

VEECO INSTRUMENTS INC  
Form 10-Q/A  
April 01, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**



(Mark One)

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

For the quarterly period ended September 30, 2004

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)

**Delaware**  
(State or Other Jurisdiction  
of Incorporation or Organization)

**11-2989601**  
(I.R.S. Employer  
Identification Number)

**100 Sunnyside Boulevard, Suite B**  
**Woodbury, New York**  
(Address of Principal Executive Offices)

**11797**  
(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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

29,731,824 shares of common stock, \$0.01 par value per share, were outstanding as of the close of business on November 8, 2004.

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**SAFE HARBOR STATEMENT**

This Quarterly Report on Form 10-Q (the Report ) contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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. Factors that may cause these differences include, but are not limited to:

The cyclical nature of the microelectronics industries we serve directly affects our business.

We operate in a highly competitive industry characterized by rapid technological change.

We depend on a limited number of customers that operate in highly concentrated industries.

Our quarterly operating results fluctuate significantly.

Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses.

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.

Our success depends on protection of our intellectual property rights. We may be subject to claims of intellectual property infringement by others.

We rely on a limited number of suppliers.

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 Company's Annual Report on Form 10-K for the year ended December 31, 2003.

Consequently, such forward-looking statements should be regarded solely as the Company's current plans, estimates and beliefs. The Company does not undertake any obligation to update any forward-looking statements to reflect future events or circumstances after the date of such statements.

**Available Information**

We file annual, quarterly and current reports, information statements and other information with the 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 Info SEC Filings, through which investors can access our filings with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to those reports. These filings are posted to our Internet site as soon as reasonably practicable after we electronically file such material with the SEC.

**EXPLANATORY NOTE**

The Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2004 was initially filed with the Securities and Exchange Commission ( SEC ) on November 9, 2004 (the Originally Filed 10-Q ). This Amendment No. 1 is being filed to reflect restatements of the following (unaudited) financial statements: condensed consolidated statements of operations and cash flows for the three and nine month periods ended September 30, 2004; condensed consolidated balance sheets as at September 30, 2004; and to make certain conforming changes. On March 16, 2005, we announced that we would restate our consolidated financial statements for the quarters ended March 31, 2004, June 30, 2004 and September 30, 2004 to reflect adjustments determined to be necessary as a result of an internal investigation of improper accounting transactions at our TurboDisc® business unit. For a description of the restatements, see Restatements in Note 2 to the accompanying (unaudited) condensed consolidated financial statements and Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Recent Events Internal Accounting Investigation; Restatement of 2004 Financial Results in this Amendment No. 1.

This Amendment No. 1 amends and restates Items 1, 2, 3, 4 and 5 of Part I and Item 6 of Part II of the Originally Filed 10-Q and, except for such items and Exhibits 31.1, 31.2, 32.1 and 32.2, no other information in the Originally Filed 10-Q is amended hereby. The explanatory caption at the beginning of each item of this Amendment No. 1 sets forth the nature of the revisions to that item.

For a discussion of events and developments subsequent to September 30, 2004, see:

our Annual Report on Form 10-K for the year ended December 31, 2004; and

our other filings subsequent to September 30, 2004.

VEECO INSTRUMENTS INC. AND SUBSIDIARIES

INDEX

|                          |   |
|--------------------------|---|
| <b><u>Part I.</u></b>    | <b><u>Financial Information</u></b>   |
| <b><u>Item 1.</u></b>    | <u>Financial Statements (Unaudited):</u><br><br><u>Condensed Consolidated Statements of Operations-Three Months Ended September 30, 2004 (Restated) and 2003</u><br><br><u>Condensed Consolidated Statements of Operations-Nine Months Ended September 30, 2004 (Restated) and 2003</u><br><br><u>Condensed Consolidated Balance Sheets-September 30, 2004 (Restated) and December 31, 2003</u><br><br><u>Condensed Consolidated Statements of Cash Flows-Nine Months Ended September 30, 2004 (Restated) and 2003</u><br><br><u>Notes to Condensed Consolidated Financial Statements</u> |
| <b><u>Item 2.</u></b>    | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations (Restated)</u>   |
| <b><u>Item 3.</u></b>    | <u>Quantitative and Qualitative Disclosure About Market Risk</u>  |
| <b><u>Item 4.</u></b>    | <u>Controls and Procedures</u>  |
| <b><u>Item 5.</u></b>    | <u>Other Information</u>  |
| <b><u>Part II.</u></b>   | <b><u>Other Information</u></b>   |
| <b><u>Item 6.</u></b>    | <u>Exhibits</u>   |
| <b><u>SIGNATURES</u></b> |   |



**Part I. Financial Information****Item 1. Financial Statements (Unaudited)**

**Veeco Instruments Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
(In thousands, except per share data)  
(Unaudited)

|   | Three Months Ended<br>September 30, |         |            |
|---|-------------------------------------|---------|------------|
|   | 2004<br>(Restated)                  |         | 2003       |
| Net sales                                   | \$                                  | 97,367  | \$ 63,144  |
| Cost of sales                               |                                     | 61,913  | 32,845     |
| Gross profit                                |                                     | 35,454  | 30,299     |
| Costs and expenses:                         |                                     |         |            |
| Selling, general and administrative expense |                                     | 19,590  | 15,204     |
| Research and development expense            |                                     | 14,900  | 11,640     |
| Amortization expense                        |                                     | 4,336   | 3,262      |
| Other expense, net                          |                                     | 170     | 146        |
| Restructuring expense, net                  |                                     |         | 1,804      |
| Operating loss                              |                                     | (3,542) | (1,757)    |
| Interest expense, net                       |                                     | 1,793   | 2,050      |
| Loss before income taxes                    |                                     | (5,335) | (3,807)    |
| Income tax benefit                          |                                     | (3,162) | (1,692)    |
| Net loss                                    | \$                                  | (2,173) | \$ (2,115) |
| Net loss per common share                   | \$                                  | (0.07)  | \$ (0.07)  |
| Diluted net loss per common share           | \$                                  | (0.07)  | \$ (0.07)  |
| Weighted average shares outstanding         |                                     | 29,670  | 29,262     |
| Diluted weighted average shares outstanding |                                     | 29,670  | 29,262     |

See Accompanying Notes.

**Veeco Instruments Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Operations**  
(In thousands, except per share data)  
(Unaudited)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2004<br>(Restated)                 | 2003       |
| Net sales                                   | \$ 287,476                         | \$ 202,372 |
| Cost of sales                               | 174,309                            | 108,073    |
| Gross profit                                | 113,167                            | 94,299     |
| Costs and expenses:                         |                                    |            |
| Selling, general and administrative expense | 61,166                             | 50,017     |
| Research and development expense            | 43,516                             | 35,507     |
| Amortization expense                        | 13,807                             | 9,563      |
| Other income, net                           | (471)                              | (749)      |
| Restructuring expense, net                  |                                    | 3,261      |
| Operating loss                              | (4,851)                            | (3,300)    |
| Interest expense, net                       | 6,231                              | 5,703      |
| Loss before income taxes                    | (11,082)                           | (9,003)    |
| Income tax benefit                          | (4,542)                            | (4,056)    |
| Net loss                                    | \$ (6,540)                         | \$ (4,947) |
| Net loss per common share                   | \$ (0.22)                          | \$ (0.17)  |
| Diluted net loss per common share           | \$ (0.22)                          | \$ (0.17)  |
| Weighted average shares outstanding         | 29,629                             | 29,245     |
| Diluted weighted average shares outstanding | 29,629                             | 29,245     |

See Accompanying Notes.

**Veeco Instruments Inc. and Subsidiaries**  
**Condensed Consolidated Balance Sheets**  
(In thousands)

|   | September 30,<br>2004<br>(Unaudited)<br>(Restated) | December 31,<br>2003 |
|---|--|----------------------|
| <b>Assets</b>   |  |                      |
| Current Assets:   |  |                      |
| Cash and cash equivalents   | \$ 110,981   | \$ 106,830           |
| Accounts receivable, less allowance for doubtful accounts of \$2,480 in 2004 and \$2,458 in 2003              | 79,102   | 69,890               |
| Inventories   | 117,659  | 97,622               |
| Prepaid expenses and other current assets   | 9,606  | 15,823               |
| Deferred income taxes   | 32,999   | 24,693               |
| Total current assets  | 350,347  | 314,858              |
| Property, plant and equipment at cost, less accumulated depreciation of \$69,216 in 2004 and \$62,504 in 2003 | 73,586   | 72,742               |
| Goodwill  | 78,816   | 72,989               |
| Purchased technology, less accumulated amortization of \$35,726 in 2004 and \$25,519 in 2003                  | 75,642   | 85,849               |
| Other intangible assets, less accumulated amortization of \$18,446 in 2004 and \$14,846 in 2003               | 16,717   | 18,842               |
| Long-term investments   | 8,043  | 12,376               |
| Deferred income taxes   | 18,926   | 18,136               |
| Other assets, net   | 2,011  | 672                  |
| Total assets  | \$ 624,088   | \$ 596,464           |
| <b>Liabilities and shareholders equity</b>  |  |                      |
| Current Liabilities:  |  |                      |
| Accounts payable  | \$ 35,099  | \$ 19,603            |
| Accrued expenses  | 47,026   | 31,616               |
| Deferred profit   | 3,182  | 2,140                |
| Income taxes payable  | 3,587  | 3,700                |
| Current portion of long-term debt   | 348  | 333                  |
| Total current liabilities   | 89,242   | 57,392               |
| Long-term debt, net of current portion  | 229,671  | 229,935              |
| Other non-current liabilities   | 2,885  | 2,808                |
| Shareholders equity   | 302,290  | 306,329              |
| Total liabilities and shareholders equity   | \$ 624,088   | \$ 596,464           |

See Accompanying Notes.

