

VEECO INSTRUMENTS INC  
Form 10-Q  
July 31, 2008  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2008

OR

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

For the transition period from            to            .

Commission file number 0-16244

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**VEECO INSTRUMENTS INC.**

(Exact Name of Registrant as Specified in Its Charter)

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|   |   |
|---|---|
| <b>Delaware</b><br>(State or Other Jurisdiction of<br>Incorporation or Organization)            | <b>11-2989601</b><br>(I.R.S. Employer<br>Identification Number) |
| <b>Terminal Drive</b><br><b>Plainview, New York</b><br>(Address of Principal Executive Offices) | <b>11803</b><br>(Zip Code)                                      |

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

Website: **www.veeco.com**

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller

reporting company)



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Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No





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32,165,513 shares of common stock, \$0.01 par value per share, were outstanding as of the close of business on July 29, 2008.

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**SAFE HARBOR STATEMENT**

This Quarterly Report on Form 10-Q (the Report ) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Discussions containing such forward-looking statements may be found in 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, and similar expressions are intended to identify forward-looking statements. All 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:

- The cyclical nature of the industries we serve directly affects our business.
- We operate in an industry characterized by rapid technological change.
- We face significant competition.
- We depend on a limited number of customers that operate in highly concentrated industries.
- The timing of our orders, shipments, and revenue recognition may cause our quarterly operating results to fluctuate significantly.
- Changes in our product mix may cause our quarterly operating results to fluctuate significantly.
- Our customers may cancel or reschedule their orders with us.
- Our sales cycle is long and unpredictable.
- Our outsourcing strategy could adversely affect our results of operations.

- We rely on a limited number of suppliers.
- Our inability to attract, retain, and motivate key employees could have a material adverse effect on our business.
- We are exposed to the risks of operating a global business.
- We are subject to foreign currency exchange risks.
- Our success depends on protection of our intellectual property rights.
- We may be subject to claims of intellectual property infringement by others.
- Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses.
- The implementation of a new information technology system may disrupt our operations.
- We may not obtain sufficient affordable funds to finance our future needs.
- We are subject to risks of non-compliance with environmental and safety regulations.
- We have adopted certain measures that may have anti-takeover effects which may make an acquisition of our company by another company more difficult.
- The other matters discussed under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Report and in the Annual Report on Form 10-K for the year ended

December 31, 2007 of Veeco Instruments Inc. ( Veeco, the Company, or we ).

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Consequently, such forward-looking statements should be regarded solely as our current plans, estimates and beliefs. We do 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 Securities and Exchange Commission (the SEC ). The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is <http://www.sec.gov>.

**Internet Address**

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

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

|   | Three months ended |                  | Six months ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | 2008               | June 30,<br>2007 | 2008             | June 30,<br>2007 |
| Net sales   | \$ 114,449         | \$ 98,769        | \$ 216,756       | \$ 197,935       |
| Cost of sales   | 66,719             | 56,524           | 126,400          | 111,995          |
| Gross profit  | 47,730             | 42,245           | 90,356           | 85,940           |
| Operating expenses:   |                    |                  |                  |                  |
| Selling, general, and administrative expense                  | 24,311             | 23,818           | 46,939           | 46,624           |
| Research and development expense                              | 15,145             | 15,903           | 29,871           | 31,292           |
| Amortization expense  | 2,426              | 2,368            | 4,382            | 6,277            |
| Restructuring expense   |                    | 1,445            | 2,875            | 1,445            |
| Asset impairment charge                                       |                    |                  | 285              |                  |
| Other income, net   | (382)              | (279)            | (378)            | (426)            |
| Total operating expenses                                      | 41,500             | 43,255           | 83,974           | 85,212           |
| Operating income (loss)                                       | 6,230              | (1,010)          | 6,382            | 728              |
| Interest expense, net   | 969                | 772              | 1,861            | 1,591            |
| Gain on extinguishment of debt                                |                    |                  |                  | (738)            |
| Income (loss) before income taxes and noncontrolling interest | 5,261              | (1,782)          | 4,521            | (125)            |
| Income tax provision  | 1,129              | 1,042            | 2,048            | 2,536            |
| Noncontrolling interest                                       | (70)               | (229)            | (146)            | (359)            |
| Net income (loss)   | \$ 4,202           | \$ (2,595)       | \$ 2,619         | \$ (2,302)       |
| Income (loss) per common share:                               |                    |                  |                  |                  |
| Net income (loss) per common share                            | \$ 0.13            | \$ (0.08)        | \$ 0.08          | \$ (0.07)        |
| Diluted net income (loss) per common share                    | \$ 0.13            | \$ (0.08)        | \$ 0.08          | \$ (0.07)        |
| Weighted average shares outstanding                           | 31,255             | 30,926           | 31,197           | 30,912           |
| Diluted weighted average shares outstanding                   | 31,590             | 30,926           | 31,435           | 30,912           |

*See accompanying notes.*





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## Veeco Instruments Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(In thousands)

|   | June 30,<br>2008<br>(Unaudited) | December 31,<br>2007 |
|---|---------------------------------|----------------------|
| <b>Assets</b>   |                                 |                      |
| Current assets:   |                                 |                      |
| Cash and cash equivalents   | \$ 109,644                      | \$ 117,083           |
| Accounts receivable, less allowance for doubtful accounts of \$985 in 2008 and \$984 in 2007    | 76,413                          | 75,207               |
| Inventories   | 115,025                         | 98,594               |
| Prepaid expenses and other current assets   | 6,741                           | 8,901                |
| Deferred income taxes   | 2,808                           | 2,649                |
| Total current assets  | 310,631                         | 302,434              |
| Property, plant, and equipment at cost, net   | 66,458                          | 66,142               |
| Goodwill  | 101,828                         | 100,898              |
| Purchased technology, less accumulated amortization of \$75,224 in 2008 and \$72,481 in 2007    | 35,809                          | 36,107               |
| Other intangible assets, less accumulated amortization of \$32,268 in 2008 and \$29,886 in 2007 | 27,812                          | 23,540               |
| Other assets  | 221                             | 213                  |
| Total assets  | \$ 542,759                      | \$ 529,334           |
| <b>Liabilities and shareholders equity</b>  |                                 |                      |
| Current liabilities:  |                                 |                      |
| Accounts payable  | \$ 37,091                       | \$ 36,639            |
| Accrued expenses  | 65,532                          | 60,201               |
| Deferred profit   | 2,890                           | 3,250                |
| Income taxes payable  | 1,086                           | 2,278                |
| Current portion of long-term debt   | 25,422                          | 25,550               |
| Total current liabilities   | 132,021                         | 127,918              |
| Deferred income taxes   | 4,673                           | 3,712                |
| Long-term debt  | 120,939                         | 121,035              |
| Other non-current liabilities   | 2,514                           | 1,978                |
| Noncontrolling interest   | 868                             | 1,014                |
| Total shareholders equity   | 281,744                         | 273,677              |
| Total liabilities and shareholders equity   | \$ 542,759                      | \$ 529,334           |

*See accompanying notes.*

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## Veeco Instruments Inc. and Subsidiaries

## Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

|  | Six months ended<br>June 30, |            |
|--|------------------------------|------------|
|  | 2008                         | 2007       |
| <b>Operating activities</b>  |                              |            |
| Net income (loss)  | \$ 2,619                     | \$ (2,302) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                              |            |
| Depreciation and amortization  | 11,503                       | 13,459     |
| Deferred income taxes  | 962                          | 447        |
| Net gain on extinguishment of long-term debt   |                              | (738)      |
| Non-cash compensation expense for stock options and restricted stock                     | 3,623                        | 2,046      |
| Noncontrolling interest  | (146)                        | (359)      |
| Non-cash asset impairment charge   | 285                          |            |
| Gain on sale of property, plant, and equipment   | (62)                         | (81)       |
| Other, net   | (3)                          |            |
| Changes in operating assets and liabilities:   |                              |            |
| Accounts receivable  | 3,314                        | 21,128     |
| Inventories  | (11,135)                     | (4,002)    |
| Accounts payable   | (533)                        | (2,425)    |
| Accrued expenses, deferred profit, and other current liabilities                         | (1,069)                      | (4,615)    |
| Other, net   | 1,097                        | (1,919)    |
| Net cash provided by operating activities  | 10,455                       | 20,639     |
| <b>Investing activities</b>  |                              |            |
| Capital expenditures   | (7,076)                      | (5,876)    |
| Payments for net assets of business acquired, net of cash acquired                       | (10,855)                     |            |
| Proceeds from sale of property, plant, and equipment                                     | 99                           | 304        |
| Net cash used in investing activities  | (17,832)                     | (5,572)    |
| <b>Financing activities</b>  |                              |            |
| Proceeds from stock issuances  | 669                          | 2,131      |
| Repayments of long-term debt   | (224)                        | (54,998)   |
| Other  | (607)                        | (1,316)    |
| Net cash used in financing activities  | (162)                        | (54,183)   |
| Effect of exchange rate changes on cash and cash equivalents                             | 100                          | 149        |
| Net decrease in cash and cash equivalents  | (7,439)                      | (38,967)   |
| Cash and cash equivalents at beginning of period   | 117,083                      | 147,046    |
| Cash and cash equivalents at end of period   | \$ 109,644                   | \$ 108,079 |
| <b>Non-cash investing and financing activities</b>                                       |                              |            |
| Exchange of convertible subordinated notes   | \$                           | \$ 118,766 |
| Transfers from property, plant, and equipment to inventory                               | \$ 385                       | \$ 402     |

See accompanying notes.



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The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States 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 for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. Operating results for the three months and six months ended June 30, 2008, are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007.

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 2008 interim quarter ends are March 30, June 29, and September 28. The 2007 interim quarter ends were April 1, July 1, and September 30. For ease of reference, we report these interim quarter ends as March 31, June 30, and September 30 in our interim condensed consolidated financial statements.

*Net Income (Loss) Per Common Share*

The following table sets forth the reconciliation of weighted average shares outstanding and diluted weighted average shares outstanding:

|  | <b>Three months ended</b> |                          | <b>Six months ended</b> |                          |
|--|---------------------------|--------------------------|-------------------------|--------------------------|
|  | <b>2008</b>               | <b>June 30,<br/>2007</b> | <b>2008</b>             | <b>June 30,<br/>2007</b> |
| Weighted average shares outstanding                                    | 31,255                    | 30,926                   | 31,197                  | 30,912                   |
| Dilutive effect of stock options and restricted stock awards and units | 335                       |                          | 238                     |                          |
| Diluted weighted average shares outstanding                            | 31,590                    | 30,926                   | 31,435                  | 30,912                   |

Net income (loss) per common share is computed using the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is computed using the weighted average number of common shares and common equivalent shares outstanding during the period.

