

VEECO INSTRUMENTS INC
Form 10-Q
October 29, 2008
Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

OR

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

For the transition period from to .

Commission file number 0-16244

VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of

11-2989601
(I.R.S. Employer

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Incorporation or Organization)

Identification Number)

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

11803
(Zip Code)

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

Website: **www.veeco.com**

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller

reporting company)

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

32,187,122 shares of common stock, \$0.01 par value per share, were outstanding as of the close of business on October 27, 2008.

Table of Contents

SAFE HARBOR STATEMENT

This Quarterly Report on Form 10-Q (the Report) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Discussions containing such forward-looking statements may be found in 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 recent turmoil in the world's credit markets may have a protracted adverse impact on capital spending in the markets we serve and, as a result, could have a material adverse effect on our business and our results of operations.

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

- We operate in an industry characterized by rapid technological change.

- We face significant competition.

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

- The timing of our orders, shipments, and revenue recognition may cause our quarterly operating results to fluctuate significantly.

- Changes in our product mix may cause our quarterly operating results to fluctuate significantly.

- Our customers may cancel or reschedule their orders with us.

- Our sales cycle is long and unpredictable.
- Our outsourcing strategy could adversely affect our results of operations.
- We rely on a limited number of suppliers.
- Our inability to attract, retain, and motivate key employees could have a material adverse effect on our business.
- We are exposed to the risks of operating a global business.
- We are subject to foreign currency exchange risks.
- Our success depends on protection of our intellectual property rights.
- We may be subject to claims of intellectual property infringement by others.
- Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses.
- 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.

Table of Contents

- The other matters discussed under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this Report and in the Annual Report on Form 10-K for the year ended December 31, 2007 of Veeco Instruments Inc. (Veeco, the Company, or we).

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 such reports. These filings are posted to our Internet site, as soon as reasonably practicable after we electronically file such material with the SEC.

Table of Contents

VEECO INSTRUMENTS INC.

INDEX

| | Page |
|---|-------------|
| <u>PART I. FINANCIAL INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>Financial Statements:</u> | |
| <u>Condensed Consolidated Statements of Operations for the Three Months and Nine Months Ended September 30, 2008 and 2007 (Unaudited)</u> | 5 |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2008 (Unaudited) and December 31, 2007</u> | 6 |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2008 and 2007 (Unaudited)</u> | 7 |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> | 8 |
| <u>Item 2.</u> | |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 17 |
| <u>Item 3.</u> | |
| <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 28 |
| <u>Item 4.</u> | |
| <u>Controls and Procedures</u> | 29 |
| <u>PART II. OTHER INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>Legal Proceedings</u> | 29 |
| <u>Item 1A.</u> | |
| <u>Risk Factors</u> | 29 |
| <u>Item 6.</u> | |
| <u>Exhibits</u> | 30 |
| <u>SIGNATURES</u> | 31 |

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

Veeco Instruments Inc. and Subsidiaries
Condensed Consolidated Statements of Operations

(In thousands, except per share data)
(Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2008 | 2007 | 2008 | 2007 |
| Net sales | \$ 115,709 | \$ 97,718 | \$ 332,465 | \$ 295,653 |
| Cost of sales | 69,626 | 61,824 | 196,026 | 173,819 |
| Gross profit | 46,083 | 35,894 | 136,439 | 121,834 |
| Operating expenses: | | | | |
| Selling, general, and administrative expense | 23,589 | 22,723 | 70,528 | 69,347 |
| Research and development expense | 15,302 | 15,049 | 45,173 | 46,341 |
| Amortization expense | 3,148 | 1,959 | 7,530 | 8,236 |
| Restructuring expense | 4,120 | 529 | 6,995 | 1,974 |
| Asset impairment charge | | | 285 | |
| Other income, net | (213) | (179) | (591) | (605) |
| Total operating expenses | 45,946 | 40,081 | 129,920 | 125,293 |
| Operating income (loss) | 137 | (4,187) | 6,519 | (3,459) |
| Interest expense, net | 1,052 | 665 | 2,913 | 2,256 |
| Gain on extinguishment of debt | | | | (738) |
| (Loss) income before income taxes and noncontrolling interest | (915) | (4,852) | 3,606 | (4,977) |
| Income tax provision | 812 | 954 | 2,860 | 3,490 |
| Noncontrolling interest | (54) | (123) | (200) | (482) |
| Net (loss) income | \$ (1,673) | \$ (5,683) | \$ 946 | \$ (7,985) |
| (Loss) income per common share: | | | | |
| Net (loss) income per common share | \$ (0.05) | \$ (0.18) | \$ 0.03 | \$ (0.26) |
| Diluted net (loss) income per common share | \$ (0.05) | \$ (0.18) | \$ 0.03 | \$ (0.26) |
| Weighted average shares outstanding | 31,458 | 31,100 | 31,293 | 30,975 |
| Diluted weighted average shares outstanding | 31,458 | 31,100 | 31,498 | 30,975 |

See accompanying notes.

Table of Contents

Veeco Instruments Inc. and Subsidiaries
Condensed Consolidated Balance Sheets

(In thousands)

| | September 30, 2008 (Unaudited) | December 31, 2007 |
|---|--------------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 117,684 | \$ 117,083 |
| Accounts receivable, less allowance for doubtful accounts of \$988 in 2008 and \$984 in 2007 | 71,919 | 75,207 |
| Inventories | 105,659 | 98,594 |
| Prepaid expenses and other current assets | 7,453 | 8,901 |
| Deferred income taxes | 2,781 | 2,649 |
| Total current assets | 305,496 | 302,434 |
| Property, plant, and equipment at cost, net | 66,493 | 66,142 |
| Goodwill | 105,355 | 100,898 |
| Purchased technology, less accumulated amortization of \$76,563 in 2008 and \$72,481 in 2007 | 34,470 | 36,107 |
| Other intangible assets, less accumulated amortization of \$34,447 in 2008 and \$29,886 in 2007 | 27,610 | 23,540 |
| Other assets | 193 | 213 |
| Total assets | \$ 539,617 | \$ 529,334 |
| Liabilities and shareholders equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 33,358 | \$ 36,639 |
| Accrued expenses | 61,820 | 60,201 |
| Deferred profit | 4,814 | 3,250 |
| Income taxes payable | 1,084 | 2,278 |
| Current portion of long-term debt | 25,426 | 25,550 |
| Total current liabilities | 126,502 | 127,918 |
| Deferred income taxes | 4,995 | 3,712 |
| Long-term debt | 120,889 | 121,035 |
| Other non-current liabilities | 2,185 | 1,978 |
| Noncontrolling interest | 814 | 1,014 |
| Total shareholders equity | 284,232 | 273,677 |
| Total liabilities and shareholders equity | \$ 539,617 | \$ 529,334 |

See accompanying notes.

