NANOMETRICS INC
Form 10-Q
November 07, 2013

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

FORM 10-Q

(Mark One)
x Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 28, 2013
OR
o 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 0-13470

NANOMETRICS INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	94-2276314
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)
1550 Buckeye Drive, Milpitas, CA	95035
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (408) 545-6000

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 Q 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 such shorter period that the registrant was required to submit and post such file) Yes Q 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.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

As of November 4, 2013 there were 23,349,469 shares of common stock, $0.001 par value, issued and outstanding.

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FOR QUARTER ENDED SEPTEMBER 28, 2013

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except share and per share amounts)
(Unaudited)

	September 28, 2013	December 29, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$43,833	$62,915
Marketable securities	49,057	46,993
Accounts receivable, net of allowances of $227 and $82, respectively	22,924	21,388
Inventories	36,543	39,659
Inventories-delivered systems	2,313	2,274
Prepaid expenses and other	7,534	7,492
Deferred income tax assets	18,091	8,593
Total current assets	180,295	189,314
Property, plant and equipment, net	46,597	43,213
Goodwill	11,580	11,352
Intangible assets, net	8,559	10,980
Deferred income tax assets	3,566	3,671
Other assets	723	924
Total assets	$251,320	$259,454
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,967	$6,398
Accrued payroll and related expenses	7,982	6,670
Deferred revenue	11,272	8,485
Other current liabilities	8,043	7,822
Income taxes payable	325	424
Current portion of debt obligations	—	928
Total current liabilities	39,589	30,727
Deferred revenue	3,531	4,307
Income taxes payable	2,334	2,135
Other long-term liabilities	2,064	2,140
Debt obligations	—	4,374
Total liabilities	47,518	43,683
Commitments and contingencies (Note 18)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 3,000,000 shares authorized; no shares issued or outstanding	—	—
Common stock, $0.001 par value, 47,000,000 shares authorized; 23,316,477 and 23,250,429, respectively, issued and outstanding	23	23
Additional paid-in capital	241,879	238,326
Accumulated deficit	(38,552)	(23,850)
Accumulated other comprehensive income	452	1,272

Total stockholders' equity	203,802	215,771
Total liabilities and stockholders' equity	$251,320	$259,454

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Net revenues:				
Products	$30,164	$32,314	$69,776	$121,728
Service	8,880	11,624	28,372	30,883
Total net revenues	39,044	43,938	98,148	152,611
Costs of net revenues:				
Cost of products	18,116	15,778	40,908	63,224
Cost of service	4,469	5,379	14,510	15,507
Amortization of intangible assets	658	629	1,963	1,903
Total costs of net revenues	23,243	21,786	57,381	80,634
Gross profit	15,801	22,152	40,767	71,977
Operating expenses:				
Research and development	8,926	7,176	24,695	22,296
Selling	6,758	6,308	20,303	20,560
General and administrative	5,424	4,861	16,442	16,525
Amortization of intangible assets	195	193	588	580
Restructuring charge	1,740	—	1,740	—
Total operating expenses	23,043	18,538	63,768	59,961
Income (loss) from operations	(7,242)	3,614	(23,001)	12,016
Other income (expense)				
Interest income	7	28	51	113
Interest expense	(118)	(262)	(549)	(795)
Other expense, net	(334)	(121)	(930)	(345)
Total other expense, net	(445)	(355)	(1,428)	(1,027)
Income (loss) before income taxes	(7,687)	3,259	(24,429)	10,989
Provision for (benefit from) income taxes	(3,133)	1,356	(9,727)	2,877
Net income (loss)	$(4,554)	$1,903	$(14,702)	$8,112
Net income (loss) per share:				
Basic	$(0.20)	$0.08	$(0.63)	$0.35
Diluted	$(0.20)	$0.08	$(0.63)	$0.34
Shares used in per share calculation:				
Basic	23,261	23,310	23,247	23,351
Diluted	23,261	23,760	23,247	23,874

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Net income (loss)	$(4,554)	$1,903	$(14,702)	$8,112
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	1,142	1,108	(837)	190
Net change on unrealized gains (losses) on available-for-sale investments	20	1	17	(3)
Other comprehensive loss	1,162	1,109	(820)	187
Comprehensive income (loss)	$(3,392)	$3,012	$(15,522)	$8,299

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NANOMETRICS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	September 28, 2013	September 29, 2012
Cash flows from operating activities:		
Net income (loss)	$(14,702)	$8,112
Reconciliation of net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,536	5,991
Stock-based compensation	5,912	4,535
Excess tax benefit from equity awards	467	(939)
Loss on disposal of fixed assets	173	246
Inventory write down	6,307	2,602
Deferred income taxes	(9,659)	2,948
Changes in fair value of contingent consideration	1,045	307
Changes in assets and liabilities:		
Accounts receivable	(1,818)	(831)
Inventories	(7,173)	(429)
Inventories-delivered systems	(300)	(571)
Prepaid expenses and other	820	(1,655)
Accounts payable, accrued and other liabilities	6,798	(12,242)
Deferred revenue	2,044	4,418
Income taxes payable	(363)	283
Net cash provided by (used in) operating activities	(3,913)	12,775
Cash flows from investing activities:		
Maturities of marketable securities	38,030	500
Escrow payment received related to Nanda acquisition	—	508
Sales of marketable securities	—	3,000
Purchases of marketable securities	(40,797)	(40,929)
Purchases of property, plant and equipment	(3,516)	(3,705)
Net cash used in investing activities	(6,283)	(40,626)
Cash flows from financing activities:		
Payments of contingent consideration	(735)	(232)
Repayments of debt obligations	(5,224)	(1,989)
Proceeds from sale of shares under employee stock option and purchase plans	3,192	3,463
Excess tax benefit from equity awards	(467)	939
Taxes paid on net issuance of stock awards	(86)	(16)
Repurchases of common stock	(5,000)	(4,960)
Net cash used in financing activities	(8,320)	(2,795)
Effect of exchange rate changes on cash and cash equivalents	(566)	411
Net decrease in cash and cash equivalents	(19,082)	(30,235)
Cash and cash equivalents, beginning of period	62,915	97,699
Cash and cash equivalents, end of period	$43,833	$67,464

See Notes to Condensed Consolidated Financial Statements

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Nature of Business and Basis of Presentation

Description of Business – Nanometrics Incorporated (“Nanometrics” or the “Company”) and its wholly owned subsidiaries design, manufacture, market, sell and support thin film, optical critical dimension and overlay dimension metrology and inspection systems used primarily in the manufacturing of semiconductors, solar photovoltaics (“solar PV”) and high-brightness LEDs (“HB-LED”), as well as by customers in the silicon wafer and data storage industries. Nanometrics' metrology systems precisely measure a wide range of film types deposited on substrates during manufacturing to control manufacturing processes and increase production yields in the fabrication of integrated circuits. The thin film metrology systems use a broad spectrum of wavelengths, high-sensitivity optics, proprietary software, and patented technology to measure the thickness and uniformity of films deposited on silicon and other substrates as well as their chemical composition. The Company’s optical critical dimension technology is a patented critical dimension measurement technology that is used to precisely determine the dimensions on the semiconductor wafer that directly control the resulting performance of the integrated circuit devices. The overlay metrology systems are used to measure the overlay accuracy of successive layers of semiconductor patterns on wafers in the photolithography process. Nanometrics' inspection systems are used to find defects on patterned and unpatterned wafers at nearly every stage of the semiconductor production flow. The corporate headquarters of Nanometrics is located in Milpitas, California.

Basis of Presentation – The accompanying condensed consolidated financial statements ("financial statements") have been prepared on a consistent basis with the audited consolidated financial statements as of December 29, 2012, and include all normal recurring adjustments necessary to fairly present the information set forth therein. All significant intercompany accounts and transactions have been eliminated in consolidation.
The financial statements have been prepared in accordance with the regulations of the United States Securities and Exchange Commission (“SEC”) for interim periods in accordance with S-X Article 10, and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. The operating results for interim periods are not necessarily indicative of the operating results that may be expected for the entire year. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the fiscal year ended December 29, 2012, which were included in the Company’s Annual Report on Form 10-K filed with the SEC on March 12, 2013.

Fiscal Period – The Company uses a 52/53 week fiscal year ending on the Saturday nearest to December 31. All references to the quarter refer to Nanometrics' fiscal quarter. The fiscal quarters presented herein include 13 weeks.

Reclassification – Certain prior year amounts have been reclassified to conform to the current year presentation.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect 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 reported period. Actual results could differ materially from those estimates. Estimates are used for, but not limited to, revenue recognition, the provision for doubtful accounts, the provision for excess, obsolete, or slow moving inventories, depreciation and amortization, valuation of intangible assets and long-lived assets, warranty accruals, income taxes, valuation of stock-based compensation, and contingencies.

Foreign Currency Translation – The assets and liabilities of foreign subsidiaries are translated from their respective functional currencies at exchange rates in effect at the balance sheet date and income and expense accounts are translated at average exchange rates during the reporting period. Resulting translation adjustments are reflected in

"Accumulated other comprehensive income (loss)," a component of stockholders' equity. Foreign currency transaction gains and losses are reflected in "Other income (expense)" in the consolidated statements of operations in the period incurred and consists of a $0.4 million loss and a $0.1 million loss for the three-month periods ended September 28, 2013, and September 29, 2012, respectively, and a $0.4 million loss in both the nine-month periods ended September 28, 2013, and September 29, 2012.

