

VEECO INSTRUMENTS INC
Form 10-Q
July 31, 2014
Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

OR

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

For the transition period from to .

Commission file number 0-16244

VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of

Incorporation or Organization)

11-2989601
(I.R.S. Employer

Identification Number)

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

11803
(Zip Code)

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

Website: **www.veeco.com**

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

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

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

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

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

40,221,908 shares of common stock were outstanding as of the close of business on July 25, 2014.

Table of Contents

Safe Harbor Statement

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

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

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

- We face significant competition;
 - We depend on a limited number of customers, located primarily in a limited number of regions, which operate in highly concentrated industries;
 - Our sales cycle is long and unpredictable;
 - We are subject to internal control evaluations and attestation requirements of Section 404 of the Sarbanes-Oxley Act and any delays or difficulty in satisfying these requirements or negative reports concerning our internal controls could adversely affect our future results of operations and our stock price;
 - The price of our common shares may be volatile and could decline significantly;
 - Our inability to attract, retain, and motivate key employees could have a material adverse effect on our business;
 - We are subject to foreign currency exchange risks;
 - The enforcement and protection of our intellectual property rights may be expensive and could divert our limited resources;
 - We may be subject to claims of intellectual property infringement by others;
 - If we are subject to cyber-attacks we could incur substantial costs and, if such attacks are successful, could result in significant liabilities, reputational harm and disruption of our operations;
 - Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses;
 - We may be required to take additional impairment charges for goodwill and indefinite-lived intangible assets or definite-lived intangible and long-lived assets;
-

Table of Contents

- Changes in accounting pronouncements or taxation rules or practices may adversely affect our financial results;
- We are subject to risks of non-compliance with environmental, health and safety regulations;
- We have significant operations in locations which could be materially and adversely impacted in the event of a natural disaster or other significant disruption;
- We have adopted certain measures that may have anti-takeover effects which may make an acquisition of our Company by another company more difficult;
- New regulations related to conflict minerals will force us to incur additional expenses, may make our supply chain more complex, and may result in damage to our relationships with customers; and
- The matters set forth in this Report generally, including the risk factors set forth in Part II. Item 1A. Risk Factors.

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

Available Information

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

Internet Address

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

Table of Contents

VEECO INSTRUMENTS INC.

INDEX

<u>SAFE HARBOR STATEMENT</u>	1
<u>PART I. FINANCIAL INFORMATION</u>	4
<u>ITEM 1. FINANCIAL STATEMENTS</u>	4
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	22
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	41
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	43
<u>PART II. OTHER INFORMATION</u>	44
<u>ITEM 1. LEGAL PROCEEDINGS</u>	44
<u>ITEM 1A. RISK FACTORS</u>	44
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	44
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	44
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	44
<u>ITEM 5. OTHER INFORMATION</u>	44
<u>ITEM 6. EXHIBITS</u>	45
<u>SIGNATURES</u>	46

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

	For the three months ended June 30,		For the six months ended June 30,	
	2014	2013	2014	2013
Net sales	\$ 95,122	\$ 97,435	\$ 185,963	\$ 159,216
Cost of sales	64,449	62,795	121,513	102,024
Gross profit	30,673	34,640	64,450	57,192
Operating expenses:				
Selling, general and administrative	21,891	19,779	43,558	39,427
Research and development	21,011	20,870	40,779	41,607
Amortization	2,899	855	5,802	1,711
Restructuring	801		1,193	531
Total operating expenses	46,602	41,504	91,332	83,276
Other operating, net	(158)	(52)	(370)	352
Changes in contingent consideration			(29,368)	
Operating income (loss)	(15,771)	(6,812)	2,856	(26,436)
Interest income (expense), net	72	236	236	428
Income (loss) before income taxes	(15,699)	(6,576)	3,092	(26,008)
Income tax provision (benefit)	(488)	(2,495)	(857)	(11,856)
Net income (loss)	\$ (15,211)	\$ (4,081)	\$ 3,949	\$ (14,152)
Income (loss) per common share:				
Basic:				
Income (loss)	\$ (0.39)	\$ (0.11)	\$ 0.10	\$ (0.37)
Diluted :				
Income (loss)	\$ (0.39)	\$ (0.11)	\$ 0.10	\$ (0.37)
Weighted average shares outstanding:				
Basic	39,379	38,764	39,275	38,740
Diluted	39,379	38,764	40,061	38,740

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

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

	For the three months ended		For the six months ended	
	2014	2013	2014	2013
Net income (loss)	\$ (15,211)	\$ (4,081)	\$ 3,949	\$ (14,152)
Other comprehensive income (loss), net of tax				
Available-for-sale securities				
Unrealized gain (loss) on available-for-sale securities	71	(246)	121	(241)
Benefit (provision) for income taxes		63		79
Less: Reclassification adjustments for gains included in net income (loss)	(45)	(13)	(45)	(50)
Net unrealized gain (loss) on available-for-sale securities	26	(196)	76	(212)
Foreign currency translation				
Foreign currency translation	(24)	(323)	109	(1,073)
Benefit (provision) for income taxes		(176)		(189)
Net foreign currency translation	(24)	(499)	109	(1,262)
Other comprehensive income (loss), net of tax	2	(695)	185	(1,474)
Comprehensive income (loss)	\$ (15,209)	\$ (4,776)	\$ 4,134	\$ (15,626)

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

Table of Contents

Veeco Instruments Inc. and Subsidiaries
Consolidated Balance Sheets
(In thousands, except share data)

	June 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 232,332	\$ 210,799
Short-term investments	252,165	281,538
Restricted cash	518	2,738
Accounts receivable, net	58,323	23,823
Inventories	48,364	59,726
Deferred cost of sales	5,714	724
Prepaid expenses and other current assets	26,774	22,579
Deferred income taxes	9,403	11,716
Total current assets	633,593	613,643
Property, plant and equipment at cost, net	83,141	89,139
Goodwill	91,521	91,348
Deferred income taxes	397	397
Intangible assets, net	108,914	114,716
Other assets	39,506	38,726
Total assets	\$ 957,072	\$ 947,969
Liabilities and equity		
Current liabilities:		
Accounts payable	\$ 27,777	\$ 35,755
Accrued expenses and other current liabilities	35,360	51,084
Customer deposits and deferred revenue	57,580	34,754
Income taxes payable	6,796	6,149
Deferred income taxes	159	159
Current portion of long-term debt	302	290
Total current liabilities	127,974	128,191
Deferred income taxes	23,057	28,052
Long-term debt	1,694	1,847
Other liabilities	2,912	9,649
Total liabilities	155,637	167,739
Equity:		
Preferred stock, 500,000 shares authorized; no shares issued and outstanding		
Common stock; \$.01 par value; authorized 120,000,000 shares; 40,210,710 and 39,666,195 shares issued and outstanding in 2014 and 2013, respectively	402	397
Additional paid-in capital	738,418	721,352
Retained earnings	57,809	53,860
Accumulated other comprehensive income	4,806	4,621
Total equity	801,435	780,230
Total liabilities and equity	\$ 957,072	\$ 947,969

