED encapsulation and other emerging technologies; 2) improving customer cost of ownership as well as our gross margins; 3) driving process improvement initiatives to make us more efficient; and 4) lowering expenses. We currently anticipate that our losses will continue in the near term.

Our outlook discussion above constitutes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Our expectations regarding future results are subject to risks and uncertainties. Our actual results may differ materially from those anticipated.

You should not place undue reliance on any forward-looking statements, which speak only as of the dates they are made.



Table of Contents**Results of Operations:****Three Months Ended March 31, 2014 and 2013**

Consistent with prior years, we report interim quarters, other than fourth quarters which always end on December 31, on a 13-week basis ending on the last Sunday within such period. The interim quarter ends are determined at the beginning of each year based on the 13-week quarters. The 2014 interim quarter ends are March 30, June 29 and September 28. The 2013 interim quarter ends were March 31, June 30 and September 29. For ease of reference, we report these interim quarter ends as March 31, June 30, and September 30 in our interim condensed consolidated financial statements.

The following table shows our Condensed Consolidated Statements of Operations, percentages of sales, and comparisons between the three months ended March 31, 2014 and 2013 (*dollars in thousands*):

|                                     | For the three months ended |          |           |    | Dollar and |         |                   |
|-------------------------------------|----------------------------|----------|-----------|----|------------|---------|-------------------|
|                                     | 2014                       |          | March 31, |    | 2013       |         | Percentage Change |
|                                     |                            |          |           |    |            |         | Period to Period  |
| Net sales                           | \$                         | 90,841   | 100.0%    | \$ | 61,781     | 100.0%  | \$ 29,060 47.0%   |
| Cost of sales                       |                            | 57,064   | 62.8%     |    | 39,229     | 63.5%   | 17,835 45.5%      |
| Gross profit                        |                            | 33,777   | 37.2%     |    | 22,552     | 36.5%   | 11,225 49.8%      |
| Operating expenses:                 |                            |          |           |    |            |         |                   |
| Selling, general and administrative |                            | 21,667   | 23.9%     |    | 19,648     | 31.8%   | 2,019 10.3%       |
| Research and development            |                            | 19,768   | 21.8%     |    | 20,737     | 33.6%   | (969) (4.7)%      |
| Amortization                        |                            | 2,903    | 3.2%      |    | 856        | 1.4%    | 2,047 239.1%      |
| Restructuring                       |                            | 392      | 0.4%      |    | 531        | 0.9%    | (139) (26.2)%     |
| Total operating expenses            |                            | 44,730   | 49.2%     |    | 41,772     | 67.6%   | 2,958 7.1%        |
| Other operating, net                |                            | (212)    | (0.2)%    |    | 404        | 0.7%    | (616) *           |
| Changes in contingent consideration |                            | (29,368) | (32.3)%   |    |            | 0.0%    | (29,368) *        |
| Operating income (loss)             |                            | 18,627   | 20.5%     |    | (19,624)   | (31.8)% | 38,251 *          |
| Interest income (expense), net      |                            | 164      | 0.2%      |    | 192        | 0.3%    | (28) (14.6)%      |
| Income (loss) before income taxes   |                            | 18,791   | 20.7%     |    | (19,432)   | (31.5)% | 38,223 *          |
| Income tax provision (benefit)      |                            | (369)    | (0.4)%    |    | (9,361)    | (15.2)% | 8,992 (96.1)%     |
| Net income (loss)                   | \$                         | 19,160   | 21.1%     | \$ | (10,071)   | (16.3)% | \$ 29,231 *       |

\* Not Meaningful

*Net Sales*

The following is an analysis of net sales by segment and by region (*dollars in thousands*):

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|                                | Net Sales |                                      |           |                  | Dollar and        |         |  |
|--------------------------------|-----------|--------------------------------------|-----------|------------------|-------------------|---------|--|
|                                | 2014      | For the three months ended March 31, |           | 2013             | Percentage Change |         |  |
|                                |           | Percent of Total                     |           | Percent of Total | Period to Period  |         |  |
| <b>Segment Analysis</b>        |           |                                      |           |                  |                   |         |  |
| LED & Solar                    | \$ 70,755 | 77.9%                                | \$ 42,307 | 68.5%            | \$ 28,448         | 67.2%   |  |
| Data Storage                   | 20,086    | 22.1%                                | 19,474    | 31.5%            | 612               | 3.1%    |  |
| Total                          | \$ 90,841 | 100.0%                               | \$ 61,781 | 100.0%           | \$ 29,060         | 47.0%   |  |
| <b>Regional Analysis</b>       |           |                                      |           |                  |                   |         |  |
| Americas (1)                   | \$ 7,880  | 8.7%                                 | \$ 12,433 | 20.1%            | \$ (4,553)        | (36.6)% |  |
| Europe, Middle East and Africa | 10,220    | 11.3%                                | 4,550     | 7.4%             | 5,670             | 124.6%  |  |
| Asia Pacific                   | 72,741    | 80.0%                                | 44,798    | 72.5%            | 27,943            | 62.4%   |  |
| Total                          | \$ 90,841 | 100.0%                               | \$ 61,781 | 100.0%           | \$ 29,060         | 47.0%   |  |

(1) Less than 1% of net sales included within the Americas caption above have been derived from other regions outside the United States.

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Our LED & Solar segment net sales increased in 2014 primarily due to increased sales of MOCVD systems to our LED customers due to increased capacity demands. Data Storage net sales were essentially flat in 2014 compared to 2013. By region, net sales increased in Asia Pacific, primarily due to an increase in MOCVD sales in China and Japan. Net sales in Europe, Middle East and Africa ( EMEA ) increased primarily due to higher sales of MOCVD and Data Storage products while net sales in the Americas decreased primarily due to lower sales of our LED and Solar products. We believe that there will continue to be period-to-period variations in the geographic distribution of net sales.