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

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2004<br>(Restated)                 | 2003       |
| <b>Operating Activities</b>   |                                    |            |
| Net loss  | \$ (6,540)                         | \$ (4,947) |
| Adjustments to reconcile net loss to net cash provided by operating activities: |                                    |            |
| Depreciation and amortization   | 23,696                             | 17,169     |
| Deferred income taxes   | (9,134)                            | (6,941)    |
| Other   | 35                                 | (67)       |
| Changes in operating assets and liabilities:                                    |                                    |            |
| Accounts receivable   | (9,574)                            | 8,001      |
| Inventories   | (20,597)                           | 2,619      |
| Accounts payable  | 15,518                             | 989        |
| Accrued expenses, deferred profit and other current liabilities                 | 11,584                             | (10,313)   |
| Other, net  | (57)                               | 354        |
| Net cash provided by operating activities                                       | 4,931                              | 6,864      |
| <b>Investing Activities</b>   |                                    |            |
| Capital expenditures  | (9,518)                            | (6,464)    |
| Net assets of business acquired   | (1,000)                            | (5,980)    |
| Proceeds from sale of assets held for sale                                      | 2,615                              | 2,332      |
| Proceeds from sale of property, plant and equipment                             | 26                                 |            |
| Net maturities of long-term investments   | 4,333                              | 4,165      |
| Net cash used in investing activities   | (3,544)                            | (5,947)    |
| <b>Financing Activities</b>   |                                    |            |
| Proceeds from stock issuance  | 3,017                              | 368        |
| Repayment of long-term debt, net  | (250)                              | (237)      |
| Net cash provided by financing activities                                       | 2,767                              | 131        |
| Effect of exchange rates on cash and cash equivalents                           | (3)                                | (184)      |
| Net change in cash and cash equivalents   | 4,151                              | 864        |
| Cash and cash equivalents at beginning of period                                | 106,830                            | 214,295    |
| Cash and cash equivalents at end of period                                      | \$ 110,981                         | \$ 215,159 |

**Non-Cash Items**

During the first nine months of 2004, the Company had non-cash items excluded from the Condensed Consolidated Statement of Cash Flows of approximately \$7.3 million. This amount consists of (1) \$6.0 million for the accrual of a contingent earnout payment to Emcore, the former owner of TurboDisc, resulting from the achievement of certain revenue targets which is payable in the first quarter of 2005 and has been reflected as additional goodwill; (2) \$0.9 million for the transfer of other current assets to property plant and equipment; and (3) \$0.4 million for the transfer of inventory to property plant and equipment.

See Accompanying Notes.



**Veeco Instruments Inc. and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**Note 1 Basis of Presentation**

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 accounting principles generally accepted in the United States 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 nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

As described in Note 2, the (unaudited) condensed consolidated statements of operations and cash flows for the three and nine month periods ended September 30, 2004 and the condensed consolidated balance sheet as of September 30, 2004, including the applicable notes, have been restated.

Loss per share is computed using the weighted average number of common shares outstanding during the period. Diluted loss per share is computed using the weighted average number of common and common equivalent shares outstanding during the period. The effect of common equivalent shares of approximately 283,000 and 525,000 for the three and nine months ended September 30, 2004, respectively, and 329,000 and 242,000 for the three and nine months ended September 30, 2003, respectively, were antidilutive, therefore diluted loss per share is not presented for such periods.

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

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2004</b>               | <b>2003</b> | <b>2004</b>              | <b>2003</b> |
|   | <b>(In thousands)</b>     |             | <b>(In thousands)</b>    |             |
| Weighted average shares outstanding           | 29,670                    | 29,262      | 29,629                   | 29,245      |
| Dilutive effect of stock options and warrants |                           |             |                          |             |
| Diluted weighted average shares outstanding   | 29,670                    | 29,262      | 29,629                   | 29,245      |

In addition, the effect of the assumed conversion of subordinated convertible notes into approximately 5.7 million common equivalent shares is antidilutive for the three and nine months ended September 30, 2004 and 2003, respectively, and therefore is not included in the above diluted weighted average shares outstanding.

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The Company accounts for its stock option plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No compensation expense is reflected in net loss, as all options granted under the stock option plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions, under which compensation expense would be recognized as incurred, of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation:

|   | Three Months Ended<br>September 30,      |            | Nine Months Ended<br>September 30, |             |
|---|--|------------|------------------------------------|-------------|
|   | 2004<br>(Restated)                       | 2003       | 2004<br>(Restated)                 | 2003        |
|   | (In thousands, except per share amounts) |            |                                    |             |
| Net loss, as reported   | \$ (2,173)                               | \$ (2,115) | \$ (6,540)                         | \$ (4,947)  |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (3,234)                                  | (3,822)    | (9,162)                            | (12,451)    |
| Pro forma net loss  | \$ (5,407)                               | \$ (5,937) | \$ (15,702)                        | \$ (17,398) |
| Loss per common share:  |  |            |                                    |             |
| Net loss per common share, as reported  | \$ (0.07)                                | \$ (0.07)  | \$ (0.22)                          | \$ (0.17)   |
| Net loss per common share, pro forma  | \$ (0.18)                                | \$ (0.20)  | \$ (0.53)                          | \$ (0.59)   |
| Diluted net loss per common share, as reported  | \$ (0.07)                                | \$ (0.07)  | \$ (0.22)                          | \$ (0.17)   |
| Diluted net loss per common share, pro forma  | \$ (0.18)                                | \$ (0.20)  | \$ (0.53)                          | \$ (0.59)   |

*Reclassifications*

Certain amounts in the 2003 consolidated financial statements have been reclassified to conform to the 2004 presentation.

**Note 2 Restatement**

On February 11, 2005, Veeco announced the postponement of the release of audited results for the fourth quarter and year ended December 31, 2004, pending completion of an internal investigation of improper accounting transactions at its TurboDisc® business unit. Veeco acquired the assets of TurboDisc in November 2003. The investigation focused principally on the value of inventory, accounts payable and certain liabilities, as well as certain revenue transactions of TurboDisc. The investigation was commenced after Veeco's internal audit staff and corporate financial management discovered improper accounting transactions in the course of a Veeco internal audit and transitioning the business to Veeco's SAP accounting system during the fourth quarter of 2004. The Audit Committee of the Company's Board of Directors supervised the accounting investigation and authorized Veeco's outside counsel, Kaye Scholer LLP, to hire Jefferson Wells International to perform forensics and accounting reconstruction work as part of the investigation. The investigation has been completed. Conclusions reached during the investigation included that the improper accounting entries were made by a single individual at TurboDisc whose employment had been terminated prior to the commencement of the investigation, and that there was no evidence found of embezzlement or diversion of corporate assets.

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On March 16, 2005, Veeco reported that it had completed its internal investigation and would be restating the financial statements previously issued for the three quarterly periods and nine months ended September 30, 2004. The pre-tax decrease to earnings previously reported is \$2.8 million, \$4.3 million and \$3.1 million for the three month periods ended March 31, 2004, June 30, 2004 and September 30, 2004, respectively. In addition, as a result of revenue recognition adjustments, (decreases) increases to revenues previously reported will be \$(3.6) million, \$(3.6) million and \$5.0 million for the three month periods ended March 31, 2004, June 30, 2004 and September 30, 2004, respectively. These revenue adjustments, in the aggregate, do not reduce total revenue recognized for 2004.



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The table set forth below shows the adjustments to the quarterly information that was previously filed on the Quarterly Report on Form 10-Q for the three and nine month periods ended September 30, 2004:

|   | Three Months Ended September 30, 2004 |                 |            | Nine Months Ended September 30, 2004 |                 |            |
|---|---------------------------------------|-----------------|------------|--------------------------------------|-----------------|------------|
|   | As filed                              | Adjustments (1) | Restated   | As filed                             | Adjustments (2) | Restated   |
| Net sales                                   | \$ 92,367                             | 5,000           | \$ 97,367  | \$ 289,738                           | \$ (2,262)      | \$ 287,476 |
| Cost of sales                               | 53,634                                | 8,279           | 61,913     | 165,825                              | 8,484           | 174,309    |
| Gross profit                                | 38,733                                | (3,279)         | 35,454     | 123,913                              | (10,746)        | 113,167    |
| Costs and expenses                          | 39,145                                | (149)           | 38,996     | 118,558                              | (540)           | 118,018    |
| Operating income (loss)                     | (412)                                 | (3,130)         | (3,542)    | 5,355                                | (10,206)        | (4,851)    |
| Interest expense, net                       | 1,793                                 |                 | 1,793      | 6,231                                |                 | 6,231      |
| Loss before income taxes                    | (2,205)                               | (3,130)         | (5,335)    | (876)                                | (10,206)        | (11,082)   |
| Income tax benefit                          | (750)                                 | (2,412)         | (3,162)    | (298)                                | (4,244)         | (4,542)    |
| Net loss                                    | (1,455)                               | (718)           | \$ (2,173) | (578)                                | (5,962)         | \$ (6,540) |
| <b>Loss per common share:</b>               |                                       |                 |            |                                      |                 |            |
| Net loss per common share                   | \$ (0.05)                             | \$ (0.02)       | \$ (0.07)  | \$ (0.02)                            | \$ (0.20)       | \$ (0.22)  |
| Weighted average shares outstanding         | 29,670                                |                 | 29,670     | 29,629                               |                 | 29,629     |
| Diluted weighted average shares outstanding | 29,670                                |                 | 29,670     | 29,629                               |                 | 29,629     |

(1) The \$5.0 million increase in revenue principally relates to revenue recognition adjustments for certain system shipments. Approximately \$7.2 million of revenue, previously recognized in the second quarter of 2004, was reversed and properly recognized in the third quarter of 2004, which was partially offset by \$2.2 million of revenue that was previously recognized in the third quarter that was reversed and properly recognized in the fourth quarter of 2004. The \$8.3 million increase in cost of sales results from a \$3.8 million increase related to the net increase in revenues and \$4.5 million resulting from adjustments in inventory, accounts payable and accrued expenses. The decrease in costs and expenses of \$0.1 million principally relates to the over accrual of certain operating expenses. The \$2.4 million adjustment to the income tax benefit reflects the tax benefit resulting from the pre-tax adjustments

(2) The \$2.3 million reduction in revenue principally results from revenue recognition adjustments for certain system shipments. The revenue for these systems was recognized in the fourth quarter. The \$8.5 million increase in cost of sales results from \$9.7 million in adjustments principally to inventory, accounts payable and certain accrued expenses partially offset by a \$1.2 million reduction due to the decrease in revenues due to the revenue recognition adjustments described above. The decrease in costs and expenses of \$0.2 million principally relates to the over accrual of certain operating expenses. The \$0.8 million adjustment to income tax benefit reflects the tax benefit resulting from the pre-tax adjustments.