Revenue Recognition – The Company derives revenue from the sale of process control metrology systems ("product revenue") as well as spare part sales, billable service, service contracts, and upgrades (together "service revenue"). Upgrades are a group of parts and/or software that change the existing configuration of a product and are included in service revenue. They are distinguished from product revenue, which consists of complete, advanced process control metrology and inspection systems (the “system(s)”). Nanometrics' systems consist of hardware and software components that function together to deliver the essential functionality of the system. Arrangements for sales of systems often include defined customer-specified acceptance criteria.

In summary, the Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price is fixed or determinable, and collectability is reasonably assured.

For product sales to existing customers, revenue recognition occurs at the time title and risk of loss transfer to the customer, which usually occurs upon shipment from the Company's manufacturing location, if it can be reliably demonstrated that the product has successfully met the defined customer specified acceptance criteria and all other recognition criteria has been met. For initial sales where the product has not previously met the defined customer specified acceptance criteria, product revenues are recognized upon the earlier of receipt of written customer acceptance or expiration of the contractual acceptance period. In Japan, where contractual terms with the customer specify risk of loss and title transfers upon customer acceptance, revenue is recognized upon receipt of written customer acceptance, provided that all other recognition criteria have been met.

The Company warrants its products against defects in manufacturing. Upon recognition of product revenue, a liability is recorded for anticipated warranty costs. On occasion, customers request a warranty period longer than the Company's standard warranty. In those instances where extended warranty services are separately quoted to the customer, the associated revenue is deferred and recognized as service revenue ratably over the term of the contract. The portion of service contracts and extended warranty services agreements that are uncompleted at the end of any reporting period are included in deferred revenue.

As part of its customer services, the Company sells software that is considered to be an upgrade to a customer's existing systems. These standalone software upgrades are not essential to the tangible product's functionality and are accounted for under software revenue recognition rules which require vendor specific objective evidence ("VSOE") of fair value to allocate revenue in a multiple element arrangement. Revenue from upgrades is recognized when the upgrades are delivered to the customer, provided that all other recognition criteria have been met.

Revenue related to spare parts is recognized upon shipment. Revenue related to billable services is recognized as the services are performed. Service contracts may be purchased by the customer during or after the warranty period and revenue is recognized ratably over the service contract period.

Frequently, the Company delivers products and various services in a single transaction. The Company's deliverables consist of tools, installation, upgrades, billable services, spare parts, and service contracts. The Company's typical multi-element arrangements include a sale of one or multiple tools that include installation and standard warranty. Other arrangements consist of a sale of tools bundled with service elements or delivery of different types of services. The Company's tools, upgrades, and spare parts are generally delivered to customers within a period of up to six months from order date. Installation is usually performed soon after delivery of the tool. The portion of revenue associated with installation is deferred based on relative selling price and that revenue is recognized upon completion of the installation. Billable services are billed on a time and materials basis and performed as requested by customers. Under service contract arrangements, services are provided as needed over the fixed arrangement term. The Company does not grant its customers a general right of return or any refund terms and imposes a penalty on orders canceled prior to the scheduled shipment date.

The Company regularly evaluates its revenue arrangements to identify deliverables and to determine whether these deliverables are separable into multiple units of accounting. In accordance with revenue recognition guidance, the Company allocates the arrangement consideration among the deliverables based on relative selling prices. The Company has established VSOE for some of its products and services when a substantial majority of selling prices falls within a narrow range when sold separately. For deliverables with no established VSOE, the Company uses best estimate of selling price to determine standalone selling price for such deliverable. The Company does not use third party evidence ("TPE") to determine standalone selling price since this information is not widely available in the market as the Company's products contain a significant element of proprietary technology and the solutions offered differ substantially from competitors. The Company has established a process for developing estimated selling prices, which incorporates historical selling prices, the effect of market conditions, gross margin objectives, pricing practices, as well as entity-specific factors. The Company monitors and evaluates estimated selling price on a regular basis to ensure that changes in circumstances are accounted for in a timely manner.

When certain elements in multiple-element arrangements are not delivered or accepted at the end of a reporting period, the relative selling prices of undelivered elements are deferred until these elements are delivered and/or accepted. If deliverables cannot be accounted for as separate units of accounting, the entire arrangement is accounted for as a single unit of accounting and revenue is deferred until all elements are delivered and all revenue recognition requirements are met.

Note 2. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides that a liability related to an unrecognized tax benefit would be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. In situations in which a net operating loss carryforward, a similar tax loss or a tax credit carryforward is not available at the reporting date under the tax law of the jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit will be presented in the financial statements as a liability and will not be combined with deferred tax assets. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. ASU 2013-11 is effective for fiscal years and interim periods beginning after December 15, 2013. The Company expects adoption of this standard to cause a balance sheet reclassification reducing long-term liability and deferred tax assets.

In February 2013, the FASB issued ASU No. 2013-02, Comprehensive Income (Topic 220) - Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("ASU 2013-02") to require reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements, which we have done within Note 13 - "Equity and Stock Based Compensation Plans". ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 was effective for the period ending March 30, 2013, and is applied prospectively.

Note 3. Fair Value Measurements and Disclosures

Fair value is defined as the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability.

The Company determines the fair values of its financial instruments based on the fair value hierarchy established in ASC 820, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 — Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Such unobservable inputs include an estimated discount rate used in the Company's discounted present value analysis of future cash flows, which reflects the Company's estimate of debt with similar terms in the current credit markets. As there is currently minimal activity in such markets, the actual rate could be materially different.

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NANOMETRICS INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

The following tables present the Company's assets and liabilities measured at estimated fair value on a recurring basis, excluding accrued interest components, categorized in accordance with the fair value hierarchy (in thousands):

	September 28, 2013 Fair Value Measurements Using Input Types				December 29, 2012 Fair Value Measurements Using Input Types			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Money market funds	$748	$—	$—	$748	$109	$—	$—	$109
Commercial paper	—	—	—	—	—	2,600	—	2,600
Municipal securities	—	—	—	—	—	—	—	—
Total cash equivalents	748	—	—	748	109	2,600	—	2,709
Marketable securities:								
U.S. Treasury securities and U.S. Government agency securities	20,738	—	—	20,738	20,568	—	—	20,568
Commercial paper, corporate debt securities, and municipal securities	—	28,319	—	28,319	—	26,425	—	26,425
Total marketable securities	20,738	28,319	—	49,057	20,568	26,425	—	46,993
Total (1)	$21,486	$28,319	$—	$49,805	$20,677	$29,025	$—	$49,702
Liabilities:								
Contingent consideration payable	$—	$—	$2,772	$2,772	$—	$—	$2,462	$2,462

(1) Excludes $43.1 million and $60.2 million held in operating accounts as of September 28, 2013, and December 29, 2012, respectively.

The fair values of the marketable securities that are classified as Level 1 in the table above were derived from quoted market prices for identical assets or liabilities that the Company has the ability to access. The fair value of marketable securities that are classified as Level 2 in the table above were derived from the following: non-binding market consensus prices that were corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques, with all significant inputs derived from or corroborated by observable market data. There were no transfers of instruments between Level 1, Level 2 and Level 3 during the financial periods presented.

Refer to Note 11 "Line of Credit and Debt Obligations" for the carrying value and fair value of the Company's debt obligations.

Changes in Level 3 liabilities (in thousands)	
Fair value at December 29, 2012	$2,462
Payments made to Zygo Corporation	(735)

Change in fair value included in earnings	1,045
Fair Value at September 28, 2013	$ 2,772

As of September 28, 2013, the Company had liabilities of $2.8 million resulting from the acquisition of certain assets from Zygo Corporation ("Zygo") which are measured at fair value on a recurring basis, with changes in fair value recorded in other income or expenses. Of the $2.8 million of Zygo liabilities at September 28, 2013, $1.0 million was a current liability and $1.8 million was a long-term liability. In the third quarter ended September 28, 2013, the Company revised its forecast for the number of units it expects to purchase from Zygo in future periods, and recorded a related increase in the fair value of the Zygo liabilities associated with the revised forecast. As of December 29, 2012, the liabilities totaled $2.5 million of which $0.7 million was a current liability and $1.8 million was a long-term liability.

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(Unaudited)

The fair values of these liabilities were determined using Level 3 inputs using a discounted cash flow model incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included estimates for discount rate, timing and the amount of cash flows.

Note 4. Cash and Investments

The following table presents cash, cash equivalents, and available-for-sale investments as of September 28, 2013, and December 29, 2012 (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
September 28, 2013				
Cash	$43,085	$—	$—	$43,085
Cash equivalents:				
Money market funds	748	—	—	748
Marketable securities:				
Commercial paper	950	—	—	950
U.S. Treasury securities	5,048	—	—	5,048
U.S. Government agency securities	15,685	8	(4)	15,689
Municipal securities	8,546	11	—	8,557
Corporate debt securities	18,803	16	(6)	18,813
Total cash, cash equivalents, and short-term investments	$92,865	$35	$(10)	$92,890
December 29, 2012				
Cash	$60,206	$—	$—	$60,206
Cash equivalents:				
Money market funds	109	—	—	109
Commercial paper	2,600	—	—	2,600
Short-term investments:				
Commercial paper	3,199	—	—	3,199
U.S. Treasury Securities	4,996	1	—	4,997
U.S. Government agency securities	15,567	6	(2)	15,571
Municipal securities	5,396	1	(1)	5,396
Corporate debt securities	17,837	2	(9)	17,830
Total cash, cash equivalents, and short-term investments	$109,910	$10	$(12)	$109,908

Available-for-sale marketable securities, readily convertible to cash, with maturity dates of 90 days or less are classified as cash equivalents, while those with maturity dates greater than 90 days are classified as marketable securities within short-term assets. All marketable securities as of September 28, 2013, and December 29, 2012, were available-for-sale and reported at fair value based on the estimated or quoted market prices as of the balance sheet date. Unrealized gains or losses, net of tax effect, are recorded in accumulated other comprehensive income (loss) within stockholders' equity.