Orders increased 45.7% to \$102.6 million from \$70.4 million in the comparable prior period. LED & Solar bookings increased 104.0% to \$87.2 million, principally due to MOCVD system orders, as our LED customers are making capacity additions. Data Storage bookings decreased 44.3% to \$15.4 million from the comparable prior period as our customers have excess manufacturing capacity and they have only been making select technology purchases.

Our book-to-bill ratio for the three months ended March 31, 2014, which is calculated by dividing bookings recorded in a given time period by revenue recognized in the same time period, was 1.13 to 1. Our backlog as of March 31, 2014 was \$154.8 million, compared to \$143.3 million as of December 31, 2013. During the three months ended March 31, 2014, we recorded backlog adjustments of approximately \$0.2 million related to orders that no longer met our booking criteria. Our backlog consists of orders for which we received a firm purchase order, a customer-confirmed shipment date within twelve months and a deposit, where required. As of March 31, 2014, we had customer deposits of \$31.3 million.

*Gross Profit*

Gross profit in dollars and gross margin for the periods indicated were as follows (*dollars in thousands*):

|                             | For the three months ended |           |      | Dollar and Percentage Change<br>Period to Period |    |         |         |
|-----------------------------|----------------------------|-----------|------|--|----|---------|---------|
|                             | 2014                       | March 31, | 2013 |  |    |         |         |
| Gross profit - LED & Solar  | \$                         | 26,452    | \$   | 13,985   | \$ | 12,467  | 89.1%   |
| <i>Gross margin</i>         |                            | 37.4%     |      | 33.1%  |    |         |         |
| Gross profit - Data Storage | \$                         | 7,325     | \$   | 8,567  | \$ | (1,242) | (14.5)% |
| <i>Gross margin</i>         |                            | 36.5%     |      | 44.0%  |    |         |         |
| Gross profit - Total Veeco  | \$                         | 33,777    | \$   | 22,552   | \$ | 11,225  | 49.8%   |
| <i>Gross margin</i>         |                            | 37.2%     |      | 36.5%  |    |         |         |

LED & Solar gross margins increased primarily due to higher volume, partially offset by a sales mix of lower margin products and fewer final acceptances. Data Storage gross margins decreased principally due to a sales mix of lower margin products.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses for the periods indicated were as follows (*dollars in thousands*):

|                                     | For the three months ended |           |           |           | Dollar and Percentage Change<br>Period to Period |       |
|-------------------------------------|----------------------------|-----------|-----------|-----------|--|-------|
|                                     | March 31,                  |           |           |           |  |       |
|                                     | 2014                       | 2013      | 2014      | 2013      |  |       |
| Selling, general and administrative | \$ 21,667                  | \$ 19,648 | \$ 21,667 | \$ 19,648 | \$ 2,019   | 10.3% |
| <i>Percentage of net sales</i>      | 23.9%                      | 31.8%     | 23.9%     | 31.8%     |  |       |

Selling, general and administrative expenses increased primarily due to equity compensation and bonus expense and the addition of costs from our ALD business, which was acquired in the fourth quarter of 2013. Partially offsetting this increase was a reduction in professional fees associated with our review of revenue accounting, which was completed in the fourth quarter of 2013.

Table of Contents*Research and Development Expenses*

Research and development expenses for the periods indicated were as follows (*dollars in thousands*):

|                                | For the three months ended<br>March 31, |        |      | Dollar and Percentage Change<br>Period to Period |                 |
|--------------------------------|---|--------|------|--|-----------------|
|                                | 2014                                    |        | 2013 |  |                 |
| Research and development       | \$                                      | 19,768 | \$   | 20,737   | \$ (969) (4.7)% |
| <i>Percentage of net sales</i> |   | 21.8%  |      | 33.6%  |                 |

We reduced our overall research and development spending by focusing our research and development expenses on projects in areas we anticipate to be high-growth. We selectively funded these product development activities which resulted in lower professional consulting expense and personnel and personnel-related costs as well as reduced spending for project materials. This decrease was partially offset by the addition of research and development costs in our ALD business, which was acquired in the fourth quarter of 2013.

*Amortization*

Amortization for the periods indicated were as follows (*dollars in thousands*):

|                                | For the three months ended<br>March 31, |       |      | Dollar and Percentage Change<br>Period to Period |                 |
|--------------------------------|---|-------|------|--|-----------------|
|                                | 2014                                    |       | 2013 |  |                 |
| Amortization                   | \$                                      | 2,903 | \$   | 856  | \$ 2,047 239.1% |
| <i>Percentage of net sales</i> |   | 3.2%  |      | 1.4%   |                 |

Amortization expense increased primarily due to the additional amortization associated with intangible assets acquired as part of our acquisition of our ALD business during the fourth quarter of 2013.

*Restructuring*

Restructuring for the periods indicated were as follows (*dollars in thousands*):

|  | For the three months ended<br>March 31, |  |      | Dollar and Percentage Change<br>Period to Period |  |
|--|---|--|------|--|--|
|  | 2014                                    |  | 2013 |  |  |

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|                                |    |      |    |      |    |       |         |
|--------------------------------|----|------|----|------|----|-------|---------|
| Restructuring                  | \$ | 392  | \$ | 531  | \$ | (139) | (26.2)% |
| <i>Percentage of net sales</i> |    | 0.4% |    | 0.9% |    |       |         |

During the three months ended March 31, 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. We expect to substantially complete the consolidation by the end of 2014. We recorded restructuring charges of \$0.4 million and notified approximately 49 employees of their termination from the Company. These charges consisted of personnel severance and related costs. We expect to incur approximately \$1.3 million of additional restructuring charges in our Data Storage segment throughout the remainder of 2014 related to these actions. The reductions in head count principally relate to our Data Storage and MBE businesses.