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The table set forth below shows the adjustments to the condensed consolidated balance sheet information as of September 30, 2004 that was previously filed on the Quarterly Report on Form 10-Q for the nine month period ended September 30, 2004:

|  | As of September 30, 2004 |                 |            |
|--|--------------------------|-----------------|------------|
|  | As filed                 | Adjustments (1) | Restated   |
| <b>Assets</b>                              |                          |                 |            |
| Current assets                             | \$ 359,110               | \$ (8,763)      | \$ 350,347 |
| Non-current assets                         | 271,274                  | 2,467           | 273,741    |
| Total assets                               | 630,384                  | (6,296)         | 624,088    |
| <b>Liabilities and shareholders equity</b> |                          |                 |            |
| Current liabilities                        | 89,576                   | (334)           | 89,242     |
| Non-current liabilities                    | 232,556                  |                 | 232,556    |
| Shareholders equity                        | 308,252                  | (5,962)         | 302,290    |
| Total liabilities and shareholders equity  | 630,384                  | (6,296)         | 624,088    |

(1) The \$8.8 million reduction to current assets principally results from a \$2.6 million decrease to accounts receivable resulting from revenue recognition adjustments, a \$6.2 million decrease to inventory resulting from revenue recognition adjustments and certain inventory valuation adjustments, a net decrease to the current portion of deferred taxes of \$0.3 million due to a \$3.6 million shift of the deferred tax asset from short-term to long-term net of a \$3.3 million increase in the asset due to the higher loss incurred, offset by an increase to prepaid expenses and other current assets of \$0.3 million due to adjusted taxes receivable. The \$2.5 million increase in non-current assets results from an increase to the non-current portion of deferred taxes of \$3.6 million due to the shift in deferred tax assets noted above, offset by a decrease in goodwill of \$1.1 million which relates to a reduction in the contingent earnout payment to Emcore Corporation, the former owner of TurboDisc, resulting from the achievement of certain revenue targets which is payable in the first quarter of 2005. The \$0.3 million decrease in current liabilities consists of a \$0.6 million decrease to income taxes payable relating to an adjustment of state tax liabilities, and a decrease of \$0.3 million to accounts payable and accrued expenses principally relating to expenses applicable to the first nine months, offset by an increase to deferred profit of \$0.6 million. The \$6.0 million decrease to shareholders equity relates to the increase in the net loss due to the various factors previously described.

**Note 3 Balance Sheet Information**

*Inventories*

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

|                       |                      |
|-----------------------|----------------------|
| September 30,<br>2004 | December 31,<br>2003 |
|-----------------------|----------------------|

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|                  | (Restated) |           |
|------------------|------------|-----------|
| Raw materials    | \$ 59,078  | \$ 49,734 |
| Work-in-progress | 38,809     | 31,887    |
| Finished goods   | 19,772     | 16,001    |
|                  | \$ 117,659 | \$ 97,622 |

*Accrued Warranty*

The Company estimates the costs that may be incurred under its warranty and records a liability in the amount of such costs at the time the related revenue is recognized. Factors that affect the Company's warranty liability include historical and anticipated rates of warranty claims and costs per claim. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. Changes in the Company's warranty liability during the period are as follows (in thousands):

|                                     |          |
|-------------------------------------|----------|
| Balance as of January 1, 2004       | \$ 3,904 |
| Warranties issued during the period | 4,015    |
| Settlements made during the period  | (1,965)  |
| Balance as of September 30, 2004    | \$ 5,954 |

**Note 4 Segment Information**

During the quarter ended September 30, 2004, the Company changed the structure of its internal organization in a manner which caused the composition of its reportable segments to change. The Company currently manages, reviews operating results, and assesses performance, as well as allocates resources, based upon this reporting structure. The change implemented by the Company was to split out the former process equipment segment into two separate reportable segments. The first segment, called "ion beam and mechanical process equipment", combines the etch, deposition, and dicing and slicing products sold mostly to data storage customers. This segment includes the production facilities in Plainview, New York, Ft. Collins, Colorado, and Camarillo, California. The second segment, called "epitaxial process equipment", includes the Molecular Beam Epitaxy ( MBE ) and Metal Organic Chemical Vapor Deposition ( MOCVD ) products primarily sold to high brightness light emitting diodes ( HB-LED ) and wireless telecommunications customers. This segment includes the production facilities in St. Paul, Minnesota, and Somerset, New Jersey. The metrology segment, which includes the production facilities in Santa Barbara, California, and Tucson, Arizona, remains unchanged. As such, the Company has restated the segment information for prior periods as if the composition of its reportable segments described above had existed in such prior periods.

The following table represents the reportable product segments of the Company (in thousands):

|   | <b>Ion Beam and<br/>Mechanical<br/>Process<br/>Equipment</b> | <b>Epitaxial Process<br/>Equipment</b> | <b>Metrology</b> | <b>Unallocated<br/>Corporate<br/>Amount</b> | <b>Restructuring<br/>Charges</b> | <b>Total</b> |
|---|--|--|------------------|---|----------------------------------|--------------|
| <b>Three Months Ended<br/>September 30, 2004 (Restated)</b>                 |  |  |                  |   |                                  |              |
| Net sales   | \$ 30,297  | \$ 33,407                              | \$ 33,663        | \$  | \$                               | \$ 97,367    |
| (Loss) income from operations<br>before interest, taxes and<br>amortization | (235)  | 828                                    | 1,933            | (1,732)                                     |                                  | 794          |
| <b>Three Months Ended<br/>September 30, 2003</b>                            |  |  |                  |   |                                  |              |
| Net sales   | 17,612   | 7,279                                  | 38,253           |   |                                  | 63,144       |
| (Loss) income from operations<br>before interest, taxes and<br>amortization | (1,173)  | 600                                    | 5,572            | (1,690)                                     | (1,804)                          | 1,505        |
| <b>Nine Months Ended<br/>September 30, 2004 (Restated)</b>                  |  |  |                  |   |                                  |              |
| Net sales   | 103,550  | 66,442                                 | 117,484          |   |                                  | 287,476      |
| Income (loss) from operations<br>before interest, taxes and<br>amortization | 3,997  | (3,757)                                | 14,386           | (5,670)                                     |                                  | 8,956        |
| Total assets  | 180,549  | 134,040                                | 135,830          | 173,669                                     |                                  | 624,088      |
| <b>Nine Months Ended<br/>September 30, 2003</b>                             |  |  |                  |   |                                  |              |
| Net sales   | 64,660   | 24,119                                 | 113,593          |   |                                  | 202,372      |
| (Loss) income from operations<br>before interest, taxes and<br>amortization | (334)  | 1,926                                  | 14,534           | (6,602)                                     | (3,261)                          | 6,263        |
| Total assets  | \$ 99,506  | \$ 60,053                              | \$ 139,291       | \$ 296,132                                  | \$                               | \$ 594,982   |

Corporate total assets are principally comprised of cash and deferred tax assets.



The following table outlines the components of goodwill by business segment at September 30, 2004 and December 31, 2003 (in thousands):

|   | September 30, 2004<br>(Restated) |           | December 31, 2003 |
|---|----------------------------------|-----------|-------------------|
| Ion Beam and Mechanical Process Equipment | \$ 21,676                        | \$        | 21,676            |
| Epitaxial Process Equipment               | 30,771                           |           | 25,944            |
| Metrology                                 | 26,369                           |           | 25,369            |
| <b>Total</b>                              | <b>\$ 78,816</b>                 | <b>\$</b> | <b>72,989</b>     |

**Note 5 Comprehensive Loss**

The Company's comprehensive loss is comprised of net loss, adjusted for foreign currency translation adjustments, the change in the fair value of forward currency contracts, and the change in the minimum pension liability, and had no other sources affecting comprehensive loss. The Company had total comprehensive loss of \$2.3 million and \$7.0 million for the three and nine months ended September 30, 2004, respectively, and \$0.2 million and \$2.3 million for the three and nine months ended September 30, 2003, respectively.

**Note 6 Restructuring**

In response to the significant decline in the business environment and market conditions in 2001 and 2002, the Company restructured its business and operations. The actions giving rise to the restructuring charges taken in 2003 described below were implemented in order for Veeco to remain competitive and such actions have benefited Veeco by reducing future operating costs.

*2003 Restructuring Charges*



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During the year ended December 31, 2003, the Company incurred a restructuring charge of approximately \$4.8 million related to the reduction in work force announced in the fourth quarter of 2002, as a result of the decline in the markets in which the Company operates. This charge included severance related costs for approximately 180 employees, which included management, administration and manufacturing employees located at the Company's Fort Collins, Colorado and Plainview and Rochester, New York ion beam and mechanical process equipment operations, the San Diego, Sunnyvale and Santa Barbara, California and Tucson, Arizona metrology facilities, the sales and service offices located in Munich, Germany and Singapore, and the corporate office in Woodbury, New York. The charge also included costs of vacating facilities in Sunnyvale, California, Munich, Germany, and relocating the office in Japan. During the nine months ended September 30, 2004, approximately \$1.3 million has been paid and approximately \$0.5 million remains accrued. The remainder is expected to be paid by the third quarter of 2005.