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During the three-month and six-month periods ended June 30, 2008, options to purchase 3.8 million shares of common stock (at prices ranging from \$18.26 to \$72.00 per share) and options to purchase 5.0 million shares of common stock (at prices ranging from \$16.93 to \$72.00 per share), respectively, were excluded from the computation of diluted earnings per share due to exercise prices that exceeded the average market price of our common stock for the period. During the three-month and six-month periods ended June 30, 2007, options to purchase 5.9 million shares of common stock (at prices ranging from \$0.27 to \$72.00 per share) in both periods were excluded from the computation of diluted earnings per share due to the net loss sustained for the period, which caused their effect to be antidilutive.

During the second quarter of 2007, we exchanged \$118.8 million of our unsecured 4.125% convertible subordinated notes due December 2008 (the Old Notes ) for \$117.8 million of a new series of 4.125% convertible subordinated notes (the New Notes ) due April 15, 2012. The effect on diluted shares of the assumed conversion of the Old Notes was approximately 1.5 million and 3.0 million common equivalent shares for the three and six months ended June 30, 2007, respectively. The converted shares were anti-dilutive and, therefore, were not included in the weighted shares outstanding for the three months and six months ended June 30, 2007. The exchange of the Old Notes for the New Notes, together with \$56 million in repurchases of Old Notes during the first quarter of 2007

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reduced the effect of the assumed conversion of the Old Notes, which was calculated using the if converted method of accounting. For the three months and six months ended June 30, 2008, the weighted-average effect on diluted shares of the assumed conversion of the remaining \$25.2 million of Old Notes is approximately 0.7 million shares in each period.

The New Notes meet the criteria for determining the effect of the assumed conversion using the treasury stock method of accounting, as long as we have the ability and the intent to settle the principal amount in cash. Under the terms of the New Notes, we may pay the principal amount of converted New Notes in cash or in shares of common stock. We have indicated that we intend to pay such amounts in cash. Using the treasury stock method, the impact of the assumed conversion of the New Notes is anti-dilutive for the three months and six months ended June 30, 2008 and 2007, as the average stock price was below the conversion price of \$27.23 for each period. The effect of the assumed converted shares is dependent on the stock price at the time of the conversion. The maximum number of common equivalent shares issuable upon conversion is approximately 6.0 million. See Note 8 for further details on our debt.

*Fair Value Measurements*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ). SFAS 157 establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). SFAS 159 permits entities to choose to measure financial assets and liabilities (except for those that are specifically excluded from the scope of the Statement) at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument by instrument basis and is irrevocable. The difference between carrying value and fair value at the election date is recorded as an adjustment to opening retained earnings. Subsequent changes in fair value are recognized in earnings.

Effective January 1, 2008, we adopted SFAS 157 and SFAS 159. Since we do not have any financial assets and liabilities that are required to be recorded at fair value, the only impact of these adoptions will be on the disclosures required by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments* in our Annual Report on Form 10-K for the year ending December 31, 2008.

*Recent Accounting Pronouncements*

On February 12, 2008, the FASB issued FASB Staff Position No. FAS 157-2, *Effective Date of FASB Statement No. 157* ( FSP 157-2 ). FSP 157-2 amends SFAS 157 to delay the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). For items within its scope, FSP 157-2 defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. We are currently evaluating the impact of adopting the provisions of SFAS 157 for non-financial assets and liabilities that are recognized or disclosed on a non-recurring basis.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* ( SFAS 141(R) ) and Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51* ( SFAS 160 ). Under SFAS 141(R), an acquiring entity will be required to recognize all the assets acquired and

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liabilities assumed in a transaction at the acquisition date at fair value with limited exceptions. SFAS 141(R) also changes the accounting treatment for certain other items that relate to business combinations. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The purpose of SFAS 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. The most significant provisions of this statement result in changes to the presentation of noncontrolling interests in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of this statement will impact the manner in which we present noncontrolling interests, but will not impact our consolidated financial position or results of operations.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* ( FSP APB 14-1 ).



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The guidance is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. FSP APB 14-1 will require issuers of convertible debt that can be settled in cash to separately account for (i.e. bifurcate) a portion of the debt associated with the conversion feature and reclassify this portion to stockholders' equity. The liability portion, which represents the fair value of the debt without the conversion feature, will be accreted to its face value over the life of the debt using the effective interest method, with the accretion expense recorded to interest. FSP APB 14-1 will be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented will be recognized as of the beginning of the first period presented. We expect the adoption of FSP APB 14-1 to have a material effect on our consolidated financial position, results of operations, and earnings per share. Effective on the date of issuance of the New Notes, we will reclassify approximately \$16.3 million from long-term debt to additional paid-in capital, and as of the adoption of FSP APB 14-1 in the beginning of 2009, our accumulated deficit will reflect approximately \$4.3 million of debt accretion that occurred between the issuance date of the New Notes and the adoption date. Approximately \$3.1 to \$3.6 million of additional interest expense will be recorded annually from the adoption date through the maturity date of the convertible debt. This interest expense will not require the use of cash.

**Note 2 Acquisition of Mill Lane Engineering**

On May 22, 2008, we acquired Mill Lane Engineering Co., Inc. ( Mill Lane ), a privately held manufacturer of web coating systems for flexible solar panels, for a purchase price of \$11.0 million plus \$0.7 million in acquisition-related fees, and plus potential future earn-out payments of up to \$19.0 million (representing additional purchase price) contingent upon the future achievement of certain operating performance criteria. Mill Lane is based in Lowell, Massachusetts and has approximately 20 employees. Mill Lane has been renamed Veeco Solar Equipment Inc. ( Veeco Solar ), and its financial results are included in our LED & Solar Process Equipment segment (see Note 5) as of the acquisition date. We have determined that this acquisition does not constitute a material business combination, and therefore, we are not including pro forma financial statements in this report.

**Note 3 Share-Based Payments***Stock Option and Restricted Stock Compensation*

Share-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 accordance with FASB Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* ( SFAS 123(R) ). The following compensation expense was included in the condensed consolidated statements of operations for the three months and six months ended June 30, 2008 and 2007 (in thousands):

|                                  | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|----------------------------------|--------------------------------|----------|------------------------------|----------|
|                                  | 2008                           | 2007     | 2008                         | 2007     |
| Share-based compensation expense | \$ 2,014                       | \$ 1,257 | \$ 3,623                     | \$ 2,046 |

As of June 30, 2008, the total unrecognized compensation cost related to nonvested stock awards and stock option awards is \$13.7 million and \$9.2 million, respectively. The related weighted average period over which we expect that such unrecognized compensation costs will be recognized as expense is approximately 2.5 years for the nonvested stock awards and 2.6 years for option awards.

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During the second quarter of 2008, we granted to certain key employees 259,670 shares of restricted common stock, 20,150 restricted stock units, and 1,115,032 stock options. The stock options will vest over a three-year period. The majority of the restricted stock awards and units will vest at the end of the fifth year after issuance, with early vesting possible based on the Company's attainment of certain performance measures. Additionally, we granted 35,000 shares of restricted common stock, which vest over a one-year period, to the non-employee members of the Board of Directors in May 2008.

A summary of our restricted stock awards including restricted stock units as of and for the six months ended June 30, 2008, is presented below:

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|  | Shares<br>(000s) | Weighted<br>Average<br>Grant-Date<br>Fair Value |
|--|------------------|---|
| Nonvested at beginning of year         | 680              | \$ 19.50  |
| Granted                                | 360              | 17.34   |
| Vested                                 | (182)            | 19.60   |
| Forfeited (including cancelled awards) | (11)             | 18.92   |
| Nonvested at June 30, 2008             | 847              | 18.57   |

A summary of our stock option plans as of and for the six months ended June 30, 2008, is presented below:

|   | Shares<br>(000s) | Weighted-<br>Average<br>Exercise Price | Aggregate<br>Intrinsic<br>Value (000s) | Weighted-<br>Average<br>Remaining<br>Contractual<br>Life (in years) |
|---|------------------|--|--|---|
| Outstanding at beginning of year        | 5,672            | \$ 23.04                               |  |   |
| Granted                                 | 1,165            | 17.39                                  |  |   |
| Exercised                               | (57)             | 11.71                                  |  |   |
| Forfeited (including cancelled options) | (457)            | 28.01                                  |  |   |
| Outstanding at June 30, 2008            | 6,323            | 21.73                                  | \$ 2,314                               | 3.5   |
| Options exercisable at June 30, 2008    | 4,486            | 23.20                                  | \$ 2,172                               | 2.2   |

**Note 4 Balance Sheet Information***Inventories*

Inventories have been determined by lower of cost (principally first-in, first-out) or market. Inventories consist of (in thousands):

|                 | June 30,<br>2008 | December 31,<br>2007 |
|-----------------|------------------|----------------------|
| Raw materials   | \$ 61,089        | \$ 58,157            |
| Work in process | 37,032           | 27,330               |
| Finished goods  | 16,904           | 13,107               |
|                 | \$ 115,025       | \$ 98,594            |

*Accrued Warranty*

We estimate the costs that may be incurred under the warranty we provide and recognize 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. We periodically assess the adequacy of our recognized warranty liability and adjust the

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amount as necessary. Changes in our warranty liability during the period are as follows (in thousands):

|                                     |    | Six months ended<br>June 30, |    |         |
|-------------------------------------|----|------------------------------|----|---------|
|                                     |    | 2008                         |    | 2007    |
| Balance at beginning of period      | \$ | 6,502                        | \$ | 7,118   |
| Warranties issued during the period |    | 3,003                        |    | 2,628   |
| Settlements made during the period  |    | (2,329)                      |    | (3,141) |
| Balance at end of period            | \$ | 7,176                        | \$ | 6,605   |

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**Note 5 Segment Information**

In 2008, we began to manage the business, review operating results and assess performance, as well as allocate resources, based upon three separate reporting segments to more accurately reflect the market focus of each business. The Light Emitting Diode ( LED ) & Solar Process Equipment segment consists of the metal organic chemical vapor deposition ( MOCVD ) and molecular beam epitaxy ( MBE ) products primarily sold to customers in the high-brightness light emitting diode ( HB-LED ), solar, and wireless industries, as well as web coaters for flexible photovoltaic applications. This segment has production facilities in Somerset, New Jersey, St. Paul, Minnesota, and Lowell, Massachusetts. The Data Storage Process Equipment segment consists of the ion beam etch, ion beam deposition, diamond like carbon, physical vapor deposition, and dicing and slicing products (collectively Ion Beam and Slider products) sold primarily to customers in the data storage industry. This segment has production facilities in Plainview, New York, Ft. Collins, Colorado, and Camarillo, California. The Metrology segment consists of products that are used to provide critical surface measurements on items such as semiconductor devices and thin film magnetic heads ( TFMHs ), as well as biological, nanoscience, and material science samples, and includes our broad line of atomic force microscopes, optical interferometers and stylus profilers sold to customers in the semiconductor and data storage industries and thousands of research facilities and scientific centers. This segment has production facilities in Camarillo and Santa Barbara, California and Tucson, Arizona.