During the three months ended March 31, 2013, we took measures to improve profitability in a challenging business environment and notified approximately 20 employees of their termination from the Company. As a result, we recorded restructuring charges of \$0.5 million consisting of personnel severance and related costs.

Table of Contents*Changes in Contingent Consideration*

Changes in contingent consideration for the periods indicated were as follows (*dollars in thousands*):

|                                     | For the three months ended |           |      | Dollar and Percentage Change |          |                  |
|-------------------------------------|----------------------------|-----------|------|------------------------------|----------|------------------|
|                                     | 2014                       | March 31, | 2013 |                              |          | Period to Period |
| Changes in contingent consideration | \$                         | (29,368)  | \$   | \$                           | (29,368) | *                |
| <i>Percentage of net sales</i>      |                            | (32.3)%   |      |                              | 0.0%     |                  |

---

\* Not Meaningful

As part of Veeco's acquisition agreement with Synos, there were certain contingent payments due to the selling shareholders of Synos dependent on the achievement of certain milestones. The aggregate fair value of the contingent consideration arrangement as of December 31, 2013 was \$29.4 million.

We estimate the fair value of acquisition-related contingent consideration based on management's probability-weighted present value of the consideration expected to be transferred during the remainder of the earn-out period, based on the forecast related to the milestones. The fair value of the contingent consideration is reassessed by us on a quarterly basis based on a collaborative effort of our operations, finance and accounting groups using additional information as it becomes available. Any change in the fair value of an acquisition's contingent consideration liability results in a remeasurement gain or loss that is recorded in the earnings of that period. As of March 31, 2014, we determined that the agreed upon post-closing milestones were not met or are not expected to be achieved and therefore reversed the remaining \$29.4 million liability of the contingent consideration and recorded it as a change in contingent consideration in the Condensed Consolidated Statement of Operations.

The post-closing milestones are divided into two contingencies. The first, tied to receipt of certain purchase orders, had an evaluation date of March 31, 2014, which, was not met and accounted for \$20.2 million of the reversed liability. The second is based on achieving certain full year 2014 revenue and gross margin thresholds, which are unlikely to be met and accounted for \$9.2 million of the reversed liability. As of March 31, 2014 the second contingency, with a maximum potential value of \$75.0 million, remains contractually outstanding.

*Income Taxes*

Income tax provision (benefit) for the periods indicated were as follows (*dollars in thousands*):

| 2014 | For the three months ended |      | Dollar and Percentage Change |
|------|----------------------------|------|------------------------------|
|      | March 31,                  | 2013 |                              |

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|                                |    |       |    |         |    |       |         |
|--------------------------------|----|-------|----|---------|----|-------|---------|
| Income tax provision (benefit) | \$ | (369) | \$ | (9,361) | \$ | 8,992 | (96.1)% |
| <i>Effective tax rate</i>      |    | 2.0%  |    | 48.2%   |    |       |         |

Our provision for income taxes consists of U.S. federal, state and local, and foreign taxes in amounts necessary to align our year-to-date tax provision with the effective tax rate we expect to achieve for the full year.

For the three months ended March 31, 2014, the effective tax rate was lower than the statutory tax rate principally because we did not provide a current tax benefit on a portion of our domestic pre-tax losses as such amounts are not realizable on a more-likely-than-not basis and we have provided for a full valuation allowance on these amounts. The effective tax rate was also impacted because we did not provide a tax provision on the gain from the settlement of the contingent consideration related to the Synos acquisition.

For the three months ended March 31, 2013, the effective tax rate was higher than the statutory tax rate as a result of the jurisdictional mix of earnings in our foreign locations, an income tax benefit related to the generation of current year research and development tax credits, and legislation enacted in the first quarter of 2013 which extended the Federal Research and Development Credit for both the 2012 and 2013 tax years.



Table of Contents**Liquidity and Capital Resources**

Our cash and cash equivalents, restricted cash and short-term investments consist of the following:

|  | March 31,<br>2014 | December 31,<br>2013 |
|--|-------------------|----------------------|
| Cash and cash equivalents  | \$ 214,682        | \$ 210,799           |
| Restricted cash  | 764               | 2,738                |
| Short-term investments   | 267,402           | 281,538              |
| Cash, cash equivalents, restricted cash and short-term investments | \$ 482,848        | \$ 495,075           |

As of March 31, 2014 and December 31, 2013, cash and cash equivalents of \$158.9 million and \$150.6 million, respectively, were held outside the United States. Liquidity is affected by many factors, some of which are based on normal ongoing operations of our business and some of which arise from fluctuations related to global economics and markets. Cash balances are generated and held in many locations throughout the world. It is our current intent to permanently reinvest our funds from Singapore, China, Taiwan, South Korea, and Malaysia outside of the United States and our current plans do not demonstrate a need to repatriate them to fund our United States operations. As of March 31, 2014, we had \$117.5 million in cash held offshore on which we would have to pay significant United States income taxes to repatriate in the event that we need the funds for our operations in the United States. Additionally, local government regulations may restrict our ability to move cash balances to meet cash needs under certain circumstances. We currently do not expect such regulations and restrictions to impact our ability to make acquisitions, pay vendors, or conduct operations throughout the global organization. As of March 31, 2014 and December 31, 2013, our restricted cash was in Germany and our short-term investments were in the United States. We believe that our projected cash flow from operations combined with our cash and short term investments will be sufficient to meet our projected working capital and other cash flow requirements for the next twelve months, as well as our contractual obligations.