Both the gross unrealized gains and gross unrealized losses for the three and nine month periods ended September 28, 2013, and September 29, 2012, were insignificant and no marketable securities had other than temporary impairment. All marketable securities as of September 28, 2013, and December 29, 2012, had maturity dates of less than two years and none were invested in foreign entities.

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Note 5. Goodwill Impairment and Long-lived Asset Impairment

The Company’s impairment review process is completed during the fourth quarter of each year or whenever events or circumstances occur that indicate that an impairment may have occurred. The Company may assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If, after assessing the qualitative factors, a company determines that it is more likely than not that the fair value of a reporting unit is less than its carrying value, then performing the two-step impairment test is necessary. Otherwise, no further testing is necessary.

The Company completed its annual goodwill impairment assessment during the fourth quarter of 2012 by first performing a qualitative assessment. As part of this assessment, the Company considered the trading value of the Company's stock, the industry trends, and the Company's sales forecast and products plans. The Company concluded that it was more likely than not that the fair value was more than the carrying values of the Company's reporting unit and therefore did not proceed to Step 1 of the goodwill impairment test.

The process of evaluating the potential impairment of long-lived assets is highly subjective and requires significant judgment. In estimating the fair value of these assets, the Company made estimates and judgments about future revenues and cash flows. The Company’s forecasts were based on assumptions that are consistent with the plans and estimates the Company is using to manage its business. Changes in these estimates could change the Company’s conclusion regarding impairment of the long-lived assets and potentially result in future impairment charges for all or a portion of their balance at December 29, 2012. The Company did not record any impairment charges in the fiscal year 2012.

Note 6. Accounts Receivable

The Company maintains arrangements under which eligible accounts receivable in Japan are sold without recourse to unrelated third party financial institutions. These receivables were not included in the consolidated balance sheet as the criteria for sale treatment had been met. The Company pays administrative fees as well as interest ranging from 1.21% to 1.475% based on the anticipated length of time between the date the sale is consummated and the expected collection date of the receivables sold. The Company sold $0.6 million and $1.2 million of receivables during the three month periods ended September 28, 2013, and September 29, 2012, respectively, and sold $5.2 million and $4.8 million of receivables during the nine month periods ended September 28, 2013, and September 29, 2012, respectively. There were no material gains or losses on the sale of such receivables. There were no amounts due from such third party financial institutions at September 28, 2013, and December 29, 2012.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(Unaudited)

Note 7. Inventories
Inventories are stated at the lower of standard cost (which approximates actual cost on a first-in, first-out basis), or market. Inventories consist of the following (in thousands):

	At September 28, 2013	December 29, 2012
Raw materials and sub-assemblies	$19,349	$22,477
Work in process	8,392	5,812
Finished goods	8,802	11,370
Inventories	36,543	39,659
Inventories-delivered systems	2,313	2,274
Total inventories	$38,856	$41,933

The Company reflects the cost of systems that were invoiced upon shipment but deferred for revenue recognition purposes separate from its inventory held for sale as "Inventories-delivered systems."

Note 8. Property, Plant and Equipment
Property, plant and equipment consist of the following (in thousands):

	At September 28, 2013	December 29, 2012
Land	$15,569	$15,573
Building and improvements	19,404	19,231
Machinery and equipment	28,299	21,523
Furniture and fixtures	2,359	2,228
Capital in progress	5,020	4,377
Total property, plant and equipment, gross	70,651	62,932
Accumulated depreciation	(24,054)	(19,719)
Total property, plant and equipment, net	$46,597	$43,213

Total depreciation expense for the three month periods ended September 28, 2013, and September 29, 2012, was $1.4 million and $1.3 million, respectively, and for the nine month periods ended September 28, 2013, and September 29, 2012, was $4.0 million and $3.5 million, respectively.

Note 9. Intangible Assets

Finite-lived intangible assets are recorded at cost, less accumulated amortization. Finite-lived intangible assets as of September 28, 2013, and December 29, 2012, consisted of the following (in thousands):

	Adjusted cost as of September 28, 2013	Accumulated amortization as of September 28, 2013	Net carrying amount as of September 28, 2013
Developed technology	$17,948	$(10,313)	$7,635
Customer relationships	9,558	(9,166)	392
Brand names	1,927	(1,675)	252
Patented technology	2,252	(1,972)	280
Trademark	80	(80)	—
Total	$31,765	$(23,206)	$8,559

	Adjusted cost as of December 29, 2012	Accumulated amortization as of December 29, 2012	Net carrying amount as of December 29, 2012
Developed technology	$17,700	$(8,277)	$9,423
Customer relationships	9,538	(8,643)	895
Brand names	1,927	(1,599)	328
Patented technology	2,252	(1,922)	330
Trademark	80	(76)	4
Total	$31,497	$(20,517)	$10,980

The amortization of finite-lived intangibles is computed using the straight-line method. Estimated lives of finite-lived intangibles range from 2 years to 10 years. Total amortization expense for each of the three month periods ended September 28, 2013, and September 29, 2012, was $0.9 million and $0.8 million, and for the nine month periods ended September 28, 2013, and September 29, 2012, was $2.6 million and $2.5 million, respectively.

At September 28, 2013, estimated future amortization expense of intangible assets were as follows (in thousands):

Fiscal years	Amount
2013	$776
2014	3,067
2015	2,379
2016	1,901
2017	230
Thereafter	206
Total future amortization expense	$8,559

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Note 10. Other Current Liabilities
Other current liabilities consist of the following (in thousands):

	At September 28, 2013	December 29, 2012
Accrued warranty	$3,402	$4,203
Accrued professional services	771	584
Customer deposits	866	73
Fair value of contingent consideration	1,041	649
Other	1,963	2,313
Total other current liabilities	$8,043	$7,822

Note 11. Line of Credit and Debt Obligations
Debt obligations consist of the following (in thousands):

	At September 28, 2013	December 29, 2012
Line of Credit		
Balance on line of credit	$—	$—
Debt Obligations		
Milpitas building mortgage	—	5,302
Total debt obligations	—	5,302
Current portion of debt obligations	—	(928)
Long-term debt obligations	$—	$4,374

Line of Credit - On April 23, 2012, the Company amended its revolving line of credit facility (i) to extend the maturity date of such facility by two years to April 30, 2014, (ii) to decrease the unused revolving line commitment fee from 0.1875% per annum to 0.10% per annum, and (iii) to reduce the minimum interest rate on borrowings from 5.75% to 3.00% per annum.
The instrument governing the line of credit facility includes certain financial covenants regarding tangible net worth. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on behalf of the Company. The value of all letters of credit outstanding reduces the total line of credit available. The revolving line of credit is collateralized by a blanket lien on all of the Company’s domestic assets excluding intellectual property and real estate. The minimum borrowing interest rate is 3.00% per annum. Borrowing is limited to the lesser of (a) $7.5 million plus the borrowing base, or (b) $20.0 million. The total borrowing available as of September 28, 2013, was $11.2 million. As of September 28, 2013, the Company was not in breach of any restrictive covenants in connection with this line of credit. There were no outstanding amounts drawn on this facility as of September 28, 2013. Although management has no current plans to request advances under this credit facility, the Company may use the proceeds of any future borrowing for general corporate purposes, future acquisitions or expansion of the Company's business.

Mortgage Loan - In July 2008, the Company entered into a loan agreement with General Electric Commercial Finance ("GE") pursuant to which it borrowed $13.5 million, secured, in part, by a lien on and security interest in the building and land comprising the Company's principal offices in Milpitas, California. The loan initially bore interest at the rate of 7.18% per annum, which rate was scheduled to reset in August 2013 to 3.03% over the weekly average yield of five-year U.S Dollar Interest Rate Swaps as published by the Federal Reserve. Monthly principal and interest payments were based on a 20 year amortization for the first 60 months and 15 year amortization thereafter. The remaining principal balance of the loan and any accrued but unpaid interest was due on August 1, 2018. According to the terms of the loan agreement, the Company could make annual pre-payments of up to 20% of the outstanding principal balance without incurring any penalty. GE subsequently sold the mortgage on March 31, 2011, to Sterling Saving Bank; however, no changes were made to the terms of the original loan agreement with GE as a result of the sale. In July 2012, the Company prepaid $1.4 million of the loan, representing 20% of the outstanding balance at the time of prepayment. On July 18, 2013, the Company repaid $4.8 million of the loan, representing the entire outstanding principal balance of the loan and all accrued interest. As of September 28, 2013, there was no outstanding balance on the loan.

The Company's level 2 valuation estimate of the fair value of its debt is based on the interest rates for similar debt instruments issued by other entities with credit ratings comparable to the Company's. The estimated fair value of the debt as of December 29, 2012 was $5.7 million.