A reconciliation of the liability for the restructuring charge recorded during 2003 for severance and relocation costs is as follows (in millions):

|   | <b>Ion Beam and<br/>Mechanical<br/>Process<br/>Equipment</b> | <b>Epitaxial<br/>Process<br/>Equipment</b> | <b>Metrology</b> | <b>Unallocated<br/>Corporate</b> | <b>Total</b> |
|---|--|--|------------------|----------------------------------|--------------|
| Charged to accrual  | \$ 2.3   | \$ 2.1                                     | \$ 0.4           | \$ 4.8                           |              |
| Add-back from 2002 accrual                                    | 0.3  |  |                  | 0.3                              |              |
| Total 2003 accrual  | 2.6  | 2.1  | 0.4              | 5.1                              |              |
| Cash payments during 2003                                     | 1.6  | 1.6  | 0.1              | 3.3                              |              |
| Cash payments during the nine months ended September 30, 2004 | 0.6  | 0.5  | 0.2              | 1.3                              |              |
| Balance as of September 30, 2004                              | \$ 0.4   | \$ 0.0                                     | \$ 0.1           | \$ 0.5                           |              |



**Note 6 Subsequent Events**

On October 5, 2004, the Company acquired substantially all of the assets and assumed certain liabilities of Manufacturing Technology Inc., ( MTI ) for \$9.5 million in cash. The MTI business includes the assets necessary for engineering, design and manufacturing of slicing and dicing systems ranging from R&D to high-volume production systems, and MTI 's intellectual property. Additionally, the Company entered into a lease with the former owner of MTI, to lease MTI 's 125,000 square foot manufacturing facility in Ventura, California. The lease period is for an initial term of 5 years with an option to renew for an additional five years. At the time of the acquisition, approximately 70 MTI employees became employees of Veeco. The acquisition will be accounted for under the purchase method of accounting. The purchase price allocation for this transaction has not yet been completed. Further information regarding this transaction will be included in the Company 's Annual Report on Form 10-K for the year ending December 31, 2004.

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

**Executive Summary:**

Veeco designs, manufactures, markets and services a broad line of equipment primarily used by manufacturers in the data storage, semiconductor, HB-LED and wireless telecommunications industries. Veeco's products also enable advancements in the growing field of nanoscience and other areas of scientific and industrial research. Our process equipment products precisely deposit or remove (etch) various materials in the manufacturing of advanced thin film magnetic heads (TFMHs) for the data storage industry and HB-LED and wireless telecommunications industries. During 2004, the Company split out the former process equipment segment into two separate reportable segments. The first segment, called Ion Beam and Mechanical Process Equipment combines the etch, deposition and dicing and slicing products sold mostly to data storage customers. The second segment, called Epitaxial Process Equipment, includes the Molecular Beam Epitaxy (MBE) and Metal Organic Chemical Vapor Deposition (MOCVD) products primarily sold to HB-LED and wireless telecommunications customers. As such, the Company has restated the segment information for prior periods as if the composition of its reportable segments described above had existed in such prior periods. Our metrology equipment is used to provide critical surface measurements on semiconductor devices and TFMHs. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality. Our metrology solutions are also key research instruments used by many universities, scientific laboratories and industrial applications.

During the past several years, we have strengthened our product lines through strategic acquisitions. In our metrology business, in June 2003, we purchased the atomic force microscope probe business from NanoDevices Inc. (NanoDevices) for approximately \$6.0 million, including transaction costs, plus a potential future earn-out payment of up to \$4.0 million based on the achievement of certain operating measures. In our epitaxial process equipment business, in November 2003, we purchased the TurboDisc business from Emcore Corporation (Emcore) for approximately \$63.7 million, including transaction costs, plus a potential future earn-out payment of up to \$20.0 million based on the achievement of certain operating measures. Also in November 2003, in our ion beam and mechanical process equipment business, we acquired the precision bar lapping company, Advanced Imaging, Inc. (Aii), for approximately \$61.4 million, including transaction costs, plus a potential future earn-out payment of up to \$9.0 million based on the achievement of certain operating measures. Most recently, in our ion beam and mechanical process equipment business, Veeco expanded its TFMH slider technologies to include slicing and dicing processes which are critical to controlling thin film head fly height, through the purchase of MTI for \$9.5 million. While we believe these acquisitions will be accretive to both sales and profits going forward, gross margin percentages have been historically lower in these product lines than in the metrology business. Therefore, Veeco's gross margin percentage may be adversely affected in the future by the lower concentration of metrology sales.

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

**Highlights of the Third Quarter of 2004:**

Orders of \$79.5 million, up from \$64.0 million in the third quarter of 2003. The order growth included \$12.3 million from companies acquired in 2003 and \$3.2 million from Veeco's historical business.

Sales of \$97.4 million, up from \$63.1 million in the third quarter of 2003. The sales growth included \$29.3 million from companies acquired in 2003 and \$5.0 million from Veeco's historical business.

Net loss of \$2.2 million, compared with a net loss of \$2.1 million in the third quarter of 2003.

Cash use of \$6.4 million, compared with cash generation of \$4.8 million in the third quarter of 2003.

**Highlights of the First Nine Months of 2004:**

Orders of \$321.3 million, up from \$200.8 million in the first nine months of 2003. The order growth included \$91.3 million from companies acquired in 2003 and \$29.2 million from Veeco's historical business.

Sales of \$287.5 million, up from \$202.4 million in the first nine months of 2003. The sales growth included \$63.0 million from companies acquired in 2003 and \$22.1 million from Veeco's historical business.

Net loss of \$6.5 million, compared with a net loss of \$4.9 million in the first nine months of 2003.

Cash generation of \$4.2 million, compared with cash generation of \$0.9 million in the nine months of 2003.

**Current Business Conditions/Outlook:**

In the third quarter of 2004, Veeco was adversely impacted by weak industry-wide capital equipment spending conditions, particularly in the HB-LED/wireless and data storage industries. As with many suppliers in the capital equipment industry, Veeco typically books approximately 60% of its orders in the last several weeks of the quarter. However, in the third quarter, many of these late quarter orders did not occur. Veeco's third quarter orders declined 36.3% sequentially from the second quarter of 2004 with orders down in all markets with the exception of scientific research. Veeco's orders for MOCVD equipment declined 71.4% sequentially as a result of spending freezes initiated by many Asian customers at the end of the quarter. Veeco's orders from data storage and semiconductor customers declined approximately 28.7% sequentially as customers in those industries carefully managed their capital spending. The decline in business conditions experienced by Veeco is similar to what other companies serving the semiconductor, data storage and HB-LED/wireless markets are reporting.



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While Veeco currently expects revenues and orders to recover in the fourth quarter from these low third quarter levels, the Company intends to reduce spending by approximately 10% in order to improve profitability in 2005 in the event that the business environment remains challenging. Veeco expects to take a charge of between \$4.5 and \$5.5 million in the fourth quarter related to the future spending reductions, restructuring and product rationalization costs, and an in-process R&D write-off relating to the acquisition of MTI.

**Technology changes are continuing in all of Veeco's markets: the continued ramp of 80 GB hard drives in data storage and investments in next generation drives (120GB); the increased use of Veeco's automated AFMs for sub 130 nanometer semiconductor applications; the opportunity for Veeco's MOCVD and MBE systems to further penetrate the emerging HB-LED and wireless markets; and the continued funding of nanoscience research, which is one driver of Veeco's scientific research business. While Veeco currently expects our customers' current capital spending reluctance to continue for several quarters, the Company believes this reluctance will ultimately be outweighed by customers' need to fund their 2005 new product technology roadmaps and to invest in the expected high-growth of next generation consumer electronics. Veeco remains well positioned to provide leadership technologies for growth applications in semiconductor, data storage, HB-LED/wireless and scientific research.**



**2004 Recap Year-to-Date**

In the first nine months of 2004, as compared to the first nine months of 2003, Veeco experienced a significant improvement in orders from its information age markets: data storage, semiconductor and HB-LED/wireless, driven by technology changes and increased capital expenditures across these markets. Overall, worldwide economic conditions appear to have improved. Consumer spending on many types of electronics has increased and various worldwide economies, such as those in the Asia-Pacific ( APAC ) region, are experiencing growth. In the first six months of 2004, Veeco saw strength in its epitaxial process equipment business, driven by capacity expansion and MOCVD equipment purchases by HB-LED manufacturers in North America, Europe and APAC. MOCVD products represented approximately 32.3% of Veeco's September 2004 backlog. The data storage industry also showed strong growth for Veeco in the first six months of 2004 as compared to 2003. However, new orders overall declined 36.3% sequentially in the third quarter of 2004 indicating a weakening of the markets served by the Company. The Company reviews a number of indicators to predict the strength of our markets going forward. These include plant utilization trends, capacity requirements, and capital spending trends. While Veeco's long-term outlook for data storage remains optimistic, this business continues to experience quarterly fluctuations due to continued capital spending management by our key customers.