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

Table of Contents

Veeco Instruments Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six months ended June 30,	
	2014	2013
Cash Flows from Operating Activities		
Net income (loss)	\$ 3,949	\$ (14,152)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation and amortization	11,600	7,985
Deferred income taxes	(2,675)	(10,571)
Non-cash equity-based compensation	9,813	6,292
Provision (recovery) for bad debt	(1,936)	11
Gross profit from sales of lab tools	(2,435)	
Change in contingent consideration	(29,368)	
Excess tax benefits from equity-based compensation		(461)
Other, net		15
Changes in operating assets and liabilities:		
Accounts receivable	(32,721)	18,099
Inventories	12,052	(4,211)
Prepaid expenses and other current assets	(6,621)	(8,901)
Accounts payable	(8,026)	20,912
Accrued expenses, customer deposits, deferred revenue and other current liabilities	29,638	(7,095)
Income taxes payable	646	(1,708)
Other, net	(692)	7,536
Net cash provided by (used in) operating activities	(16,776)	13,751
Cash Flows from Investing Activities		
Capital expenditures	(4,509)	(5,999)
Proceeds from the liquidation of short-term investments	121,233	272,449
Payments for purchases of short-term investments	(92,029)	(420,767)
Proceeds from sale of lab tools	7,034	
Other	(685)	(718)
Net cash provided by (used in) investing activities	31,044	(155,035)
Cash Flows from Financing Activities		
Proceeds from stock option exercises	9,125	313
Restricted stock tax withholdings	(1,867)	(2,335)
Excess tax benefits from equity-based compensation		461
Repayments of long-term debt	(141)	(132)
Net cash provided by (used in) financing activities	7,117	(1,693)
Effect of exchange rate changes on cash and cash equivalents	148	(32)
Net increase (decrease) in cash and cash equivalents	21,533	(143,009)
Cash and cash equivalents as of beginning of period	210,799	384,557
Cash and cash equivalents as of end of period	\$ 232,332	\$ 241,548

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

Table of Contents

Veeco Instruments Inc. and Subsidiaries

Notes to Consolidated Financial Statements (Unaudited)

Note 1 Basis of Presentation

The accompanying unaudited consolidated financial statements of Veeco Instruments Inc. (together with its consolidated subsidiaries, "Veeco", the Company, we, us and our, unless the context indicates otherwise) have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. ") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles ("U.S. GAAP") for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. Operating results for the three and six months ended June 30, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in our annual report on Form 10-K for the year ended December 31, 2013.

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

Use of Estimates

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

Income (Loss) Per Common Share

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

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Basic weighted average shares outstanding	39,379	38,764	39,275	38,740
Dilutive effect of stock options and restricted stock			786	
Diluted weighted average shares outstanding	39,379	38,764	40,061	38,740

Basic income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is computed using the weighted average number of common shares and common equivalent shares outstanding during the period. For the three months ended June 30, 2014 and the three and six months ended June 30, 2013, we reported a net loss, and accordingly, the basic and diluted weighted average shares outstanding are equal because any increase to basic weighted average shares outstanding would be antidilutive. As a result, for the three months ended June 30, 2014 and the three and six months ended June 30, 2013, we excluded 0.8 million, 0.7 million and 0.6 million common equivalent shares, respectively, that would have otherwise been dilutive.

Table of Contents

Additionally, not included above were additional stock options and restricted stock outstanding that had exercise or grant prices in excess of the average market value of our common stock during the period and are therefore antidilutive. There were 1.4 million of such underlying shares for both the three and six months ended June 30, 2014. There were 0.9 million and 1.2 million of such underlying shares for the three and six months ended June 30, 2013, respectively.

Revenue Recognition

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

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

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

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

we did have VSOE for all undelivered elements or the delivery of all elements of the arrangement.

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

Table of Contents

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

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

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

Recent Accounting Pronouncements

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period: In June 2014, the FASB issued Accounting Standards Update No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period* (Topic 718). The amendments in this ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015; earlier adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Revenue from Contracts with Customers: In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU No. 2014-09 requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard outlines a five-step model to be used to make the revenue recognition determination and requires new financial statement disclosures. The standard is effective for interim and annual periods beginning after December 15, 2016 and allows entities to choose among different transition alternatives. We are evaluating the impact of adopting the standard on our consolidated financial statements and related financial statement disclosures and we have not yet determined which method of adoption will be selected.

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

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

Table of Contents

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

Parent's Accounting for the Cumulative Translation Adjustment: In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This new standard is intended to resolve diversity in practice regarding the release into net income of a cumulative translation adjustment (CTA) upon derecognition of a subsidiary or group of assets within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. We have adopted this as of January 1, 2014 and currently anticipate that it could have an impact on our consolidated financial statements, in the event of derecognition of a foreign subsidiary in 2014 or thereafter. During the three months ended June 30, 2014, the Company began executing a plan to liquidate our foreign subsidiary in Japan. Please see note *Commitments, Contingencies and Other Matters* for additional information.

Note 2 Business Combinations

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

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

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

The post-closing milestones are divided into two contingencies. The first, tied to receipt of certain purchase orders, had an evaluation date of March 31, 2014, which was not met and accounted for \$20.2 million of the reversed liability. The second is based on achieving certain full year 2014 revenue and gross margin thresholds, which are unlikely to be met and accounted for \$9.2 million of the reversed liability. As of June 30, 2014 the second contingency, with a maximum potential value of \$75.0 million, remains contractually outstanding.

During the three months ended June 30, 2014, we finalized the working capital adjustment under the purchase agreement. Upon acquisition, the working capital adjustment was estimated to be \$2.7 million. Based on the final adjustment, the working capital adjustment was reduced to \$1.3 million. As a result, a \$1.4 million adjustment was made that increased goodwill by \$0.2 million and reduced accrued expenses by \$1.2 million for the relief of a potential liability that the former shareholders have retained.

Table of Contents**Note 3 Income Taxes**

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

Our effective tax rate for the three months ended June 30, 2014 was a benefit of 3.1% compared to a benefit of 37.9% during the three months ended June 30, 2013. Our effective tax rate for the six months ended June 30, 2014 was a benefit of 27.7% compared to a benefit of 45.6% during the six months ended June 30, 2013. A tax benefit for each period was provided to the extent of future reversals of taxable temporary differences which relate primarily to tax deductible intangibles. Our effective tax rate for 2014 differed from the expected net operating loss carry forward benefit at the U.S. federal statutory rate of 35% primarily because of the inability to recognize such benefit due to uncertainties relating to future taxable income in terms of both its timing and its sufficiency, which would enable us to realize the federal carry forward benefit. The effective tax rate for the six months ended June 30, 2014, was also impacted because we did not provide a tax provision on the gain from the settlement of the contingent consideration related to the Synos acquisition. Our effective tax rate for 2013 differed from the U.S. federal statutory rate as a result of the jurisdictional mix of earnings in our foreign locations, an income tax benefit related to the generation of current year research and development tax credits, and legislation enacted in the first quarter of 2013 which extended the Federal Research & Development Credit for both the 2012 and 2013 tax years.

Note 4 Balance Sheet Information*Cash and Cash Equivalents*

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

Short-Term Investments

Total available-for-sale securities and gains and losses in Accumulated Other Comprehensive Income (Loss) consist of the following (*in thousands*):

	June 30, 2014			
	Amortized Cost	Gains in Accumulated Other Comprehensive Income	Losses in Accumulated Other Comprehensive Income	Estimated Fair Value
U.S. treasuries	\$ 123,672	\$ 12	\$	\$ 123,684

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Corporate debt		65,176		111		(2)		65,285
Government agency securities		63,192		4				63,196
Total available-for-sale securities	\$	252,040	\$	127	\$	(2)	\$	252,165

During the three and six months ended June 30, 2014, available-for-sale securities were liquidated for total proceeds of \$89.2 million and \$121.2 million, respectively. For the three and six months ended June 30, 2014 there were minimal realized gains on these liquidations. During the three and six months ended June 30, 2013, available-for-sale securities were liquidated for total proceeds of \$171.2 million and \$272.4 million, respectively. For the three and six months ended June 30, 2013 there were minimal realized gains on these liquidations. The cost of securities sold is based on specific identification.

Table of Contents

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

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

	June 30, 2014	
	Estimated Fair Value	Gross Unrealized Losses
Corporate debt	\$ 3,350	\$ (2)
Total	\$ 3,350	\$ (2)

	December 31, 2013	
	Estimated Fair Value	Gross Unrealized Losses
Corporate debt	\$ 37,654	\$ (36)
U. S. treasuries	29,068	(1)
Total	\$ 66,722	\$ (37)

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

The Company regularly reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether an unrealized loss was considered to be temporary or other-than-temporary and therefore impaired include: the length of time and extent to which fair value has been lower than the cost basis; the financial condition and near-term prospects of the investee; and whether it is more likely than not that the Company will be required to sell the security prior to recovery. The Company believes the gross unrealized losses on the Company's short-term investments as of June 30, 2014 and December 31, 2013 were temporary in nature and therefore did not recognize any impairment.