Note 12. Net Income/(Loss) Per Share

The Company presents both basic and diluted earnings per share on the face of its condensed consolidated statements of operations. Basic earnings per share are computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding for the period. Diluted earnings per share are computed using the weighted-average number of shares of common stock outstanding plus the effect of all dilutive securities representing potential shares of common stock outstanding during the period.
A reconciliation of the share denominator of the basic and diluted net income (loss) per share computations for the three and nine month periods ended September 28, 2013, and September 29, 2012, is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Weighted average common shares outstanding used in basic net income (loss) per share calculation	23,261	23,310	23,247	23,351
Dilutive common stock equivalents, using treasury stock method	—	450	—	523
Shares used in diluted net income (loss) per share computation	23,261	23,760	23,247	23,874

Since the Company had a net loss for the three and nine month periods ended September 28, 2013, 410 and 387 potentially dilutive securities, respectively, were not included in the computation of diluted shares for the periods as inclusion of such shares would have been anti-dilutive. Accordingly, basic and diluted net loss per share were the same for the three and nine month periods ending September 28, 2013.

Note 13. Equity and Stock Based Compensation Plans

Options

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected term of options granted was calculated using the simplified method. The risk-free rate is based on the U.S. Treasury rates in effect during the corresponding period of grant. The expected volatility is based on the historical volatility of Nanometrics' stock price. The dividend yield reflects that the Company has not paid any cash dividends since inception and does not intend to pay any cash dividends in the foreseeable future.

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	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Stock Options				
Expected life	4.6 years	4.6 years	4.5 years	4.5 years
Volatility	64.38 %	75.44 %	71.04 %	77.96 %
Risk free interest rate	1.52 %	0.74 %	1.00 %	0.84 %
Dividends	—	—	—	—
Employee Stock Purchase Plan				
Expected life	0.5 years	0.5 years	0.5 years	0.5 years
Volatility	25.94 %	38.58 %	26.75 %	45.47 %
Risk free interest rate	0.10 %	0.16 %	0.11 %	0.12 %
Dividends	—	—	—	—

The weighted average fair value per share of the stock options awarded in the three month periods ended September 28, 2013, and September 29, 2012, was $7.75 and $8.94, respectively, and in the nine month periods ended September 28, 2013, and September 29, 2012, was $8.55 and $10.5, respectively, based on the fair market value of the Company’s common stock on the grant dates.

A summary of activity under the Company’s stock option plans during the nine month period ended September 28, 2013, is as follows:

	Number of Shares Outstanding (Options)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in Thousands)
Options				
Outstanding at December 29, 2012	2,020,319	$12.01	4.44	$6,770
Exercised	(218,474)	7.46		
Granted	374,700	15.22		
Cancelled	(121,881)	15.10		
Outstanding at September 28, 2013	2,054,664	$12.90	4.28	$7,158
Exercisable at September 28, 2013	1,258,894	$11.43	3.49	$6,150

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company’s closing stock price of $16.05 as of September 28, 2013, which would have been received by the option holders had all option holders exercised their options as of that date. The total intrinsic value of options exercised during the three month periods ended September 28, 2013, and September 29, 2012, was $0.2 million and $1.0 million, respectively. The total intrinsic value of options exercised during the nine month periods ended September 28, 2013, and September 29, 2012, was $1.7 million and $4.5 million, respectively.

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Restricted Stock Units ("RSUs")
A summary of activity for RSUs during the nine month period ended September 28, 2013, is as follows:

	Number of RSUs	Weighted Average Fair Value
Outstanding RSU as of December 29, 2012	235,162	$16.32
Granted	292,360	15.41
Released	(85,707)	15.55
Cancelled	(9,518)	14.41
Outstanding RSU as of September 28, 2013	432,297	$16.05

Stock-based Compensation Expense
Stock-based compensation expense for all share-based payment awards made to the Company's employees and directors pursuant to the employee stock option and employee stock purchase plans by function was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Cost of products	$55	$50	$153	$128
Cost of service	74	62	204	195
Research and development	412	289	1,092	952
Selling	476	451	1,418	1,374
General and administrative	789	630	2,149	1,886
Restructuring	896	—	896	—
Total stock-based compensation expense	$2,702	$1,482	$5,912	$4,535

Note 14. Accumulated Other Comprehensive Income (Loss)

The following table shows a summary of changes in accumulated other comprehensive income (loss) by component for the nine months ended September 28, 2013 (in thousands):

	Defined Benefit Pension Plans	Foreign Currency Translations	Unrealized Gain (Loss) on Investment	Total
Balance as of December 29, 2012	$(179)	$1,453	$(2)	$1,272
Other comprehensive income	—	(837)	17	(820)
Balance as of September 28, 2013	$(179)	$616	$15	$452

Note 15. Warranties

The Company sells the majority of its products with a 12 months repair or replacement warranty from the date of acceptance. The Company provides an accrual for estimated future warranty costs based upon the historical relationship of warranty costs to the cost of products sold. The estimated future warranty obligations related to product sales are recorded in the period in which the related revenue is recognized. The estimated future warranty obligations are affected by the warranty periods, sales volumes, product failure rates, material usage, and labor and replacement costs incurred in correcting a product failure. If actual product failure rates, material usage, labor or replacement costs were to differ from the Company’s estimates, revisions to the estimated warranty obligations would be required. The warranty accrual represents the best estimate of the amount necessary to settle future and existing claims on products sold as of the balance sheet date. The Company periodically assesses the adequacy of its reported warranty reserve and adjusts such amounts in accordance with changes in these factors. Components of the warranty accrual, which were included in the accompanying condensed consolidated balance sheets with other current liabilities, were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Balance as of beginning of period	$3,519	$ 4,943	$4,203	$ 4,797
Accruals for warranties issued during period	801	881	1,924	3,545
Aggregate changes in liabilities related to preexisting warranties	360	206	962	1,364
Settlements during the period	(1,278)	(1,381)	(3,687)	(5,057)
Balance as of end of period	$3,402	$ 4,649	$3,402	$ 4,649

Note. 16. Restructuring

The Company recorded a restructuring charge of $1.7 million during the three month period ended September 28, 2013 as a result of its decision to consolidate a portion of its European operations to maximize efficiencies. This amount includes charges primarily related to employee severance and non-cash acceleration of vesting of RSUs in the amount of $0.8 million and $0.9 million, respectively. No cash payments related to employee severance have been made as of September 28, 2013. The Company expects to complete this restructuring plan by May 2014 and expects to incur an additional $0.2 million over the next seven months.

At September 28, 2013, the components of the Company's restructuring reserve of $0.8 million consist primarily of employee severance expenses and were included in the accompanying condensed consolidated balance sheet with other current liabilities. The following table summarizes restructuring related activities (in thousands):

	Employee severance and benefits
Balance as of December 29, 2012	$—
Charges	1,740
Cash Payments	—
Non-cash acceleration of vesting of RSUs	(896)
Balance as of September 28, 2013	$844

Note 17. Income Taxes

The Company accounts for income taxes under the provisions of ASC 740, Accounting for Income Taxes. The Company adjusts its effective tax rate each quarter to be consistent with the estimated annual effective tax rate. The Company also records the tax effect of unusual or infrequently occurring discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or tax rates, in the interim period in which they occur. The Company's effective tax rate reflects the impact of a portion of its earnings being taxed in foreign jurisdictions as well as a valuation allowance maintained on certain deferred tax assets.

The Company recorded a tax benefit of $3.1 million and a tax provision of $1.4 million for the three month periods ended September 28, 2013, and September 29, 2012, respectively. The Company recorded a tax benefit of $9.7 million and a tax provision of $2.9 million for the nine month periods ended September 28, 2013, and September 29, 2012, respectively. The change during the three and nine months ended September 28, 2013, compared to the corresponding periods in 2012, is primarily due to a net loss recorded by the Company in the three and nine months ended September 28, 2013, as well as a one-time benefit of $0.6 million recorded during the three month period ended March 30, 2013, related to the retroactive reinstatement of the 2012 federal R&D Tax Credit.

As of September 28, 2013, the Company continued to maintain a valuation allowance against certain net deferred tax assets as a result of uncertainties regarding the realization of the asset due to cumulative losses and uncertainty of future taxable income in various tax jurisdictions. In the event that the Company determines that the deferred tax assets are realizable, an adjustment to the valuation allowance will be reflected in the tax provision for the period such determination is made.

The Company is subject to taxation in the United States and various states including California, and foreign jurisdictions including South Korea, Japan, China, Germany, France and the United Kingdom. Due to tax attribute carry-forwards, the Company is subject to examination by the IRS for tax years beginning from the 2003 tax year for U.S. tax purposes. The Company is also subject to examination in various states for tax years beginning from the 2002 tax year. The Company is also subject to examination in various foreign jurisdictions beginning from the 2006 tax year.

The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. The total amount of accrued penalties and interest is not material for the nine month period ended September 28, 2013. The Company reduced its unrecognized tax benefits by an immaterial amount during the nine month period ended September 28, 2013 as a result of a lapse of statute of limitations in Japan. During the next twelve months, the Company anticipates increases in its unrecognized tax benefits of approximately $0.7 million.

Note 18. Commitments and Contingencies

Intellectual Property Indemnification Obligations – The Company will, from time to time, in the normal course of business, agree to indemnify certain customers, vendors or others against third party claims that the Company’s products, when used for their intended purpose(s), or the Company's intellectual property, infringe the intellectual property rights of such third parties or other claims made against parties with which it enters into contractual relationships. It is not possible to determine the maximum potential amount of liability under these indemnification obligations due to the limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in each particular claim. Historically, the Company has not made payments under these obligations and believes that the estimated fair value of these agreements is immaterial. Accordingly, no liabilities have been recorded for these obligations in the accompanying unaudited consolidated balance sheets as of September 28, 2013, and December 29, 2012.