Veeco expects that its business will improve in 2004 as compared to 2003, both in its historical businesses as well as its acquired businesses. Veeco currently expects that its MOCVD and precision bar lapping and slicing technologies (acquired in November 2003 and October 2004) will add approximately \$90 to \$95 million in revenue for 2004 compared with only a minimal contribution to Veeco's 2003 performance due to the fact that none of these acquisitions were consummated prior to the fourth quarter of 2003. A substantial portion of this revenue growth is coming from the MOCVD business. In contrast to the growth experienced in the MOCVD business, the transition of Veeco's lapping business from a single customer focus to a broader penetration of the data storage industry is occurring more slowly than originally estimated. The Company's recent purchase of MTI further positions Veeco as a key back-end supplier to the data storage industry and Veeco expects that the combination of MTI and Aii will enable Veeco to achieve growth in its Slider Operations. There can be no assurance that Veeco's performance expectations will be realized.



**Recent Events:**

*Internal Accounting Investigation: Restatement of 2004 Financial Results*

On February 11, 2005, Veeco announced the postponement of the release of audited results for the fourth quarter and year ended December 31, 2004, pending completion of an internal investigation of improper accounting transactions at its TurboDisc® business unit. Veeco acquired the assets of TurboDisc in November 2003. The investigation focused principally on the value of inventory, accounts payable and certain liabilities, as well as certain revenue transactions of TurboDisc. The investigation was commenced after Veeco's internal audit staff and corporate financial management discovered improper accounting transactions in the course of a Veeco internal audit and transitioning the business to Veeco's SAP accounting system during the fourth quarter of 2004. The Audit Committee of the Company's Board of Directors supervised the accounting investigation and authorized Veeco's outside counsel, Kaye Scholer LLP, to hire Jefferson Wells International to perform forensics and accounting reconstruction work as part of the investigation. The investigation has been completed. Conclusions reached during the investigation included that the improper accounting entries were made by a single individual at TurboDisc whose employment had been terminated prior to the commencement of the investigation, and that there was no evidence found of embezzlement or diversion of corporate assets.

The results of the investigation led to the restatement of financial statements previously issued for the three quarterly periods and nine months ended September 30, 2004. The restatement included a \$10.2 million adjustment to pre-tax earnings, comprised of \$8.1 million in adjustments relating to inventory, accruals and accounts payable and \$2.1 million in adjustments relating to revenue recognition issues. Additional information relating to the restatement is included in Note 2 to the (unaudited) condensed consolidated financial statements. Veeco has made a number of personnel changes to help strengthen the management of the epitaxial process equipment group and the TurboDisc business unit since the discovery of the accounting issues giving rise to the investigation, including the replacement of the General Manager of the epitaxial process equipment group, creation of the positions of General Manager of the TurboDisc business unit, General Manager of the St. Paul MBE site, Group Controller of the epitaxial process equipment group and the appointment of a new controller of the TurboDisc business unit.

The adjustments included in the restatement are summarized in the tables included in Note 2 to the (unaudited) condensed consolidated financial statements.

**Results of Operations:**

Three Months Ended September 30, 2004 and 2003

The following tables show selected items of Veeco's Consolidated Statements of Operations, percentages of sales, and comparisons between the three months ended September 30, 2004 and 2003 and the analysis of sales and orders for the same periods between our segments, industries, and regions (in thousands):

|                    | Three Months ended<br>September 30, |      | Dollar<br>Incr/(Decr)<br>Year to Year<br>(Restated) |
|--------------------|-------------------------------------|------|---|
| 2004<br>(Restated) |                                     | 2003 |   |

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|   |    |         |        |    |         |        |    |         |
|---|----|---------|--------|----|---------|--------|----|---------|
| Net sales                                   | \$ | 97,367  | 100.0% | \$ | 63,144  | 100.0% | \$ | 34,223  |
| Cost of sales                               |    | 61,913  | 63.6   |    | 32,845  | 52.0   |    | 29,068  |
| Gross profit                                |    | 35,454  | 36.4   |    | 30,299  | 48.0   |    | 5,155   |
| Operating expenses:                         |    |         |        |    |         |        |    |         |
| Selling, general and administrative expense |    | 19,590  | 20.1   |    | 15,204  | 24.1   |    | 4,386   |
| Research and development expense            |    | 14,900  | 15.3   |    | 11,640  | 18.4   |    | 3,260   |
| Amortization expense                        |    | 4,336   | 4.4    |    | 3,262   | 5.2    |    | 1,074   |
| Other expense, net                          |    | 170     | 0.2    |    | 146     | 0.2    |    | 24      |
| Restructuring expenses                      |    |         |        |    | 1,804   | 2.9    |    | (1,804) |
| Total operating expenses                    |    | 38,996  | 40.1   |    | 32,056  | 50.8   |    | 6,940   |
| Operating loss                              |    | (3,542) | (3.6)  |    | (1,757) | (2.8)  |    | (1,785) |
| Interest expense, net                       |    | 1,793   | 1.8    |    | 2,050   | 3.2    |    | (257)   |
| Loss before income taxes                    |    | (5,335) | (5.5)  |    | (3,807) | (6.0)  |    | (1,528) |
| Income tax benefit                          |    | (3,162) | (3.3)  |    | (1,692) | (2.7)  |    | (1470)  |
| Net loss                                    | \$ | (2,173) | (2.2)% | \$ | (2,115) | (3.3)% | \$ | (58)    |

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|                                 | Sales              |           |                          |          | Orders             |           |                          |          | Book to Bill Ratio |          |
|---------------------------------|--------------------|-----------|--------------------------|----------|--------------------|-----------|--------------------------|----------|--------------------|----------|
|                                 | Three Months ended |           | Dollar and Percentage    |          | Three Months ended |           | Dollar and Percentage    |          | 2004               | 2003     |
|                                 | September 30, 2004 | 2003      | Incr/(Decr) Year to Year | Restated | September 30, 2004 | 2003      | Incr/(Decr) Year to Year | Restated | Restated           | Restated |
| <b>Segment Analysis</b>         |                    |           |                          |          |                    |           |                          |          |                    |          |
| Ion Beam and Mechanical Process |                    |           |                          |          |                    |           |                          |          |                    |          |
| Equipment                       | \$ 30,297          | \$ 17,612 | \$ 12,685                | 72.0%    | \$ 18,728          | \$ 24,985 | \$ (6,257)               | (25.0)%  | 0.62               | 1.42     |
| Epitaxial Process               |                    |           |                          |          |                    |           |                          |          |                    |          |
| Equipment                       | 33,407             | 7,279     | 26,128                   | 359.0    | 15,545             | 2,200     | 13,345                   | 606.6    | 0.47               | 0.30     |
| Metrology                       | 33,663             | 38,253    | (4,590)                  | (12.0)   | 45,224             | 36,857    | 8,367                    | 22.7     | 1.34               | 0.96     |
| Total                           | \$ 97,367          | \$ 63,144 | \$ 34,223                | 54.2%    | \$ 79,497          | \$ 64,042 | \$ 15,455                | 24.1%    | 0.82               | 1.01     |
| <b>Industry Analysis</b>        |                    |           |                          |          |                    |           |                          |          |                    |          |
| Data Storage                    | \$ 27,055          | \$ 19,341 | \$ 7,714                 | 39.9%    | \$ 18,832          | \$ 21,247 | \$ (2,415)               | (11.4)%  | 0.70               | 1.10     |
| HB-LED/wireless                 | 34,424             | 7,673     | 26,751                   | 348.6    | 14,652             | 6,914     | 7,738                    | 111.9    | 0.43               | 0.90     |
| Semiconductor                   | 10,366             | 8,708     | 1,658                    | 19.0     | 15,866             | 9,411     | 6,455                    | 68.6     | 1.53               | 1.08     |
| Research and Industrial         | 25,522             | 27,422    | (1,900)                  | (6.9)    | 30,147             | 26,470    | 3,677                    | 13.9     | 1.18               | 0.97     |
| Total                           | \$ 97,367          | \$ 63,144 | \$ 34,223                | 54.2%    | \$ 79,497          | \$ 64,042 | \$ 15,455                | 24.1%    | 0.82               | 1.01     |
| <b>Regional Analysis</b>        |                    |           |                          |          |                    |           |                          |          |                    |          |
| US                              | \$ 31,800          | \$ 24,242 | \$ 7,558                 | 31.2%    | \$ 31,825          | \$ 25,468 | \$ 6,357                 | 25.0%    | 1.00               | 1.05     |
| Europe                          | 18,494             | 9,436     | 9,058                    | 96.0     | 17,343             | 11,510    | 5,833                    | 50.7     | 0.94               | 1.22     |
| Japan                           | 13,032             | 13,192    | (160)                    | (1.2)    | 12,959             | 10,679    | 2,280                    | 21.4     | 0.99               | 0.81     |
| Asia-Pacific                    | 34,041             | 16,274    | 17,767                   | 109.2    | 17,370             | 16,385    | 985                      | 6.0      | 0.51               | 1.01     |
| Total                           | \$ 97,367          | \$ 63,144 | \$ 34,223                | 54.2%    | \$ 79,497          | \$ 64,042 | \$ 15,455                | 24.1%    | 0.82               | 1.01     |

During the quarter ended September 30, 2004, the Company changed the structure of its internal organization in a manner that caused the composition of its reportable segments to change. The Company currently manages, reviews operating results, and assesses performance, as well as allocates resources, based upon this reporting structure. The change implemented by the Company was to split out the former process equipment segment into two separate reporting segments. The new ion beam and mechanical process equipment segment combines the etch, deposition, and dicing and slicing products sold mostly to data storage customers. The new epitaxial process equipment segment includes the MBE and MOCVD products sold to HB-LED and wireless customers. The metrology segment remains unchanged. Accordingly, the Company has restated the segment information for the prior periods.