A summary of the cash flow activity for the three months ended March 31, 2014 is as follows (*in thousands*):

*Cash Flows from Operating Activities*

|   |             |
|---|-------------|
| Net income (loss)   | \$ 19,160   |
| Non-cash charges:   |             |
| Change in contingent consideration  | (29,368)    |
| Depreciation and amortization   | 5,771       |
| Non-cash equity-based compensation  | 4,722       |
| Other   | (1,760)     |
| Changes in operating assets and liabilities:  |             |
| Accounts receivable   | (26,939)    |
| Inventories   | 8,150       |
| Accounts payable  | (7,432)     |
| Accrued expenses, customer deposits, deferred revenue and other current liabilities | 11,608      |
| Other   | (2,313)     |
| Net cash provided by (used in) operating activities                                 | \$ (18,401) |

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The primary cash drivers of the \$18.4 million use of cash from operations were:

- A \$26.9 million use of cash due to the increase in accounts receivable, primarily due to the timing of invoicing to customers resulting in receivables remaining outstanding at the end of the quarter;
- A \$7.4 million use of cash due to the decrease in accounts payable primarily driven by reduced purchasing activity;
- An \$8.2 million generation of cash due to the decrease in inventory due to our reduced purchasing activity, and;

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- An \$11.6 million generation of cash due to the increase in accrued expenses primarily driven by increases in payroll related accruals and customer deposits.

*Cash Flows from Investing Activities*

|   |    |          |
|---|----|----------|
| Proceeds from the liquidation of short-term investments | \$ | 32,030   |
| Payments for purchases of short-term investments        |    | (17,989) |
| Other   |    | 78       |
| Net cash provided by (used in) investing activities     | \$ | 14,119   |

The primary cash driver of the \$14.1 million generation of cash from investing was due to the net liquidation of short-term investments during the period.

*Cash Flows from Financing Activities*

|   |    |       |
|---|----|-------|
| Proceeds from stock option exercises                | \$ | 8,316 |
| Other   |    | (240) |
| Net cash provided by (used in) financing activities | \$ | 8,076 |

The primary cash driver of the \$8.1 million generation of cash from financing was an \$8.3 million generation of cash due to stock option exercises.

As of March 31, 2014, restricted cash consists of \$0.8 million which serves as collateral for bank guarantees that provide financial assurance that the Company will fulfill certain customer or lease obligations. This cash is held in custody by the issuing bank, and is restricted as to withdrawal or use while the related bank guarantees are outstanding.

Subsequent to quarter end, on April 11, 2014, we invested an additional \$0.6 million in our cost method investment in the form of additional bridge notes.

**Contractual Obligations**

There have been no significant changes to our Contractual Obligations table, except for purchase commitments, in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of our 2013 annual report on Form 10-K. As of March 31, 2014 our purchase commitments are \$85.5 million. Pursuant to our agreement to acquire Synos, we may be obligated to pay up to an additional \$75

million if certain conditions are met. We currently do not expect this contingency to be met.

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**Application of Critical Accounting Policies**

*General*

Our discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. Management continually monitors and evaluates its estimates and judgments, including those related to bad debts, inventories, intangible and other long-lived assets, income taxes, warranty obligations, restructuring costs, and contingent liabilities, including potential litigation. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We consider certain accounting policies related to revenue recognition, short-term investments, the valuation of inventories, the impairment of goodwill and indefinite-lived intangible assets, the impairment of long-lived assets, fair value measurements, warranty costs, income taxes and equity-based compensation to be critical policies due to the estimation processes involved in each. We have reclassified certain amounts previously reported in our financial statements to conform to the current presentation.

*Revenue Recognition*

We recognize revenue when all of the following criteria have been met: persuasive evidence of an arrangement exists with a customer; delivery of the specified products has occurred or services have been rendered; prices are contractually fixed or determinable; and collectability is reasonably assured. Revenue is recorded including shipping and handling costs and excluding applicable taxes related to sales. A significant portion of our revenue is derived from contractual arrangements with customers that have multiple elements, such as systems, upgrades, components, spare parts, maintenance and service plans. For sales arrangements that contain multiple elements, we split the arrangement into separate units of accounting if the individually delivered elements have value to the customer on a standalone basis. We also evaluate whether multiple transactions with the same customer or related party should be considered part of a multiple element arrangement, whereby we assess, among other factors, whether the contracts or agreements are negotiated or executed within a short time frame of each other or if there are indicators that the contracts are negotiated in contemplation of each other. When we have separate units of accounting, we allocate revenue to each element based on the following selling price hierarchy: vendor-specific objective evidence ( VSOE ) if available; third party evidence ( TPE ) if VSOE is not available; or our best estimate of selling price ( BEBP ) if neither VSOE nor TPE is available. We utilize BEBP for the majority of the elements in our arrangements. The accounting guidance for selling price hierarchy did not include BEBP for arrangements entered into prior to January 1, 2011, and as such we recognized revenue for those arrangements as described below.

We consider many facts when evaluating each of our sales arrangements to determine the timing of revenue recognition, including the contractual obligations, the customer's creditworthiness and the nature of the customer's post-delivery acceptance provisions. Our system sales arrangements, including certain upgrades, generally include field acceptance provisions that may include functional or mechanical test procedures. For the majority of our arrangements, a customer source inspection of the system is performed in our facility or test data is sent to the customer documenting that the system is functioning to the agreed upon specifications prior to delivery. Historically, such source inspection or test data replicates the field acceptance provisions that will be performed at the customer's site prior to final acceptance of the system. As such, we objectively demonstrate that the criteria specified in the contractual acceptance provisions are achieved prior to delivery and, therefore, we recognize revenue upon delivery since there is no substantive contingency remaining related to the acceptance provisions at that date, subject to the retention amount constraint described below. For new products, new applications of existing products or for products with substantive customer acceptance provisions where we cannot objectively demonstrate that the criteria specified in the contractual acceptance provisions have been achieved prior to delivery, revenue and the associated costs are deferred and fully recognized upon the receipt of final customer

acceptance, assuming all other revenue recognition criteria have been met.