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

	June 30, 2014
	Estimated Fair Value
Due in one year or less	\$ 212,814

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Due in 1 - 2 years		39,351
Total available-for-sale securities	\$	252,165

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

Table of Contents*Restricted Cash*

As of June 30, 2014 and December 31, 2013, restricted cash was \$0.5 million and \$2.7 million, respectively, which serves as collateral for bank guarantees that provide financial assurance that the Company will fulfill certain customer obligations. This cash is held in custody by the issuing bank and is restricted as to withdrawal or use while the related bank guarantees are outstanding.

Accounts Receivable, Net

Accounts receivable are presented net of allowance for doubtful accounts of \$0.8 million and \$2.4 million as of June 30, 2014 and December 31, 2013, respectively. We evaluate the collectability of accounts receivable based on a combination of factors. In cases where we become aware of circumstances that may impair a customer's ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount that we reasonably believe will be collected. For all other customers, we recognize an allowance for doubtful accounts based on the length of time the receivables are past due and consideration of other factors such as industry conditions, the current business environment and its historical experience.

During the three and six months ended June 30, 2014, we collected \$1.9 million of previously reserved accounts. As a result, we reversed the related allowance and bad debt expense associated with this receivable.

Inventories

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

	June 30, 2014	December 31, 2013
Materials	\$ 29,034	\$ 34,301
Work in process	12,736	12,900
Finished goods	6,594	12,525
	\$ 48,364	\$ 59,726

Property, Plant and Equipment, Net

As of June 30, 2014, we are holding \$2.9 million of tools that were previously used in our laboratories, for sale. These tools are carried in machinery and equipment, as a component of property, plant and equipment, net in our Consolidated Balance Sheets. These tools are the same type of tools we sell to our customers in the ordinary course of our business. During the three and six months ended June 30, 2014, we converted and sold \$3.2 million and \$4.6 million, respectively, of tools that we had previously used in our laboratories as Veeco Certified Equipment at an aggregate selling price of \$4.7 million and \$7.0 million, respectively, which is included in revenue in our Consolidated Statements of

Operations.

Goodwill

Changes in our goodwill are as follows (*in thousands*):

Beginning balance as of December 31, 2013	\$	91,348
Purchase price adjustment (see <i>Business Combinations</i>)		173
Ending balance as of June 30, 2014	\$	91,521

Cost Method Investment

We maintain certain investments in support of our strategic business objectives, including a non-marketable cost method investment. Our ownership interest is less than 20% of the investee's voting stock and we do not exert significant influence, therefore the investment is recorded at cost. The carrying value of the investment was \$17.7 million and \$16.9 million at June 30, 2014 and December 31, 2013, respectively and is included in "Other assets" on the Consolidated Balance Sheet. The investment is subject to a periodic impairment review; however, there are no open-market valuations, and the impairment analysis requires significant judgment. This analysis includes assessment of the investee's financial condition, the business

Table of Contents

outlook for its products and technology, its projected results and cash flow, the likelihood of obtaining subsequent rounds of financing, and the impact of any relevant contractual equity preferences held by us or others. Fair value of the investment is not estimated unless there are identified events or changes in circumstances that could have a significant adverse effect on the fair value of the investment. No such events or circumstances are present.

Customer Deposits and Deferred Revenue

As of June 30, 2014 and December 31, 2013, we had customer deposits of \$33.5 million and \$27.5 million, respectively recorded as a component of customer deposits and deferred revenue.

Accrued Warranty

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

		June 30,		
	2014		2013	
Balance as of the beginning of period	\$	5,662	\$	4,942
Warranties issued during the period		1,653		1,806
Settlements made during the period		(1,963)		(2,540)
Changes in estimate during the period		279		
Balance as of the end of period	\$	5,631	\$	4,208

Mortgage Payable

We have a mortgage payable with approximately \$2.0 million and \$2.1 million outstanding as of June 30, 2014 and December 31, 2013, respectively. The mortgage accrues interest at an annual rate of 7.91%, and the final payment is due on January 1, 2020. We estimate the fair value of the mortgage as of June 30, 2014 and December 31, 2013 was approximately \$2.1 million and \$2.3 million, respectively.

Accumulated Other Comprehensive Income

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

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

	Gross		Taxes		Net
As of June 30, 2014					
Translation adjustments	\$ 5,827	\$	(392)	\$	5,435
Minimum pension liability	(1,160)		424		(736)
Unrealized gain on available-for-sale securities	125		(18)		107
Accumulated other comprehensive income	\$ 4,792	\$	14	\$	4,806

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

Table of Contents*Equity*

Summary share activities impacting our common stock and additional paid-in capital balances are as follows (*in thousands*):

	For the Six Months Ended June 30, 2014 Shares
Restricted Stock	
Grants	206
Gross Vesting	168
Shares Withheld to Cover Taxes & Cancelled	(55)
Net Shares Vested	113
Stock Options	
Exercised	384

Note 5 Segment Information

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

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

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Table of Contents

The following tables present certain data pertaining to our reportable segments and a reconciliation of segment profit (loss) to income (loss) before income taxes for the three and six months ended June 30, 2014 and 2013, respectively, and goodwill and total assets as of June 30, 2014 and December 31, 2013 (*in thousands*):

	LED & Solar	Data Storage	Unallocated	Total
Three months ended June 30, 2014				
Net sales	\$ 77,154	\$ 17,968	\$	\$ 95,122
Segment profit (loss)	\$ (1,616)	\$ (343)	\$ (5,021)	\$ (6,980)
Interest income (expense), net			72	72
Amortization	(2,576)	(323)		(2,899)
Equity-based compensation	(2,339)	(683)	(2,069)	(5,091)
Restructuring	(73)	(728)		(801)
Income (loss) before income taxes	\$ (6,604)	\$ (2,077)	\$ (7,018)	\$ (15,699)
Three months ended June 30, 2013				
Net sales	\$ 75,933	\$ 21,502	\$	\$ 97,435
Segment profit (loss)	\$ 3,124	\$ (121)	\$ (5,247)	\$ (2,244)
Interest income (expense), net			236	236
Amortization	(532)	(323)		(855)
Equity-based compensation	(1,316)	(488)	(1,909)	(3,713)
Income (loss) before income taxes	\$ 1,276	\$ (932)	\$ (6,920)	\$ (6,576)

	LED & Solar	Data Storage	Unallocated	Total
Six months ended June 30, 2014				
Net sales	\$ 147,909	\$ 38,054	\$	\$ 185,963
Segment profit (loss)	\$ 508	\$ (991)	\$ (9,221)	\$ (9,704)
Interest income (expense), net			236	236
Amortization	(5,155)	(647)		(5,802)
Equity-based compensation	(4,512)	(1,382)	(3,919)	(9,813)
Restructuring	(237)	(956)		(1,193)
Changes in contingent consideration	29,368			29,368
Income (loss) before income taxes	\$ 19,972	\$ (3,976)	\$ (12,904)	\$ 3,092
Six months ended June 30, 2013				
Net sales	\$ 118,240	\$ 40,976	\$	\$ 159,216
Segment profit (loss)	\$ (8,098)	\$ 254	\$ (10,058)	\$ (17,902)
Interest income (expense), net			428	428
Amortization	(1,064)	(647)		(1,711)
Equity-based compensation	(2,026)	(618)	(3,648)	(6,292)
Restructuring	(423)	(50)	(58)	(531)
Income (loss) before income taxes	\$ (11,611)	\$ (1,061)	\$ (13,336)	\$ (26,008)

	LED & Solar	Data Storage	Unallocated	Total
As of June 30, 2014				
Goodwill	\$ 91,521	\$	\$	\$ 91,521
Total assets	\$ 384,903	\$ 35,611	\$ 536,558	\$ 957,072

As of December 31, 2013				
Goodwill	\$ 91,348	\$	\$	\$ 91,348
Total assets	\$ 359,464	\$ 37,910	\$ 550,595	\$ 947,969

As of June 30, 2014 and December 31, 2013 unallocated assets were comprised principally of cash and cash equivalents, restricted cash and short-term investments.