Net sales of \$97.4 million for the third quarter of 2004 were up 54.2% from the comparable 2003 period. By segment, ion beam and mechanical process equipment sales increased by \$12.7 million, or 72.0%, while epitaxial process equipment sales increased by \$26.1 million, or 359.0%, and metrology sales decreased by \$4.6 million, or 12.0%, each as compared to the third quarter of 2003. The improvement in ion beam and mechanical process equipment sales is principally attributable to a \$12.3 million increase in the data storage market and a \$0.4 million net increase in other market segments. The increase in the data storage market for that segment included \$9.3 million in deposition and etch equipment sales and \$3.0 million from the Aii business. The improvement in epitaxial process equipment is primarily due to \$26.3 million in sales from the TurboDisc business unit, partially offset by a \$0.2 million net decrease in other businesses. The decrease in metrology sales is principally attributable to a \$4.7 million decrease in optical metrology, particularly sales to data storage customers in the APAC region. By region, there continues to be a shift in sales from the U.S. to the APAC region. We are also beginning to see our customers shift manufacturing from Japan to the APAC region. APAC region sales increased by \$17.8 million in the third quarter of 2004 as compared to the third quarter of 2003. This significant growth in sales was attributable to sales from the acquired companies and the manufacturing base shift noted above. The Company believes that there will continue to be quarter-to-quarter variations in the geographic distribution of sales.

Orders of \$79.5 million for the third quarter of 2004 represented an increase of \$15.5 million, or 24.1%, over the comparable 2003 period. By segment, ion beam and mechanical process equipment orders declined by 25.0%, as a result of reductions in deposition and etch equipment orders. The \$13.3 million increase in epitaxial process equipment orders was principally due to \$12.1 million in orders for TurboDisc, plus an increase of \$1.2 million in MBE orders. The 22.7% increase in metrology orders was due to a \$6.7 million increase in AFM orders, consisting mostly of automated AFM products sold to customers in the semiconductor business, and a \$1.7 million increase in optical metrology products primarily to research and industrial customers. Orders for the third quarter of 2004 were down 36.3% sequentially from the \$124.7 million

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reported in the second quarter of 2004. Compared to the second quarter, orders to HB-LED/wireless customers decreased 71.4%, due to a \$30.3 million decrease in TurboDisc orders. This decrease in business resulted from spending freezes initiated by many Asian customers at the end of the quarter, as they paused to absorb the significant amount of Veeco equipment purchased in the first half of 2004. Data storage and semiconductor orders declined approximately 28.7% from the second quarter, while scientific research orders increased approximately 20.9% from the same period.

The Company's book/bill ratio for the third quarter of 2004, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period, was 0.82. During the quarter ended September 30, 2004, the Company experienced order cancellations of \$7.5 million and the rescheduling of order delivery dates by customers. The Company's backlog as of September 30, 2004, was approximately \$146.4 million. Due to changing business conditions and customer requirements, the Company may continue to experience cancellations and/or rescheduling of orders.

Gross profit for the quarter ended September 30, 2004, was 36.4%, compared to 48.0% in the third quarter of 2003. This decrease was partially due to a product mix shift from the higher margin metrology segment to the lower margin ion beam and mechanical process equipment and epitaxial process equipment segments, largely due to the 2003 acquisitions in these segments. The metrology percentage of total sales declined from 60.6% in 2003 to 34.6% in 2004. Ion beam and mechanical process equipment gross margins decreased from 38.8% to 34.8%, primarily due to an unfavorable product mix. Epitaxial process equipment gross margins declined from 41.4% to 24.7% due to a 7.4% drop in MBE gross margins, as more low margin research tools were sold in 2004 than 2003 and by lower than expected margins in Veeco's newly acquired TurboDisc business. Metrology gross margins decreased from 54.0% to 49.5%, due to a 4.7% reduction in AFM margins resulting from unfavorable mix, caused by a lower concentration of higher margin research AFM instruments, and lower volumes in Optical Metrology.

Selling, general and administrative expenses were \$19.6 million, or 20.1% of sales in the third quarter of 2004, compared with \$15.2 million, or 24.1% in the third quarter of 2003. Of the \$4.4 million increase, \$3.5 million was due to expenses of the TurboDisc and Aii businesses, with the balance attributable to higher selling expenses related to the increase in sales, higher personnel costs including incentive bonus accruals, and consulting and audit costs related to the implementation of Section 404 of Sarbanes-Oxley.

Research and development expense totaled \$14.9 million in the third quarter of 2004, an increase of \$3.3 million from the third quarter of 2003, of which \$2.6 million was due to spending in the acquired TurboDisc and Aii businesses. As a percentage of sales, research and development decreased in the third quarter of 2004 to 15.3% from 18.4% for the third quarter of 2003.

There were no restructuring expenses for the third quarter of 2004. The restructuring expense of \$1.8 million in the third quarter of 2003 was primarily due to severance costs for layoffs that were related to the actions announced in the fourth quarter of 2002.

Net interest expense in the third quarter of 2004 was \$1.8 million compared to \$2.1 million in the third quarter of 2003. The change is predominantly made up of a \$0.4 million of interest income on a federal income tax refund received in the third quarter of 2004.

Income taxes for the quarter ended September 30, 2004, amounted to a benefit of \$3.2 million, or 59.3% of loss before income taxes as compared with a benefit of \$1.7 million, or 44.4% of loss before income taxes in 2003. The higher than statutory effective benefit rate in 2004 and 2003, respectively, was a result of the impact of foreign and state tax benefits.

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Nine Months Ended September 30, 2004 and 2003

The following tables show selected items of Veeco's Consolidated Statements of Operations, percentages of sales, and comparisons between the nine months ended September 30, 2004 and 2003 and the analysis of sales and orders for the same periods between our segments, industries, and regions (in thousands):

|   | 2004<br>(Restated) |          | Nine Months ended<br>September 30, |   | 2003 |         | Dollar<br>Incr/(Decr)<br>Year to Year<br>(Restated) |    |         |
|---|--------------------|----------|------------------------------------|---|------|---------|---|----|---------|
|   | \$                 |          |                                    | % | \$   |         |   | %  |         |
| <b>Net sales</b>                            | \$                 | 287,476  | 100.0%                             |   | \$   | 202,372 | 100.0%  | \$ | 85,104  |
| Cost of sales                               |                    | 174,309  | 60.6                               |   |      | 108,073 | 53.4  |    | 66,236  |
| Gross profit                                |                    | 113,167  | 39.4                               |   |      | 94,299  | 46.6  |    | 18,868  |
| Operating expenses:                         |                    |          |                                    |   |      |         |   |    |         |
| Selling, general and administrative expense |                    | 61,166   | 21.3                               |   |      | 50,017  | 24.7  |    | 11,149  |
| Research and development expense            |                    | 43,516   | 15.1                               |   |      | 35,507  | 17.5  |    | 8,009   |
| Amortization expense                        |                    | 13,807   | 4.8                                |   |      | 9,563   | 4.7   |    | 4,244   |
| Other income, net                           |                    | (471)    | (0.1)                              |   |      | (749)   | (0.3)   |    | 278     |
| Restructuring expenses                      |                    |          |                                    |   |      | 3,261   | 1.6   |    | (3,261) |
| Total operating expenses                    |                    | 118,018  | 41.1                               |   |      | 97,599  | 48.2  |    | 20,419  |
| Operating loss                              |                    | (4,851)  | (1.7)                              |   |      | (3,300) | (1.6)   |    | (1,551) |
| Interest expense, net                       |                    | 6,231    | 2.2                                |   |      | 5,703   | 2.8   |    | 528     |
| Loss before income taxes                    |                    | (11,082) | (3.9)                              |   |      | (9,003) | (4.4)   |    | (2,079) |
| Income taxes benefit                        |                    | (4,542)  | (1.6)                              |   |      | (4,056) | (2.0)   |    | (486)   |
| Net loss                                    | \$                 | (6,540)  | (2.3)%                             |   | \$   | (4,947) | (2.4)%  | \$ | (1,593) |

|                                 | Sales                              |            |   |       | Orders                             |            |   |       | Book to                                  |      |
|---------------------------------|------------------------------------|------------|---|-------|------------------------------------|------------|---|-------|--|------|
|                                 | Nine Months ended<br>September 30, |            | Dollar and<br>Percentage<br>Incr/(Decr)<br>Year to Year<br>(Restated) |       | Nine Months ended<br>September 30, |            | Dollar and<br>Percentage<br>Incr/(Decr)<br>Year to Year |       | Bill Ratio<br>2004<br>2003<br>(Restated) |      |
|                                 | 2004<br>(Restated)                 | 2003       |   | %     | 2004                               | 2003       |   | %     | 2004                                     | 2003 |
| <b>Segment Analysis</b>         |                                    |            |   |       |                                    |            |   |       |  |      |
| Ion Beam and Mechanical Process |                                    |            |   |       |                                    |            |   |       |  |      |
| Equipment                       | \$ 103,550                         | \$ 64,660  | \$ 38,890   | 60.1% | \$ 92,934                          | \$ 78,135  | \$ 14,799   | 18.9% | 0.90                                     | 1.21 |
| Epitaxial Process               |                                    |            |   |       |                                    |            |   |       |  |      |
| Equipment                       | 66,442                             | 24,119     | 42,323  | 175.5 | 109,231                            | 14,887     | 94,344  | 633.7 | 1.64                                     | 0.62 |
| Metrology                       | 117,484                            | 113,593    | 3,891   | 3.4   | 119,133                            | 107,766    | 11,367  | 10.5  | 1.01                                     | 0.95 |
| Total                           | \$ 287,476                         | \$ 202,372 | \$ 85,104   | 42.1% | \$ 321,298                         | \$ 200,788 | \$ 120,510  | 60.0% | 1.12                                     | 0.99 |
| <b>Industry Analysis</b>        |                                    |            |   |       |                                    |            |   |       |  |      |
| Data Storage                    | \$ 94,020                          | \$ 62,746  | \$ 31,274   | 49.8% | \$ 90,221                          | \$ 70,344  | \$ 19,877   | 28.3% | 0.96                                     | 1.12 |
| HB-LED/wireless                 | 72,401                             | 26,169     | 46,232  | 176.7 | 104,745                            | 27,119     | 77,626  | 286.2 | 1.45                                     | 1.04 |
| Semiconductor                   | 39,187                             | 30,785     | 8,402   | 27.3  | 48,187                             | 28,462     | 19,725  | 69.3  | 1.23                                     | 0.92 |
| Research and Industrial         | 81,868                             | 82,672     | (804)   | (1.0) | 78,145                             | 74,863     | 3,282   | 4.4   | 0.95                                     | 0.91 |
| Total                           | \$ 287,476                         | \$ 202,372 | \$ 85,104   | 42.1% | \$ 321,298                         | \$ 200,788 | \$ 120,510  | 60.0% | 1.12                                     | 0.99 |
| <b>Regional Analysis</b>        |                                    |            |   |       |                                    |            |   |       |  |      |
| US                              | \$ 103,571                         | \$ 76,885  | \$ 26,686   | 34.7% | \$ 133,063                         | \$ 82,023  | \$ 51,040   | 62.2% | 1.28                                     | 1.07 |
| Europe                          | 49,036                             | 34,505     | 14,531  | 42.1  | 43,998                             | 30,945     | 13,053  | 42.2  | 0.90                                     | 0.90 |
| Japan                           | 47,542                             | 44,579     | 2,963   | 6.6   | 48,550                             | 41,225     | 7,325   | 17.8  | 1.02                                     | 0.92 |
| Asia-Pacific                    | 87,327                             | 46,403     | 40,924  | 88.2  | 95,687                             | 46,595     | 49,092  | 105.4 | 1.10                                     | 1.00 |