On January 13, 2012, the Company entered into a settlement and limited patent cross license agreement with KLA-Tencor Corporation to resolve all existing patent litigation between the parties. Pursuant to the settlement agreement, the Company agreed to make a one-time payment of $2.5 million to KLA-Tencor Corporation and each party agreed to a cross-license of the patents that were subject to the litigation. The Company accrued for the one-time payment of $2.5 million as expense incurred in fiscal year 2011, and the payment was made in the three month period ended March 31, 2012.

Note 19. Geographic and Significant Customer Information

The Company has one operating segment, which is the sale, design, manufacture, marketing and support of thin film, optical critical dimension, overlay dimension metrology and inspection systems. The following table summarizes total net revenues (based on the deployments and service location of the systems) and long-lived assets (excluding intangible assets) attributed to significant geographic regions (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Total net revenues:				
United States	$ 15,665	$ 6,888	$ 41,426	$ 32,337
China	901	1,270	6,952	3,907
Japan	2,387	5,896	9,617	12,746
South Korea	9,805	18,554	18,946	75,663
Israel	486	147	1,248	6,623
Taiwan	3,737	6,233	6,959	12,105
Singapore	2,157	792	6,602	1,579
All Other	3,906	4,158	6,398	7,651
Total net revenues	$ 39,044	$ 43,938	$ 98,148	$ 152,611

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	At	
	September 28, 2013	December 29, 2012
Long-lived tangible assets:		
United States	$43,771	$40,600
Japan	107	148
South Korea	476	520
All Other	2,243	1,945
Total long-lived tangible assets	$46,597	$43,213

The following customers accounted for 10% or more of total accounts receivable:

	At			
	September 28, 2013		December 29, 2012	
Intel Corporation	10.0	%	12.3	%
SK Hynix	46.0	%	***	
Samsung Electronics Co. Ltd.	***		***	
Micron Technology, Inc.	***		***	
Taiwan Semiconductor Mfg. Co.	***		17.3	%

*** The customer accounted for less than 10% of total accounts receivable for that period.

The following customers accounted for 10% or more of total revenue

	Three Months Ended				Nine Months Ended			
	September 28, 2013		September 29, 2012		September 28, 2013		September 29, 2012	
Intel Corporation	34.3	%	15.3	%	29.8	%	20.1	%
SK Hynix	23.3	%	24.1	%	17.5	%	18.9	%
Samsung Electronics Co. Ltd.	***		17.4	%	9.4	%	31.6	%
Taiwan Semiconductor Mfg. Co.	***		12.8	%	***		***	

Note 20. Stock Repurchase

On May 29, 2012, the Company's Board of Directors approved a program to repurchase up to $20.0 million of the Company's common stock. Stock repurchases under this program may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased is dependent on a variety of factors including price, corporate and regulatory requirements and other market conditions. Under this program, the Company repurchased and retired 250,400 shares of the Company's common stock at the weighted average price of $14.15 per share during fiscal 2012. During the three months ended March 30, 2013, the Company repurchased and retired 332,771 shares of the Company's common stock at the weighted average price of $15.03 per share. The Company did not repurchase any of its common stock during the three months ended September 28, 2013. As of September 28, 2013, the Company had repurchased and retired 583,171 shares of the Company's common stock at a weighted average price of $14.65 per share under this authorization, and there remained $11.5 million available for the future repurchase of shares of common stock.

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

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. The statements contained in this document that are not purely historical are forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding future periods, financial results, revenues, margins, growth, customers, tax rates, product performance, and the impact of accounting rules on our business and the future implications of our statements regarding goals, strategy, and similar terms. We may identify these statements by the use of words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” "intend," "likely," “may,” “might,” "plan," "potential," "predict," "project," "should," “will,” "would," and other similar expressions. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements, except as may otherwise be required by law.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain risks, uncertainties and changes in circumstances, many of which may be difficult to predict or beyond our control, including those factors referenced in Part II, Item 1A “Risk Factors” and elsewhere in this document, and in Part I Item 1A "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012. In particular our results could vary significantly based on: changes in customer and industry spending; rate and extent of changes in product mix; adoption of new products; timing of orders, shipments, and acceptance of products; our ability to secure volume supply agreements; and general economic conditions. In evaluating our business, investors should carefully consider these factors in addition to any other risks and uncertainties set forth elsewhere. The occurrence of the events described in the risk factors and elsewhere in this report as well as other risks and uncertainties could materially and adversely affect our business, operating results and financial condition. While management believes that the discussion and analysis in this report is adequate for a fair presentation of the information presented, we recommend that you read this discussion and analysis in conjunction with (i) our audited consolidated financial statements and notes thereto for the fiscal year ended December 29, 2012, which were included in our 2012 Annual Report on Form 10-K filed with the Securities Exchange Commission (SEC) on March 12, 2013, and (ii) our other filings with the SEC.

We are an innovator in the field of metrology and inspection systems for semiconductor manufacturing and other industries. Our systems are designed to precisely monitor film thickness and critical dimensions that are necessary to control the manufacturing process and to identify defects that can affect production yields and performance.

Principal factors that impact our revenue growth include capital expenditures by manufacturers of semiconductors to increase capacity and to enable their development of new technologies, and our ability to take market share. The increasing complexity of the manufacturing processes for semiconductors is an important factor in the demand for our innovative metrology systems, as are the adoption of optical critical dimension metrology across fabrication processes, adoption of immersion lithography and double patterning, adoption of new types of thin film materials, the adoption of advanced packaging strategies and wafer backside inspection and the need for improved process control to drive process efficiencies. Our strategy is to continue to innovate organically as well as to evaluate strategic acquisitions to address business challenges and opportunities.

Our revenues are primarily derived from product sales but are also derived from customer service and system upgrades ("services") for the installed base of our products. For the three months ended September 28, 2013, we derived 77.3% of our total net revenues from product sales and 22.7% of our total net revenues from services. For the nine months ended September 28, 2013, we derived 71.1% of our total net revenues from product sales and 28.9% of our total net revenues from services.

Overview

Nanometrics Incorporated and its subsidiaries ("Nanometrics", the "Company", or "we") is a leading provider of advanced, high-performance process control metrology and inspection systems used primarily in the fabrication of integrated circuits, high-brightness LEDs ("HB-LED"), discrete components and data storage devices. Our automated and integrated systems address numerous process control applications, including critical dimension and film thickness measurement, device topography, defect inspection, overlay registration, and analysis of various other film properties such as optical, electrical and material characteristics. Our process control solutions are deployed throughout the fabrication process, from front-end-of-line substrate manufacturing, to high-volume production of semiconductors and other devices, to advanced wafer-scale packaging applications. Our systems enable device manufacturers to improve yields, increase productivity and lower their manufacturing

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costs. Our defect inspection systems locate large area and microscopic defects on patterned and unpatterned wafers. This system can be used for inspection at nearly every stage of the semiconductor production flow.

Nanometrics Products

We offer a diverse line of systems to address the broad range of process control requirements of the semiconductor manufacturing industry. In addition, we believe that our engineering expertise, strategic acquisitions, supplier alliances and short-cycle production strategies enable us to develop and offer advanced process control solutions in the future that should address industry advancement and trends. We categorize our systems as follows:

Automated Standalone Systems

Our automated systems are made up of both semi-automated and fully automated metrology systems which are employed in both high-volume and low-volume production environments. The Atlas® II, Atlas XP/Atlas XP+ and Atlas-M represent our line of high-performance metrology systems providing optical critical dimension ("OCD®"), thin film metrology and wafer stress for transistor and interconnect metrology applications. The OCD technology is supported by our NanoCD® suite of solutions including our NanoDiffract® software and NanoGen™ scalable computing engine that enables visualization, modeling, and analysis of complex structures. The UniFire® system enables users to measure multiple parameters at any given process step in the advanced packaging process flow for critical dimension, overlay, and topography applications. Our SPARK™ defect inspection system, offers ultra-fast inspection of patterned and unpatterned semiconductor wafers.

We continue to offer automated products for 200mm factories running at 90nm nodes and above, as well as systems supporting micro-electrical mechanical systems ("MEMS"). Our Q240AT is a 200mm overlay metrology system that extends the technology capability of our customers' existing factories.

System Platform

The Lynx platform enables cluster metrology factory automation for improved cost of ownership to our customers by combining our Atlas II, IMPULSE®, UniFire metrology and SPARK inspection systems in configurations to provide high throughput, reduced footprint systems for leading 300mm wafer metrology applications including OCD, overlay, and thin film process control.

Integrated Systems

Our integrated metrology ("IM") systems are installed directly onto wafer processing equipment to provide near real-time measurements for improved process control and maximum throughput. Our IM systems are sold directly to end customers and through OEM channels. The IMPULSE system is our latest metrology platform for OCD, DBO, and thin film metrology and has been successfully qualified on numerous OEM platforms. Our 90x0 system is qualified for OEM and direct sales supporting thin film and OCD applications. Our NanoCD solutions suite is sold in conjunction with our IMPULSE and legacy 90x0 systems. Our Trajectory™ system provides in-line measurement of layers in thin film thickness and composition in semiconductor applications.

Materials Characterization

Our Materials Characterization products include systems that are used to monitor the physical, optical, electrical and material characteristics of discrete electronic industry, HB-LED, solar PV, compound semiconductor, strained silicon and silicon-on-insulator ("SOI") devices, including composition, crystal structure, layer thickness, dopant concentration, contamination and electron mobility.

Our Vertex™ is a photoluminescence ("PL") mapping system designed for high-volume compound semiconductor metrology applications including power control and photonics applications. The RPMBlue™ is our latest PL mapping system designed specifically for the HB-LED market. We sell Fourier-Transform Infrared ("FTIR") automated and manual systems in the QS2200/3300 and QS1200 respectively. The FTIR systems are spectrometers designed for non-destructive wafer analysis for various applications. The NanoSpec® line of products includes the 6100 which supports thin film measurement across all applications in both low volume production and research applications.