Prior to 2008, we managed the business based on two segments, Process Equipment and Metrology. The Process Equipment segment combined the ion beam etch, ion beam deposition, diamond like carbon, physical vapor deposition, and dicing and slicing products with the MOCVD and MBE technologies. This change in segment composition was based upon management's view that the business segments should coincide more precisely with the markets in which each segment sells its products. The Metrology segment has remained unchanged. The prior year segment financial information presented below has been conformed to the current period presentation.

We evaluate the performance of our reportable segments based on income (loss) from operations before interest, income taxes, amortization and certain items ( EBITA ), 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 EBITA reports baseline performance and thus provides useful information. Certain items include restructuring expenses, asset impairment charges, and debt-related gains. The accounting policies of the reportable segments are the same as those described in the summary of critical accounting policies.

The following tables present certain data pertaining to our reporting segments and a reconciliation of EBITA to income (loss) before income taxes and noncontrolling interest for the three months and six months ended June 30, 2008 and 2007, and goodwill and total assets as of June 30, 2008 and December 31, 2007 (in thousands):



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|  | LED & Solar<br>Process<br>Equipment | Data Storage<br>Process<br>Equipment | Metrology  | Unallocated<br>Corporate<br>Amount | Total   |
|--|-------------------------------------|--------------------------------------|------------|------------------------------------|---------|
| <b>Three months ended June 30, 2008</b>  |                                     |                                      |            |                                    |         |
| Net sales  | \$ 45,090                           | \$ 36,762                            | \$ 32,597  | \$                                 | 114,449 |
| Income (loss) before interest, taxes,<br>amortization, and certain items (EBITA) | \$ 8,732                            | \$ 5,178                             | \$ (1,250) | \$ (4,004)                         | 8,656   |
| Interest expense, net  |                                     |                                      |            | 969                                | 969     |
| Amortization expense   | 967                                 | 952                                  | 394        | 113                                | 2,426   |
| Income (loss) before income taxes and<br>noncontrolling interest                 | \$ 7,765                            | \$ 4,226                             | \$ (1,644) | \$ (5,086)                         | 5,261   |
| <b>Three months ended June 30, 2007</b>  |                                     |                                      |            |                                    |         |
| Net sales  | \$ 27,957                           | \$ 32,059                            | \$ 38,753  | \$                                 | 98,769  |
| Income (loss) before interest, taxes,<br>amortization, and certain items (EBITA) | \$ 3,812                            | \$ 1,570                             | \$ 388     | \$ (2,967)                         | 2,803   |
| Interest expense, net  |                                     |                                      |            | 772                                | 772     |
| Amortization expense   | 959                                 | 951                                  | 325        | 133                                | 2,368   |
| Restructuring expense  |                                     |                                      | 1,352      | 93                                 | 1,445   |
| Income (loss) before income taxes and<br>noncontrolling interest                 | \$ 2,853                            | \$ 619                               | \$ (1,289) | \$ (3,965)                         | (1,782) |

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| <b>Six months ended June 30, 2008</b>   |    |        |    |        |    |        |            |         |
|---|----|--------|----|--------|----|--------|------------|---------|
| Net sales   | \$ | 87,221 | \$ | 60,841 | \$ | 68,694 | \$         | 216,756 |
| Income (loss) before interest, taxes, amortization, and certain items (EBITA) | \$ | 17,330 | \$ | 3,707  | \$ | 573    | \$(7,686)  | 13,924  |
| Interest expense, net   |    |        |    |        |    |        | 1,861      | 1,861   |
| Amortization expense  |    | 1,453  |    | 1,904  |    | 800    | 225        | 4,382   |
| Restructuring expense   |    | 7      |    | 124    |    | 190    | 2,554      | 2,875   |
| Asset impairment charge   |    |        |    |        |    |        | 285        | 285     |
| Income (loss) before income taxes and noncontrolling interest                 | \$ | 15,870 | \$ | 1,679  | \$ | (417)  | \$(12,611) | 4,521   |
| <b>Six months ended June 30, 2007</b>   |    |        |    |        |    |        |            |         |
| Net sales   | \$ | 50,364 | \$ | 67,741 | \$ | 79,830 | \$         | 197,935 |
| Income (loss) before interest, taxes, amortization, and certain items (EBITA) | \$ | 5,591  | \$ | 4,002  | \$ | 4,410  | \$(5,553)  | 8,450   |
| Interest expense, net   |    |        |    |        |    |        | 1,591      | 1,591   |
| Amortization expense  |    | 3,282  |    | 1,902  |    | 736    | 357        | 6,277   |
| Restructuring expense   |    |        |    |        |    | 1,352  | 93         | 1,445   |
| Gain on extinguishment of debt  |    |        |    |        |    |        | (738)      | (738)   |
| Income (loss) before income taxes and noncontrolling interest                 | \$ | 2,309  | \$ | 2,100  | \$ | 2,322  | \$(6,856)  | (125)   |

|                                |    | <b>LED &amp; Solar<br/>Process<br/>Equipment</b> | <b>Data Storage<br/>Process<br/>Equipment</b> | <b>Metrology</b> | <b>Unallocated<br/>Corporate<br/>Amount</b> | <b>Total</b> |         |         |
|--------------------------------|----|--|---|------------------|---|--------------|---------|---------|
| <b>As of June 30, 2008</b>     |    |  |   |                  |   |              |         |         |
| Goodwill                       | \$ | 42,083   | \$  | 30,377           | \$  | 29,368       | \$      | 101,828 |
| Total assets                   |    | 146,821  |   | 149,670          |   | 119,017      | 127,251 | 542,759 |
| <b>As of December 31, 2007</b> |    |  |   |                  |   |              |         |         |
| Goodwill                       | \$ | 41,153   | \$  | 30,377           | \$  | 29,368       | \$      | 100,898 |
| Total assets                   |    | 121,326  |   | 144,944          |   | 121,060      | 142,004 | 529,334 |

Corporate total assets are comprised principally of cash and cash equivalents and property and equipment at June 30, 2008 and December 31, 2007.

**Note 6 Income Taxes**

We adopted FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* ( FIN 48 ) on January 1, 2007. As a result of adopting FIN 48, we recognized a \$0.8 million increase to our reserves for uncertain tax positions during the first quarter of 2007, which was recorded as an increase to the January 1, 2007 accumulated deficit balance. At the adoption date of January 1, 2007, we had approximately \$2.3 million of unrecognized tax benefits, including the cumulative effect increase to our reserve for uncertain tax positions. For the year ended December 31, 2007, we released approximately \$0.4 million of the reserve relating to foreign unrecognized tax benefits. As a result, we had \$1.9 million of unrecognized tax benefits at December 31, 2007. For the six months ended June 30, 2008, our reserve for unrecognized tax benefits decreased by approximately \$0.4 million primarily due to the expiration of the statute of limitations relating to certain foreign tax positions. As a result, we had \$1.5 million of unrecognized tax benefits at June 30, 2008, all of which relate to positions taken on our foreign tax returns and represent the amount of unrecognized tax benefits that, if recognized, would favorably impact the effective income tax rate in future periods.



We or one of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state, local, and foreign jurisdictions. All material federal, state, local, and foreign income tax matters have been concluded for years through 2002 subject to subsequent utilization of net operating losses generated in such years.

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We are continuing our practice of recognizing interest and penalties related to income tax matters in income tax expense. The total accrual for interest and penalties related to uncertain tax positions was approximately \$0.4 million as of June 30, 2008.

**Note 7 Comprehensive Income**

Total comprehensive income for the three months and six months ended June 30, 2008 and 2007 was as follows (in thousands):



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|                              | Three months ended |            | Six months ended |            |
|------------------------------|--------------------|------------|------------------|------------|
|                              | 2008               | 2007       | 2008             | 2007       |
| Net income (loss)            | \$ 4,202           | \$ (2,595) | \$ 2,619         | \$ (2,302) |
| Foreign currency translation | (1,270)            | (419)      | 1,763            | (94)       |
| Total comprehensive income   | \$ 2,932           | \$ (3,014) | \$ 4,382         | \$ (2,396) |

**Note 8 Debt**

*Convertible Debt*

During the first quarter of 2007, we repurchased \$56.0 million of our Old Notes for \$54.8 million, reducing the amount of the Old Notes outstanding from \$200.0 million to \$144.0 million. As a result of these repurchases, we recorded a net gain from the extinguishment of debt of \$0.7 million.

During the second quarter of 2007, we issued New Notes pursuant to privately negotiated exchange agreements with certain holders of the Old Notes. Under these agreements, such holders agreed to exchange \$118.8 million aggregate principal amount of the Old Notes for approximately \$117.8 million aggregate principal amount of New Notes. Following the exchange transactions, approximately \$25.2 million of the Old Notes, with a conversion price of \$38.51 per common share, remained outstanding. No net gain or loss was recorded on the exchange transactions since the carrying value of the Old Notes including unamortized deferred financing costs approximated the exchange value of the New Notes.

The New Notes initially will be convertible into 36.7277 shares of common stock per \$1,000 principal amount of New Notes (equivalent to a conversion price of \$27.23 per share or a premium of 38% over the closing market price for our common stock on April 16, 2007). Holders may convert the New Notes at any time during the period beginning on January 15, 2012 through the close of business on the second day prior to April 15, 2012 and earlier upon the occurrence of certain events including our common stock trading at prices equal to 130% over the conversion price for a specified period.