Table of Contents

Veeco Instruments Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows

(In thousands)
(Unaudited)

| | Nine months ended September 30, | |
|--|------------------------------------|------------|
| | 2008 | 2007 |
| Operating activities | | |
| Net income (loss) | \$ 946 | \$ (7,985) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 18,138 | 19,288 |
| Deferred income taxes | 1,260 | 1,111 |
| Non-cash restructuring charge | 3,018 | |
| Net gain on extinguishment of long-term debt | | (738) |
| Non-cash compensation expense for stock options and restricted stock | 5,671 | 3,490 |
| Noncontrolling interest | (200) | (482) |
| Non-cash asset impairment charge | 285 | |
| Gain on sale of property, plant, and equipment | (67) | (79) |
| Bad debt expense | 4 | 40 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 6,663 | 19,932 |
| Inventories | (1,703) | (4,801) |
| Accounts payable | (4,168) | (5,042) |
| Accrued expenses, deferred profit, and other current liabilities | (5,449) | 524 |
| Other, net | (1,978) | (2,481) |
| Net cash provided by operating activities | 22,420 | 22,777 |
| Investing activities | | |
| Capital expenditures | (10,430) | (6,854) |
| Payments for net assets of business acquired, net of cash acquired | (10,970) | |
| Proceeds from sale of property, plant, and equipment | 104 | 311 |
| Net cash used in investing activities | (21,296) | (6,543) |
| Financing activities | | |
| Proceeds from stock issuances | 681 | 2,781 |
| Repayments of long-term debt | (270) | (55,407) |
| Payments for debt issuance costs | | (1,503) |
| Restricted stock tax withholdings | (969) | (314) |
| Net cash used in financing activities | (558) | (54,443) |
| Effect of exchange rate changes on cash and cash equivalents | 35 | (435) |
| Net change in cash and cash equivalents | 601 | (38,644) |
| Cash and cash equivalents at beginning of period | 117,083 | 147,046 |
| Cash and cash equivalents at end of period | \$ 117,684 | \$ 108,402 |
| Non-cash investing and financing activities | | |
| Accrual of earn-out payments for business acquired | \$ 3,527 | \$ |
| Exchange of convertible subordinated notes | \$ | \$ 118,766 |
| Transfers from property, plant, and equipment to inventory | \$ 404 | \$ 473 |
| Transfers from inventory to property, plant, and equipment | \$ 385 | \$ 78 |

See accompanying notes.

Table of Contents

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 months and nine months ended September 30, 2008, are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. For further information, refer to the financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007.

Consistent with prior years, we report interim quarters, other than fourth quarters which always end on December 31, on a 13-week basis ending on the last Sunday within such period. The interim quarter ends are determined at the beginning of each year based on the 13-week quarters. The 2008 interim quarter ends are March 30, June 29, and September 28. The 2007 interim quarter ends were April 1, July 1, and September 30. For ease of reference, we report these interim quarter ends as March 31, June 30, and September 30 in our interim condensed consolidated financial statements.

Net (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 September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|--------|------------------------------------|--------|
| | 2008 | 2007 | 2008 | 2007 |
| Weighted average shares outstanding | 31,458 | 31,100 | 31,293 | 30,975 |
| Dilutive effect of stock options and restricted stock awards and units | | | 205 | |
| Diluted weighted average shares outstanding | 31,458 | 31,100 | 31,498 | 30,975 |

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

During the three-month period ended September 30, 2008, options to purchase 5.7 million shares of common stock (at prices ranging from \$0.27 to \$72.00 per share) were excluded from the computation of diluted earnings per share due to the net loss sustained for the period, which caused

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their effect to be antidilutive. During the nine-month period ended September 30, 2008, options to purchase 4.8 million shares of common stock (at prices ranging from \$16.56 to \$72.00 per share), respectively, were excluded from the computation of diluted earnings per share due to exercise prices that exceeded the average market price of our common stock for the period. During the three-month and nine-month periods ended September 30, 2007, options to purchase 5.7 million shares of common stock (at prices ranging from \$0.27 to \$72.00 per share) in both periods were excluded from the computation of diluted earnings per share due to the net loss sustained for the period, which caused their effect to be antidilutive.

During the second quarter of 2007, we exchanged \$118.8 million of our unsecured 4.125% convertible subordinated notes due December 2008 (the Old Notes) for \$117.8 million of a new series of 4.125% convertible subordinated notes (the New Notes) due April 15, 2012. The effect on diluted shares of the assumed conversion of the Old Notes was approximately 0.7 million and 2.2 million common equivalent shares for the three months and nine months ended September 30, 2007, respectively. The converted shares were anti-dilutive and, therefore, were not included in the weighted shares outstanding for the three months and nine months ended September 30, 2007. The

Table of Contents

exchange of the Old Notes for the New Notes, together with \$56 million in 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. For the three months and nine months ended September 30, 2008, the weighted-average effect on diluted shares of the assumed conversion of the remaining \$25.2 million of Old Notes is approximately 0.7 million shares in each period.

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

Fair Value Measurements

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

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

Recent Accounting Pronouncements

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

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (SFAS 141(R)) and Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements* an

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Amendment of ARB No. 51 (SFAS 160). Under SFAS 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition date at fair value with limited exceptions. SFAS 141(R) also changes the accounting treatment for certain other items that relate to business combinations. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The purpose of SFAS 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. The most significant provisions of this statement result in changes to the presentation of noncontrolling interests in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of this statement will impact the manner in which we present noncontrolling interests, but will not impact our consolidated financial position or results of operations.

Table of Contents

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 and requires comparative disclosures only for periods subsequent to initial adoption. The adoption of the provisions of SFAS 161 will not impact our consolidated financial position or results of operations.

In May 2008, the FASB issued FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1). The guidance is effective for fiscal years beginning after December 15, 2008, and interim periods within those years. FSP APB 14-1 will require issuers of convertible debt that can be settled in cash to separately account for (i.e. bifurcate) a portion of the debt associated with the conversion feature and reclassify this portion to stockholders' equity. The liability portion, which represents the fair value of the debt without the conversion feature, will be accreted to its face value over the life of the debt using the effective interest method, with the accretion expense recorded to interest. FSP APB 14-1 will be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented will be recognized as of the beginning of the first period presented. We expect the adoption of FSP APB 14-1 to have a material effect on our consolidated financial position, results of operations, and earnings per share. Effective as of date of issuance of the New Notes, we will reclassify approximately \$16.3 million from long-term debt to additional paid-in capital, and as of the adoption of FSP APB 14-1 in the beginning of 2009, our accumulated deficit will reflect approximately \$4.8 million of debt accretion that occurred between the issuance date of the New Notes and the adoption date. Approximately \$3.2 to \$3.7 million of additional interest expense will be recorded annually from the adoption date through the maturity date of the convertible debt. This additional interest expense will not require the use of cash.