Table of Contents**Note 6 Fair Value Measurements**

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

- Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access.
- Level 2 inputs utilize other-than-quoted prices that are observable, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3 inputs are unobservable and are typically based on our own assumptions, including situations where there is little, if any, market activity.

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

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

The major categories of assets and liabilities measured on a recurring basis, at fair value, as of June 30, 2014 and December 31, 2013, are as follows (*in thousands*):

	June 30, 2014			
	Level 1	Level 2	Level 3	Total
U.S. treasuries	\$ 123,684	\$	\$	\$ 123,684
Corporate debt		65,285		65,285
Government agency securities		63,196		63,196

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

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

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

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

Table of Contents

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

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

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

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

	Level 3
Balance as of December 31, 2013	\$ (29,368)
Addition of contingent consideration	
Payment on contingent consideration, net of adjustment	
Fair value adjustment of contingent consideration	29,368
Balance as of June 30, 2014	\$

Note 7 Derivative Financial Instruments

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

During the three months ended December 31, 2013, we entered into an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates related to a particular receivable. The net fair value of these collars as of December 31,

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

2013 was approximately \$0.9 million. During the three months ended June 30, 2014, the collars were closed and resulted in a realized gain of \$0.4 million. As of June 30, 2014, there were no outstanding derivative instruments.

(in thousands)	Component of	As of December 31, 2013 Fair Value	Maturity Dates	Notional Amount
<u>Not Designated as Hedges under ASC 815</u>				
Foreign currency exchange forwards	Prepaid and other current assets	\$ 1	January 2014	\$ 4,700
Foreign currency collar	Prepaid and other current assets	906	October 2014	34,069
Total Derivative Instruments		\$ 907		\$ 38,769

Table of Contents

(in thousands)	Location of realized net gain (loss) and changes in the fair value of derivatives	Amount of realized net gain (loss) and changes in the fair value of derivatives			
		For the three months ended		For the six months ended	
		June 30,		June 30,	
		2014	2013	2014	2013
Foreign currency exchange forwards	Other operating, net	\$ 6	\$ (71)	\$ (89)	\$ 157
Foreign currency collar	Other operating, net	(124)		(457)	
		For the three months ended		For the six months ended	
		2014	2013	2014	2013
Weighted average notional amount of derivatives outstanding		\$ 10,457	\$ 1,360	\$ 11,201	\$ 1,994

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

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

During the first quarter of 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. We expect to substantially complete the consolidation by the end of 2014. During the three and six months ended June 30, 2014, we recorded restructuring charges of \$0.8 million and \$1.2 million. During the six months ended June 30, 2014 we notified approximately 49 employees of their termination from the Company. These charges consisted of personnel severance and related costs. We expect to incur approximately \$1.1 million and \$0.1 million of additional restructuring charges in our Data Storage segment throughout the remainder of 2014 and 2015, respectively, related to these actions. The reductions in head count principally relate to our Data Storage and MBE businesses.

During the six months ended June 30, 2013, we took measures to improve profitability, including a reduction of discretionary expenses, realignment of our senior management team and consolidation of certain sales, business and administrative functions. As a result of these actions, we recorded a restructuring charge of \$0.5 million. We did not record any restructuring charges during the three months ended June 30, 2013.

Subsequent to quarter end, the company announced additional restructuring activities. Included in these activities is further consolidation of our Data Storage Segment facilities and additional headcount reductions to help contain costs and further improve profitability. As a result of these actions, we anticipate total costs of approximately \$3.9 million, all of which will be incurred through the remainder of 2014.

Restructuring Liability

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

The following is a reconciliation of the restructuring liability through June 30, 2014 (*in thousands*):

	Balance as of		Rollforward of Restructuring Liability			Balance as of		Short-term portion
	January 1, 2014		For the six months ended June 30, 2014			June 30, 2014		
	\$		Expense Incurred	Cash Payments	Adjustments	\$	\$	
2012 Restructuring	\$	195	\$	\$	(195)	\$	\$	
2013 Restructuring		338			(182)		156	
2014 Restructuring				1,193	(489)		704	
Total	\$	533	\$	1,193	\$	(866)	\$	860

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

Table of Contents

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

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

Cumulative Translation Adjustment

During the three months ended June 30, 2014, the Company began executing a plan to liquidate our foreign subsidiary in Japan. We currently expect to be substantially liquidated by the end of the year. As a result of this liquidation we expect to realize into income the balance of the CTA at the time of liquidation. The balance in the CTA account as of June 30, 2014 was approximately \$3.5 million.

Legal Proceedings

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

Table of Contents

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

Executive Summary

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

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

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

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

As of June 30, 2014, Veeco had approximately 780 employees to support our customers through product and process development, training, manufacturing, and sales and service sites in the U.S., South Korea, Taiwan, China, Singapore, Japan, Europe and other locations.

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

Highlights of the Second Quarter of 2014

Selected financial highlights include:

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

- Revenue decreased 2.4% to \$95.1 million in 2014 from \$97.4 million in 2013. LED & Solar revenues increased 1.6% to \$77.1 million from \$75.9 million in 2013. Data Storage revenues decreased 16.4% to \$18.0 million from \$21.5 million in 2013;
- Orders increased 22.6% to \$104.0 million in 2014, compared to \$84.8 million in 2013;
- Our gross margin decreased to 32.2% in 2014 from 35.6% in 2013. Gross margins in LED & Solar decreased from 34.7% in 2013 to 31.0%. Data Storage gross margins decreased from 38.6% in 2013 to 37.7%.
- Our selling, general and administrative expenses increased to \$21.9 million from \$19.8 million in 2013. Selling, general and administrative expenses were 23.0% of net sales in 2014 compared to 20.3% in 2013;
- Our research and development expenses increased to \$21.0 million from \$20.9 million in 2013. Research and development expenses were 22.1% of net sales in 2014, compared to 21.4% in 2013;
- Net income (loss) in 2014 was (\$15.2) million compared to (\$4.1) million in 2013;
- Diluted net income (loss) per share in 2014 was (\$0.39) compared to (\$0.11) in 2013.

Table of Contents

Outlook

After a long downturn in our MOCVD business, LED fab utilization rates have improved to high levels at most key accounts and LED lighting adoption is accelerating. Our customers are also reporting better market demand for LED backlighting products. It is encouraging to see that our leading customers are beginning to place orders for capacity expansions. MOCVD business conditions have improved from last year, but we have seen no sustained improvement in our other businesses. We have been working to streamline our business operations and reduce our expense structure, enabling investments in high growth opportunities such as LED and OLED display. These activities are planned through the rest of 2014 and will result in an approximate 10% reduction in our operating expenses as we exit 2014.

Trends in the LED markets remain favorable, as indicated by our MOCVD first half order and revenue patterns compared to last year. While quarterly MOCVD order patterns fluctuate, we see solid growth ahead. We expect that Veeco's orders in the second half of fiscal 2014 will be better than the first half, driven primarily by growth in MOCVD. Yet, the timing and magnitude of key customer expansions could cause MOCVD orders to vary and be unpredictable on a quarterly basis. We continue to invest in MOCVD products and technology development to further improve our customers' cost of ownership and manufacturing capability. Competitive pricing pressure, which had a dramatic effect on our gross margins in 2013, is also difficult to predict.

Our new ALD business was acquired as a pre-revenue business and thus decreased our earnings in 2013 and is currently expected to negatively impact our financial performance this year as well. The timing of production ALD orders from our key customer could have a significant impact on our expected revenue growth. We did not receive any ALD orders from our key customer in the first half of 2014.

While Data Storage orders improved a bit on a sequential basis, low growth is expected to continue in the hard drive industry; our customers have excess manufacturing capacity and they have only been making select technology purchases. Future demand for our Data Storage products is unclear and orders are expected to fluctuate.