*Credit Agreement*

During the third quarter of 2007, we entered into a Credit Agreement with HSBC Bank USA, National Association, as administrative agent ( HSBC ), and the lenders named therein (the New Credit Agreement ). The New Credit Agreement amended and restated, and effectively replaced, the prior Credit Agreement, dated as of March 15, 2005, among Veeco, HSBC and the lenders named therein (the Prior Credit Agreement ). The Prior Credit Agreement was set to expire on March 15, 2008. The New Credit Agreement provides for revolving credit borrowings of up to \$100.0 million. As of June 30, 2008 and December 31, 2007, there were no borrowings outstanding. Interest expense associated with the credit agreement recorded during the six months ended June 30, 2008 was \$0.1 million, of which the majority is included in accrued expenses as of June 30, 2008.

**Note 9 Commitments, Contingencies and Other Matters**

*Restructuring Expenses*

During 2007, management initiated a profit improvement plan, resulting in severance costs for approximately 90 employees, or approximately 7.5% of our employees, which included management, administration, and manufacturing employees companywide. Furthermore, we took additional measures to improve profitability, including



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a reduction of discretionary expenses, realignment of our sales organization to more closely match current market and regional opportunities, and consolidation of certain engineering groups within our data storage business, which included the discontinuation of two products. In conjunction with these activities, we recognized a restructuring charge of approximately \$6.7 million during 2007.

During the first quarter of 2008, we consolidated our Corporate headquarters into our Plainview, New York location. As a result, we incurred an additional restructuring charge, representing the remaining lease rentals and estimated property taxes for the facility we vacated, offset by the estimated expected sublease income to be received. We made certain assumptions in determining the charge, which included estimated sublease income and terms of the sublease as well as the estimated discount rate to be used in determining the fair value of the liability. We developed these assumptions based on our understanding of the current real estate market as well as current market interest rates. The assumptions are based on management's best estimates, and will be adjusted periodically if better information is obtained. During the second quarter of 2008, we did not incur any additional restructuring charges. Restructuring expenses for the three months and six months ended June 30, 2008 and 2007 are as follows (in thousands):

|                             | Three months ended<br>June 30, |          | Six months ended<br>June 30, |          |
|-----------------------------|--------------------------------|----------|------------------------------|----------|
|                             | 2008                           | 2007     | 2008                         | 2007     |
| Lease-related costs         | \$                             | \$       | \$ 2,554                     | \$       |
| Personnel severance costs   |                                | 1,445    | 321                          | 1,445    |
| Total restructuring expense | \$                             | \$ 1,445 | \$ 2,875                     | \$ 1,445 |

The following is a reconciliation of the liability for the restructuring charge from inception through June 30, 2008 (in thousands):

|   | LED & Solar<br>Process<br>Equipment | Data Storage<br>Process<br>Equipment | Metrology | Unallocated<br>Corporate | Total    |
|---|-------------------------------------|--------------------------------------|-----------|--------------------------|----------|
| <b>Short-Term Liability</b>               |                                     |                                      |           |                          |          |
| <i>2007 Activity</i>                      |                                     |                                      |           |                          |          |
| Personnel severance charges               | \$ 34                               | \$ 658                               | \$ 1,153  | \$ 2,469                 | \$ 4,314 |
| Purchase order commitments                |                                     | 1,840                                |           |                          | 1,840    |
| Total charged to accrual (1)              | 34                                  | 2,498                                | 1,153     | 2,469                    | 6,154    |
| Cash payments                             | (17)                                | (435)                                | (751)     | (633)                    | (1,836)  |
| Balance as of December 31, 2007           | 17                                  | 2,063                                | 402       | 1,836                    | 4,318    |
| <i>2008 Activity</i>                      |                                     |                                      |           |                          |          |
| Lease-related costs                       |                                     |                                      |           | 971                      | 971      |
| Personnel severance charges               | 7                                   | 124                                  | 190       |                          | 321      |
| Total charged to accrual                  | 7                                   | 124                                  | 190       | 971                      | 1,292    |
| Reclassification from long-term liability |                                     |                                      |           | 236                      | 236      |
| Cash payments                             | (12)                                | (1,262)                              | (396)     | (1,134)                  | (2,804)  |
| Balance as of June 30, 2008               | \$ 12                               | \$ 925                               | \$ 196    | \$ 1,909                 | \$ 3,042 |
| <b>Long-Term Liability</b>                |                                     |                                      |           |                          |          |
| <i>2008</i>                               |                                     |                                      |           |                          |          |
| Lease-related costs                       | \$                                  | \$                                   | \$        | \$ 1,583                 | \$ 1,583 |
| Reclassification to short-term liability  |                                     |                                      |           | (236)                    | (236)    |

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|                             |    |    |    |    |       |    |       |
|-----------------------------|----|----|----|----|-------|----|-------|
| Balance as of June 30, 2008 | \$ | \$ | \$ | \$ | 1,347 | \$ | 1,347 |
|-----------------------------|----|----|----|----|-------|----|-------|

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(1) In 2007, a charge of \$0.6 million for the modification of stock options was recorded as part of a termination agreement with each of five key employees as an increase to additional paid-in capital. No such charge was recorded in 2008.



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The balance of the restructuring accrual is expected to be paid over the next thirty-six months, or the remaining life of the lease for the former Corporate headquarters. During the third quarter of 2008, we expect to incur an additional \$3.7 million charge related to the expense associated with the mutually agreed-upon termination of the employment agreement with Veeco's former CEO following the successful completion of the CEO transition, as well as a \$0.7 million charge for the remaining lease payments on one of our Metrology facilities and additional severance costs for employees in our Metrology business.

In addition to restructuring expenses, during the first quarter of 2008, we recorded a \$0.3 million asset impairment charge associated with property and equipment abandoned as part of the consolidation of our Corporate headquarters into our Plainview facility.

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

**Executive Summary**

We design, manufacture, market, and service enabling solutions for customers in the HB-LED, solar, data storage, semiconductor, scientific research and industrial markets. We have leading technology positions in our three businesses: LED & Solar Process Equipment, Data Storage Process Equipment, and Metrology.

Our LED & Solar Process Equipment products, which include MOCVD and MBE technologies, and web coaters for flexible photovoltaic applications, are used in the manufacturing of HB-LEDs and wireless devices (such as power amplifiers) and solar panels. Our Data Storage Process Equipment products, which include ion beam etch and deposition, physical vapor deposition and other technologies, are used primarily in the manufacturing of TFMHs for the data storage industry. Our Metrology equipment is used to provide critical surface measurements in research and production environments. In production, our equipment allows customers, such as those in semiconductor and data storage, to monitor their products throughout the manufacturing process in order to improve yields, reduce costs, and improve product quality. We also sell our broad line of atomic force microscopes ( AFMs ), scanning probe microscopes ( SPMs ), optical interferometers, and stylus profilers to thousands of universities, research facilities and scientific centers worldwide to enable a variety of nanotechnology related research.

We currently maintain facilities in Arizona, California, Colorado, Minnesota, New Jersey, New York, and Massachusetts, with sales and service locations around the world.

During 2007, management established a profit improvement plan, resulting in a 7.5% reduction in our employment levels, a reduction of discretionary expenses, the realignment of our sales organization to match more closely current market and regional opportunities, and the consolidation of certain engineering groups within our data storage business, which included the discontinuation of two products. In conjunction with these activities, we recognized a restructuring charge of approximately \$6.7 million during the year ended December 31, 2007, as well as an inventory write-off of \$4.8 million and an asset impairment charge of \$1.1 million. During the first quarter of 2008, we incurred additional restructuring and asset impairment charges of \$3.2 million, primarily due to the consolidation and relocation of our Corporate headquarters into our Plainview, New York location. In 2008, we have begun to see the positive impact of these restructuring activities on our profitability.

**Highlights of the Second Quarter of 2008**

- Revenue was \$114.4 million, a 16% increase over the second quarter of 2007.

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- Orders were \$136.5 million, up 21% from the second quarter of 2007.
- Net income was \$4.2 million, or \$0.13 per share, compared to net loss of \$(2.6) million, or \$(0.08) per share, in the second quarter of 2007.
- Gross margins were 41.7%, compared to 42.8% in the second quarter of 2007.
- We completed the purchase of Mill Lane, renamed Veeco Solar Equipment Inc., expanding our solar product offerings to include web coaters for flexible photovoltaic applications. As anticipated, this acquisition did not affect our second quarter revenue or order performance.

### **Outlook**



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We expect 2008 to be a recovery year for Veeco in both revenue growth and profitability. In mid 2007, John Peeler joined Veeco as its new Chief Executive Officer ( CEO ) and initiated a turnaround-plan focused on the following key initiatives:

- Directing Veeco's resources to the best growth opportunities;
- Strengthening the global sales and services organization;
- Improving profitability in the short term through revenue growth, gross margin improvement and cost containment activities;
- Ensuring that each of Veeco's product businesses, LED & Solar Process Equipment, Data Storage Process Equipment, and Metrology, are executing well; and

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- Improving Veeco's business processes to increase effectiveness, predictability and profitability.

As we navigate 2008, we are seeing growth opportunities in several of our core markets, particularly in our LED & Solar Process Equipment business. It is our intention to significantly increase the research and development spending in this business segment to drive new product introductions. Veeco's purchase of Mill Lane will further enable us to exploit the technology growth opportunity for Veeco in 2009 and beyond represented by the solar industry, due to our thin film process knowledge and technology capabilities. During the fourth quarter of 2007, as part of management's profit improvement plan, we discontinued two product lines, consolidated facilities, and made other changes to our Data Storage Process Equipment business to better reflect the volume of business and growth rates in that industry. As a result of these actions, we believe that Veeco is positioned for improved profitability while staying well-aligned to our customers technology requirements. The performance of Veeco's Data Storage business has been positively impacted by our cost cutting activities as well as some demand pull from key data storage customers who are utilizing Veeco's products for capacity purchases and to enable their move to larger wafer sizes.

In February 2008, we provided annual guidance that revenues will grow a minimum of 10% this year to approximately \$440 million based upon significant new product introductions and continued investments in technology by our customers across our various end markets. During the second quarter of 2008, this guidance was revised to \$450-\$455 million in revenues to reflect the additional revenues expected from the operations of Mill Lane. We are currently seeing strength in our LED & Solar Process Equipment and Data Storage Process Equipment businesses resulting from customer technology and capacity spending; but declines in our Metrology business due to weak semiconductor and research end market conditions.