Note 2 Acquisition of Mill Lane Engineering

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

Note 3 Share-Based Payments

Stock Option and Restricted Stock Compensation

Share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the employee requisite service period in accordance with FASB Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)). The following compensation expense was included in the condensed consolidated statements of operations for the three months and nine months ended September 30, 2008 and 2007 (in thousands):

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| | Three months ended September 30, | | Nine months ended September 30, | |
|----------------------------------|-------------------------------------|----------|------------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Share-based compensation expense | \$ 2,048 | \$ 1,505 | \$ 5,671 | \$ 3,490 |

As of September 30, 2008, the total unrecognized compensation cost related to nonvested stock awards and stock option awards is \$10.6 million and \$7.8 million, respectively. The related weighted average period over which we expect that such unrecognized compensation costs will be recognized as expense is approximately 2.5 years for both the nonvested stock awards and the option awards.

During the third quarter of 2008, we granted to certain key employees 14,500 shares of restricted common

Table of Contents

stock, 10,000 restricted stock units, and 61,000 stock options. The stock options will vest over a three-year period and the restricted stock awards and units will vest over a four-year period.

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

| | Shares (000s) | Weighted Average Grant-Date Fair Value |
|--|------------------|---|
| Nonvested at beginning of year | 680 | \$ 19.50 |
| Granted | 384 | 17.30 |
| Vested | (361) | 19.67 |
| Forfeited (including cancelled awards) | (23) | 18.40 |
| Nonvested at September 30, 2008 | 680 | 18.21 |

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

| | Shares (000s) | Weighted- Average Exercise Price | Aggregate Intrinsic Value (000s) | Weighted- Average Remaining Contractual Life (in years) |
|---|------------------|--|--|---|
| Outstanding at beginning of year | 5,672 | \$ 23.04 | | |
| Granted | 1,226 | 17.35 | | |
| Exercised | (58) | 11.71 | | |
| Forfeited (including cancelled options) | (1,117) | 30.78 | | |
| Outstanding at September 30, 2008 | 5,723 | 20.43 | \$ 1,229 | 3.6 |
| Options exercisable at September 30, 2008 | 4,114 | 21.45 | \$ 1,202 | 2.5 |

Note 4 Balance Sheet Information*Inventories*

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

| | September 30, 2008 | December 31, 2007 |
|-----------------|-----------------------|----------------------|
| Raw materials | \$ 60,084 | \$ 58,157 |
| Work in process | 32,841 | 27,330 |

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| | | | | |
|----------------|----|---------|----|--------|
| Finished goods | | 12,734 | | 13,107 |
| | \$ | 105,659 | \$ | 98,594 |

Accrued Warranty

We estimate the costs that may be incurred under the warranty we provide and recognize a liability in the amount of such costs at the time the related revenue is recognized. Factors that affect our warranty liability include product failure rates, material usage and labor costs incurred in correcting product failures during the warranty period. We periodically assess the adequacy of our recognized warranty liability and adjust the amount as necessary. Changes in our warranty liability during the period are as follows (in thousands):

Table of Contents

| | Nine months ended | | | |
|-------------------------------------|-------------------|---------|------|---------|
| | September 30, | | 2007 | |
| | 2008 | | 2007 | |
| Balance at beginning of period | \$ | 6,502 | \$ | 7,118 |
| Warranties issued during the period | | 4,962 | | 4,170 |
| Settlements made during the period | | (4,096) | | (4,788) |
| Balance at end of period | \$ | 7,368 | \$ | 6,500 |

Note 5 Segment Information

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

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

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

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

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| | LED & Solar Process Equipment | Data Storage Process Equipment | Metrology | Unallocated Corporate Amount | Total |
|--|-------------------------------------|--------------------------------------|-----------|------------------------------------|------------|
| Three months ended September 30, 2008 | | | | | |
| Net sales | \$ 40,983 | \$ 43,256 | \$ 31,470 | \$ | \$ 115,709 |
| Income (loss) before interest, taxes, amortization, and certain items (EBITA) | \$ 5,477 | \$ 6,739 | \$ 45 | \$ (3,929) | \$ 8,332 |
| Interest expense, net | | | | 1,052 | 1,052 |
| Amortization expense | 1,587 | 952 | 495 | 114 | 3,148 |
| Restructuring expense | | | 437 | 3,683 | 4,120 |
| Purchase accounting adjustment (1) | 927 | | | | 927 |
| Income (loss) before income taxes and noncontrolling interest | \$ 2,963 | \$ 5,787 | \$ (887) | \$ (8,778) | \$ (915) |

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Table of Contents

| Three months ended September 30, 2007 | | | | | | | | | | |
|---|----|--------|----|---------|----|--------|----|---------|----|---------|
| Net sales | \$ | 31,824 | \$ | 31,099 | \$ | 34,795 | \$ | | \$ | 97,718 |
| Income (loss) before interest, taxes, amortization, and certain items (EBITA) | \$ | 3,196 | \$ | (947) | \$ | (395) | \$ | (3,553) | \$ | (1,699) |
| Interest expense, net | | | | | | | | 665 | | 665 |
| Amortization expense | | 492 | | 952 | | 399 | | 116 | | 1,959 |
| Restructuring expense | | | | 159 | | 46 | | 324 | | 529 |
| Income (loss) before income taxes and noncontrolling interest | \$ | 2,704 | \$ | (2,058) | \$ | (840) | \$ | (4,658) | \$ | (4,852) |

| Nine months ended September 30, 2008 | | | | | | | | | | |
|---|----|---------|----|---------|----|---------|----|----------|----|---------|
| Net sales | \$ | 128,204 | \$ | 104,097 | \$ | 100,164 | \$ | | \$ | 332,465 |
| Income (loss) before interest, taxes, amortization, and certain items (EBITA) | \$ | 22,807 | \$ | 10,446 | \$ | 618 | \$ | (11,615) | \$ | 22,256 |
| Interest expense, net | | | | | | | | 2,913 | | 2,913 |
| Amortization expense | | 3,040 | | 2,856 | | 1,295 | | 339 | | 7,530 |
| Restructuring expense | | 7 | | 124 | | 627 | | 6,237 | | 6,995 |
| Asset impairment charge | | | | | | | | 285 | | 285 |
| Purchase accounting adjustment (1) | | 927 | | | | | | | | 927 |
| Income (loss) before income taxes and noncontrolling interest | \$ | 18,833 | \$ | 7,466 | \$ | (1,304) | \$ | (21,389) | \$ | 3,606 |