Our system sales arrangements, including certain upgrades, generally do not contain provisions for right of return or forfeiture, refund, or other purchase price concessions. In the rare instances where such provisions are included, we defer all revenue until such rights expire. In many cases our products are sold with a billing retention, typically 10% of the sales price (the retention amount), which is typically payable by the customer when field acceptance provisions are completed. The amount of revenue

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recognized upon delivery of a system or upgrade, if any, is limited to the lower of i) the amount billed that is not contingent upon acceptance provisions or ii) the value of the arrangement consideration allocated to the delivered elements, if such sale is part of a multiple-element arrangement.

For transactions entered into prior to January 1, 2011, under the accounting rules for multiple-element arrangements in place at that time, we deferred the greater of the retention amount or the relative fair value of the undelivered elements based on VSOE. When we could not establish VSOE or TPE for all undelivered elements of an arrangement, revenue on the entire arrangement was deferred until the earlier of the point when we did have VSOE for all undelivered elements or the delivery of all elements of the arrangement.

Our sales arrangements, including certain upgrades, generally include installation. The installation process is not deemed essential to the functionality of the equipment since it is not complex; that is, it does not require significant changes to the features or capabilities of the equipment or involve building elaborate interfaces or connections subsequent to factory acceptance. We have a demonstrated history of consistently completing installations in a timely manner and can reliably estimate the costs of such activities. Most customers engage us to perform the installation services, although there are other third-party providers with sufficient knowledge who could complete these services. Based on these factors, we deem the installation of our systems to be inconsequential or perfunctory relative to the system as a whole, and as a result, do not consider such services to be a separate element of the arrangement. As such, we accrue the cost of the installation at the time of revenue recognition for the system.

In Japan, where our contractual terms with customers generally specify title and risk and rewards of ownership transfer upon customer acceptance, revenue is recognized and the customer is billed upon the receipt of written customer acceptance. During the fourth quarter of fiscal 2013, we began using a distributor for almost all of our product and service sales to customers in Japan. Title and risk and rewards of ownership of our system sales still transfer to our end-customers upon their acceptance. As such, there is no impact to our policy of recognizing revenue upon receipt of written acceptance from the end customer.

Revenue related to maintenance and service contracts is recognized ratably over the applicable contract term. Component and spare part revenue are recognized at the time of delivery in accordance with the terms of the applicable sales arrangement.

*Short-Term Investments*

We determine the appropriate balance sheet classification of our investments at the time of purchase and evaluate the classification at each balance sheet date. As part of our cash management program, we maintain a portfolio of marketable securities which are classified as available-for-sale. These securities include United States treasuries and government agency securities with maturities of greater than three months. Securities classified as available-for-sale are carried at fair market value, with the unrealized gains and losses, net of tax, included in the determination of comprehensive income (loss) and reported in equity. Net realized gains and losses are included in net income (loss).

*Inventory Valuation*

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Inventories are stated at the lower of cost (principally first-in, first-out method) or market. On a quarterly basis, management assesses the valuation and recoverability of all inventories, classified as materials (which include raw materials, spare parts and service inventory), work-in-process and finished goods.

Materials inventory is used primarily to support the installed tool base and spare parts sales and is reviewed for excess quantities or obsolescence by comparing on-hand balances to historical usage, and adjusted for current economic conditions and other qualitative factors. Historically, the variability of such estimates has been impacted by customer demand and tool utilization rates.

The work-in-process and finished goods inventory is principally used to support system sales and is reviewed for recoverability by considering whether on hand inventory would be utilized to fulfill the related backlog. As we typically receive deposits for our orders, the variability of this estimate is reduced as customers have a vested interest in the orders they place with us. Recoverability of such inventory is evaluated by monitoring customer demand, current sales trends and product gross margins. Management also considers qualitative factors such as future product demand based on market outlook, which is based principally upon production requirements resulting from customer purchase orders received with a customer-confirmed



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shipment date within the next twelve months. Historically, the variability of these estimates of future product demand has been impacted by backlog cancellations or modifications resulting from unanticipated changes in technology or customer demand.

Following identification of potential excess or obsolete inventory, management evaluates the need to write down inventory balances to its estimated market value, if less than its cost. Inherent in the estimates of market value are management's estimates related to our future manufacturing schedules, customer demand, technological and/or market obsolescence, possible alternative uses, and ultimate realization of potential excess inventory. Unanticipated changes in demand for our products may require a write down of inventory that could materially affect our operating results.

*Goodwill and Indefinite-Lived Intangible Asset Impairment*

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. We account for goodwill and intangible assets with indefinite useful lives in accordance with relevant accounting guidance related to goodwill and other intangible assets, which states that goodwill and intangible assets with indefinite useful lives should not be amortized, but instead tested for impairment at least annually at the reporting unit level. Our policy is to perform this annual impairment test in the fourth quarter, using a measurement date of October 1st, of each fiscal year or more frequently if impairment indicators arise. Impairment indicators include, among other conditions, cash flow deficits, a historical or anticipated decline in revenue or operating profit, adverse legal or regulatory developments and a material decrease in the fair value of some or all of the assets.

The guidance provides an option for an entity to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not (that is, a likelihood of more than 50%) that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary.