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|       |            |            |           |       |            |            |            |       |      |      |
|-------|------------|------------|-----------|-------|------------|------------|------------|-------|------|------|
| Total | \$ 287,476 | \$ 202,372 | \$ 85,104 | 42.1% | \$ 321,298 | \$ 200,788 | \$ 120,510 | 60.0% | 1.12 | 0.99 |
|-------|------------|------------|-----------|-------|------------|------------|------------|-------|------|------|

During the quarter ended September 30, 2004, the Company changed the structure of its internal organization in a manner that caused the composition of its reportable segments to change. The Company currently manages, reviews operating results, and assesses performance, as well as allocates resources, based upon this reporting structure. The change implemented by the Company was to split out the former process equipment segment into two separate reporting segments. The new ion beam and mechanical process equipment segment combines the etch, deposition, and dicing and slicing products sold mostly to data storage customers. The new epitaxial process equipment segment includes the MBE and MOCVD products sold to HB-LED and wireless customers. The metrology segment remains unchanged. Accordingly, the Company has restated the segment information for the prior periods.

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Net sales of \$287.5 million for the nine months ended September 30, 2004 were up 42.1% from the comparable 2003 period. By segment, ion beam and mechanical process equipment sales were up \$38.9 million, or 60.1%, due to increases of \$25.6 million in etch and deposition equipment, mostly to the data storage market, and \$13.3 million of Aii products, also to data storage customers, each as compared to the first nine months of 2003. Epitaxial process equipment sales were up \$42.3 million, or 175.5%, due to \$49.6 million of TurboDisc sales, mostly to customers in the HB-LED industry, partially offset by a \$7.3 million reduction in MBE sales. Metrology sales increased by \$3.9 million, or 3.4%. By region, there continues to be a shift in sales from the U.S. to the Asia-Pacific region, which experienced a \$40.9 million increase in sales in the nine months ended September 30, 2004 compared to the 2003 period, due to the acquired companies and the manufacturing base shifts noted above. The Company believes that there will continue to be period-to-period variations in the geographic distribution of sales.

Orders of \$321.3 million for the nine months ended September 30, 2004 represented a \$120.5 million, or 60.0%, increase over the comparable 2003 period. By segment, the 18.9% improvement in ion beam and mechanical process equipment orders was driven by \$5.1 million in orders for Aii systems plus a \$9.7 million increase in deposition and etch product orders. The 633.7% increase in epitaxial process equipment orders was principally due to orders for TurboDisc products, which amounted to approximately \$86.2 million. The 10.5% improvement in metrology orders was due to a \$14.7 million increase in automated AFM orders, mainly to the semiconductor market.

The Company's book/bill ratio for the nine months ended September 30, 2004, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period, was 1.12.

Gross profit for the nine months ended September 30, 2004, was 39.4%, including a \$1.5 million reduction in gross profit related to the acquisitions of TurboDisc and Aii. This charge was the result of purchase accounting adjustments due to the required capitalization of profit in inventory and the elimination of certain deferred revenue. Excluding the impact of these adjustments, gross profit as a percentage of net sales was 39.9% in the nine months ended September 30, 2004, compared to 46.6% in the comparable period of 2003. This decrease was mostly due to a product mix shift from the higher margin metrology segment to the lower margin ion beam and mechanical process equipment and epitaxial process equipment segments, largely due to the 2003 acquisitions. The metrology percentage of total sales declined from 56.1% in 2003 to 40.9% in 2004. Exclusive of the purchase accounting adjustments, the ion beam and mechanical process equipment margins decreased from 40.1% to 35.0%. This reduction was principally due to an unfavorable product mix including lower margins for certain advance development products. Exclusive of the purchase accounting adjustments, epitaxial process equipment margins declined from 37.0% to 24.7% due to lower than expected margins in Veeco's newly acquired TurboDisc business. The metrology gross margin for the first nine months of 2004 was consistent with 2003 at 52.7%.

Selling, general and administrative expenses were \$61.2 million, or 21.3% of sales, in the nine months ended September 30, 2004, compared with \$50.0 million, or 24.7% of sales, in the nine months ended September 30, 2003. Of the \$11.1 million increase, \$9.1 million was due to expenses of the TurboDisc and Aii businesses, with the balance attributable to higher selling expenses related to the increase in sales, as well as consulting and audit costs related to the implementation of Section 404 of Sarbanes-Oxley.

Research and development expense totaled \$43.5 million during the first nine months of 2004, an increase of \$8.0 million from the first nine months of 2003. The increase is primarily attributable to \$6.5 million in spending in the TurboDisc and Aii businesses. As a percentage of sales, research and development decreased during the nine months ended September 30, 2004 to 15.1% from 17.5% for the corresponding period of 2003.

There were no restructuring expenses during the first nine months of 2004. The restructuring expense of \$3.3 million in the first nine months of 2003 was primarily due to severance costs for layoffs that were related to the actions announced in the fourth quarter of 2002.



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Net interest expense in the nine months ended September 30, 2004 was \$6.2 million compared to \$5.7 million in the nine months ended September 30, 2003. The change is due to the reduction in interest income resulting from lower cash balances as a result of the acquisitions completed in the fourth quarter of 2003, partially offset by \$0.4 million in interest income on a federal income tax refund received in the third quarter of 2004.

Income taxes for the nine months ended September 30, 2004, amounted to a benefit of \$4.5 million, or 41.0% of loss before income taxes, as compared with a benefit of \$4.1 million, or 45.1% of loss before income taxes, in 2003. The higher than statutory effective benefit rate in 2004 and 2003, respectively, was a result of the impact of foreign and state tax benefits.

## Liquidity and Capital Resources

The Company had a net increase in cash of \$4.2 million for the nine months ended September 30, 2004. Cash provided by operations was \$4.9 million for this period, as compared to cash provided by operations of \$6.9 million for the comparable 2003 period. Net loss adjusted for non-cash items provided operating cash flows of \$8.1 million for the nine months ended September 30, 2004, compared to \$5.2 million for the comparable 2003 period. The amount of net loss adjusted for non-cash items for the nine months ended September 30, 2004 was partially offset by a decrease in net operating assets and liabilities of \$3.2 million. Accounts receivable for the nine months ended September 30, 2004 increased by \$9.6 million, primarily as a result of higher sales volume. During the nine months ended September 30, 2004, inventories increased by approximately \$20.6 million, principally related to shipment delays in the process equipment segments and the build up of raw materials and work-in-process for products to be shipped in the fourth quarter of 2004 and first quarter of 2005. During the nine months ended September 30, 2004, accounts payable increased by \$15.5 million, principally as a result of increased inventory levels. Accrued expenses and other current liabilities increased \$11.6 million during the nine months ended September 30, 2004. This increase is due to a \$3.8 million increase in customer deposits, a \$3.8 million increase in accrued personnel costs including salaries, benefits, bonus and commissions, accrued interest costs of \$2.3 million, and accrued installation and warranty costs of \$1.5 million, plus smaller items that amounted to a net increase of \$0.2 million.

Cash used by investing activities of \$3.5 million for the nine months ended September 30, 2004 resulted from capital expenditures of \$9.5 million and \$1.0 million for the payment to Nanodevices for the earn-out provision related to production targets achieved by the acquired business partially offset by cash received from the sale of a building and other assets of \$2.7 million and the utilization of long-term investments of \$4.3 million.

Cash provided by financing activities of \$2.8 million for the nine months ended September 30, 2004 resulted from proceeds received from stock issuance of \$3.0 million partially offset by \$0.2 million in net repayments of long-term debt.