| Nine months ended September 30, 2007 | | | | | | | | | | |
|---|----|--------|----|--------|----|---------|----|----------|----|---------|
| Net sales | \$ | 82,188 | \$ | 98,840 | \$ | 114,625 | \$ | | \$ | 295,653 |
| Income (loss) before interest, taxes, amortization, and certain items (EBITA) | \$ | 8,787 | \$ | 3,055 | \$ | 4,015 | \$ | (9,106) | \$ | 6,751 |
| Interest expense, net | | | | | | | | 2,256 | | 2,256 |
| Amortization expense | | 3,774 | | 2,854 | | 1,135 | | 473 | | 8,236 |
| Restructuring expense | | | | 159 | | 1,398 | | 417 | | 1,974 |
| Gain on extinguishment of debt | | | | | | | | (738) | | (738) |
| Income (loss) before income taxes and noncontrolling interest | \$ | 5,013 | \$ | 42 | \$ | 1,482 | \$ | (11,514) | \$ | (4,977) |

| | | LED & Solar Process Equipment | Data Storage Process Equipment | Metrology | Unallocated Corporate Amount | Total | | | | |
|---------------------------------|----|--|---|------------------|---|--------------|----|---------|----|---------|
| As of September 30, 2008 | | | | | | | | | | |
| Goodwill | \$ | 45,610 | \$ | 30,377 | \$ | 29,368 | \$ | | \$ | 105,355 |
| Total assets | | 132,342 | | 148,531 | | 116,866 | | 141,878 | | 539,617 |
| As of December 31, 2007 | | | | | | | | | | |
| Goodwill | \$ | 41,153 | \$ | 30,377 | \$ | 29,368 | \$ | | \$ | 100,898 |
| Total assets | | 121,326 | | 144,944 | | 121,060 | | 142,004 | | 529,334 |

(1) This adjustment relates to the required capitalization of profit in inventory associated with the acquisition of Mill Lane which is included in cost of sales.

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

Note 6 Income Taxes

For the nine months ended September 30, 2008, our reserve for unrecognized tax benefits decreased by approximately \$0.3 million primarily due to the expiration of the statute of limitations relating to certain foreign tax positions. As a result, we had \$1.6 million of unrecognized tax benefits at September 30, 2008, all of which relate to

Table of Contents

positions taken on our foreign tax returns and represent the amount of unrecognized tax benefits that, if recognized, would favorably impact the effective income tax rate in future periods.

We or one of our subsidiaries file income tax returns in the U.S. federal jurisdiction and various state, local, and foreign jurisdictions. All material federal, state, local, and foreign income tax matters have been concluded for years through 2002 subject to subsequent utilization of net operating losses generated in such years. During the third quarter of 2008, the Internal Revenue Service initiated an examination of our Federal income tax return for the calendar year 2006. In addition, our tax returns are under examination in certain foreign jurisdictions.

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

Note 7 Comprehensive (Loss) Income

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

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| | Three months ended | | Nine months ended | |
|--|--------------------|------------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2008 | 2007 | 2008 | 2007 |
| Net (loss) income | \$ (1,673) | \$ (5,683) | \$ 946 | \$ (7,985) |
| Foreign currency translation (loss) gain | (555) | 1,481 | 1,208 | 1,387 |
| Total comprehensive (loss) income | \$ (2,228) | \$ (4,202) | \$ 2,154 | \$ (6,598) |

Note 8 Debt

Convertible Debt

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

During the second quarter of 2007, we issued New Notes pursuant to privately negotiated exchange agreements with certain holders of the Old Notes. Under these agreements, such holders agreed to exchange \$118.8 million aggregate principal amount of the Old Notes for approximately \$117.8 million aggregate principal amount of New Notes. No net gain or loss was recorded on the exchange transactions since the carrying value of the Old Notes including unamortized deferred financing costs approximated the exchange value of the New Notes. Following the exchange transactions, approximately \$25.2 million of the Old Notes, with a conversion price of \$38.51 per common share, remained outstanding. The Old Notes are due in December 2008, and we expect to pay off these notes through the use of our available cash balances.

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

Credit Agreement

During the third quarter of 2007, we entered into a Credit Agreement with HSBC Bank USA, National Association, as administrative agent (HSBC), and the lenders named therein (the Credit Agreement). The Credit Agreement provides for revolving credit borrowings of up to \$100.0 million. As of September 30, 2008 and December 31, 2007, there were no borrowings outstanding. Interest expense associated with the credit agreement recorded during the nine months ended September 30, 2008 was \$0.2 million, of which \$0.1 million is included in accrued expenses as of September 30, 2008.

Table of Contents**Note 9 Commitments, Contingencies and Other Matters***Legal Proceedings*

On August 11, 2008, we announced that we had settled the patent litigation which we had brought in 2003 in the United States District Court for the Central District of California against Asylum Research Corporation, a privately-held company founded by former Veeco employees (Asylum). In the lawsuit, we had alleged that the manufacture, use, and sale of Asylum's MFP-3D AFM constituted willful infringement of five patents owned by us, as well as other claims. In the settlement, Veeco and Asylum agreed to drop all pending claims against each other and agreed to a five year, worldwide cross license of each company's patents and a mutual covenant not to sue on patents either party has a right to assert. Asylum made a net payment to Veeco and will pay an ongoing royalty to Veeco for the five-year term of the cross license. As part of the settlement, Asylum acknowledged the validity of the Veeco patents asserted in the case. During the case, we capitalized legal costs incurred to defend our patents and are now amortizing these capitalized costs over the remaining lives of these patents. Payments received from Asylum have been and will continue to be netted against the capitalized legal costs upon receipt.

Restructuring Expenses

During 2007, management initiated a profit improvement plan, resulting in severance costs for approximately 90 employees, or approximately 7.5% of our employees, which included management, administration, and manufacturing employees companywide. Furthermore, we took additional measures to improve profitability, including a reduction of discretionary expenses, realignment of our sales organization to more closely match current market and regional opportunities, and consolidation of certain engineering groups within our data storage business, which included the discontinuation of two products. In conjunction with these activities, we recognized a restructuring charge of approximately \$6.7 million during 2007.