If we determine the two-step impairment test is necessary, we are required to determine if it is appropriate to use the operating segment, as defined under guidance for segment reporting, as the reporting unit, or one level below the operating segment, depending on whether certain criteria are met. We have identified five reporting units that are required to be reviewed for impairment. The five reporting units are aggregated into two segments: the VIBE and Mechanical reporting units which are reported in our Data Storage segment; and the MOCVD, MBE and ALD reporting units which are reported in our LED & Solar segment. In identifying the reporting units management considered the economic characteristics of operating segments including the products and services provided, production processes, types or classes of customer and product distribution.

We perform this impairment test by first comparing the fair value of our reporting units to their respective carrying amount. When determining the estimated fair value of a reporting unit, we utilize a discounted future cash flow approach since reported quoted market prices are not available for our reporting units. Developing the estimate of the discounted future cash flow requires significant judgment and projections of future financial performance. The key assumptions used in developing the discounted future cash flows are the projection of future revenues and expenses, working capital requirements, residual growth rates and the weighted average cost of capital. In developing our financial projections, we consider historical data, current internal estimates and market growth trends. Changes to any of these assumptions could materially change the fair value of the reporting unit. We reconcile the aggregate fair value of our reporting units to our adjusted market capitalization as a supporting calculation. The adjusted market capitalization is calculated by multiplying the average share price of our common stock for the last ten trading days prior to the measurement date by the number of outstanding common shares and adding a control premium.

If the carrying value of the reporting units exceed the fair value we would then compare the implied fair value of our goodwill to the carrying amount in order to determine the amount of the impairment, if any.

*Definite-Lived Intangible and Long-Lived Assets*

Definite-lived intangible assets consist of purchased technology, customer-related intangible assets, patents, trademarks, covenants not-to-compete, software licenses and deferred financing costs. Purchased technology consists of the core proprietary manufacturing technologies associated with the products and offerings obtained through acquisition and are initially recorded at fair value. Customer-related intangible assets, patents, trademarks, covenants not-to-compete and software licenses that are obtained in an acquisition are initially recorded at fair value. Other software licenses and deferred financing costs are initially

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recorded at cost. Intangible assets with definitive useful lives are amortized using the straight-line method over their estimated useful lives for periods ranging from 2 years to 17 years.

Property, plant and equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the related assets using the straight-line method for financial statement purposes. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the improvements.

Long-lived assets, such as property, plant, and equipment and intangible assets with definite useful lives, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment indicators include, among other conditions, cash flow deficits, a historical or anticipated decline in revenue or operating profit, adverse legal or regulatory developments and a material decrease in the fair value of some or all of the assets. Assets are grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flow expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

*Accounting for Acquisitions*

Our growth strategy has included the acquisition of businesses. The purchase price of these acquisitions has been determined after due diligence of the acquired business, market research, strategic planning, and the forecasting of expected future results and synergies. Estimated future results and expected synergies are subject to judgment as we integrate each acquisition and attempt to leverage resources.

The accounting for the acquisitions we have made requires that the assets and liabilities acquired, as well as any contingent consideration that may be part of the agreement, be recorded at their respective fair values at the date of acquisition. This requires management to make significant estimates in determining the fair values, especially with respect to intangible assets, including estimates of expected cash flows, expected cost savings and the appropriate weighted average cost of capital. As a result of these significant judgments to be made we often obtain the assistance of independent valuation firms. We complete these assessments as soon as practical after the closing dates. Any excess of the purchase price over the estimated fair values of the identifiable net assets acquired is recorded as goodwill.

*Fair Value Measurements*

Accounting guidance requires that we disclose the type of inputs we use to value our assets and liabilities that are required to be measured at fair value, based on three categories of inputs as defined in such. Level 1 inputs are quoted, unadjusted prices in active markets for identical assets or liabilities that we have the ability to access at the measurement date. Level 2 inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, such as quoted prices for similar assets or liabilities. Level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. These requirements apply to our long-lived assets, goodwill, cost method investment and intangible assets. We use Level 3 inputs to value all of such assets. We primarily apply the market approach for recurring fair value measurements.

*Warranty Cost*

Our warranties are typically valid for one year from the date of final acceptance. We estimate the costs that may be incurred under the warranty we provide and record a liability in the amount of such costs at the time the related revenue is recognized. Estimated warranty costs are determined by analyzing specific product and historical configuration statistics and regional warranty support costs. Our warranty obligation is affected by product failure rates, material usage, and labor costs incurred in correcting product failures during the warranty period. Unforeseen component failures or exceptional component performance can also result in changes to warranty costs. If actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required.

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*Income Taxes*

We are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax expense, together with assessing temporary differences resulting from differing treatment of items for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities, which are included within our Consolidated Balance Sheets. The carrying value of our deferred tax assets is adjusted by a partial valuation allowance to recognize the extent to which the future tax benefits will be recognized on a more likely than not basis. Our deferred tax assets consist primarily of net operating loss and tax credit carry forwards and timing differences between the book and tax treatment of inventory, acquired intangible assets, and other asset valuations. Realization of these net deferred tax assets is dependent upon our ability to generate future taxable income.

We record valuation allowances in order to reduce our deferred tax assets to the amount expected to be realized. In assessing the adequacy of recorded valuation allowances, we consider a variety of factors, including the scheduled reversal of deferred tax liabilities, future taxable income and prudent and feasible tax planning strategies. Under the relevant accounting guidance, factors such as current and previous operating losses are given significantly greater weight than the outlook for future profitability in determining the deferred tax asset carrying value.

Relevant accounting guidance addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under such guidance, we must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such uncertain tax positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution.