We remain focused on managing the Company back to profitable growth by: 1) developing and launching game-changing new products that enable cost effective LED lighting, flexible OLED display encapsulation and other emerging technologies; 2) improving customer cost of ownership as well as our gross margins; 3) driving process improvement initiatives to make us more efficient; and 4) lowering expenses. The combination of improved business conditions, execution on our growth initiatives and lower operating expenses should help improve the Company's profitability in 2015.

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

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

Table of Contents**Results of Operations:****Three Months Ended June 30, 2014 and 2013**

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

The following table shows our Consolidated Statements of Operations, percentages of sales, and comparisons between the three months ended June 30, 2014 and 2013 (*dollars in thousands*):

	For the three months ended June 30,				Dollar and Percentage Change Period to Period	
	2014		2013			
Net sales	\$ 95,122	100.0%	\$ 97,435	100.0%	\$ (2,313)	(2.4)%
Cost of sales	64,449	67.8%	62,795	64.4%	1,654	2.6%
Gross profit	30,673	32.2%	34,640	35.6%	(3,967)	(11.5)%
Operating expenses:						
Selling, general and administrative	21,891	23.0%	19,779	20.3%	2,112	10.7%
Research and development	21,011	22.1%	20,870	21.4%	141	0.7%
Amortization	2,899	3.0%	855	0.9%	2,044	239.1%
Restructuring	801	0.8%		0.0%	801	*
Total operating expenses	46,602	49.0%	41,504	42.6%	5,098	12.3%
Other operating, net	(158)	(0.2)%	(52)	(0.1)%	(106)	203.8%
Operating income (loss)	(15,771)	(16.6)%	(6,812)	(7.0)%	(8,959)	131.5%
Interest income (expense), net	72	0.1%	236	0.2%	(164)	(69.5)%
Income (loss) before income taxes	(15,699)	(16.5)%	(6,576)	(6.7)%	(9,123)	138.7%
Income tax provision (benefit)	(488)	(0.5)%	(2,495)	(2.6)%	2,007	(80.4)%
Net income (loss)	\$ (15,211)	(16.0)%	\$ (4,081)	(4.2)%	\$ (11,130)	272.7%

* Not Meaningful

Net Sales

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

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

	2014	Net Sales		Percent of Total	Percent of Total	Dollar and	
		For the three months ended June 30,				Percentage Change	
		Percent of Total	2013			Period to Period	
Segment Analysis							
LED & Solar	\$ 77,154	81.1%	\$ 75,933	77.9%	\$ 1,221	1.6%	
Data Storage	17,968	18.9%	21,502	22.1%	(3,534)	(16.4)%	
Total	\$ 95,122	100.0%	\$ 97,435	100.0%	(2,313)	(2.4)%	
Regional Analysis							
Americas (1)	\$ 14,410	15.1%	\$ 12,644	13.0%	\$ 1,766	14.0%	
Europe, Middle East and Africa	6,099	6.4%	6,930	7.1%	(831)	(12.0)%	
Asia Pacific	74,613	78.5%	77,861	79.9%	(3,248)	(4.2)%	
Total	\$ 95,122	100.0%	\$ 97,435	100.0%	(2,313)	(2.4)%	

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

Table of Contents

Our LED & Solar segment net sales increased slightly in 2014 primarily due to higher sales of MBE systems. Data Storage net sales decreased in 2014 as our customers continue to have excess manufacturing capacity and have only been making select technology purchases. By region, net sales decreased in Asia Pacific, primarily due to a decrease in MOCVD sales in China and Japan. Net sales in Europe, Middle East and Africa (EMEA) also decreased primarily due to lower sales of our Data Storage products, while net sales in the Americas increased primarily due to higher sales of our LED and Solar products. We believe that there will continue to be period-to-period variations in the geographic distribution of net sales.

Orders increased 22.6% to \$104.0 million from \$84.8 million in the comparable prior period. LED & Solar bookings increased 38.9% to \$80.7 million, principally due to MOCVD system orders, as certain of our LED customers are making modest capacity additions. Data Storage bookings decreased 12.4% to \$23.3 million from the comparable prior period as our customers continue to have excess manufacturing capacity and have only been making select technology purchases.

Our book-to-bill ratio for the three months ended June 30, 2014, which is calculated by dividing bookings recorded in a given time period by revenue recognized in the same time period, was 1.09 to 1. Our backlog as of June 30, 2014 was \$162.8 million, compared to \$143.3 million as of December 31, 2013. During the three months ended June 30, 2014, we recorded backlog adjustments of approximately \$0.7 million related to orders that no longer met our booking criteria as well as an adjustments related to foreign currency translation of \$0.2 million. Our backlog consists of orders for which we received a firm purchase order, a customer-confirmed shipment date within twelve months and a deposit, where required. As of June 30, 2014, we had customer deposits of \$33.5 million.

Gross Profit

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

	For the three months ended		Dollar and Percentage Change Period to Period	
	2014	June 30, 2013		
Gross profit - LED & Solar	\$ 23,891	\$ 26,349	\$ (2,458)	(9.3)%
<i>Gross margin</i>	31.0%	34.7%		
Gross profit - Data Storage	\$ 6,782	\$ 8,291	\$ (1,509)	(18.2)%
<i>Gross margin</i>	37.7%	38.6%		
Gross profit - Total Veeco	\$ 30,673	\$ 34,640	\$ (3,967)	(11.5)%
<i>Gross margin</i>	32.2%	35.6%		

LED & Solar gross margins decreased primarily due to a sales mix of lower margin products. Lower average selling prices and fewer final acceptances also contributed to the decline in gross margin. Data Storage gross margins decreased principally due to a reduction in volume, partially offset by a sales mix of higher margin products.

Selling, General and Administrative Expenses

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

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

	For the three months ended			Dollar and Percentage Change	
	June 30,			Period to Period	
	2014	2013			
Selling, general and administrative	\$ 21,891	\$ 19,779	\$ 2,112		10.7%
<i>Percentage of net sales</i>	23.0%	20.3%			

Selling, general and administrative expenses increased primarily due to equity compensation, personnel and personnel-related, and bonus expenses as well as the addition of costs from our ALD business, which was acquired in the fourth quarter of 2013. Partially offsetting this increase was the collection of a customer receivable during the second quarter, which was previously

Table of Contents

reserved for in the fourth quarter of 2013, and a reduction in professional fees associated with our review of revenue accounting, which was completed in the fourth quarter of 2013.

Research and Development Expenses

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

	For the three months ended			Dollar and Percentage Change Period to Period		
	2014	June 30,	2013			
Research and development	\$	21,011	\$	20,870	\$ 141	0.7%
<i>Percentage of net sales</i>		22.1%		21.4%		

Research and development expenses remained flat. The addition of research and development costs in our ALD business, which was acquired in the fourth quarter of 2013, was principally offset by a reduction in overall research and development spending across the Company. We continue to focus our research and development expenses on projects in areas we anticipate to be high-growth. We selectively funded these product development activities which resulted in lower professional consulting expense, as well as reduced spending for project materials and personnel and personnel-related costs.

Amortization

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

	For the three months ended			Dollar and Percentage Change Period to Period		
	2014	June 30,	2013			
Amortization	\$	2,899	\$	855	\$ 2,044	239.1%
<i>Percentage of net sales</i>		3.0%		0.9%		

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

Restructuring

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

	For the three months ended			Dollar and Percentage Change
	2014	June 30,	2013	
Restructuring	\$	801	\$	\$ 801 *
<i>Percentage of net sales</i>		0.8%		*

* Not Meaningful

During the first quarter of 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. We expect to substantially complete the consolidation by the end of 2014. During the three months ended June 30, 2014, we recorded restructuring charges of \$0.8 million. These charges consisted of personnel severance and related costs. We expect to incur approximately \$1.1 million and \$0.1 million of additional restructuring charges in our Data Storage segment throughout the remainder of 2014 and 2015, respectively, related to these actions. The reductions in head count principally relate to our Data Storage and MBE businesses.