While we currently expect our 2008 operating spending to increase due to necessary raises, incentive compensation and other variable costs, we believe that our significant cost-cutting actions in 2007 and continued cost containment focus will allow us to decrease our operating spending as a percentage of sales in 2008. In 2008, we are undergoing a significant period of transition to improve our financial performance after a disappointing 2007. Our goal is to increase gross margins in 2008, with improvements in each of our businesses, specifically in the latter half of 2008 as revenues are forecasted to increase. We anticipate that progress in this area will continue to come from activities such as better supply chain management, including outsourcing of new products, differentiated, value-added new product introductions, and development of common hardware and software platforms.

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**Results of Operations:**

*Three Months Ended June 30, 2008 and 2007*





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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 2008 interim quarter ends are March 30, June 29 and September 28. The 2007 interim quarter ends were April 1, July 1 and September 30. For ease of reference, we report these interim quarter ends as March 31, June 30, and September 30 in our interim condensed consolidated financial statements.

The following table shows our Consolidated Statements of Operations, percentages of sales, and comparisons between the three months ended June 30, 2008 and 2007 (dollars in thousands):

|   | Three Months Ended<br>June 30, |         |        |    | Dollar and<br>Percentage<br>Change |        |    |         |         |
|---|--------------------------------|---------|--------|----|------------------------------------|--------|----|---------|---------|
|   | 2008                           |         | 2007   |    |                                    |        |    |         |         |
| Net sales   | \$                             | 114,449 | 100.0% | \$ | 98,769                             | 100.0% | \$ | 15,680  | 15.9%   |
| Cost of sales   |                                | 66,719  | 58.3   |    | 56,524                             | 57.2   |    | 10,195  | 18.0    |
| Gross profit  |                                | 47,730  | 41.7   |    | 42,245                             | 42.8   |    | 5,485   | 13.0    |
| Operating expenses:   |                                |         |        |    |                                    |        |    |         |         |
| Selling, general, and administrative expense                  |                                | 24,311  | 21.3   |    | 23,818                             | 24.1   |    | 493     | 2.1     |
| Research and development expense                              |                                | 15,145  | 13.2   |    | 15,903                             | 16.1   |    | (758)   | (4.8)   |
| Amortization expense  |                                | 2,426   | 2.1    |    | 2,368                              | 2.4    |    | 58      | 2.4     |
| Restructuring expense   |                                |         | 0.0    |    | 1,445                              | 1.5    |    | (1,445) | (100.0) |
| Other income, net   |                                | (382)   | (0.3)  |    | (279)                              | (0.3)  |    | 103     | 36.9    |
| Total operating expenses                                      |                                | 41,500  | 36.3   |    | 43,255                             | 43.8   |    | (1,755) | (4.1)   |
| Operating income (loss)                                       |                                | 6,230   | 5.4    |    | (1,010)                            | (1.0)  |    | 7,240   | 716.8   |
| Interest expense, net   |                                | 969     | 0.8    |    | 772                                | 0.8    |    | 197     | 25.5    |
| Income (loss) before income taxes and noncontrolling interest |                                | 5,261   | 4.6    |    | (1,782)                            | (1.8)  |    | 7,043   | 395.2   |
| Income tax provision  |                                | 1,129   | 1.0    |    | 1,042                              | 1.0    |    | 87      | 8.3     |
| Noncontrolling interest                                       |                                | (70)    | (0.1)  |    | (229)                              | (0.2)  |    | (159)   | (69.4)  |
| Net income (loss)   | \$                             | 4,202   | 3.7%   | \$ | (2,595)                            | (2.6)% | \$ | 6,797   | 261.9%  |

### Net Sales and Orders

Net sales of \$114.4 million for the three months ended June 30, 2008 were up 15.9% compared to the comparable 2007 quarter. The following is an analysis of sales and orders by segment and by region (dollars in thousands):

|                          | Sales                          |           |                                 |        | Orders                         |            |                                 |        | Book-to-Bill<br>Ratio |      |
|--------------------------|--------------------------------|-----------|---------------------------------|--------|--------------------------------|------------|---------------------------------|--------|-----------------------|------|
|                          | Three Months Ended<br>June 30, |           | Dollar and Percentage<br>Change |        | Three Months Ended<br>June 30, |            | Dollar and<br>Percentage Change |        |                       |      |
|                          | 2008                           | 2007      | Year to Year                    |        | 2008                           | 2007       | Year to Year                    |        | 2008                  | 2007 |
| <b>Segment Analysis</b>  |                                |           |                                 |        |                                |            |                                 |        |                       |      |
| LED & Solar Process      |                                |           |                                 |        |                                |            |                                 |        |                       |      |
| Equipment                | \$ 45,090                      | \$ 27,957 | \$ 17,133                       | 61.3%  | \$ 52,061                      | \$ 36,385  | \$ 15,676                       | 43.1%  | 1.15                  | 1.30 |
| Data Storage Process     |                                |           |                                 |        |                                |            |                                 |        |                       |      |
| Equipment                | 36,762                         | 32,059    | 4,703                           | 14.7   | 51,716                         | 41,282     | 10,434                          | 25.3   | 1.41                  | 1.29 |
| Metrology                | 32,597                         | 38,753    | (6,156)                         | (15.9) | 32,735                         | 34,786     | (2,051)                         | (5.9)  | 1.00                  | 0.90 |
| Total                    | \$ 114,449                     | \$ 98,769 | \$ 15,680                       | 15.9%  | \$ 136,512                     | \$ 112,453 | \$ 24,059                       | 21.4%  | 1.19                  | 1.14 |
| <b>Regional Analysis</b> |                                |           |                                 |        |                                |            |                                 |        |                       |      |
| North America            | \$ 44,688                      | \$ 31,275 | \$ 13,413                       | 42.9%  | \$ 52,769                      | \$ 39,428  | \$ 13,341                       | 33.8%  | 1.18                  | 1.26 |
| Europe                   | 23,142                         | 20,593    | 2,549                           | 12.4   | 19,131                         | 22,091     | (2,960)                         | (13.4) | 0.83                  | 1.07 |
| Japan                    | 5,989                          | 11,251    | (5,262)                         | (46.8) | 7,809                          | 17,057     | (9,248)                         | (54.2) | 1.30                  | 1.52 |
| Asia Pacific             | 40,630                         | 35,650    | 4,980                           | 14.0   | 56,803                         | 33,877     | 22,926                          | 67.7   | 1.40                  | 0.95 |

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|       |    |         |    |        |    |        |       |    |         |    |         |    |        |       |      |      |
|-------|----|---------|----|--------|----|--------|-------|----|---------|----|---------|----|--------|-------|------|------|
| Total | \$ | 114,449 | \$ | 98,769 | \$ | 15,680 | 15.9% | \$ | 136,512 | \$ | 112,453 | \$ | 24,059 | 21.4% | 1.19 | 1.14 |
|-------|----|---------|----|--------|----|--------|-------|----|---------|----|---------|----|--------|-------|------|------|

By segment, LED & Solar Process Equipment sales were up 61.3% due to an increase in end user demand

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and expanding applications for HB-LEDs, as well as strong customer acceptance of Veeco's newest generation systems. Additionally, Data Storage Process Equipment sales were up 14.7%, primarily as a result of increased volume due to the timing of customers' requirements in the data storage industry, as well as a favorable product mix and increased capacity spending. These increases were partially offset by a decrease in Metrology sales of 15.9%, primarily due to a slowdown in the semiconductor and research and industrial markets. By region, net sales increased by 42.9%, 12.4% and 14.0% in North America, Europe, and Asia Pacific, respectively, and decreased by 46.8% in Japan. We believe that there will continue to be quarter-to-quarter variations in the geographic distribution of sales.

Orders for the second quarter of 2008 increased by 21.4% from the comparable 2007 period. By segment, the 43.1% increase in orders for LED & Solar Process Equipment was driven by an increase in end user demand and expanding applications for HB-LEDs, as well as strong customer acceptance of Veeco's newest generation systems. The 25.3% increase in Data Storage Process Equipment orders was primarily due to an increase in demand from key data storage customers who are utilizing Veeco's products to enable their move to larger wafer sizes, as well as increased capacity spending. The 5.9% decrease in Metrology orders was due to decreased orders for AFM products due to lower demand in the semiconductor and research and industrial markets.

Our book-to-bill ratio for the second quarter of 2008, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period, was 1.19. Our backlog as of June 30, 2008 was \$211.3 million, compared to \$173.5 million as of December 31, 2007. During the quarter ended June 30, 2008, we experienced an increase in backlog of \$12.7 million due to the acquisition of Mill Lane, offset by order cancellations of \$2.8 million. Due to changing business conditions and customer requirements, we may continue to experience cancellations and/or rescheduling of orders.

*Gross Profit*

Gross profit for the quarter ended June 30, 2008, was 41.7%, compared to 42.8% in the second quarter of 2007. Metrology gross margins decreased from 44.4% in the prior year period to 43.8%, principally due to lower sales volume and less favorable pricing for automated AFM products associated with a slowdown in the semiconductor market. Additionally, Data Storage Process Equipment gross margins decreased from 43.0% in the prior-year period to 40.2%, due to favorable warranty experience in the prior year period, as well as higher manufacturing utilization in the 2007 period compared to 2008, resulting in better absorption of fixed costs. LED & Solar Process Equipment gross margins increased from 40.3% in the prior-year period to 41.4%, primarily due to product mix, as well as a significant increase in sales volume as compared to the prior-year period. The aggregate decrease in gross profit resulted principally from a lower proportion of Metrology sales as well as a lower concentration of non-system sales, which both have higher average gross margins than our other products.

*Operating Expenses*

Selling, general and administrative expenses increased by \$0.5 million, or 2.1%, from the prior-year period primarily due to increased bonus incentives and profit sharing as a result of better than budgeted performance as compared to the second quarter of 2007, and an increase in non-cash compensation expense related to stock options and shares of restricted stock. This was partially offset by a decrease in selling expense due to decreased AFM spending. As a percentage of sales, selling, general and administrative expenses decreased from 24.1% in the second quarter of 2007 to 21.3% in the second quarter of 2008.

Research and development expense decreased \$0.8 million from the second quarter of 2007, primarily due to a more focused approach to data storage product development as well as the shutdown of our research and development facility in Fremont, California, which was announced in the fourth quarter of 2007. As a percentage of sales, research and development decreased from 16.1% in the second quarter of 2007 to 13.2% in the second quarter of 2008.