*Equity-Based Compensation*

We grant equity-based awards, such as stock options and restricted stock or restricted stock units, to certain key employees to create a clear and meaningful alignment between compensation and shareholder return and to enable the employees to develop and maintain a stock ownership position. While the majority of our equity awards feature time-based vesting, performance-based equity awards, which are awarded from time to time to certain key Company executives, vest as a function of performance, and may also be subject to the recipient's continued employment which also acts as a significant retention incentive.

Equity-based compensation cost is measured at the grant date, based on the fair value of the award and is recognized as expense over the employee requisite service period. In order to determine the fair value of stock options on the date of grant, we apply the Black-Scholes option-pricing model. Inherent in the model are assumptions related to risk-free interest rate, dividend yield, expected stock-price volatility and option life.

The risk-free rate assumed in valuing the options is based on the U.S. Treasury yield curve in effect at the time of grant for the expected term of the option. The dividend yield assumption is based on our historical and future expectation of dividend payouts. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on objective data derived from public sources, the expected stock-price volatility and option life assumptions require a level of judgment which make them critical accounting estimates.

We use an expected stock-price volatility assumption that is a combination of both historical volatility calculated based on the daily closing prices of our common stock over a period equal to the expected term of the option and implied volatility, and utilization of market data of actively traded options on our common stock, which are obtained from public data sources. We believe that the historical volatility of the price of our common stock over the expected term of the option is a strong indicator of the expected future volatility and that implied volatility takes into consideration market expectations of how future volatility will differ from historical volatility. Accordingly, we believe a combination of both historical and implied volatility provides the best estimate of the future volatility of the market price of our common stock.

The expected option term, representing the period of time that options granted are expected to be outstanding, is estimated using a lattice-based model incorporating historical post vest exercise and employee termination behavior.

We estimate forfeitures using our historical experience, which is adjusted over the requisite service period based on the extent to which actual forfeitures differ or are expected to differ, from such estimates. Because of the significant amount of judgment

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used in these calculations, it is reasonably likely that circumstances may cause the estimate to change.

With regard to the weighted-average option life assumption, we consider the exercise behavior of past grants and model the pattern of aggregate exercises.

We settle the exercise of stock options with newly issued shares.

With respect to grants of performance based awards, we assess the probability that such performance criteria will be met in order to determine the compensation expense. Consequently, the compensation expense is recognized straight-line over the vesting period. If that assessment of the probability of the performance condition being met changes, we would recognize the impact of the change in estimate in the period of the change. As with the use of any estimate, and owing to the significant judgment used to derive those estimates, actual results may vary.

We have elected to treat awards with only service conditions and with graded vesting as one award. Consequently, the total compensation expense is recognized straight-line over the entire vesting period, so long as the compensation cost recognized at any date at least equals the portion of the grant date fair value of the award that is vested at that date.

**Recent Accounting Pronouncements**

*Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity.* In April 2014, the FASB issued ASU No. 2014-08 that changes the threshold for reporting discontinued operations and adds new disclosures. The new guidance defines a discontinued operation as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. For disposals of individually significant components that do not qualify as discontinued operations, an entity must disclose pre-tax earnings of the disposed component. For public business entities, this guidance is effective prospectively for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

*Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or Tax Credit Carryforward Exists.* In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or Tax Credit Carryforward Exists.* ASU 2013-11 requires entities to present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward when settlement in this manner is available under the tax law. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. We adopted this as of January 1, 2014 and it did not have a material impact on our consolidated financial statements.

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*Presentation of Financial Statements:* In April 2013, the FASB issued ASU No. 2013-07, Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting. The objective of ASU 2013-07 is to clarify when an entity should apply the liquidation basis of accounting. The update provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. This ASU is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. We adopted this as of January 1, 2014 and will evaluate the materiality of its impact on our consolidated financial statements when there are any indications that liquidation is imminent.



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*Parent's Accounting for the Cumulative Translation Adjustment:* In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This new standard is intended to resolve diversity in practice regarding the release into net income of a cumulative translation adjustment (CTA) upon derecognition of a subsidiary or group of assets within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. We have adopted this as of January 1, 2014 and currently anticipate that it could have an impact on our consolidated financial statements, in the event of derecognition of a foreign subsidiary in 2014 or subsequently. We cannot currently estimate the amount of CTA to be released into income from any potential derecognition.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Net sales to foreign customers represented approximately 91.3% and 79.9% of our total net revenues for the three months ended March 31, 2014 and 2013, respectively. We expect that net sales to foreign customers will continue to represent a large percentage of our total net sales. Our net sales denominated in foreign currencies represented approximately 22.6% and 3.8% of our total net sales for the three months ended March 31, 2014 and 2013, respectively. The significant increase in percentage of net sales in foreign currency was driven by a few large sales, aggregating approximately \$16.4 million, that were denominated in Japanese Yen. As of March 31, 2014 the related receivables were still outstanding. We have an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates related to these receivables.

We are exposed to financial market risks, including changes in foreign currency exchange rates. The change in currency exchange rates that have the largest impact on translating our international operating profit (loss) is the Japanese Yen and Chinese Yuan. We use derivative financial instruments to mitigate these risks. We do not use derivative financial instruments for speculative or trading purposes. We generally enter into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known currency exposures. The following tables are in thousands:

| (in thousands)                                | Component of                     | As of March 31, 2014<br>Fair Value | Maturity Dates | Notional Amount |
|---|----------------------------------|------------------------------------|----------------|-----------------|
| <u>Not Designated as Hedges under ASC 815</u> |                                  |                                    |                |                 |
| Foreign currency exchange forwards            | Prepaid and other current assets | \$                                 | April 2014     | \$ 6,400        |
| Foreign currency collar                       | Prepaid and other current assets | 573                                | October 2014   | 34,069          |
| Total Derivative Instruments                  |                                  | \$ 573                             |                | \$ 40,469       |

| (in thousands)                                | Component of                     | As of December 31, 2013<br>Fair Value | Maturity Dates | Notional Amount |
|---|----------------------------------|---------------------------------------|----------------|-----------------|
| <u>Not Designated as Hedges under ASC 815</u> |                                  |                                       |                |                 |
| Foreign currency exchange forwards            | Prepaid and other current assets | \$ 1                                  | January 2014   | \$ 4,700        |
| Foreign currency collar                       | Prepaid and other current assets | 906                                   | October 2014   | 34,069          |