During the first quarter of 2008, we consolidated our Corporate headquarters into our Plainview, New York location. As a result, we incurred an additional restructuring charge of \$2.6 million, representing the remaining lease rentals and estimated property taxes for the facility we vacated, offset by the estimated expected sublease income to be received. We made certain assumptions in determining the charge, which included estimated sublease income and terms of the sublease as well as the estimated discount rate to be used in determining the fair value of the liability. We developed these assumptions based on our understanding of the current real estate market as well as current market interest rates. The assumptions were based on management's best estimates, and will be adjusted periodically if better information is obtained.

During the second quarter of 2008, we did not incur any additional restructuring charges. During the third quarter of 2008, we recorded a charge of \$4.1 million, comprised of the following: \$3.7 million related to a mutually agreed-upon termination of the employment agreement with Veeco's former CEO following the successful completion of the CEO transition, which included a charge of \$3.0 million for the acceleration of stock-based compensation expense; personnel severance costs of \$0.1 million for Metrology employees; and \$0.3 million in lease-related expenses associated with the termination of the lease for a Metrology facility in Santa Barbara, California. Restructuring expenses for the three months and nine months ended September 30, 2008 and 2007 are as follows (in thousands):

**Three months ended
September 30,**

**Nine months ended
September 30,**

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| | 2008 | | 2007 | | 2008 | | 2007 | |
|-------------------------------|------|-------|------|-----|------|-------|------|-------|
| Lease-related costs | \$ | 282 | \$ | | \$ | 2,836 | \$ | |
| Personnel severance costs | | 820 | | 529 | | 1,141 | | 1,974 |
| Modification of equity awards | | 3,018 | | | | 3,018 | | |
| Total restructuring expense | \$ | 4,120 | \$ | 529 | \$ | 6,995 | \$ | 1,974 |

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

Table of Contents

| | LED & Solar Process Equipment | Data Storage Process Equipment | Metrology | Unallocated Corporate | Total |
|---------------------------------------|-------------------------------------|--------------------------------------|-----------|--------------------------|----------|
| Short-Term Liability | | | | | |
| <i>2007 Activity</i> | | | | | |
| Personnel severance charges | \$ 34 | \$ 658 | \$ 1,153 | \$ 2,469 | \$ 4,314 |
| Purchase order commitments | | 1,840 | | | 1,840 |
| Total charged to accrual (1) | 34 | 2,498 | 1,153 | 2,469 | 6,154 |
| Cash payments | (17) | (435) | (751) | (633) | (1,836) |
| Balance as of December 31, 2007 | 17 | 2,063 | 402 | 1,836 | 4,318 |
| <i>2008 Activity</i> | | | | | |
| Lease-related costs | | | 282 | 971 | 1,253 |
| Personnel severance charges | 7 | 124 | 344 | 666 | 1,141 |
| Total charged to accrual (2) | 7 | 124 | 626 | 1,637 | 2,394 |
| Short-term/long-term reclassification | | | | 25 | 25 |
| Cash payments | (15) | (2,069) | (780) | (2,369) | (5,233) |
| Balance as of September 30, 2008 | \$ 9 | \$ 118 | \$ 249 | \$ 1,128 | \$ 1,504 |
| Long-Term Liability | | | | | |
| <i>2008</i> | | | | | |
| Lease-related costs | \$ | \$ | \$ | \$ 1,583 | \$ 1,583 |
| Short-term/long-term reclassification | | | | (25) | (25) |
| Other adjustments | | | | (172) | (172) |
| Balance as of September 30, 2008 | \$ | \$ | \$ | \$ 1,386 | \$ 1,386 |

(1) In 2007, a charge of \$0.6 million for the modification of stock options was recorded as part of a termination agreement with each of five key employees as an increase to additional paid-in capital.

(2) In 2008, a charge of \$3.0 million for the acceleration of equity awards was recorded as part of a mutually agreed upon termination with our former CEO (who currently remains as Chairman of the Board of Directors) as an increase to additional paid-in capital.

The balance of the restructuring accrual is expected to be paid over the next thirty-three months, or the remaining life of the lease for the former Corporate headquarters. Given the recent change in business climate, management is currently evaluating various cost cutting actions, and it is likely that we will incur restructuring charges in the fourth quarter, depending upon the timing and extent of actions under consideration. We are not able to estimate the extent of these charges at this time.

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

Table of Contents

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

Executive Summary

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

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

We currently maintain facilities in Arizona, California, Colorado, Minnesota, New Jersey, New York, and Massachusetts, with sales and service locations in North America, Europe, Japan, and the Asia Pacific region.

During 2007, management established a profit improvement plan, resulting in a 7.5% reduction in our employment levels, a reduction of discretionary expenses, the realignment of our sales organization to match more closely market and regional opportunities, consolidation of our Corporate headquarters, and the consolidation of certain engineering groups within our Data Storage Process Equipment business, which included the discontinuation of two products. In conjunction with these activities, we recognized a restructuring charge of approximately \$6.7 million during the year ended December 31, 2007, as well as an inventory write-off of \$4.8 million and an asset impairment charge of \$1.1 million. During the nine months ended September 30, 2008, we incurred additional restructuring charges of \$7.0 million and asset impairment charges of \$0.3 million, discussed further in Results of Operations below. Through the first nine months of 2008, we have seen the positive impact of these restructuring activities on the Company's operating expenses.

Highlights of the Third Quarter of 2008

- Revenue was \$115.7 million, an 18% increase over the third quarter of 2007.
- Orders were \$90.2 million, down 24% from the third quarter of 2007.

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- Net loss was (\$1.7) million, or (\$0.05) per share, compared to net loss of (\$5.7) million, or (\$0.18) per share, in the third quarter of 2007.
- Gross margins were 39.8%, compared to 36.7% in the third quarter of 2007.

Highlights of the First Nine Months of 2008

- Revenue was \$332.5 million, a 12% increase over the comparable 2007 period.
- Orders were \$335.9 million, consistent with the comparable 2007 period.
- Net income was \$0.9 million, or \$0.03 per share, compared to a net loss of (\$8.0) million, or (\$0.26) per share, in the comparable 2007 period.
- Gross margins were 41.0%, compared to 41.2% in 2007.

Outlook

For the first nine months of 2008, the Company has reported a meaningful recovery year in both revenue growth and profitability. While Veeco has delivered strong revenue growth and profit improvement in 2008, in the third quarter we experienced a deterioration in business conditions with a sharp decline in orders of MOCVD systems as the HB-LED industry digests the significant number of new tools purchased this past year, and the global credit crisis caused customers to delay or forego capacity and technology purchases. Third quarter orders of \$90.2 million were significantly below our prior expectations, and the Company also experienced some push-outs and cancellations of equipment purchases.