Amortization expense was \$2.4 million in the second quarter of both 2008 and 2007. Amortization decreased due to certain technology-based intangible assets becoming fully amortized; however, this was offset by amortization in the current period for intangible assets acquired as part of the acquisition of Mill Lane in the second quarter of 2008.

Restructuring expense of \$1.4 million for the second quarter of 2007 consisted of personnel severance costs principally associated with our Metrology operations. No such costs were incurred in the second quarter of 2008.

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*Interest Expense, Net*

Net interest expense in the second quarter of 2008 was \$1.0 million, compared to \$0.8 million in the second quarter of 2007. The increase in net interest expense is due to lower interest income resulting primarily from lower interest rates during the current period, compounded by lower cash balances invested.

*Income Taxes*

Income tax provision for the quarter ended June 30, 2008 was \$1.1 million compared to \$1.0 million in the second quarter of 2007. The 2008 provision for income taxes included \$0.8 million relating to our foreign operations which continue to be profitable, and \$0.3 million relating to our domestic operations. Due to significant domestic net operating loss carryforwards, which are fully reserved by a valuation allowance, our domestic operations are not expected to incur significant income taxes for the foreseeable future. The 2007 provision for income taxes included \$0.7 million relating to our foreign operations and \$0.3 million relating to our domestic operations.

*Six Months Ended June 30, 2008 and 2007*



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The following table shows our Consolidated Statements of Operations, percentages of sales, and comparisons between the six months ended June 30, 2008 and 2007 (dollars in thousands):

|   | 2008 |         | Six Months Ended<br>June 30,<br>2007 |    | Dollar and<br>Percentage<br>Change |        |    |         |         |
|---|------|---------|--------------------------------------|----|------------------------------------|--------|----|---------|---------|
|   |      |         |                                      |    |                                    |        |    |         |         |
| Net sales   | \$   | 216,756 | 100.0%                               | \$ | 197,935                            | 100.0% | \$ | 18,821  | 9.5%    |
| Cost of sales   |      | 126,400 | 58.3                                 |    | 111,995                            | 56.6   |    | 14,405  | 12.9    |
| Gross profit  |      | 90,356  | 41.7                                 |    | 85,940                             | 43.4   |    | 4,416   | 5.1     |
| Operating expenses:   |      |         |                                      |    |                                    |        |    |         |         |
| Selling, general, and administrative expense                  |      | 46,939  | 21.7                                 |    | 46,624                             | 23.6   |    | 315     | 0.7     |
| Research and development expense                              |      | 29,871  | 13.8                                 |    | 31,292                             | 15.8   |    | (1,421) | (4.5)   |
| Amortization expense  |      | 4,382   | 2.0                                  |    | 6,277                              | 3.2    |    | (1,895) | (30.2)  |
| Restructuring expense   |      | 2,875   | 1.3                                  |    | 1,445                              | 0.7    |    | 1,430   | 99.0    |
| Asset impairment charge                                       |      | 285     | 0.1                                  |    |                                    | 0.0    |    | 285     | 100.0   |
| Other income, net   |      | (378)   | (0.2)                                |    | (426)                              | (0.2)  |    | (48)    | (11.3)  |
| Total operating expenses                                      |      | 83,974  | 38.7                                 |    | 85,212                             | 43.1   |    | (1,238) | (1.5)   |
| Operating income  |      | 6,382   | 3.0                                  |    | 728                                | 0.3    |    | 5,654   | 776.6   |
| Interest expense, net   |      | 1,861   | 0.9                                  |    | 1,591                              | 0.8    |    | 270     | 17.0    |
| Gain on extinguishment of debt                                |      |         | 0.0                                  |    | (738)                              | (0.4)  |    | (738)   | (100.0) |
| Income (loss) before income taxes and noncontrolling interest |      | 4,521   | 2.1                                  |    | (125)                              | (0.1)  |    | 4,646   | 3,716.8 |
| Income tax provision  |      | 2,048   | 1.0                                  |    | 2,536                              | 1.3    |    | (488)   | (19.2)  |
| Noncontrolling interest                                       |      | (146)   | (0.1)                                |    | (359)                              | (0.2)  |    | (213)   | (59.3)  |
| Net income (loss)   | \$   | 2,619   | 1.2%                                 | \$ | (2,302)                            | (1.2)% | \$ | 4,921   | 213.8%  |

### Net Sales and Orders

Net sales of \$216.8 million for the six months ended June 30, 2008 were up 9.5% compared to the comparable 2007 period. The following is an analysis of sales and orders by segment and by region (dollars in thousands):

|                          | Sales                        |         |   |         | Orders                       |          |   |    | Book-to-Bill<br>Ratio |      |         |    |          |        |      |      |
|--------------------------|------------------------------|---------|---|---------|------------------------------|----------|---|----|-----------------------|------|---------|----|----------|--------|------|------|
|                          | Six Months Ended<br>June 30, |         | Dollar and Percentage<br>Change<br>Year to Year |         | Six Months Ended<br>June 30, |          | Dollar and<br>Percentage Change<br>Year to Year |    |                       |      |         |    |          |        |      |      |
|                          | 2008                         | 2007    |   |         | 2008                         | 2007     |   |    | 2008                  | 2007 |         |    |          |        |      |      |
| <b>Segment Analysis</b>  |                              |         |   |         |                              |          |   |    |                       |      |         |    |          |        |      |      |
| LED & Solar Process      |                              |         |   |         |                              |          |   |    |                       |      |         |    |          |        |      |      |
| Equipment                | \$                           | 87,222  | \$  | 50,364  | \$                           | 36,858   | 73.2%   | \$ | 90,738                | \$   | 72,769  | \$ | 17,969   | 24.7%  | 1.04 | 1.44 |
| Data Storage Process     |                              |         |   |         |                              |          |   |    |                       |      |         |    |          |        |      |      |
| Equipment                |                              | 60,840  |   | 67,741  |                              | (6,901)  | (10.2)  |    | 92,326                |      | 73,598  |    | 18,728   | 25.4   | 1.52 | 1.09 |
| Metrology                |                              | 68,694  |   | 79,830  |                              | (11,136) | (13.9)  |    | 62,707                |      | 71,993  |    | (9,286)  | (12.9) | 0.91 | 0.90 |
| Total                    | \$                           | 216,756 | \$  | 197,935 | \$                           | 18,821   | 9.5%  | \$ | 245,771               | \$   | 218,360 | \$ | 27,411   | 12.6%  | 1.13 | 1.10 |
| <b>Regional Analysis</b> |                              |         |   |         |                              |          |   |    |                       |      |         |    |          |        |      |      |
| North America            | \$                           | 77,766  | \$  | 66,502  | \$                           | 11,264   | 16.9%   | \$ | 93,410                | \$   | 73,500  | \$ | 19,910   | 27.1%  | 1.20 | 1.11 |
| Europe                   |                              | 41,029  |   | 34,955  |                              | 6,074    | 17.4  |    | 35,014                |      | 41,176  |    | (6,162)  | (15.0) | 0.85 | 1.18 |
| Japan                    |                              | 22,743  |   | 31,147  |                              | (8,404)  | (27.0)  |    | 16,779                |      | 29,795  |    | (13,016) | (43.7) | 0.74 | 0.96 |
| Asia Pacific             |                              | 75,218  |   | 65,331  |                              | 9,887    | 15.1  |    | 100,568               |      | 73,889  |    | 26,679   | 36.1   | 1.34 | 1.13 |
| Total                    | \$                           | 216,756 | \$  | 197,935 | \$                           | 18,821   | 9.5%  | \$ | 245,771               | \$   | 218,360 | \$ | 27,411   | 12.6%  | 1.13 | 1.10 |





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By segment, LED & Solar Process Equipment sales were up 73.2% due to an increase in end user demand and expanding applications for HB-LEDs, as well as strong customer acceptance of Veeco's newest generation systems. This was partially offset by a 10.2% decrease in Data Storage Process Equipment sales due to the timing of customers' requirements in the data storage industry. Additionally, Metrology sales decreased 13.9%, primarily due to a slowdown in the semiconductor and research and industrial markets. By region, net sales increased by 16.9%, 17.4% and 15.1% in North America, Europe, and Asia Pacific, respectively, and decreased by 27.0% in Japan. We believe that there will continue to be quarter-to-quarter variations in the geographic distribution of sales.

Orders for the six month period increased by 12.6% from the comparable 2007 period. By segment, the 24.7% increase in orders for LED & Solar Process Equipment was driven by an increase in end user demand and expanding applications for HB-LEDs, as well as strong customer acceptance of Veeco's newest generation systems. The 25.4% increase in Data Storage Process Equipment orders was primarily due to an increase in orders for slicing and dicing products used to create TFMHs. The 12.9% decrease in Metrology orders was due to decreased orders for AFM products due to lower demand in the semiconductor and research and industrial markets.

Our book-to-bill ratio for the six months ended June 30, 2008 was 1.13. Our backlog as of June 30, 2008 was \$211.3 million, compared to \$173.5 million as of December 31, 2007. During the six months ended June 30, 2008, we experienced an increase in backlog of \$12.7 million due to the acquisition of Mill Lane, offset by order cancellations of \$4.0 million. Due to changing business conditions and customer requirements, we may continue to experience cancellations and/or rescheduling of orders.

*Gross Profit*

Gross profit for the six months ended June 30, 2008, was 41.7%, compared to 43.4% in the comparable 2007 period. Metrology gross margins decreased from 46.9% in the prior year period to 45.3%, principally due to lower sales volume and less favorable pricing for automated AFM products associated with a slowdown in the semiconductor market. Additionally, Data Storage Process Equipment gross margins decreased from 42.3% in the prior-year period to 38.3%, due to favorable warranty experience in the prior year period, as well as higher manufacturing utilization in the 2007 period compared to 2008, resulting in better absorption of fixed costs. LED & Solar Process Equipment gross margins increased from 39.3% in the prior-year period to 41.2%, primarily due to favorable pricing on new MOCVD products and a favorable product mix in MBE products, as well as a significant overall increase in sales volume as compared to the prior-year period. The aggregate decrease in gross profit resulted principally from a lower proportion of Metrology sales as well as a lower concentration of non-system sales, both of which have higher average gross margins than our other products.

*Operating Expenses*

Selling, general and administrative expenses increased by \$0.3 million, or 0.7%, from the prior-year period primarily due to increased bonus incentives and profit sharing as a result of better than budgeted performance as compared to the second quarter of 2007, compounded by an increase in non-cash compensation expense related to stock options and shares of restricted stock, as well as an increase in salary and salary-related expenses associated with senior executives hired in the second half of 2007. This was partially offset by a decrease in selling expense due to decreased AFM spending. As a percentage of sales, selling, general and administrative expenses decreased from 23.6% in 2007 to 21.7% in 2008.