We are continually working to strengthen our competitive position by developing new technologies and products in our market segment. In furtherance of our goals, we have:

- Introduced new products in every core product line and primary market served;

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- Diversified our product line and addressed new markets through acquisitions, such as the 2011 acquisition of Nanda Technologies GmbH, a supplier of high sensitivity, high throughput defect inspection systems;

- Continued development of new measurement and inspection technologies for advanced fabrication processes; and

- Researched and developed innovative applications of existing technology to new market opportunities within the solar PV, HB-LED, and data storage industries.

Important Themes and Significant Trends

The semiconductor equipment industry is characterized by cyclical growth. Changing trends in the semiconductor industry continue to drive the need for metrology as a major component of manufacturing systems. These trends include:

- Proliferation of Optical Critical Dimension Metrology across Fabrication Processes. Our customers use photolithographic processes to create patterns on wafers. Critical dimensions must be carefully controlled during this process. In advanced node device definition, additional monitoring of thickness and profile dimensions on these patterned structures at CMP, Etch, and Thin Film processing is driving broader OCD adoption. Our proprietary OCD systems can provide the critical process control of these circuit dimensions that is necessary for successful manufacturing of these state of the art devices. Nanometrics OCD technology is broadly adopted across NAND, DRAM, HDD, and logic semiconductor manufacturing processes.
- Adoption of Advanced Packaging Processes: Our customers use photolithographic, etching, metallization and wafer thinning to enable next generation advanced packaging solutions for semiconductor devices. The new packaging leads to increased functionality in smaller, less expensive form factors. Advanced packages can be broken down into high density flip chip or bump packages that increase pin density allowing for more complex I/O on advanced CPU parts. Or, similar or different devices can be stacked at the wafer level using a Through Silicon Via ("TSV") process. The TSV process enables high density small form factor parts, being primarily driven by mobile consumer products (i.e. cellular telephones with integrated CMOS camera sensors). Increasingly, advanced packaging technologies are being adopted by our end customers.
- Adoption of New Types of Thin Film Materials. The need for ever increasing device circuit speed coupled with lower power consumption has pushed semiconductor device manufacturers to begin the replacement of the traditional aluminum etch back interconnect flows as well as conventional gate dielectric materials, all which drive a broader adoption of thin film and OCD metrology systems. To achieve greater semiconductor device speed, manufacturers have adopted copper in Logic/IDM and it is now proliferating in next generation DRAM and Flash nodes. Additionally, to achieve improved transistor performance in logic devices and higher cell densities in memory devices, new materials including high dielectric constant (or high-k) gate materials are increasingly being substituted for traditional silicon-oxide gate dielectric materials. High-k materials are comprised of complex thin films including layers of hafnium oxide and a bi-layer of thin film metals. Our advanced metrology and inspection solutions are required for control of process steps, which are critical to enable the device performance improvements that these new materials allow.
- Development of 3D Transistor Architectures. Our end customers continue to improve device density and performance by scaling front end of line transistor architectures. Many of these designs, including FinFET transistors and 3D-NAND have buried features and high aspect ratio stacked features that enable improved performance and density. The advanced designs require additional process control to manage the complex shapes and materials properties, driving additional applications for both OCD and our UniFire systems.
- Need for Improved Process Control to Drive Process Efficiencies. Competitive forces influencing semiconductor device manufacturers, such as price-cutting and shorter product life cycles, place pressure on manufacturers to rapidly achieve production efficiency. Device manufacturers are using our integrated and automated systems throughout the fabrication to ensure that manufacturing processes scale rapidly, are accurate and can be repeated on a consistent

basis.

Reduced Number of Customers. Our market is characterized by an ongoing oligopolistic trend which drives customer concentration. Our largest customer accounted for 34.3% of our total revenue for the third quarter of 2013, and our largest customer accounted for 17.4% of our total revenue for the third quarter of 2012. Our largest customer accounted for 29.8% of our total revenue for the first nine months of 2013, and our largest customer accounted for 31.6% of our total revenue for the first nine months of 2012.

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Critical Accounting Policies

The preparation of our financial statements conforms to accounting principles generally accepted in the United States of America, which requires management, in applying our accounting policies, to make estimates and judgments that have an important impact on our reported amounts of assets, liabilities, revenue, expenses and related disclosures at the date of our financial statements. On an on-going basis, management evaluates its estimates including those related to bad debts, inventory valuations, warranty obligations and income taxes. 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 management's estimates. Since December 29, 2012, there have been no significant changes to our critical accounting policies discussed in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

Recent Accounting Pronouncements

See Note 2 of the Unaudited Condensed Consolidated Financial Statements for a description of recent accounting pronouncements, including the respective dates of adoption and effects or anticipated effects on results of operations and financial condition.

Results of Operations

Three and Nine Month Periods Ended September 28, 2013 and September 29, 2012

Total net revenues - Our net revenues comprised the following categories (in thousands, except percentages):

	Three Months Ended				Nine Months Ended			
	September 28, 2013	September 29, 2012	Changes In Amount	%	September 28, 2013	September 29, 2012	Changes In Amount	%
Automated Systems	$22,965	$ 26,588	$(3,623)	(13.6)%	$51,593	$ 104,675	$(53,082)	(50.7)%
Integrated Systems	4,453	2,663	1,790	67.2 %	8,369	9,453	(1,084)	(11.5)%
Materials Characterization	2,746	3,063	(317)	(10.3)%	9,814	7,600	2,214	29.1 %
Total product revenues	30,164	32,314	(2,150)	(6.7)%	69,776	121,728	(51,952)	(42.7)%
Service revenues	8,880	11,624	(2,744)	(23.6)%	28,372	30,883	(2,511)	(8.1)%
Total net revenues	$39,044	$ 43,938	$(4,894)	(11.1)%	$98,148	$ 152,611	$(54,463)	(35.7)%

For the three and nine month periods ended September 28, 2013, total product revenues decreased by $2.2 million and $52.0 million, respectively, relative to the comparable 2012 periods. In the three and nine month periods ended September 28, 2013, net revenues from automated systems decreased by $3.6 million and $53.1 million, respectively, relative to the comparable 2012 periods. The year over year decrease in Automated Systems and Integrated Systems was primarily due to a substantial decline in demand and capital spending by two of our largest customers, as a result of their lack of capacity expansion in memory and logic production. Net revenues from our materials characterization products decreased by $0.3 million and increased by $2.2 million in the three and nine month periods ended September 28, 2013, respectively, relative to the comparable 2012 periods. The year over year increase in sales of Materials Characterization was primarily due to non-recurring sales of several relatively high priced products into the bare silicon substrate market in the first quarter of 2013.

For the three and nine month periods ended September 28, 2013, service revenues decreased by $2.7 million and $2.5 million, respectively, relative to the comparable 2012 periods. The decrease in the three month period and the increase in the nine month period was primarily due to upgrades of a large number of installed tools by a customer during the second quarter of 2012 and the first quarter of 2013. Upgrades tend to fluctuate from quarter to quarter based on availability of new functionality from upgrades and customer production cycles which determine when customers purchase available upgrades.

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With a significant portion of the world's semiconductor manufacturing capacity located in Asia, a substantial portion of our revenues continue to be generated in that region. Although sales to customers within individual countries of that region will vary from time to time, we expect that a substantial portion of our revenues will continue to be generated in Asia.

Gross margin. Our gross margin for product and services was as follows:

	Three Months Ended		Nine Months Ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Product	37.8 %	49.2 %	38.6 %	46.5 %
Services	49.7 %	53.7 %	48.9 %	49.8 %

The calculation of product gross margin includes both cost of products and amortization of intangible assets. Product gross margin for the three and nine month periods ended September 28, 2013, was 37.8% and 38.6%, respectively, reflecting a decrease of 11.4 percentage points and 7.9 percentage points, respectively, from the comparable periods in 2012. The decrease is primarily due to an adverse impact of additional reserves for excess and obsolete inventory for the discontinued Mosaic™ product line in the three months ended September 28, 2013, as well as fixed costs such as fixed overhead, amortization of intangible assets against lower revenue in the three and nine month periods ended September 28, 2013.

The gross margin for our services business was 49.7% and 48.9% for the three and nine month periods ended September 28, 2013, respectively, reflecting a decrease of 4 percentage points and an decrease of 0.9 percentage points, respectively, from the comparable periods in 2012, due principally to decreased upgrade revenues, which typically have higher margins than system sales, and the effects of lower labor and material costs associated with delivery of services under contracts.

Operating expenses. Our operating expenses comprised the following (in thousands, except percentages):

	Three Months Ended		Changes in		Nine Months Ended		Changes in	
	September 28, 2013	September 29, 2012	Amount	%	September 28, 2013	September 29, 2012	Amount	%
Research and development	$8,926	$7,176	$1,750	24.4 %	$24,695	$22,296	$2,399	10.8 %
Selling	6,758	6,308	450	7.1 %	20,303	20,560	(257)	(1.3)%
General and administrative	5,424	4,861	563	11.6 %	16,442	16,525	(83)	(0.5)%
Amortization of intangible assets	195	193	2	1.0 %	588	580	8	1.4 %
Restructuring	1,740	—	1,740	100.0 %	1,740	—	1,740	100.0 %
Total operating expenses	$23,043	$18,538	$4,505	24.3 %	$63,768	$59,961	$3,807	6.3 %

Research and development. Research and development expenses increased $1.8 million for the three month period ended September 28, 2013, over the comparable period in 2012. The result is primarily due to an $1.2 million increase in spending for development projects and related activities and a $0.3 million increase in labor costs.