Table of Contents

While the Company has a healthy prospect list for new orders in the fourth quarter, it appears that the global economic climate and constrained financing environment may cause a broad slowdown in capital equipment purchases by our customers, with uncertainty as to the depth and duration of the downturn. Due to this limited visibility, we are unable to give an accurate assessment of fourth quarter orders, and we currently anticipate order rates to come under pressure for the foreseeable future. Veeco estimates that its revenues for the fourth quarter of 2008 will be \$110-\$118 million.

The Company is taking corrective actions to lower our cost structure in preparation for what is likely to be a reduced revenue year in 2009. Our goal is to lower our spending while maintaining strategic investments in research and development, particularly in our LED & Solar business. It is our intent to emerge from the present economic environment in a strong position to enable future revenue and profit growth. Since the Company is currently evaluating various cost cutting actions, it is likely that Veeco will incur restructuring charges in the fourth quarter, depending upon the timing and extent of actions under consideration. We are not able to estimate the extent of these charges at this time.

Despite the recent deteriorating business conditions, Veeco has forecasted revenues in the range of \$440 to \$450 million in 2008, up approximately 10% from the \$402.5 million reported in 2007, as well as a meaningful profit improvement as compared to 2007. The Company believes that it is well-positioned to capitalize on exciting multi-year technology trends across our LED & Solar, Data Storage and Metrology businesses, and we have made significant progress this year in refocusing our businesses and improving our performance. We have a strong balance sheet and positive cash flow, and we expect at this time that we can manage Veeco through the global economic crisis while maintaining our commitment to R&D to ensure our long-term growth and success.

Veeco will remain focused on executing our core strategies to improve the Company's performance:

- Directing Veeco's resources to the best growth opportunities;

- Strengthening the global sales and services organization;

- Maximizing profitability through a continued focus on gross margin improvement and cost containment activities;

- Ensuring that each of Veeco's product businesses, LED & Solar Process Equipment, Data Storage Process Equipment, and Metrology, are executing well; and

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

Table of Contents

Results of Operations:

Three Months Ended September 30, 2008 and 2007

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Consistent with prior years, we report interim quarters, other than fourth quarters, which always end on December 31, on a 13-week basis ending on the last Sunday within such period. The interim quarter ends are determined at the beginning of each year based on the 13-week quarters. The 2008 interim quarter ends are March 30, June 29 and September 28. The 2007 interim quarter ends were April 1, July 1 and September 30. For ease of reference, we report these interim quarter ends as March 31, June 30, and September 30 in our interim condensed consolidated financial statements.

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

| | Three Months Ended September 30, | | | | Dollar and Percentage Change | | |
|--|-------------------------------------|---------|--------|----|------------------------------------|--------|------------------|
| | 2008 | | 2007 | | | | |
| Net sales | \$ | 115,709 | 100.0% | \$ | 97,718 | 100.0% | \$ 17,991 18.4% |
| Cost of sales | | 69,626 | 60.2 | | 61,824 | 63.3 | 7,802 12.6 |
| Gross profit | | 46,083 | 39.8 | | 35,894 | 36.7 | 10,189 28.4 |
| Operating expenses: | | | | | | | |
| Selling, general, and administrative expense | | 23,589 | 20.4 | | 22,723 | 23.3 | 866 3.8 |
| Research and development expense | | 15,302 | 13.2 | | 15,049 | 15.4 | 253 1.7 |
| Amortization expense | | 3,148 | 2.7 | | 1,959 | 2.0 | 1,189 60.7 |
| Restructuring expense | | 4,120 | 3.6 | | 529 | 0.5 | 3,591 678.8 |
| Other income, net | | (213) | (0.2) | | (179) | (0.2) | 34 19.0 |
| Total operating expenses | | 45,946 | 39.7 | | 40,081 | 41.0 | 5,865 14.6 |
| Operating income (loss) | | 137 | 0.1 | | (4,187) | (4.3) | 4,324 103.3 |
| Interest expense, net | | 1,052 | 0.9 | | 665 | 0.7 | 387 58.2 |
| Loss before income taxes and noncontrolling interest | | (915) | (0.8) | | (4,852) | (5.0) | (3,937) (81.1) |
| Income tax provision | | 812 | 0.6 | | 954 | 0.9 | (142) (14.9) |
| Noncontrolling interest | | (54) | (0.0) | | (123) | (0.1) | (69) (56.1) |
| Net loss | \$ | (1,673) | (1.4)% | \$ | (5,683) | (5.8)% | \$ 4,010 (70.6)% |

Net Sales and Orders

Net sales of \$115.7 million for the three months ended September 30, 2008 were up 18.4% compared to the comparable 2007 quarter. The following is an analysis of sales and orders by segment and by region (dollars in thousands):

| Segment | Sales | | | | Orders | | | | Book-to-Bill Ratio | |
|-----------------|-------------------------------------|-----------|---------------------------------|--------------|-------------------------------------|------------|---------------------------------|--------------|-----------------------|------|
| | Three Months Ended September 30, | | Dollar and Percentage Change | | Three Months Ended September 30, | | Dollar and Percentage Change | | 2008 | 2007 |
| | 2008 | 2007 | Year to Year | Year to Year | 2008 | 2007 | Year to Year | Year to Year | | |
| Analysis | | | | | | | | | | |
| LED & Solar | | | | | | | | | | |
| Process | | | | | | | | | | |
| Equipment | \$ 40,983 | \$ 31,824 | \$ 9,159 | 28.8% | \$ 25,775 | \$ 48,679 | \$ (22,904) | (47.1)% | 0.63 | 1.53 |
| Data Storage | | | | | | | | | | |
| Process | | | | | | | | | | |
| Equipment | 43,256 | 31,099 | 12,157 | 39.1 | 32,359 | 32,239 | 120 | 0.4 | 0.75 | 1.04 |
| Metrology | 31,470 | 34,795 | (3,325) | (9.6) | 32,031 | 37,399 | (5,368) | (14.4) | 1.02 | 1.07 |
| Total | \$ 115,709 | \$ 97,718 | \$ 17,991 | 18.4% | \$ 90,165 | \$ 118,317 | \$ (28,152) | (23.8)% | 0.78 | 1.21 |
| Regional | | | | | | | | | | |
| Analysis | | | | | | | | | | |
| North America | \$ 38,865 | \$ 29,014 | \$ 9,851 | 34.0% | \$ 31,256 | \$ 48,196 | \$ (16,940) | (35.1)% | 0.80 | 1.66 |
| Europe | 28,578 | 18,244 | 10,334 | 56.6 | 22,650 | 22,220 | 430 | 1.9 | 0.79 | 1.22 |
| Japan | 6,604 | 12,585 | (5,981) | (47.5) | 7,769 | 12,330 | (4,561) | (37.0) | 1.18 | 0.98 |
| Asia Pacific | 41,662 | 37,875 | 3,787 | 10.0 | 28,490 | 35,571 | (7,081) | (19.9) | 0.68 | 0.94 |
| Total | \$ 115,709 | \$ 97,718 | \$ 17,991 | 18.4% | \$ 90,165 | \$ 118,317 | \$ (28,152) | (23.8)% | 0.78 | 1.21 |