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Research and development expense decreased \$1.4 million from the comparable 2007 period, primarily due to a more focused approach to data storage product development. As a percentage of sales, research and development decreased from 15.8% in 2007 to 13.8% in 2008.

Amortization expense was \$4.4 million in the 2008 period, compared to \$6.3 million in 2007. The decrease was driven by certain technology-based intangible assets becoming fully amortized, offset by the amortization in the

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current period of intangibles acquired as part of the acquisition of Mill Lane.

Restructuring expense of \$2.9 million incurred in the first quarter of 2008 consists of \$2.6 million in lease-related costs associated with the consolidation and relocation of our Corporate headquarters into our Plainview, New York facility, and \$0.3 million of personnel severance costs relating to management's restructuring plan announced in 2007. Restructuring expense in 2007 of \$1.4 million consisted of personnel severance costs.

An asset impairment charge of \$0.3 million was taken during 2008 primarily for leasehold improvements and furniture and fixtures abandoned in connection with the consolidation and relocation of our Corporate headquarters into our Plainview, New York facility during the first quarter. No such expense was incurred in the prior year period.

*Interest Expense, Net*

Net interest expense in the six-month period ended June 30, 2008 was \$1.9 million, compared to \$1.6 million in the comparable 2007 period. This increase in net interest expense was due to lower interest income resulting from lower interest rates and lower average cash balances invested during the current period, offset by a decrease in interest expense resulting from the extinguishment of \$56.0 million of debt during the first quarter of 2007.

*Gain on Extinguishment of Debt*

During the first quarter of 2007, we repurchased \$56.0 million of our convertible subordinated notes, reducing the amount outstanding from \$200.0 million to \$144.0 million. The repurchase amount was \$55.1 million in cash, of which \$54.8 million related to principal and \$0.3 million related to accrued interest. As a result of these repurchases, we recorded a net gain from the extinguishment of debt in the amount of \$0.7 million in 2007.

*Income Taxes*

Income tax provision for the six months ended June 30, 2008 was \$2.0 million compared to \$2.5 million in the comparable prior year period, primarily as a result of a \$0.4 million decrease in the FIN 48 reserve relating to foreign unrecognized tax benefits. The 2008 provision for income taxes included \$1.4 million relating to our foreign operations which continue to be profitable, and \$0.6 million relating to our domestic operations. Due to significant domestic net operating loss carryforwards, which are fully reserved by a valuation allowance, our domestic operations are not expected to incur significant income taxes for the foreseeable future. The 2007 provision for income taxes included \$1.9 million relating to our foreign operations and \$0.6 million relating to our domestic operations.

**Liquidity and Capital Resources**

Historically, our principal capital requirements have included the funding of acquisitions and capital expenditures. We traditionally have generated cash from operations and debt and stock issuances. Our ability to generate sufficient cash flows from operations is dependent on the continued demand for our products and services. A summary of the cash flow activity for the six months ended June 30, 2008 and 2007 is as follows (in thousands):

|   | <b>Six Months Ended<br/>June 30,</b> |             |
|---|--------------------------------------|-------------|
|   | <b>2008</b>                          | <b>2007</b> |
| Net cash provided by operating activities             | \$ 10,455                            | \$ 20,639   |
| Net cash used in investing activities                 | (17,832)                             | (5,572)     |
| Net cash used in financing activities                 | (162)                                | (54,183)    |
| Effect of exchange rates on cash and cash equivalents | 100                                  | 149         |
| Net change in cash and cash equivalents               | (7,439)                              | (38,967)    |
| Cash and cash equivalents at beginning of period      | 117,083                              | 147,046     |
| Cash and cash equivalents at end of period            | \$ 109,644                           | \$ 108,079  |

We had a net decrease in cash of \$7.4 million during the six months ended June 30, 2008. Cash provided by operations was \$10.5 million for this period, as compared to cash provided by operations of \$20.6 million for the comparable 2007 period. Net income adjusted for non-cash items provided operating cash flows of \$18.8 million for

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the six months ended June 30, 2008. Net cash provided by operations for the six months ended June 30, 2008 was impacted by a net change in net operating assets and liabilities of \$8.3 million. This was driven by an increase in inventories of approximately \$11.1 million due to an increase in finished goods for process equipment systems scheduled to ship in future quarters.

For the six months ended June 30, 2007, we had a net decrease in cash of \$39.0 million, primarily due to the repurchase of \$56.0 million of our 4.125% convertible subordinated notes due 2008. Cash provided by operations was \$20.6 million for the 2007 period, comprised of a net loss adjusted for non-cash items, providing operating cash flows of \$12.4 million, and a change in net operating assets and liabilities of \$8.2 million.

Cash used in investing activities of \$17.8 million for the six months ended June 30, 2008 resulted primarily from the acquisition of Mill Lane, net of cash acquired and unpaid accruals, for \$10.9 million. Capital expenditures of \$7.1 million also impacted cash used in investing activities. During the remainder of 2008, we expect to invest an estimated additional \$9.8 million in capital projects primarily related to engineering equipment and lab tools used in producing, testing and process development of our products and enhanced manufacturing facilities. Cash used in investing activities of \$5.6 million for the six months ended June 30, 2007 resulted primarily from capital expenditures of \$5.9 million, partially offset by \$0.3 million in proceeds from the sale of property, plant, and equipment.



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Cash used in financing activities for the six months ended June 30, 2008 totaled \$0.2 million, resulting from \$0.6 million in restricted stock tax withholdings and \$0.2 million in mortgage payments, offset by proceeds of \$0.6 million from stock issuances resulting from stock option exercises. Cash used in financing activities for the six months ended June 30, 2007 totaled \$54.2 million, primarily consisting of \$55.0 million used to repurchase a portion of our outstanding convertible subordinated notes (discussed below) and \$1.0 million in payments for debt issuance costs, partially offset by \$2.1 million from the issuance of common stock resulting from the exercise of employee stock options.

During the first quarter of 2007, we repurchased \$56.0 million of our 4.125% convertible subordinated notes due 2008, for \$55.1 million (including accrued interest) in cash which reduced the amount of convertible subordinated notes outstanding from \$200.0 million to \$144.0 million. As a result of these repurchases, we recorded a net gain of \$0.7 million. We may engage in similar transactions in the future depending on market conditions, our cash position and other factors

During the second quarter of 2007, we issued new convertible subordinated notes pursuant to privately negotiated exchange agreements with certain holders of the original 4.125% convertible subordinated notes. Under these agreements, such holders agreed to exchange \$118.8 million aggregate principal amount of the Old Notes for approximately \$117.8 million aggregate principal amount of New Notes due April 15, 2012. Following the exchange transactions, approximately \$25.2 million of the Old Notes remained outstanding. No net gain or loss was recorded on the exchange transactions since the carrying value of the Old Notes including unamortized deferred financing costs approximated the exchange value of the New Notes.

The New Notes initially are convertible into 36.7277 shares of common stock per \$1,000 principal amount of New Notes at a conversion price of \$27.23 at any time during the period beginning on January 15, 2012 through the close of business on the second day prior to April 15, 2012 and earlier upon the occurrence of certain events. We pay interest on the New Notes on April 20 and October 15 of each year.

During the third quarter of 2007, we entered into the New Credit Agreement with HSBC Bank, as administrative agent. The New Credit Agreement provides for borrowings of up to \$100.0 million with an annual interest rate that is a floating rate equal to the prime rate of the agent bank. A LIBOR-based interest rate option is also provided. Borrowings may be used for general corporate purposes, including working capital requirements and acquisitions. The New Credit Agreement contains certain restrictive covenants, and we are required to satisfy certain financial tests under the New Credit Agreement. As of June 30, 2008, we are in compliance with all covenants. Substantially all of our assets and those of our material domestic subsidiaries, other than real estate, have been pledged to secure our obligations under the New Credit Agreement. The revolving credit facility under the New Credit Agreement expires on March 31, 2012. As of June 30, 2008 and December 31, 2007, there were no borrowings or unsecured letters of credit outstanding.

We believe that existing cash balances together with cash generated from operations and amounts available

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under the New Credit Agreement 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. We believe we will be able to meet our obligation to repay the \$25.2 million outstanding Old Notes that mature on December 21, 2008 and the \$117.8 million outstanding New Notes that mature on April 15, 2012 through combination of conversion of the notes outstanding, refinancing, cash generated from operations, and other means.

In 2006, we invested \$0.5 million to purchase 19.9% of the common stock of Fluens Corporation ( Fluens ), of which 31% is owned by one of our Senior Vice Presidents. Veeco and Fluens have jointly developed a next-generation process for high-rate deposition of aluminum oxide for data storage applications. If this development is successful and upon the satisfaction of certain additional conditions by May 2009, we will be obligated to purchase the balance of the outstanding stock of Fluens for \$3.5 million plus an earn-out payment to Fluens stockholders based on future performance.

**Contractual Obligations**

There have been no significant changes to our Contractual Obligations table in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of our 2007 Annual Report on Form 10-K.

**Application of Critical Accounting Policies**

*General:* Our discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, management evaluates its estimates and judgments, including those related to bad debts, inventories, intangible assets 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, the valuation of inventories, the impairment of goodwill and indefinite-lived intangible assets, the impairment of long-lived assets, warranty costs, the accounting for income taxes, and share-based compensation to be critical policies due to the estimation processes involved in each.

*Revenue Recognition:* We recognize revenue in accordance with the SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Certain of our product sales are accounted for as multiple-element arrangements in accordance with Emerging Issues Task Force ( EITF ) 00-21, *Revenue Arrangements with Multiple Deliverables*. A multiple-element arrangement is a transaction which may involve the delivery or performance of multiple products, services, or rights to use assets, and performance may occur at different points in time or over different periods of time. We recognize revenue when persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collectability



is reasonably assured. For products produced according to our published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment. For products produced according to a particular customer's specifications, revenue is recognized when the product has been tested, it has been demonstrated that it meets the customer's specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount of any customer retention (generally 10% to 20%), which is not payable by the customer until installation is completed and final customer acceptance is achieved. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% to 2% of the sales value of the related equipment. For new products, new applications of existing products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 80% to 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the amount billed at the time of shipment. The profit on the amount billed for these transactions is deferred and recorded as deferred profit in the accompanying condensed consolidated balance sheets. Service and maintenance contract revenues are recorded as deferred revenue, which is

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included in other accrued expenses, and recognized as revenue on a straight-line basis over the service period of the related contract.