Subsequent to quarter end, the company announced additional restructuring activities. Included in these activities is further consolidation of our Data Storage Segment facilities and additional headcount reductions to help contain costs and further improve profitability. As a result of these actions, we anticipate total costs of approximately \$3.9 million, all of which will be incurred through the remainder of 2014.

Table of Contents

We did not record any restructuring charges during the three months ended June 30, 2013.

Income Taxes

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

	For the three months ended June 30,			Dollar and Percentage Change Period to Period	
	2014		2013		
Income tax provision (benefit)	\$	(488)	\$	(2,495)	\$ 2,007 (80.4)%
Effective tax rate		3.1%		37.9%	

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

For the three months ended June 30, 2014, the effective tax rate was lower than the statutory tax rate principally because we did not provide a current tax benefit on a portion of our domestic pre-tax losses as such amounts are not realizable on a more-likely-than-not basis and we have provided for a full valuation allowance on these amounts.

For the three months ended June 30, 2013, the effective tax rate was higher than the statutory tax rate primarily due to tax rate differences in the foreign jurisdictions in which the Company operates and an income tax benefit related to the generation of current year research and development tax credits.

Table of Contents**Six Months Ended June 30, 2014 and 2013**

The following table shows our Consolidated Statements of Operations, percentages of sales, and comparisons between the six months ended June 30, 2014 and 2013 (*dollars in thousands*):

	For the six months ended June 30,				Dollar and Percentage Change Period to Period	
	2014		2013			
Net sales	\$ 185,963	100.0%	\$ 159,216	100.0%	\$ 26,747	16.8%
Cost of sales	121,513	65.3%	102,024	64.1%	19,489	19.1%
Gross profit	64,450	34.7%	57,192	35.9%	7,258	12.7%
Operating expenses:						
Selling, general and administrative	43,558	23.4%	39,427	24.8%	4,131	10.5%
Research and development	40,779	21.9%	41,607	26.1%	(828)	(2.0)%
Amortization	5,802	3.1%	1,711	1.1%	4,091	239.1%
Restructuring	1,193	0.6%	531	0.3%	662	124.7%
Total operating expenses	91,332	49.1%	83,276	52.3%	8,056	9.7%
Other operating, net	(370)	(0.2)%	352	0.2%	(722)	*
Changes in contingent consideration	(29,368)	(15.8)%		0.0%	(29,368)	*
Operating income (loss)	2,856	1.5%	(26,436)	(16.6)%	29,292	*
Interest income (expense), net	236	0.1%	428	0.3%	(192)	(44.9)%
Income (loss) before income taxes	3,092	1.7%	(26,008)	(16.3)%	29,100	*
Income tax provision (benefit)	(857)	(0.5)%	(11,856)	(7.4)%	10,999	(92.8)%
Net income (loss)	\$ 3,949	2.1%	\$ (14,152)	(8.9)%	\$ 18,101	*

* Not Meaningful

Net Sales

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

	Net Sales For the six months ended June 30,				Dollar and Percentage Change Period to Period	
	2014	Percent of Total	2013	Percent of Total		
Segment Analysis						
LED & Solar	\$ 147,909	79.5%	\$ 118,240	74.3%	\$ 29,669	25.1%
Data Storage	38,054	20.5%	40,976	25.7%	(2,922)	(7.1)%
Total	\$ 185,963	100.0%	\$ 159,216	100.0%	\$ 26,747	16.8%
Regional Analysis						
Americas (1)	\$ 22,290	12.0%	\$ 25,077	15.8%	(2,787)	(11.1)%

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Europe, Middle East and Africa	16,319	8.8%	11,480	7.2%	4,839	42.2%
Asia Pacific	147,354	79.2%	122,659	77.0%	24,695	20.1%
Total	\$ 185,963	100.0%	\$ 159,216	100.0%	\$ 26,747	16.8%

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

Table of Contents

Our LED & Solar segment net sales increased in 2014 primarily due to increased sales of MOCVD systems to certain of our LED customers due to higher capacity requirements. Data Storage net sales decreased as our customers continue to have excess manufacturing capacity and have only been making select technology purchases. By region, net sales increased in Asia Pacific, primarily due to an increase in MOCVD sales in China and Japan. Net sales in Europe, Middle East and Africa (EMEA) also increased primarily due to higher sales of MOCVD and Data Storage products while net sales in the Americas decreased. We believe that there will continue to be period-to-period variations in the geographic distribution of net sales.

Orders increased 33.1% to \$206.6 million from \$155.2 million in the comparable prior period. LED & Solar bookings increased 66.5% to \$167.8 million, principally due to MOCVD system orders, as certain of our LED customers are making modest capacity additions. Data Storage bookings decreased 28.6% to \$38.8 million from the comparable prior period as our customers have excess manufacturing capacity and they have only been making select technology purchases.

Our book-to-bill ratio for the six months ended June 30, 2014, which is calculated by dividing bookings recorded in a given time period by revenue recognized in the same time period, was 1.11 to 1. Our backlog as of June 30, 2014 was \$162.8 million, compared to \$143.3 million as of December 31, 2013. During the six months ended June 30, 2014, we recorded backlog adjustments of approximately \$0.9 million related to orders that no longer met our booking criteria as well as adjustments related to foreign currency translation of \$0.2 million. Our backlog consists of orders for which we received a firm purchase order, a customer-confirmed shipment date within twelve months and a deposit, where required. As of June 30, 2014, we had customer deposits of \$33.5 million.

Gross Profit

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

	For the six months ended		Dollar and Percentage Change	
	2014	June 30, 2013	Period to Period	
Gross profit - LED & Solar	\$ 50,343	\$ 40,334	\$ 10,009	24.8%
<i>Gross margin</i>	34.0%	34.1%		
Gross profit - Data Storage	\$ 14,107	\$ 16,858	\$ (2,751)	(16.3)%
<i>Gross margin</i>	37.1%	41.1%		
Gross profit - Total Veeco	\$ 64,450	\$ 57,192	\$ 7,258	12.7%
<i>Gross margin</i>	34.7%	35.9%		

LED & Solar gross margins remained flat from the comparable prior period despite the increase in sales volume primarily due to a sales mix of lower margin products and fewer final acceptances. Data Storage gross margins decreased principally due to reduced sales volume and a sales mix of lower margin products.

Selling, General and Administrative Expenses

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

	For the six months ended		Dollar and Percentage Change				
	2014	June 30,	2013	Period to Period			
Selling, general and administrative	\$	43,558	\$	39,427	\$	4,131	10.5%
<i>Percentage of net sales</i>		23.4%		24.8%			

Selling, general and administrative expenses increased primarily due to bonus, equity compensation and personnel and personnel-related expenses as well as the addition of costs from our ALD business, which was acquired in the fourth quarter of 2013. Partially offsetting this increase was a reduction in professional fees associated with our review of revenue accounting, which was completed in the fourth quarter of 2013 and the collection of a customer receivable during the second quarter, which was previously reserved for in the fourth quarter of 2013.

Table of Contents*Research and Development Expenses*

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

	For the six months ended June 30,			Dollar and Percentage Change Period to Period	
	2014		2013		
Research and development	\$	40,779	\$	41,607	\$ (828) (2.0)%
<i>Percentage of net sales</i>		21.9%		26.1%	

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

Amortization

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

	For the six months ended June 30,			Dollar and Percentage Change Period to Period	
	2014		2013		
Amortization	\$	5,802	\$	1,711	\$ 4,091 239.1%
<i>Percentage of net sales</i>		3.1%		1.1%	

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

Restructuring

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

	For the six months ended June 30,			Dollar and Percentage Change Period to Period	
	2014		2013		

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Restructuring	\$	1,193	\$	531	\$	662	124.7%
<i>Percentage of net sales</i>		0.6%		0.3%			

During the first quarter of 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. We expect to substantially complete the consolidation by the end of 2014. During the six months ended June 30, 2014, we recorded restructuring charges of \$1.2 million and notified approximately 49 employees of their termination from the Company. These charges consisted of personnel severance and related costs. We expect to incur approximately \$1.1 million and \$0.1 million of additional restructuring charges in our Data Storage segment throughout the remainder of 2014 and 2015, respectively, related to these actions. The reductions in head count principally relate to our Data Storage and MBE businesses.