By segment, LED & Solar Process Equipment sales were up 28.8% due to an increase in end user demand from expanding applications for HB-LEDs, strong customer acceptance of Veeco's newest generation systems, and \$5.0 million in sales from the solar equipment product line,

which was acquired in the second quarter of 2008 as a result of the Mill Lane

Table of Contents

acquisition. Additionally, Data Storage Process Equipment sales were up 39.1%, primarily as a result of customers' technology and capacity requirements. These increases were partially offset by a decrease in Metrology sales of 9.6%, primarily due to a slowdown in the semiconductor and research and industrial markets. By region, net sales increased by 34.0%, 56.6% and 10.0% in North America, Europe, and Asia Pacific, respectively, and decreased by 47.5% in Japan. We believe that there will continue to be quarter-to-quarter variations in the geographic distribution of sales.

Orders for the third quarter of 2008 decreased by 23.8% from the comparable 2007 period. By segment, the 47.1% decrease in orders for LED & Solar Process Equipment was a result of the HB-LED industry's slower absorption of the significant number of new MOCVD tools purchased during the past two years. Additionally, the global credit crisis has caused customers to delay or forego capacity and technology purchases. The 14.4% decrease in Metrology orders was due to decreased orders for AFM products due to lower demand in the semiconductor and research and industrial markets. Data Storage Process Equipment orders remained flat when compared to the 2007 period.

Our book-to-bill ratio for the third quarter of 2008, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period, was 0.78 to 1. Our backlog as of September 30, 2008 was \$176.0 million, compared to \$173.5 million as of December 31, 2007. During the quarter ended September 30, 2008, we experienced a decrease in backlog of \$9.7 million primarily from order cancellations. The outlook for orders in the fourth quarter is uncertain, and it appears that the global economic climate and constrained financing environment may cause a broad slowdown in capital equipment purchases by our customers. Due to these changing business conditions and weak capital equipment spending by customers in our business, as well as the global credit crisis, we expect to experience continued volatility in the form of cancellations and/or rescheduled orders.

Gross Profit

Gross profit for the quarter ended September 30, 2008, was 39.8%, compared to 36.7% in the third quarter of 2007 primarily due to strong performance in Process Equipment. Data Storage Process Equipment gross margins increased from 33.5% in the prior-year period to 39.8%, primarily from an increase in sales volume due to increased capacity spending, a favorable product mix and favorable pricing when compared to the prior comparable period, and cost reductions resulting from management's profit improvement plan, introduced in the fourth quarter of 2007. LED & Solar Process Equipment gross margins increased from 33.4% in the prior-year period to 36.0%, primarily due to an increase in sales volume, as well as a favorable product mix, as compared to the prior-year period. The current-year period includes a reduction in gross profit of \$0.9 million related to the acquisition of Mill Lane. This reduction was the result of purchase accounting, which requires adjustments to capitalize inventory at fair value. This impact is reflected in cost of sales. Metrology gross margins increased from 42.6% in the prior year period to 44.9%, despite a reduction in sales volume, principally due to a richer product mix, as well as a reduction in costs.

Operating Expenses

Selling, general and administrative expenses increased by \$0.9 million, or 3.8%, from the prior-year period primarily due to increased bonus incentives as a result of improved profitability, and an increase in non-cash compensation expense related to stock options and shares of restricted stock. These increases were partially offset by reductions in consulting services and travel and entertainment expense resulting from our cost reduction efforts. As a percentage of sales, selling, general and administrative expenses decreased from 23.3% in the third quarter of 2007 to 20.4% in the third quarter of 2008.

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Research and development expense increased \$0.3 million from the third quarter of 2007, primarily due to research efforts in LED & Solar Process Equipment. As a percentage of sales, research and development decreased from 15.4% in the third quarter of 2007 to 13.2% in the third quarter of 2008.

Amortization expense increased by \$1.2 million, or 60.7% from the third quarter of 2007, due primarily to amortization of intangible assets acquired as part of the acquisition of Mill Lane in the second quarter of 2008.

Restructuring expense of \$4.1 million in the third quarter of 2008 consisted of \$3.7 million associated with the acceleration of equity awards and other severance costs resulting from the mutually agreed upon termination of the employment agreement of our former CEO, as well as \$0.4 million for severance and lease-related charges in Metrology. Restructuring expense of \$0.5 million in the third quarter of 2007 consisted of personnel severance costs incurred across all divisions.

Table of Contents

Interest Expense, Net

Net interest expense in the third quarter of 2008 was \$1.1 million, compared to \$0.7 million in the third quarter of 2007. The increase in net interest expense is due to a reduction in interest income resulting primarily from lower interest rates during the current period.

Income Taxes

Income tax provision for the quarter ended September 30, 2008 was \$0.8 million, compared to \$1.0 million in the third quarter of 2007. The 2008 provision for income taxes included \$0.5 million relating to our foreign operations which continue to be profitable, and \$0.3 million relating to our domestic operations. The 2007 provision for income taxes included \$0.6 million relating to our foreign operations and \$0.4 million relating to our domestic operations.

