VEECO INSTRUMENTS INC
Form 10-Q
August 07, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2007
OR
o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission file number 0-16244

VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**11-2989601** (I.R.S. Employer Identification Number)
100 Sunnyside Boulevard, Suite B **Woodbury, New York** (Address of Principal Executive Offices)	**11797-2902** (Zip Code)

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

Website: **www.veeco.com**

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

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

31,739,823 shares of common stock, $0.01 par value per share, were outstanding as of the close of business on July 31, 2007.

SAFE HARBOR STATEMENT

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

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

We operate in an industry characterized by rapid technological change.

We face significant competition.

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

Our quarterly operating results fluctuate significantly.

We face securities class action and shareholder derivative lawsuits which could result in substantial costs, diversion of management s attention and resources and negative publicity.

Our outsourcing strategy could adversely affect our results of operations.

We rely on a limited number of suppliers.

Any difficulty or 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 and the requirement to comply with laws and regulations of various jurisdictions such as import/export controls, which may not apply to our non-U.S. competitors.

We are subject to foreign currency exchange risks.

Our success depends on protection of our intellectual property rights.

We may be subject to claims of intellectual property infringement by others.

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

Changes in accounting standards for stock-based compensation may adversely affect our stock price and our ability to attract, motivate and retain key employees.

The implementation of a new information technology system may disrupt our operations.

We may not obtain sufficient affordable funds to finance our future needs.

We are subject to risks of non-compliance with environmental and safety regulations.

We have adopted certain measures that may have anti-takeover effects which may make an acquisition of our company by another company more difficult.

The other matters discussed under the heading Management s Discussion and Analysis of Financial Condition and Results of Operations contained in this Report and in the Annual Report on Form 10-K for the year ended December 31, 2006 of Veeco Instruments Inc. (Veeco or the Company).

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

Available Information

We file annual, quarterly and current reports, information statements and other information with the Securities and Exchange Commission (the SEC). The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that site is http://www.sec.gov.

Internet Address

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

VEECO INSTRUMENTS INC.

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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 June 30, 2007	Three Months Ended June 30, 2006
Net sales	$ 98,769	$ 111,635
Cost of sales	56,524	61,923
Gross profit	42,245	49,712
Costs and expenses:		
Selling, general and administrative expense	23,818	24,996
Research and development expense	15,903	15,252
Amortization expense	2,368	3,989
Restructuring expense	1,445	
Other income, net	(279)	(132)
Total operating expenses	43,255	44,105
Operating (loss) income	(1,010)	5,607
Interest expense, net	772	1,149
(Loss) income before income taxes and noncontrolling interest	(1,782)	4,458
Income tax provision	1,042	1,433
Noncontrolling interest	(229)	
Net (loss) income	$ (2,595)	$ 3,025
Net (loss) income per common share	$ (0.08)	$ 0.10
Diluted net (loss) income per common share	$ (0.08)	$ 0.10
Weighted average shares outstanding	30,926	30,322
Diluted weighted average shares outstanding	30,926	31,254

See accompanying notes.

Veeco Instruments Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Six Months Ended June 30, 2007		Six Months Ended June 30, 2006	
Net sales	$	197,935	$	205,553
Cost of sales		111,995		114,072
Gross profit		85,940		91,481
Costs and expenses:				
Selling, general and administrative expense		46,624		46,326
Research and development expense		31,292		29,838
Amortization expense		6,277		8,004
Restructuring expense		1,445		
Other (income) expense, net		(426)		67
Total operating expenses		85,212		84,235
Operating income		728		7,246
Interest expense, net		1,591		2,527
Gain on extinguishment of debt		(738)		(330)
(Loss) income before income taxes and noncontrolling interest		(125)		5,049
Income tax provision		2,536		2,266
Noncontrolling interest		(359)		
Net (loss) income	$	(2,302)	$	2,783
Net (loss) income per common share	$	(0.07)	$	0.09
Diluted net (loss) income per common share	$	(0.07)	$	0.09
Weighted average shares outstanding		30,912		30,208
Diluted weighted average shares outstanding		30,912		30,946

See accompanying notes.

Veeco Instruments Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(In thousands)

	June 30, 2007 (Unaudited)	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 108,079	$ 147,046
Accounts receivable, less allowance for doubtful accounts of $2,716 in 2007 and $2,683 in 2006	65,215	86,589
Inventories	104,658	100,355
Prepaid expenses and other current assets	10,323	9,378
Deferred income taxes	2,650	2,565
Total current assets	290,925	345,933
Property, plant and equipment at cost, less accumulated depreciation of $92,436 in 2007 and $88,087 in 2006	72,105	73,510
Goodwill	100,898	100,898
Purchased technology, less accumulated amortization of $69,757 in 2007 and $64,736 in 2006	38,831	43,852
Other intangible assets, less accumulated amortization of $28,281 in 2007 and $26,740 in 2006	24,301	25,053
Other assets	214	354
Total assets	$ 527,274	$ 589,600
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 38,153	$ 40,588
Accrued expenses	44,653	48,714
Deferred profit	1,244	251
Income taxes payable	1,924	2,723
Current portion of long-term debt	5,489	5,597
Total current liabilities	91,463	97,873
Deferred income taxes	2,987	2,423
Long-term debt	146,496	203,607
Other non-current liabilities	2,120	2,304
Noncontrolling interest	1,802	1,642
Shareholders equity	282,406	281,751
Total liabilities and shareholders equity	$ 527,274	$ 589,600

See accompanying notes.