During the six months ended June 30, 2013, we took measures to improve profitability, including a reduction of discretionary expenses, realignment of our senior management team and consolidation of certain sales, business and administrative functions. As a result of these actions, we recorded a restructuring charge of \$0.5 million.

Subsequent to quarter end, the company announced additional restructuring activities. Included in these activities is further consolidation of our Data Storage Segment facilities and additional headcount reductions to help contain costs and further improve profitability. As a result of these actions, we anticipate total costs of approximately \$3.9 million, all of which will be incurred through the remainder of 2014.

Table of Contents*Changes in Contingent Consideration*

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

	For the six months ended			Dollar and Percentage Change
	2014	June 30, 2013		
Changes in contingent consideration	\$ (29,368)	\$	\$ (29,368)	*
<i>Percentage of net sales</i>	(15.8)%		0.0%	

* Not Meaningful

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

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

The post-closing milestones are divided into two contingencies. The first, tied to receipt of certain purchase orders, had an evaluation date of March 31, 2014, which, was not met and accounted for \$20.2 million of the reversed liability. The second is based on achieving certain full year 2014 revenue and gross margin thresholds, which are unlikely to be met and accounted for \$9.2 million of the reversed liability. As of June 30, 2014 the second contingency, with a maximum potential value of \$75.0 million, remains contractually outstanding.

Income Taxes

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

	For the six months ended			Dollar and Percentage Change
	2014	June 30, 2013		

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Income tax provision (benefit)	\$	(857)	\$	(11,856)	\$	10,999	(92.8)%
<i>Effective tax rate</i>		27.7%		45.6%			

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

For the six months ended June 30, 2014, the effective tax rate was lower than the statutory tax rate principally because we did not provide a current tax benefit on a portion of our domestic pre-tax losses as such amounts are not realizable on a more-likely-than-not basis and we have provided for a full valuation allowance on these amounts. The effective tax rate was also impacted because we did not provide a tax provision on the gain from the settlement of the contingent consideration related to the Synos acquisition.

For the six months ended June 30, 2013, the effective tax rate was higher than the statutory tax rate primarily due to tax rate differences in the foreign jurisdictions in which the Company operates, an income tax benefit related to the generation of current year research and development tax credits, and a discrete benefit related to legislation enacted in the first quarter of 2013 which extended the Federal Research and Development Credit for both the 2012 and 2013 tax years.

Table of Contents**Liquidity and Capital Resources**

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

	June 30, 2014	December 31, 2013
Cash and cash equivalents	\$ 232,332	\$ 210,799
Restricted cash	518	2,738
Short-term investments	252,165	281,538
Cash, cash equivalents, restricted cash and short-term investments	\$ 485,015	\$ 495,075

As of June 30, 2014 and December 31, 2013, cash and cash equivalents of \$154.9 million and \$150.6 million, respectively, were held outside the United States. Liquidity is affected by many factors, some of which are based on normal ongoing operations of our business and some of which arise from fluctuations related to global economics and markets. Cash balances are generated and held in many locations throughout the world. It is our current intent to permanently reinvest our funds from Singapore, China, Taiwan, South Korea, and Malaysia outside of the United States and our current plans do not demonstrate a need to repatriate them to fund our United States operations. As of June 30, 2014, we had \$127.3 million in cash held offshore on which we would have to pay significant United States income taxes to repatriate in the event that we need the funds for our operations in the United States. Additionally, local government regulations may restrict our ability to move cash balances to meet cash needs under certain circumstances. We currently do not expect such regulations and restrictions to impact our ability to make acquisitions, pay vendors, or conduct operations throughout the global organization. As of June 30, 2014 and December 31, 2013, our restricted cash was in Germany and our short-term investments were in the United States. We believe that our projected cash flow from operations combined with our cash and short term investments will be sufficient to meet our projected working capital and other cash flow requirements for the next twelve months, as well as our contractual obligations.

A summary of the cash flow activity for the six months ended June 30, 2014 is as follows (*in thousands*):

Cash Flows from Operating Activities

Net income (loss)	\$ 3,949
Non-cash charges:	
Change in contingent consideration	(29,368)
Depreciation and amortization	11,600
Non-cash equity-based compensation	9,813
Other	(7,046)
Changes in operating assets and liabilities:	
Accounts receivable	(32,721)
Inventories	12,052
Accounts payable	(8,026)
Accrued expenses, customer deposits, deferred revenue and other current liabilities	29,638
Other	(6,667)
Net cash provided by (used in) operating activities	\$ (16,776)

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

The primary cash drivers of the \$16.8 million use of cash from operations were:

- A \$32.7 million use of cash due to the increase in accounts receivable, primarily due to the timing of invoicing to customers resulting in receivables remaining outstanding at the end of the quarter;
- A \$8.0 million use of cash due to the decrease in accounts payable primarily driven by reduced purchasing activity;
- An \$12.1 million generation of cash due to the decrease in inventory due to our reduced purchasing activity, and;
- An \$29.6 million generation of cash due to the increase in accrued expenses primarily driven by increases in payroll related accruals, customer deposits and deferred revenue.

Table of Contents*Cash Flows from Investing Activities*

Proceeds from the liquidation of short-term investments	\$	121,233
Payments for purchases of short-term investments		(92,029)
Other		1,840
Net cash provided by (used in) investing activities	\$	31,044

The primary cash driver of the \$31.0 million generation of cash from investing was due to the net liquidation of short-term investments during the period.

Cash Flows from Financing Activities

Proceeds from stock option exercises	\$	9,125
Other		(2,008)
Net cash provided by (used in) financing activities	\$	7,117

The primary cash driver of the \$7.1 million generation of cash from financing was an \$9.1 million generation of cash due to stock option exercises.

As of June 30, 2014, restricted cash consists of \$0.5 million which serves as collateral for bank guarantees that provide financial assurance that the Company will fulfill certain customer or lease obligations. This cash is held in custody by the issuing bank, and is restricted as to withdrawal or use while the related bank guarantees are outstanding.

Table of Contents

Off-Balance Sheet Arrangements and Contractual Obligations

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources other than the lease commitments, letters of credit and bank guarantees, purchase commitments and other obligations discussed below.

Long-Term Debt

Long-term debt obligations consist of principle and interest payments for our St. Paul, MN facility. As of June 30, 2014, the Company's total future principle and interest payments have not changed significantly from our Contractual Obligations table in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of our 2013 annual report on Form 10-K.

Lease Commitments

The Company's major facility leases are typically for terms not exceeding 5 years and generally provide renewal options for terms not exceeding five additional years. As of June 30, 2014, the Company's total future minimum lease payments under noncancelable operating leases have not changed significantly from our Contractual Obligations table in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of our 2013 annual report on Form 10-K.

In accordance with relevant accounting guidance, we account for our office leases as operating leases with expiration dates ranging from 2014 through 2018, excluding renewal options. There are future minimum annual rental payments required under the leases. Leasehold improvements made at the beginning of or during a lease are amortized over the shorter of the remaining lease term or the estimated useful lives of the assets. There are no material sublease payments receivable associated with the leases.

Letters of Credit and Bank Guarantees

Letters of credit and bank guarantees are issued by a bank on our behalf as needed. As of June 30, 2014, we had letters of credit outstanding of \$0.6 million and bank guarantees outstanding of \$2.5 million, of which, \$0.5 million is collateralized against cash that is restricted from use. As of June 30, 2014, we had \$43.7 million of unused lines of credit available. The line of credit is available to draw upon to cover performance bonds as required by our customers.

Purchase Commitments

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

Purchase commitments are primarily for inventory used in manufacturing our products. It has been our practice not to enter into purchase commitments extending beyond one year. As of June 30, 2014, we have \$67.7 million in open purchase commitments and \$10.6 million of offsetting supplier deposits.

Other Obligations

Pursuant to our agreement to acquire Synos, we may be obligated to pay up to an additional \$75 million if certain conditions are met. We currently do not expect this contingency to be met.