The Company believes that existing cash balances together with cash generated from operations and amounts available under the Company's \$100.0 million revolving credit facility (the Facility) will be sufficient to meet the Company's projected working capital and other cash flow requirements for the next twelve months, as well as the Company's contractual obligations over the next three years. Amounts available for borrowing under the Facility are subject to certain financial tests. At September 30, 2004, the amount available for borrowing under the facility was approximately \$100.0 million. The Facility expires on March 31, 2005. The Company is currently in negotiations with the banks who are parties to the Facility and expects to be able to secure a similar facility prior to the expiration of the current Facility. The Company believes it will be able to meet its obligation to repay the outstanding \$220.0 million convertible subordinated notes that mature on December 21, 2008 through a combination of conversion of the notes outstanding, refinancing, cash generated from operations, and/or other means. The Company is required to pay interest on the outstanding convertible subordinated notes in June and December of each year until the notes mature. Based on the full outstanding value of the notes as of September 30, 2004, the semi-annual interest obligation is approximately \$4.5 million. The Company believes it will be able to meet its obligation to pay the interest required through existing cash balances and cash generated from operations. In connection with the issuance of these notes, the Company purchased U.S government securities to secure the first six scheduled interest payments due on the notes. The last of these securities will be used for the interest payment due in December 2004.

The Company is potentially liable for payment of earn-out provisions to the former owners of the businesses acquired in 2003 based on operating targets achieved by those acquired businesses. The maximum amount of these contingent liabilities is \$32.0 million consisting of \$9.0 million to the former shareholders of Aii, \$3.0 million to the former shareholders of Nanodevices, Inc., and \$20.0 million to Emcore, the former owner of TurboDisc. Earn-out amounts would be paid to Nanodevices, Inc., during each of the first quarters of 2005, 2006 and 2007, if revenue targets are reached during the preceding year. Earn-out amounts would be paid during each of the first quarters of 2005, 2006 and 2007 to the former owners of Aii, and during each of the first quarters of 2005 and 2006 to Emcore, if revenue targets are met. Payments to the former shareholders of Aii and to Emcore are based on a set percentage of revenues in excess of certain targets for the preceding fiscal year. The Company paid \$1.0 million of the amount potentially payable to Nanodevices, Inc., during the third quarter of 2004 and, based on the Company's current projections, expects to pay Nanodevices approximately \$1.5 million during the first quarter of 2005. Additionally, the Company expects

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to pay a substantial portion (\$15.0 million to \$18.0 million) of the amount potentially payable to Emcore during the first quarter of 2005, based upon revenue achieved through September 30, 2004 and projections for the fourth quarter of 2004. Except as noted herein, the Company does not have an estimate of how much, or when, amounts may be due to the former owners of Aii, Nanodevices or Emcore for each fiscal year.

### Application of Critical Accounting Policies

*General:* Veeco's discussion and analysis of its financial condition and results of operations are based upon Veeco's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Veeco 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 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. The Company considers certain accounting policies related to revenue recognition, the valuation of inventories, the impairment of goodwill and indefinite-lived intangible assets and the impairment of long lived assets to be critical policies due to the estimation processes involved in each.

*Revenue Recognition:* Effective January 1, 2000, the Company changed its method for accounting for revenue recognition in accordance with Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*. In December 2003, the SEC issued SAB No. 104, *Revenue Recognition*, which updates the guidance provided in SAB No. 101, integrates the related Frequently Asked Questions, and recognizes the role of the FASB's Emerging Issues Task Force (EITF) consensus on Issue 00-21. SAB No. 104 deletes certain interpretive material no longer necessary, and conforms the remaining interpretive material retained to the pronouncements issued by the EITF on various revenue recognition topics, including EITF 00-21. It further clarifies that a company should first refer to EITF 00-21 in order to determine if there is more than one unit of accounting and then to refer to SAB No. 104 for revenue recognition for the unit of accounting. The Company recognizes revenue when persuasive evidence of an arrangement exists, the seller's price is fixed or determinable and collectibility is reasonably assured. For products produced according to the Company's 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, which generally occurs upon shipment. For products produced according to a particular customer's specifications, revenue is recognized when the product has been tested and 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 balance sheets. At September 30, 2004 and December 31, 2003, \$3.2 million and \$2.1 million, respectively, are recorded in deferred profit. Service and maintenance contract revenues are recorded as deferred revenue, which is included in other accrued expenses, and recognized as revenue on a straight-line basis over

the service period of the related contract. The Company provides for warranty costs at the time the related revenue is recognized.

*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. The Company's 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 18 to 24 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 Veeco's 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:* The Company has significant intangible assets related to goodwill and other acquired intangibles. In assessing the recoverability of the Company's goodwill and other indefinite-lived intangible assets, the Company 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 the assets not previously recorded.

*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 depreciation period, 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 level for which there is identifiable cash flows that are largely independent of the cash flows generated by other asset groups.

*Deferred Taxes:* As part of the process of preparing Veeco's consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating our actual current tax exposure, 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 consolidated balance sheet. The measurement of deferred tax assets is adjusted by a valuation allowance to recognize the extent to which, more likely than not, the future tax benefits will be recognized.

At September 30, 2004, we have deferred tax assets, net of valuation allowances, of \$48.0 million. We believe it is more likely than not that we will be able to realize these assets through the reduction of future taxable income.

We record valuation allowances to reduce our deferred tax assets to the amount expected to be realized. In assessing the adequacy of recorded valuation allowances, we consider a variety of factors, including the scheduled reversal of deferred tax liabilities, future taxable income, and prudent and feasible tax planning strategies. Should we determine that we are unable to use all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income tax expense, thereby reducing net income in the period such determination was made.

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

Veeco's net sales to foreign customers represented approximately 67% and 64% of Veeco's total net sales for the three and nine months ended September 30, 2004, respectively, and 62% for both the three and nine months ended September 30, 2003, respectively. The Company expects that net sales to foreign customers will continue to represent a large percentage of Veeco's total net sales. Veeco's net sales denominated in foreign currencies represented approximately 18% and 20% of Veeco's total net sales for the three and nine months ended September 30, 2004, respectively, and 25% and 26% of Veeco's total net sales for the three and nine months ended September 30, 2003, respectively. The aggregate foreign currency exchange (losses) gains for the three and nine months ended September 30, 2004, were \$(0.3) million and \$(0.1) million, respectively, compared to \$0.1 million and \$0.3 million for the three and nine months ended September 30, 2003. Included in the aggregate foreign currency exchange (losses) gains were (losses) gains relating to forward contracts of \$(0.1) million and \$0.1 million for the three and nine months ended September 30, 2004, respectively, compared to \$0.4 million and \$(0.1) million for the three and nine months ended September 30, 2003. Veeco is exposed to financial market risks, including changes in foreign currency exchange rates. The changes in currency exchange rates that have had the largest impact on translating Veeco's international operating profit related to exchange rates for the Yen and the Euro. To mitigate these risks, Veeco uses derivative financial instruments. Veeco does not use derivative financial instruments for speculative or trading purposes. The Company entered 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 was \$3.8 million and \$4.4 million for the three and nine months ended September 30, 2004, respectively. As of September 30, 2004, the Company had entered into forward contracts for the month of October for the notional amount of approximately \$4.2 million, which approximates the fair market value of the contracts on September 30, 2004. In addition, the Company enters into derivative contracts designed to hedge exposure to forecasted cash flows for certain transactions. The Company entered into a forward contract on April 21, 2004, for the notional amount of \$0.5 million, which will be settled on or about November 1, 2004. On April 22, 2004 the company entered into an additional forward contract for the notional amount of \$0.5 million, which will be settled on or about March 1, 2005. Due to a decline in value of these contracts the Company has included \$0.1 million in other comprehensive loss, to account for the fair value of these contracts in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*.

**Item 4. Controls and Procedures.**

The Company's 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 the Company 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 Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures under the supervision of and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic Securities and Exchange Commission filings.

As required by SEC Rule 13a-15(b), Veeco conducted an evaluation, under the supervision and with the participation of Veeco's management, including Veeco's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of its fiscal year. As a result of the discovery by management of improper accounting entries made at its TurboDisc business unit which led to adjustments requiring the restatement of the Company's financial statements for the quarterly

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periods ended March 31, 2004, June 30, 2004 and September 30, 2004, management has now determined that a deficiency existed in the internal control over financial reporting at the end of such quarterly periods. Since November 10, 2003, the date of the acquisition of the assets constituting the TurboDisc business unit, the business unit was operating under a legacy accounting system which was under the supervision of one individual and did not provide management with the depth of information Veeco is typically accustomed to. Management determined to institute a new accounting system at the business unit and in the course of the final implementation of such system in the quarter ended December 31, 2004, the improper accounting entries were discovered. Management believes that the new accounting system and attendant control process, together with the replacement of financial personnel at the TurboDisc business unit has remedied the deficiency in control over financial reporting that lead to the restatement.

Subsequent to that evaluation there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, these controls after such evaluation.



**Item 5. Other Information**

On October 5, 2004, the Company acquired substantially all of the assets and assumed certain liabilities of Manufacturing Technology Inc., ( MTI ) for \$9.5 million in cash. The MTI business includes the assets necessary for engineering, design and manufacturing of slicing and dicing systems ranging from R&D to high-volume production systems, and MTI's intellectual property. Additionally, the Company entered into a lease with the former owner of MTI, to lease MTI's 125,000 square foot manufacturing facility in Ventura, California. The lease period is for an initial term of 5 years with an option to renew for an additional five years. At the time of the acquisition, approximately 70 MTI employees became employees of Veeco. The acquisition will be accounted for under the purchase method of accounting. The purchase price allocation for this transaction has not yet been completed. Further information regarding this transaction will be included in the Company's Annual Report on Form 10-K for the year ending December 31, 2004.

**Part II.**

**Item 6. Exhibits.**

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

| Number | Description  | Incorporated by Reference<br>to the Following Document:         |
|--------|--|---|
| 10.1   | Eighth Amendment dated as of August 25, 2004 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, JPMorgan Chase Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein. | Current Report on Form 8-K, filed August 31, 2004, Exhibit 10.1 |
| 31.1   | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities 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 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

**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: March 31, 2005

Veeco Instruments Inc.

By: */s/ EDWARD H. BRAUN*  
**Edward H. Braun**



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

**EXHIBIT INDEX**

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