Veeco Instruments Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Operating activities		
Net (loss) income	$ (2,302)	$ 2,783
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	13,459	14,594
Deferred income taxes	447	303
Gain on extinguishment of debt	(738)	(330)
Non-cash compensation expense for share-based payments	2,046	721
Noncontrolling interest in net loss of subsidiary	(359)	
Gain on sale of property, plant and equipment	(81)	(16)
Other		21
Changes in operating assets and liabilities:		
Accounts receivable	21,128	2,659
Inventories	(4,002)	(6,354)
Accounts payable	(2,425)	6,765
Accrued expenses, deferred profit and other current liabilities	(4,615)	(1,576)
Other, net	(1,919)	(2,827)
Net cash provided by operating activities	20,639	16,743
Investing activities		
Capital expenditures	(5,876)	(9,570)
Proceeds from sale of property, plant and equipment	304	35
Payments for net assets of businesses acquired		(3,161)
Other		(580)
Net cash used in investing activities	(5,572)	(13,276)
Financing activities		
Proceeds from stock issuance	2,131	7,983
Repayments of long-term debt	(54,998)	(19,585)
Other	(1,316)	
Net cash used in financing activities	(54,183)	(11,602)
Effect of exchange rates on cash and cash equivalents	149	(335)
Net change in cash and cash equivalents	(38,967)	(8,470)
Cash and cash equivalents at beginning of period	147,046	124,499
Cash and cash equivalents at end of period	$ 108,079	$ 116,029

Non-Cash Items

During the six months ended June 30, 2007, the Company had non-cash items, which were excluded from the Condensed Consolidated Statements of Cash Flows of approximately $118.8 million related to a debt exchange and transfers between fixed assets and inventory totaling $0.5 million. During the six months ended June 30, 2006, the Company had transfers between fixed assets and inventory totaling $0.6 million.

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 U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. Operating results for the three and six months ended June 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. 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, 2006.

Consistent with prior years, the Company reports interim quarters, other than fourth quarters which end on December 31, on a 13-week basis ending on the last Sunday within such period. The interim quarter ends are determined at the beginning of each year based on the 13-week quarters. The 2007 interim quarter ends are April 1, July 1 and September 30. The 2006 interim quarter ends were April 2, July 2 and October 1. For ease of reference, the Company reports these interim quarter ends as March 31, June 30, and September 30 in its interim condensed consolidated financial statements.

Net (Loss) Income Per Common Share

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

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	(In thousands)			
Weighted average shares outstanding	30,926	30,322	30,912	30,208
Dilutive effect of stock options and restricted stock awards		932		738
Diluted weighted average shares outstanding	30,926	31,254	30,912	30,946

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

During the three and six month periods ended June 30, 2007, options to purchase 5.9 million shares of common stock (at prices ranging from $0.27 to $72.00 per share) that were outstanding were excluded from the computation of diluted earnings per share. During the comparable 2006 periods, options to purchase 2.9 million and 3.2 million shares of common stock (at prices ranging from $23.98 to $72.00 and $22.63 to $72.00 per share, respectively) that were outstanding, were excluded from the computation of diluted earnings per share. In the 2007 periods, the Company recorded net losses, so the effect of all options outstanding was anti-dilutive. In 2006, the exercise price of these options exceeded the average market price of our common stock, thereby causing their effect to be anti-dilutive.

During the second quarter of 2007, the Company issued a new series of 4.125% convertible subordinated notes due April 15, 2012 (the New Notes) pursuant to privately negotiated exchange agreements with certain holders of its outstanding 4.125% convertible subordinated notes due 2008 (the Old Notes). In total, the Company exchanged $118.8 million of Old Notes for $117.8 million of New Notes.

The effect of the assumed conversion of the Old Notes is approximately 1.5 million and 3.0 million common equivalent shares for the three and six months ended June 30, 2007, respectively, and 5.2 million and 5.3 million for the comparable periods of 2006, respectively. The converted shares are anti-dilutive, and therefore, are not included in the weighted shares outstanding for the three and six months ended June 30, 2007 and 2006, respectively. The second quarter 2007 debt exchange, together with $56 million in debt repurchases of Old Notes during the first quarter of 2007 reduced the effect of the assumed conversion of the Old Notes, which was calculated using the if converted method of accounting.

The New Notes meet the criteria for determining the effect of the assumed conversion using the treasury stock method of accounting, as long as the Company has the ability and the intent to settle the principal amount of the New Notes in cash. Under the terms of the New Notes, the Company may pay the principal amount of converted New Notes in cash or in shares of common stock. The Company has indicated that it intends to pay such amounts in cash. Using the treasury stock method, the impact of the assumed conversion of the New Notes is anti-dilutive for the three and six months ended June 30, 2007, as the average stock price was below the conversion price of $27.23 for both the three and six month periods. The effect of the assumed converted shares is dependent on the stock price at the time of the conversion. The maximum common equivalent shares issuable upon conversion is approximately 4.3 million.

Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation 48, *Accounting for Uncertainty in Income Taxes* (FIN 48)*, an interpretation of FASB Statement No. 109* (SFAS 109), which became effective for Veeco on January 1, 2007. FIN 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. The Company is required to make many subjective assumptions and judgments regarding its income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time and changes in assumptions and judgments can materially affect the amounts recognized in the Company s condensed consolidated financial statements. The impact of the Company s reassessment during the first quarter of 2007 of its tax positions in accordance with FIN 48 resulted in a $0.8 million reduction to the January 1, 2007 retained earnings balance. For additional information regarding the adoption of FIN 48, see Note 5, Income Taxes.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The adoption of this statement is not expected to have a material impact on the Company s consolidated financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS 159 permits entities to choose to measure financial assets and liabilities (except for those that are specifically scoped out of the Statement) at fair value. The election to measure a financial asset or liability at fair value can be made on an instrument-by-instrument basis and is irrevocable. The difference between carrying value and fair value at the election date is recorded as an adjustment to opening retained earnings. Subsequent changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The adoption of this statement is not expected to have a material impact on the Company s consolidated financial position or results of operations.

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Note 2 Share-Based Payments

Stock Option and Restricted Stock Plans

During the three and six months ended June 30, 2007 and 2006, the Company made equity compensation awards under the Veeco Instruments Inc. 2000 Stock Incentive Plan, as amended, (the 2000 Plan). In 2007, the Company granted to certain key employees: 442,750 shares of restricted common stock, 15,800 restricted stock units and 599,000 stock options during the three month period ended June 30, 2007 and an additional 3,000 shares of restricted common stock in the first quarter of 2007. In the three and six months ended June 30, 2007, 89,720 shares of restricted stock vested, of which the Company cancelled 16,343 shares due to executives electing to receive fewer shares in lieu of paying withholding taxes. Also during the three and six month periods ended June 30, 2007, the Company cancelled 18,384 and 19,584 shares of restricted stock related to employee terminations, respectively. In the comparable 2006 periods, the Company granted to certain key employees: 198,250 shares of restricted common stock and 146,200 stock options. There were no cancellations of restricted common stock during those prior year periods. All awards to employees vest over three years. The Company also granted 40,000 shares of restricted common stock, which vest over a one-year period, to the non-employee members of the Board of Directors in May of 2007 and 2006. The 2000 Plan provides for the grant to officers and key employees of up to 8,530,000 share-based awards (of which, 1,857,335 are available for future option grants as of June 30, 2007) in common stock of the Company. Of those, up to 1,700,000 of the awards may be issued in the form of restricted stock (974,083 shares of the total available for future grants as of June 30, 2007, are available in the form of restricted stock).

Total compensation expense related to restricted stock awards and stock options recognized in operating results under Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)), was $1.2 million and $2.0 million for the three and six months ended June 30, 2007, respectively and $0.5 million and $0.7 million for the comparable prior year periods. As of June 30, 2007, the total unrecognized compensation cost related to nonvested stock awards is $11.4 million and stock option awards is $4.2 million. The related weighted average period over which it is expected that such unrecognized compensation costs will be recognized is approximately 2.6 years for the nonvested stock awards and 2.7 years for option awards.

A summary of the Company s restricted stock awards including restricted stock units as of June 30, 2007, is presented below:

	Shares (000 s)	Weighted-Average Grant -Date Fair Value
Nonvested at beginning of year	244	$ 22.50
Granted	502	19.23
Vested	(90)	25.17
Forfeited	(20)	16.79
Nonvested as of June 30, 2007	636	$ 19.72

The Company applies the Black-Scholes option-pricing model to determine the fair value of options on the grant date. Inherent in that model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a level of judgment which make them critical accounting estimates. Since the fourth quarter of 2005, the Company has used an expected stock-price volatility assumption that is a combination of both historical and implied volatilities of the underlying stock, which are obtained from public data sources. Prior to that time, the Company based this assumption solely on historical volatility. The Company considers the exercise behavior of past grants and models the pattern of aggregate exercises in determining the expected weighted-average option life.

The following assumptions were used to estimate the fair value of stock options granted using the Black-Scholes option-pricing model for the following periods:

	Granted in 2007	Granted in 2006	Unvested at January 1, 2006
Weighted-average expected stock-price volatility	35%	40%	60%
Weighted-average expected option life	3 years	3 years	4 years
Average risk-free interest rate	5.0%	5.0%	3.6%
Average dividend yield	0%	0%	0%

A summary of the Company s stock option plans as of and for the six months ended June 30, 2007, is presented below:

	Shares (000 s)	Weighted-Average Exercise Price	Aggregate Intrinsic Value (000 s)	Weighted-Average Remaining Contractual Life (in years)
Outstanding at beginning of year	6,363	$ 25.58		
Granted	599	19.57		
Exercised	(124)	16.17		
Forfeited (including cancelled options)	(915)	37.58		