Table of Contents

Application of Critical Accounting Policies

General

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

Revenue Recognition

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

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

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

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

Table of Contents

upon acceptance provisions or ii) the value of the arrangement consideration allocated to the delivered elements, if such sale is part of a multiple-element arrangement.

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

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

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

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

Short-Term Investments

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

Inventory Valuation

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

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

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

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

Table of Contents

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

Goodwill and Indefinite-Lived Intangible Asset Impairment

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

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

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

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

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

Definite-Lived Intangible and Long-Lived Assets

Definite-lived intangible assets consist of purchased technology, customer-related intangible assets, patents, trademarks, covenants not-to-compete, software licenses and deferred financing costs. Purchased technology consists of the core proprietary manufacturing technologies associated with the products and offerings obtained through acquisition and are initially recorded at fair value. Customer-related intangible assets, patents, trademarks, covenants not-to-compete and software licenses that are obtained in an acquisition are initially recorded at fair value. Other software licenses and deferred financing costs are initially recorded at cost. Intangible assets with definitive useful lives are amortized using the straight-line method over their estimated useful lives for periods ranging from 2 years to 17 years.

Table of Contents

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

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

Accounting for Acquisitions

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

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

Fair Value Measurements

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

Warranty Cost

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

Table of Contents

Income Taxes

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

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

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

Equity-Based Compensation

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

Recent Accounting Pronouncements

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period: In June 2014, the FASB issued Accounting Standards Update No. 2014-12, *Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period* (Topic 718). The amendments in this ASU require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Revenue from Contracts with Customers: In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU No. 2014-09 requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard outlines a five-step model to be used to make the revenue recognition determination and requires new financial statement disclosures. The standard is effective for interim and annual periods beginning after December 15, 2016 and allows entities to choose among different transition alternatives. We are evaluating the impact of adopting the standard on our consolidated financial statements and related financial statement disclosures, and we have not yet determined which method of adoption will be selected.

Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. In April 2014, the FASB issued ASU No. 2014-08 that changes the threshold for reporting discontinued operations and adds new disclosures. The new guidance defines a discontinued operation as a disposal of a component or group of components that is disposed of or is classified as held for sale and represents a

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

strategic shift that has (or will have) a major effect on an entity's operations and financial results. For disposals of individually significant components that do not qualify as discontinued operations, an entity must disclose pre-tax earnings of the disposed component. For public business entities, this guidance is effective prospectively for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

Table of Contents

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

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

Parent's Accounting for the Cumulative Translation Adjustment: In March 2013, the FASB issued ASU No. 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*. This new standard is intended to resolve diversity in practice regarding the release into net income of a cumulative translation adjustment (CTA) upon derecognition of a subsidiary or group of assets within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. We have adopted this as of January 1, 2014 and currently anticipate that it could have an impact on our consolidated financial statements, in the event of derecognition of a foreign subsidiary in 2014 or thereafter. During the three months ended June 30, 2014, the Company began executing a plan to liquidate our foreign subsidiary in Japan. Please see note *Commitments, Contingencies and Other Matters* for additional information.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Net sales to foreign customers represented approximately 84.9% and 88.0% of our total net revenues for the three and six months ended June 30, 2014 respectively, and 87.0% and 84.2% for the comparable 2013 periods. We expect that net sales to foreign customers will continue to represent a large percentage of our total net sales. Our net sales denominated in foreign currencies represented approximately 2.9% and 12.6% of our total sales for the three and six months ended June 30, 2014 respectively, and 3.1% and 3.4% for the comparable 2013 periods. The significant increase in percentage of net sales in foreign currency during the six months ended June 30, 2014 was driven by a few large sales, aggregating approximately \$16.4 million, that were denominated in Japanese Yen. As of June 30, 2014 the related receivable was fully collected. We had an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates related to these receivables while they remained outstanding.

During the three months ended December 31, 2013, we entered into an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates. The net fair value of these collars as of December 31, 2013 was approximately \$0.9 million. During the three months ended June 30, 2014, the collars were closed and resulted in a realized gain of \$0.4 million.

Edgar Filing: VEECO INSTRUMENTS INC - Form 10-Q

We are exposed to financial market risks, including changes in foreign currency exchange rates. The change in currency exchange rates that have the largest impact on translating our international operating profit (loss) is the Japanese Yen and Chinese Yuan. We use derivative financial instruments to mitigate these risks. We do not use derivative financial instruments for speculative or trading purposes. We generally enter into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known currency exposures. As of June 30, 2014, there were no outstanding derivative instruments.

Table of Contents

(in thousands)	Component of	As of December 31, 2013		Notional Amount
		Fair Value	Maturity Dates	
<u>Not Designated as Hedges under ASC 815</u>				
Foreign currency exchange forwards	Prepaid and other current assets	\$ 1	January 2014	\$ 4,700
Foreign currency collar	Prepaid and other current assets	906	October 2014	34,069
Total Derivative Instruments		\$ 907		\$ 38,769

(in thousands)	Location of realized net gain (loss) and changes in the fair value of derivatives	Amount of realized net gain (loss) and changes in the fair value of derivatives			
		For the three months ended June 30,		For the six months ended June 30,	
		2014	2013	2014	2013
Foreign currency exchange forwards	Other operating, net	\$ 6	\$ (71)	\$ (89)	\$ 157
Foreign currency collar	Other operating, net	(124)		(457)	

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

We centrally manage our investment portfolios considering investment opportunities and risk, tax consequences and overall financing strategies. Our investment portfolio includes fixed-income securities with a fair value of approximately \$252.2 million as of June 30, 2014. An immediate 100 basis point increase in interest rates may result in a decrease in the fair value of the June 30, 2014 portfolio of approximately \$0.9 million. While an increase in interest rates may reduce the fair value of the investment portfolio, it is unlikely that we will realize the losses in our Consolidated Statements of Operations unless the individual fixed-income securities are sold prior to recovery or the loss is determined to be other-than-temporary.

Table of Contents

Item 4. Controls and Procedures

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

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

There have been no changes in our internal controls or other factors during the fiscal quarter ended June 30, 2014 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Table of Contents

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

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

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

Item 1A. Risk Factors

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

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Table of Contents**Item 6. Exhibits**

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

Number	Description	Incorporated by Reference to the Following Document:
10.1	Letter Agreement dated April 8, 2014 between Veeco and Shubham Maheshwari	*
10.2	Form of Notice of Performance Share Award and related terms and conditions pursuant to the Veeco 2010 Stock Incentive Plan, effective June 2014	*
10.3	Amendment dated June 12, 2014 to Employment Agreement between Veeco and John R. Peeler	*
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.	*
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.	*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.	*
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.	*
101.INS	XBRL Instance	**
101.SCH	XBRL Schema	**
101.PRE	XBRL Presentation	**
101.CAL	XBRL Calculation	**
101.DEF	XBRL Definition	**
101.LAB	XBRL Label	**

* Filed herewith

** Filed herewith electronically

Table of Contents

SIGNATURES

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

Date: July 31, 2014

Veeco Instruments Inc.

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

By: */s/ SHUBHAM MAHESHWARI*
Shubham Maheshwari
Executive Vice President and Chief Financial Officer

Table of Contents**INDEX TO EXHIBITS**

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

Number	Description	Incorporated by Reference to the Following Document:
10.1	Letter Agreement dated April 8, 2014 between Veeco and Shubham Maheshwari	*
10.2	Form of Notice of Performance Share Award and related terms and conditions pursuant to the Veeco 2010 Stock Incentive Plan, effective June 2014	*
10.3	Amendment dated June 12, 2014 to Employment Agreement between Veeco and John R. Peeler	*
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.	*
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934.	*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	*
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	*
101.INS	XBRL Instance	**
101.SCH	XBRL Schema	**
101.PRE	XBRL Presentation	**
101.CAL	XBRL Calculation	**
101.DEF	XBRL Definition	**
101.LAB	XBRL Label	**

* Filed herewith

** Filed herewith electronically