*Inventory Valuation:* Inventories are stated at the lower of cost (principally first-in, first-out method) or market. Management evaluates the need to record adjustments for impairment of inventory on a quarterly basis. Our policy is to assess the valuation of all inventories, including raw materials, work-in-process, finished goods and spare parts. Obsolete inventory or inventory in excess of management's estimated usage for the next 12 months requirements is written down to its estimated market value, if less than its cost. Inherent in the estimates of market value are management's estimates related to our future manufacturing schedules, customer demand, technological and/or market obsolescence, possible alternative uses and ultimate realization of excess inventory.

*Goodwill and Indefinite-Lived Intangible Asset Impairment:* We have significant intangible assets related to goodwill and other acquired intangibles. In assessing the recoverability of our goodwill and other indefinite-lived intangible assets, we must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If it is determined that impairment indicators are present and that the assets will not be fully recoverable, their carrying values are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic 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 levels for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Changes in strategy and/or market conditions could significantly impact these assumptions, and thus Veeco may be required to record impairment charges for those assets not previously recorded. During the fourth quarter of 2007, as required, we performed an annual impairment test, and based upon the judgment of management, it was determined that no impairment exists.

*Long-Lived Asset Impairment:* The carrying values of long-lived assets are periodically reviewed to determine if any impairment indicators are present. If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization or depreciation period, the carrying values of such assets are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic 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 is identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Assumptions utilized by management in reviewing for impairment of long-lived assets could be effected by changes in strategy and/or market conditions which may require us to record additional impairment charges for these assets, as well as impairment charges on other long-lived assets not previously recorded.

*Warranty Costs:* 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. As our customer engineers and process support engineers are highly trained and deployed

globally, labor availability is a significant factor in determining labor costs. The quantity and availability of critical replacement parts is another significant factor in estimating warranty costs. 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.

*Income Taxes:* As part of the process of preparing our Consolidated Financial Statements, 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 accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our Condensed Consolidated Balance Sheets. The carrying value of our deferred tax assets is adjusted by a valuation allowance to recognize the extent to which the future tax benefits will be recognized on a more likely than not basis. Our net deferred tax assets consist primarily of net operating loss and tax credit carryforwards, and timing differences between the book and tax treatment of inventory 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

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scheduled reversal of deferred tax liabilities, future taxable income, and prudent and feasible tax planning strategies. Under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ( SFAS 109 ), 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.

At June 30, 2008, we had a valuation allowance of approximately \$70.1 million against substantially all of our domestic net deferred tax assets, which consist of net operating loss and tax credit carryforwards, as well as temporary deductible differences. The valuation allowance was calculated in accordance with the provisions of SFAS 109, which places primary importance on our historical results of operations. Although our operating results in prior years were significantly affected by restructuring and other charges, our historical losses and the loss incurred in 2007 represent negative evidence sufficient to require a full valuation allowance under the provisions of SFAS 109. If we are able to realize part or all of the deferred tax assets in future periods, we will reduce our provision for income taxes with a release of the valuation allowance in an amount that corresponds with the income tax liability generated.

In July 2006, the FASB issued FIN 48, which became effective for us on January 1, 2007. FIN 48 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 FIN 48, 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 under 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.

*Share-Based Compensation:* We account for our share-based compensation in accordance with SFAS 123(R). SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Additionally, SFAS No. 123(R) requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under previous accounting literature, which has the effect of reducing consolidated net operating cash flows and increasing consolidated net financing cash flows in periods after adoption. For the six months ended June 30, 2008, we did not recognize any consolidated financing cash flows for such excess tax deductions.

Under SFAS 123(R), we are required to record the fair value of stock-based compensation awards as an expense. In order to determine the fair value of stock options on the grant date, we apply the Black-Scholes option-pricing model. Inherent in the model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual 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 and implied volatilities of the underlying stock, which is obtained from public data sources. We consider the exercise behavior of past grants and model the pattern of aggregate exercises in determining the expected weighted-average option life.

**Recent Accounting Pronouncements**

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On February 12, 2008, the FASB issued FSP 157-2. FSP 157-2 amends SFAS 157 to delay the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (that is, at least annually). For items within its scope, FSP 157-2 defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Currently we believe the impact of the adoption of FSP 157-2 in 2009 will be on our disclosures only.

In December 2007, the FASB issued SFAS 141(R) and SFAS 160. Under SFAS 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition date at fair value with limited exceptions. SFAS 141(R) also changes the accounting treatment for certain other items that relate to business combinations. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The purpose of SFAS 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. The most significant provisions of this statement result in changes to the presentation of noncontrolling interests in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of this statement will impact the manner in which we present noncontrolling interests, but will not impact our consolidated financial position or results of operations.

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In May 2008, the FASB issued FSP APB 14-1. The guidance is effective for fiscal years beginning after December 15, 2008 and interim periods within those years. FSP APB 14-1 will require issuers of convertible debt that can be settled in cash to separately account for (i.e. bifurcate) a portion of the debt associated with the conversion feature and reclassify this portion to stockholders' equity. The liability portion, which represents the fair value of the debt without the conversion feature, will be accreted to its face value over the life of the debt using the effective interest method, with the accretion expense recorded to interest. FSP APB 14-1 will be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented will be recognized as of the beginning of the first period presented. We expect the adoption of FSP APB 14-1 to have a material effect on our consolidated financial position, results of operations, and earnings per share. Effective on the date of issuance of the New Notes, we will reclassify approximately \$16.3 million from long-term debt to additional paid-in capital, and as of the adoption of FSP APB 14-1 in the beginning of 2009, our accumulated deficit will reflect approximately \$4.3 million of debt accretion that occurred between the issuance date of the New Notes and the adoption date. Approximately \$3.1 to \$3.6 million of additional interest expense will be recorded annually from the adoption date through the maturity date of the convertible debt. This interest expense will not require the use of cash.

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

Our net sales to foreign customers represented approximately 61.0% and 64.1%, respectively, of our total net sales for the three months and six months ended June 30, 2008, and 68.3% and 66.4%, respectively, for the comparable 2007 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 19.7% and 17.8% of our total net sales for the three months and six months ended June 30, 2008, respectively, and 20.6% and 20.5%, respectively, for the comparable 2007 periods.

The condensed consolidated results of operations for the three months and six months ended June 30, 2008 include aggregate foreign currency losses of less than \$0.1 million and gains of approximately \$0.1 million, respectively, which were net of gains of approximately \$0.1 million and losses of \$0.2 million, respectively, related to forward contracts. For the three months and six months ended June 30, 2007, the results included aggregate foreign currency losses of approximately \$0.2 million and \$0.3 million, respectively, which included gains of less than \$0.1 million and losses of approximately \$0.1 million, respectively related to forward contracts.

We are exposed to financial market risks, including changes in foreign currency exchange rates. The changes in currency exchange rates that have the largest impact on translating our international operating profit are the Japanese Yen and the Euro. We use derivative financial instruments to mitigate these risks. We do not use derivative financial instruments for speculative or trading purposes. We generally enter into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known currency exposures. The average notional amount of such contracts was approximately \$1.5 million and \$2.3 million, respectively, for the three months and six months ended June 30, 2008. On June 26, 2008 we entered into two forward contracts for the month of July for the total notional amount of approximately \$1.6 million. The fair values of the contracts at inception were zero, which did not significantly change at June 30, 2008. We do not anticipate any significant future loss from fluctuations in currency exchange rates, as our hedging strategy is designed to minimize the risk of such fluctuations.

Assuming first quarter 2008 variable debt and investment levels, the effect of a one-point change in interest rates would not have a material effect on net interest expense.

**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 it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC'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.

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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 CEO and Chief Financial Officer ( CFO ), as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings.

We have implemented new company-wide integrated applications software. As of April 1, 2008, we have completed the conversion to this new platform in all of Veeco s business locations other than at the Mill Lane location, which was recently acquired by Veeco. As a result, certain changes have been made to our internal controls, which management believes will strengthen our internal control structure. There have been no other significant changes in our internal controls or other factors during the fiscal quarter ended June 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



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**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Refer to Item 3. Legal Proceedings in Part I of our Annual Report on Form 10-K for the year ended December 31, 2007 and Item 1 Legal Proceedings in Part II of our Quarterly Report on Form 10-Q for the quarter ended March 31, 2008.

**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, 2007. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K.

**Item 4. Submission of Matters to a Vote of Security Holders.**

The annual meeting of stockholders of the Company was held on May 2, 2008. The matters voted on at the meeting were: (a) the election of three directors: (i) Joel A. Elftmann, (ii) John R. Peeler and (iii) Peter J. Simone; and (b) ratification of the Board's appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for the year ending December 31, 2008. The terms of each of the following directors continued after the meeting: Edward H. Braun, Richard A. D'Amore, Heinz K. Fridrich, Douglas A. Kingsley, Roger D. McDaniel and Irwin H. Pfister. As of the record date for the meeting, there were 31,879,935 shares of common stock outstanding, each of which was entitled to one vote with respect to each of the matters voted on at the meeting. Each of the directors up for reelection was reelected and the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm was ratified by the required number of votes on each such matter. The results of the voting were as follows:

| <b>Matter</b> | <b>For</b> | <b>Withheld</b> |
|---------------|------------|-----------------|
| (a)(i)        | 21,128,950 | 2,986,797       |
| (a)(ii)       | 21,128,114 | 2,987,633       |
| (a)(iii)      | 21,008,210 | 3,107,537       |

| <b>Matter</b> | <b>For</b> | <b>Against</b> | <b>Abstained</b> | <b>Broker<br/>Non-Votes</b> |
|---------------|------------|----------------|------------------|-----------------------------|
| (b)           | 23,624,958 | 465,021        | 25,770           |                             |

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   | Service Agreement effective July 24, 2008 between Edward H. Braun and Veeco Instruments Inc.   | *  |
| 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. | *  |

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\* Filed herewith

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**SIGNATURES**

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

Date: July 30, 2008

Veeco Instruments Inc.

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

By: */s/ JOHN F. REIN, JR.*  
John F. Rein, Jr.  
*Executive Vice President and Chief Financial Officer*

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**INDEX TO EXHIBITS**

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