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Total Derivative Instruments \$ 907 \$ 38,769

| (in thousands)                     | Location of realized net gain (loss) and changes in the fair value of derivatives | Amount of realized net gain (loss) and changes in the fair value of derivatives |        |
|------------------------------------|---|---|--------|
|                                    |   | For the three months ended March 31,  |        |
|                                    |   | 2014  | 2013   |
| Foreign currency exchange forwards | Other operating, net  | \$ (95)   | \$ 228 |
| Foreign currency collar            | Other operating, net  | (333)   |        |

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We believe that based upon our hedging strategy, a 10% change in foreign exchange rates would have an immaterial impact on the Condensed Consolidated Statements of Operations. We believe that this quantitative measure has inherent limitations because it does not take into account any governmental actions or changes in either customer purchasing patterns or our financing and operating strategies.

We centrally manage our investment portfolios considering investment opportunities and risk, tax consequences and overall financing strategies. Our investment portfolio includes fixed-income securities with a fair value of approximately \$267.4 million as of March 31, 2014. An immediate 100 basis point increase in interest rates may result in a decrease in the fair value of the March 31, 2014 portfolio of approximately \$1.4 million. While an increase in interest rates may reduce the fair value of the investment portfolio, it is unlikely that we will realize the losses in our Condensed Consolidated Statements of Operations unless the individual fixed-income securities are sold prior to recovery or the loss is determined to be other-than-temporary.

**Item 4. Controls and Procedures**

Our senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-15 and 15d-15 under the Securities Exchange Act of 1934 (the Exchange Act )) designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision of and with the participation of management, including the chief executive officer and chief financial officer, as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There have been no changes in our internal controls or other factors during the fiscal quarter ended March 31, 2014 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Veeco and certain other parties were named as defendants in a lawsuit filed on April 25, 2013 in the Superior Court of California, County of Sonoma. The plaintiff in the lawsuit, Patrick Colbus, seeks unspecified damages and asserts claims that he suffered burns and other injuries while he was cleaning a molecular beam epitaxy system alleged to have been manufactured by Veeco. The lawsuit alleges, among other things, that the molecular beam epitaxy system was defective and that Veeco failed to adequately warn of the potential risks of the system. Veeco believes this lawsuit is without merit and intends to defend vigorously against the claims. Veeco is unable to predict the outcome of this action or to reasonably estimate the possible loss or range of loss, if any, arising from the claims asserted therein. The Company believes that, in the event of any recovery by the plaintiff from Veeco, such recovery would be fully covered by Veeco's insurance.

We are involved in various other legal proceedings arising in the normal course of our business. We do not believe that the ultimate resolution of these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

**Item 1A. Risk Factors**

Information regarding risk factors appears in the Safe Harbor Statement at the beginning of this quarterly report on Form 10-Q and in Part I Item 1A of our annual report on Form 10-K for the year ended December 31, 2013. There have been no material changes from the risk factors previously disclosed in our annual report on Form 10-K for the year ended December 31, 2013.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

**Not Applicable**

**Item 5. Other Information**

**None**

Table of Contents**Item 6. Exhibits**

Unless otherwise indicated, each of the following exhibits has been previously filed with the SEC by the Company under File No. 0-16244.

| <b>Number</b> | <b>Description</b>   | <b>Incorporated by Reference to the<br/>Following Document:</b> |
|---------------|--|---|
| 10.1          | Letter Agreement dated December 9, 2013 between Veeco and David Glass  | *   |
| 31.1          | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.                  | *   |
| 31.2          | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.                  | *   |
| 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. | *   |
| 101.INS       | XBRL Instance  | **  |
| 101.XSD       | XBRL Schema  | **  |
| 101.PRE       | XBRL Presentation  | **  |
| 101.CAL       | XBRL Calculation   | **  |
| 101.DEF       | XBRL Definition  | **  |
| 101.LAB       | XBRL Label   | **  |

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\* Filed herewith

\*\* Filed herewith electronically

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**SIGNATURES**

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

Date: May 5, 2014

Veeco Instruments Inc.

By:

/s/ JOHN R. PEELER  
John R. Peeler  
Chairman and Chief Executive Officer

By:

/s/ DAVID D. GLASS  
David D. Glass  
Executive Vice President and Chief Financial Officer

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Unless otherwise indicated, each of the following exhibits has been previously filed with the Securities and Exchange Commission by the Company under File No. 0-16244.

| <b>Number</b> | <b>Description</b>  | <b>Incorporated by Reference to the Following Document:</b> |
|---------------|---|---|
| 10.1          | Letter Agreement dated December 9, 2013 between Veeco and David Glass   | *   |
| 31.1          | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.                   | *   |
| 31.2          | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.                   | *   |
| 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. | *   |
| 101.INS       | XBRL Instance   | **  |
| 101.XSD       | XBRL Schema   | **  |
| 101.PRE       | XBRL Presentation   | **  |
| 101.CAL       | XBRL Calculation  | **  |
| 101.DEF       | XBRL Definition   | **  |
| 101.LAB       | XBRL Label  | **  |

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\* Filed herewith

\*\* Filed herewith electronically

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