Research and development expenses increased by $2.4 million for the nine month period ended September 28, 2013, over the comparable period in 2012, primarily due to a $2.6 million increase in spending for development projects and related activities, a $0.2 million increase in depreciation on capital equipment, a $0.2 million increase in facilities costs, offset in part by a $0.6 million decrease in labor costs associated with a decrease in headcount.

Selling. Selling expenses increased by $0.5 million for the three month period ended September 28, 2013, over the comparable period in 2012, primarily due to a $0.2 million increase in depreciation, a $0.1 million increase in marketing costs and a $0.1 million increase in recruiting expenses.

Selling expenses decreased by $0.3 million for the nine month period ended September 28, 2013, over the comparable period in 2012, primarily due to a $0.7 million decrease in labor costs, including bonus expense, a $0.2 million decrease in travel expenses related to lower sales activities, and a $0.2 million decrease in marketing activities,

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offset in part by a $0.7 million increase in depreciation of additional equipment used by our sales and applications departments and evaluation tools at customers sites, and a $0.3 million increase in recruiting expenses.

General and administrative. General and administrative expenses increased by $0.6 million for the three month period ended September 28, 2013, over the comparable period in 2012, primarily due to a $0.4 million increase in labor costs and a $0.2 million increase in legal and accounting fees.

General and administrative expenses decreased by $0.1 million for the nine month period ended September 28, 2013, over the comparable period in 2012, primarily due to a $0.6 million decrease in facilities expense offset in part by a $0.5 million increase in labor costs.

Amortization of intangible assets. Amortization of intangible assets increased slightly for the three and nine month periods ended September 28, 2013, when compared to the same periods in 2012, due primarily to the fluctuation of foreign currency exchange rates.

Restructuring. We recorded a restructuring charge of $1.7 million during the three month period ended September 28, 2013 as a result of our decision to consolidate a portion of our European operations to maximize efficiencies. This amount includes charges primarily related to employee severance and non-cash acceleration of vesting of RSUs in the amount of $0.8 million and $0.9 million, respectively. No cash payments related to employee severance have been made as of September 28, 2013. We expect to complete this restructuring plan by May 2014, and expect to incur an additional $0.2 million million over the next seven months.

Other Income (expense), net. Our net other income (expense) consisted of the following categories (in thousands, except percentages):

	Three Months Ended		Changes in		Nine Months Ended		Changes in	
	September 28, 2013	September 29, 2012	Amount	%	September 28, 2013	September 29, 2012	Amount	%
Interest income	$7	$28	$(21)	(75.0)%	$51	$113	$(62)	(54.9)%
Interest expense	(118)	(262)	144	(55.0)%	(549)	(795)	246	(30.9)%
Other expense, net	(334)	(121)	(213)	176.0 %	(930)	(345)	(585)	169.6 %
Total other income (expense), net	$(445)	$(355)	$(90)	25.4 %	$(1,428)	$(1,027)	$(401)	39.0 %

For the three and nine months ended September 28, 2013, compared to the same periods of 2012, interest income declined minimally as the total balances of cash, cash equivalents, and marketable securities remained relatively flat. Interest expense for the three and nine months ended September 28, 2013, was lower than the comparable prior year periods primarily due to a lower principal balance on our mortgage of our headquarters as a result of monthly payments and a prepayment of $1.4 million in July of 2012. On July 18, 2013, we repaid the entire outstanding principal balance of the mortgage and all accrued interest. Consequently, we expect interest expense to be lower in future periods. Other expense, net represents an increase of $0.2 million and $0.6 million during the three and nine month periods ended September 28, 2013, and September 29, 2012, respectively. The increase during the three month period ended September 28, 2013, compared to the same period of 2012 is primarily due to a $0.1 million net increase in fair value of contingent consideration payable. The increase during the nine month period ended September 28, 2013, compared to the same period of 2012 is primarily due to a $0.8 million net increase in fair value of contingent consideration payable, offset by a $0.2 million reduction of foreign exchange loss.

Income taxes. We account for income taxes under the provisions of ASC 740, Accounting for Income Taxes. We adjust the effective tax rate each quarter to be consistent with the estimated annual effective tax rate. We also record the tax effect of unusual or infrequently occurring discrete items, including changes in judgment about valuation allowances and effects of changes in tax laws or tax rates, in the interim period in which they occur. Our effective tax rate reflects the impact of a portion of its earnings being taxed in foreign jurisdictions as well as a valuation allowance maintained on certain deferred tax assets.

We recorded a tax benefit of $3.1 million and $9.7 million for the three month and nine month periods ended September 28, 2013, respectively. We recorded a tax provision of $1.4 million and $2.9 million for the three month and nine month periods ended September 29, 2012, respectively. The change during the three and nine months ended

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September 28, 2013, compared to the corresponding periods in 2012, is primarily due to our net loss for the quarter and nine months ended September 28, 2013, as well as a one-time benefit of $0.6 million recorded during the three month period ended March 30, 2013 related to the retroactive reinstatement of the 2012 federal R&D Tax Credit.

As of September 28, 2013, we continued to maintain a valuation allowance against certain net deferred tax assets as a result of uncertainties regarding the realization of the asset due to cumulative losses and uncertainty of future taxable income in various tax jurisdictions. In the event that we determine that the deferred tax assets are realizable, an adjustment to the valuation allowance will be reflected in the tax provision for the period such determination is made. We are subject to taxation in the United States and various states including California, and foreign jurisdictions including South Korea, Japan, China, Germany, France and the United Kingdom. Due to tax attribute carry-forwards, we are subject to examination by the IRS for tax years beginning from the 2003 tax year for U.S. tax purposes. We are also subject to examination in various states for tax years beginning from the 2002 tax year. We are also subject to examination in various foreign jurisdictions beginning from the 2006 tax year.

We accrue interest and penalties related to unrecognized tax benefits in our provision for income taxes. The total amount of accrued penalties and interest is not material for the three and nine month periods ended September 28, 2013. We reduced our unrecognized tax benefits by an immaterial amount during the three and nine month periods ended September 28, 2013, as a result of a lapse of statute of limitations in Japan. During the next twelve months, we anticipate an increase in our unrecognized tax benefits of approximately $0.7 million.

Liquidity and Capital Resources

We maintain an ongoing investment strategy of maintaining a portion of our cash and investments in available-for-sale investments with the objective of preserving capital and maintaining liquidity while mitigating concentration risk and increasing yields. Our policy is to maintain a marketable securities portfolio consisting of highly rated investments that may include: obligations issued by the US Treasury and its agencies, corporate bonds and commercial paper, tax exempt debt obligations of US municipalities, and time deposits at commercial banks. Our policy is that, with the exception of US treasury and agency issues, no single issue at the time of purchase, may exceed 5% of the total portfolio or have a duration exceeding 2 years. At September 28, 2013, and December 29, 2012, we held marketable securities of $49.1 million and $47.0 million, respectively.

We have historically relied on cash flow from operations, borrowings under a credit facility and mortgage, and issuances of equity securities for our liquidity needs. At September 28, 2013, our cash, cash equivalents, and marketable securities totaled $92.9 million and working capital was $140.7 million, compared to $109.9 million and $158.6 million, respectively, as of December 29, 2012.

Our principal cash requirements include working capital, capital expenditures, payment of taxes and payment of principal and interest on borrowings. In addition, we regularly evaluate our ability to repurchase our common stock and acquire other businesses and technologies.

Cash flows from operating activities -

Cash used by operating activities for the nine month period ended September 28, 2013, was $3.9 million, which resulted primarily from the following factors: net loss of $14.7 million offset by an increase in non-cash items of $10.8 million. Non-cash items primarily consisted of depreciation and amortization expense of $6.5 million, stock based compensation of $5.9 million, inventory write down of $6.3 million, and a $1.0 million increase in the fair value of contingent consideration, offset in part by $9.7 million of deferred income taxes. The change in non-cash working capital as of September 28, 2013, from December 29, 2012, was primarily due to a $1.8 million increase in accounts receivable during the nine months ended September 28, 2013, and a $7.2 million decrease in inventory (this amount includes a $4.0 million non-cash transfer of inventory to fixed assets), partially offset by a $2.0 million increase in deferred revenue and a $6.8 million increase in accounts payable.

Cash provided by operating activities for the nine month period ended September 29, 2012, was $12.8 million, which resulted primarily from the following factors: net income of $8.1 million, and non-cash items of $15.7 million which consisted primarily of: depreciation and amortization of $7.1 million, deferred income tax of $2.9 million, stock based compensation of $4.5 million, and inventory write down of 1.4 million. This operating cash flow was offset by an $11.0 million decrease in non-cash working capital, consisting principally of an increase in prepaid expenses and other

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assets of $1.7 million, associated principally with prepaid taxes, and a decrease in accounts payable and other accrued liabilities of $12.2 million, which included a $2.5 million payment of a legal settlement accrued at December 31, 2011, a $1.6 million reduction in accrued payroll and related expenses, and a $1.0 million reduction in accrued professional services fees. The non-cash working capital decrease was partly offset by an increase in deferred revenue of $4.4 million.

Cash flows from investing activities -
For the nine month period ended September 28, 2013, $40.8 million of cash was used for purchases of marketable securities, and $3.5 million for capital asset purchases. These outflows were offset by $38.0 million cash received from maturities of marketable securities.
For the nine month period ended September 29, 2012, $40.6 million of cash was used for investing activities consisting of $40.9 million for the purchase of marketable securities, and $3.7 million for capital asset purchases. These outflows were offset by $3.0 million cash received from sales of marketable securities, $0.5 million cash received from maturity of marketable securities, and $0.5 million cash received from the escrow related to the acquisition of Nanda due to post closing working capital adjustments.
Cash flows from financing activities -
For the nine month period ended September 28, 2013, $8.3 million was used for financing activities primarily composed of $5.0 million used to repurchase common stock, $5.2 million used to repay debt obligations, and a $0.5 million reduction related to the effect of excess tax benefits from the exercise of stock options. These payments were partially offset by $3.2 million, net of tax, received from the issuance of common stock from employee stock option exercises and stock purchased under the employee stock purchase program.
For the nine month period ended September 29, 2012, $2.8 million was used for financing activities primarily composed of $5.0 million used to repurchase common stock and $2.0 million used to repay debt obligations. These payments were partially offset by $3.5 million received from the issuance of common stock from employee stock option exercises and stock purchased under the employee stock purchase program, and $0.9 million of excess tax benefits from employee stock option exercises.

Line of Credit - On April 23, 2012, we amended our revolving line of credit facility with Comerica Bank principally (i) to extend the maturity date of such facility by two years to April 30, 2014, (ii) decrease the unused revolving line commitment fee from 0.1875% per annum to 0.10% per annum, and (iii) reduce the minimum interest rate on borrowings from 5.75% to 3.00% per annum.

The instrument governing the line of credit facility includes certain financial covenants regarding tangible net worth. The revolving line of credit agreement includes a provision for the issuance of commercial or standby letters of credit by the bank on our behalf. The value of all letters of credit outstanding reduces the total line of credit available. The revolving line of credit is collateralized by a blanket lien on all of our domestic assets excluding intellectual property and real estate. The minimum borrowing interest rate is 3.00% per annum. Borrowing is limited to the lesser of (a) $7.5 million plus the borrowing base, or (b) $20.0 million. The total borrowing available as of September 28, 2013 was $11.2 million. As of September 28, 2013, we were not in breach of any restrictive covenants in connection with this line of credit. There were no outstanding amounts drawn on this facility as of September 28, 2013, or December 31, 2012. Although management has no current plans to request advances under this credit facility, we may use the proceeds of any future borrowing for general corporate purposes, future acquisitions or expansion of our business.

Mortgage Loan - In July 2008, we entered into a loan agreement with General Electric Commercial Finance ("GE") pursuant to which we borrowed $13.5 million, secured, in part, by a lien on and security interest in the building and land comprising our principal offices in Milpitas, California. The loan initially bore interest at the rate of 7.18% per annum which rate was scheduled to reset in August 2013 to 3.03% over the weekly average yield of five-year U.S Dollar Interest Rate Swaps as published by the Federal Reserve. Monthly principal and interest payments were based on a 20 year amortization for the first 60 months and 15 year amortization thereafter. The remaining principal balance of the loan and any accrued but unpaid interest was due on August 1, 2018. According to the terms of the loan agreement, we could make annual pre-payments of up to 20% of the outstanding principal balance without incurring any penalty. GE subsequently sold the mortgage on March 31, 2011, to Sterling Saving Bank; however, no changes were made to the terms of the original loan agreement with GE as a result of the sale. In July 2012, we prepaid $1.4 million of the loan, respectively, representing 20% of the outstanding balance at the time of prepayment. On July 18, 2013, we repaid $4.8 million of the loan, representing the entire outstanding principal balance of the loan and all accrued interest. We did not

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incur any fees associated with the prepayment of the loan. As of September 28, 2013, there was no outstanding balance, compared to $5.3 million at December 29, 2012.

Repurchases of Common Stock - On May 29, 2012, our Board of Directors approved a program to repurchase up to $20.0 million of our common stock. Stock repurchases under this program may be made through open market and privately negotiated transactions, at times and in such amounts as management deems appropriate. The timing and actual number of shares repurchased is dependent on a variety of factors including price, corporate and regulatory requirements and other market conditions. Under this program, we repurchased and retired 250,400 shares our common stock at the weighted average price of $14.15 per share during fiscal 2012. During the three months ended March 30, 2013, we repurchased and retired 332,771 shares our common stock at the weighted average price of $15.03 per share. We did not repurchase any of our common stock during the three months ended September 28, 2013. As of September 28, 2013, we had repurchased and retired 583,171 shares of our common stock at a weighted average price of $14.65 per share under this authorization, and there remained $11.5 million available for the future repurchase of shares of common stock.

Business Partnership - On June 17, 2009, we announced a strategic business relationship with Zygo under which we purchased inventory and certain other assets including the UniFire system from Zygo and the two companies entered into a supply agreement. We will make payments to Zygo (with an estimated present value of $2.8 million as of September 28, 2013, compared to $2.5 million as of December 29, 2012) over a period of time as acquired inventory is sold and other aspects of the supply agreement are executed. We made royalty and sustaining engineering payments of 0.7 million and 0.2 million to Zygo in the nine month periods ended September 28, 2013, and September 29, 2012, respectively.

We have evaluated and will continue to evaluate the acquisitions of products, technologies or businesses that are complementary to our business. These activities may result in product and business investments, which may affect our cash position and working capital balances. Some of these activities might require significant cash outlays.

We believe our cash, cash equivalents, marketable securities, and borrowing availability will be sufficient to meet our needs through at least the next twelve months. Our ability to fund our working capital needs, planned capital expenditures and scheduled debt payments, as well as to comply with all of the financial covenants under our debt agreements, depends on our future operating performance and cash flow, which in turn are subject to prevailing economic conditions, and to financial, business and other factors, some of which are beyond our control.

Off-Balance Sheet Arrangements

As of September 28, 2013, we had no off-balance sheet arrangements or obligations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk does not differ materially from that discussed in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012, filed with the SEC on March 12, 2013. However, we cannot give any assurance as to the effect that future changes in interest rates or foreign currency rates will have on our consolidated financial position, results of operations or cash flows.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer, Timothy J. Stultz, and our Chief Financial Officer, Ronald W. Kisling, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and

Chief Financial Officer concluded that as of September 28, 2013, our disclosure controls and procedures were effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 were (i) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (ii) accumulated and reported to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely discussions regarding required disclosures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three month period ended September 28, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and CFO, has designed our disclosure controls and procedures and our internal control over financial reporting to provide reasonable assurances that the controls' objectives will be met. However, management does not expect that disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within Nanometrics have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any system's design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of a system's control effectiveness into future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

Investing in our securities involves a high degree of risk. In assessing these risks, you should carefully consider the information included in or incorporated by reference into this report, including our financial statements and the related notes thereto. You should carefully review and consider all of the risk factors set forth in Part l, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012, filed with the SEC on March 12, 2013. The risks described in our Annual Report on Form 10-K are not the only ones we face. Additional risks and uncertainties that are not presently known to us or that we currently believe are immaterial may also impair our business operations. Our business, operating results and financial conditions could be materially harmed by any of these risks. The trading price of our common stock could decline due to any of these risks and investors may lose all or part of their investment. There have been no material changes in our risk factors from those discussed in our Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

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

We have not granted any equity awards outside of our approved stock plans, nor made any unregistered sales of equity securities in the three and nine month periods ended September 28, 2013.

During the three month period ended September 28, 2013, we did not repurchase any of our common stock under any share repurchase program, and there remains $11.5 million available for the future repurchase of shares of our common stock.

ITEM 6. EXHIBITS

The following exhibits are filed, furnished or incorporated by reference with this Quarterly Report on Form 10-Q:

Exhibit No.	Description
3(i)	Certificate of Incorporation
3.1(1)	Certificate of Incorporation of the Registrant
3(ii)	Bylaws
3.2(2)	Bylaws of the Registrant
31	Rule 13a-14(a)/15d-14(a) Certifications
31.1(3)	Certification of Timothy J. Stultz, principal executive officer of the Registrant, pursuant to rule 13a-14(a) or rule 15a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2(3)	Certification of Ronald W. Kisling, principal financial officer of the Registrant, pursuant to rule 13a-14(a) or rule 15a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Section 1350 Certifications
32.1(3)	Certification of Timothy J. Stultz, principal executive officer of the Registrant, and Ronald W. Kisling, principal financial officer of the Registrant, pursuant to rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101(4)	The following financial statements, formatted in XBRL: (i) Condensed Consolidated Balance Sheets at September 28, 2013, and December 29, 2012, (ii) Condensed Consolidated Statements of Operations for the three and nine months ended September 28, 2013, and September 29, 2012 (iii) Condensed Consolidated Statements of Cash Flows for the nine months September 28, 2013, and September 29, 2012, and (v) Notes to Unaudited Condensed Consolidated Financial Statements, tagged as blocks of text. The information is Exhibit 101 is “furnished” and not “filed”, as provided in Rule 402 of Regulation S-T.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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(1)

Incorporated by reference to Exhibit 3.1 filed with the Registrant's Current Report on Form 8-K (SEC File No. 000-13470) filed with the Securities and Exchange Commission ("SEC") on October 5, 2006.

(2) Incorporated by reference to Exhibit 3.1 filed with the Registrant's Current Report on Form 8-K (SEC File No. 000-13470) filed with the SEC on April 12, 2012.

(3) Filed herewith.

(4) Furnished herewith.

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.

NANOMETRICS INCORPORATED
(Registrant)

By: /S/ RONALD W. KISLING
Ronald W. Kisling
Chief Financial Officer

Dated: November 7, 2013

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