Nine Months Ended September 30, 2008 and 2007

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

| | 2008 | | Nine Months Ended September 30, | | 2007 | | Dollar and Percentage Change | | |
|---|------|---------|------------------------------------|----|---------|--------|------------------------------------|---------|---------|
| | | | | | | | | | |
| Net sales | \$ | 332,465 | 100.0% | \$ | 295,653 | 100.0% | \$ | 36,812 | 12.5% |
| Cost of sales | | 196,026 | 59.0 | | 173,819 | 58.8 | | 22,207 | 12.8 |
| Gross profit | | 136,439 | 41.0 | | 121,834 | 41.2 | | 14,605 | 12.0 |
| Operating expenses: | | | | | | | | | |
| Selling, general, and administrative expense | | 70,528 | 21.2 | | 69,347 | 23.4 | | 1,181 | 1.7 |
| Research and development expense | | 45,173 | 13.6 | | 46,341 | 15.7 | | (1,168) | (2.5) |
| Amortization expense | | 7,530 | 2.3 | | 8,236 | 2.8 | | (706) | (8.6) |
| Restructuring expense | | 6,995 | 2.1 | | 1,974 | 0.7 | | 5,021 | 254.4 |
| Asset impairment charge | | 285 | 0.1 | | 0.0 | 0.0 | | 285 | 100.0 |
| Other income, net | | (591) | (0.2) | | (605) | (0.2) | | (14) | (2.3) |
| Total operating expenses | | 129,920 | 39.1 | | 125,293 | 42.4 | | 4,627 | 3.7 |
| Operating income (loss) | | 6,519 | 1.9 | | (3,459) | (1.2) | | 9,978 | 288.5 |
| Interest expense, net | | 2,913 | 0.8 | | 2,256 | 0.7 | | 657 | 29.1 |
| Gain on extinguishment of debt | | | 0.0 | | (738) | (0.2) | | (738) | (100.0) |
| Income (loss) before income taxes and noncontrolling interest | | 3,606 | 1.1 | | (4,977) | (1.7) | | 8,583 | 172.5 |
| Income tax provision | | 2,860 | 0.9 | | 3,490 | 1.2 | | (630) | (18.1) |
| Noncontrolling interest | | (200) | (0.1) | | (482) | (0.2) | | (282) | (58.5) |
| Net income (loss) | \$ | 946 | 0.3% | \$ | (7,985) | (2.7)% | \$ | 8,931 | 111.8% |

Net Sales and Orders

Net sales of \$332.5 million for the nine months ended September 30, 2008 were up 12.5% compared to the comparable 2007 period. The following is an analysis of sales and orders by segment and by region (dollars in thousands):

| Segment Analysis | Sales | | | | Orders | | | | Book-to-Bill Ratio | |
|--------------------------|------------------------------------|------------|---|--------|------------------------------------|------------|---|--------|--------------------|------|
| | Nine Months Ended September 30, | | Dollar and Percentage Change Year to Year | | Nine Months Ended September 30, | | Dollar and Percentage Change Year to Year | | 2008 | 2007 |
| | 2008 | 2007 | | | 2008 | 2007 | | | | |
| LED & Solar Process | | | | | | | | | | |
| Equipment | \$ 128,205 | \$ 82,188 | \$ 46,017 | 56.0% | \$ 116,513 | \$ 121,448 | \$ (4,935) | (4.1)% | 0.91 | 1.48 |
| Data Storage Process | | | | | | | | | | |
| Equipment | 104,096 | 98,840 | 5,256 | 5.3 | 124,685 | 105,837 | 18,848 | 17.8 | 1.20 | 1.07 |
| Metrology | 100,164 | 114,625 | (14,461) | (12.6) | 94,738 | 109,392 | (14,654) | (13.4) | 0.95 | 0.95 |
| Total | \$ 332,465 | \$ 295,653 | \$ 36,812 | 12.5% | \$ 335,936 | \$ 336,677 | \$ (741) | (0.2)% | 1.01 | 1.14 |
| Regional Analysis | | | | | | | | | | |
| North America | \$ 116,631 | \$ 95,516 | \$ 21,115 | 22.1% | \$ 124,666 | \$ 121,696 | \$ 2,970 | 2.4% | 1.07 | 1.27 |

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| | | | | | | | | | | |
|--------------|------------|------------|-----------|--------|------------|------------|----------|--------|------|------|
| Europe | 69,607 | 53,199 | 16,408 | 30.8 | 57,664 | 63,396 | (5,732) | (9.0) | 0.83 | 1.19 |
| Japan | 29,347 | 43,732 | (14,385) | (32.9) | 24,548 | 42,125 | (17,577) | (41.7) | 0.84 | 0.96 |
| Asia Pacific | 116,880 | 103,206 | 13,674 | 13.2 | 129,058 | 109,460 | 19,598 | 17.9 | 1.10 | 1.06 |
| Total | \$ 332,465 | \$ 295,653 | \$ 36,812 | 12.5% | \$ 335,936 | \$ 336,677 | \$ (741) | (0.2)% | 1.01 | 1.14 |

Table of Contents

By segment, LED & Solar Process Equipment sales were up 56.0% due to an increase in end user demand from expanding applications for HB-LEDs, as well as strong customer acceptance of Veeco's newest generation systems. Additionally, Data Storage Process Equipment sales increased by 5.3% due to customers' technology and capacity requirements. This was partially offset by a decrease in Metrology sales of 12.6%, primarily due to a slowdown in the semiconductor and research and industrial markets. By region, net sales increased by 22.1%, 30.8% and 13.2% in North America, Europe, and Asia Pacific, respectively, and decreased by 32.9% in Japan. We believe that there will continue to be quarter-to-quarter variations in the geographic distribution of sales.

Orders for the nine-month period ended September 30, 2008 were essentially flat with the comparable 2007 period. By segment, the 13.4% decrease in Metrology orders was due to decreased orders for AFM products resulting from lower demand in the semiconductor, research, and industrial markets. The 4.1% decrease in orders for LED & Solar Process Equipment was due primarily to the third quarter 2008 decline in MOCVD orders as the HB-LED industry absorbs the significant number of new MOCVD tools purchased in the past two years. These decreases are principally offset by a 17.8% increase in Data Storage Process Equipment orders, primarily for slicing and dicing products used to create TFMHs.

Our book-to-bill ratio for the nine months ended September 30, 2008 was 1.01 to 1. Our backlog as of September 30, 2008 was \$176.0 million, compared to \$173.5 million as of December 31, 2007. During the nine months ended September 30, 2008, we experienced an increase in backlog of \$12.7 million due to the acquisition of Mill Lane, offset by order cancellations of \$13.7 million. The outlook for orders in the fourth quarter is uncertain, and it appears that the global economic climate and constrained financing environment may cause a broad slowdown in capital equipment purchases by our customers. Due to these changing business conditions and weak capital equipment spending by customers in our businesses, as well as the global credit crisis, we expect to experience continued volatility in the form of cancellations and/or rescheduled orders.

Gross Profit

Gross profit for the nine months ended September 30, 2008, was 41.0%, compared to 41.2% in the comparable 2007 period. Strong performance in Process Equipment due primarily to an increase in sales volume was offset primarily by unfavorable sales volume in Metrology. LED & Solar Process Equipment gross margins increased from 37.0% in the prior-year period to 39.6%, primarily due to a significant overall increase in sales volume as compared to the prior-year period as well as favorable pricing on new MOCVD products and a favorable product mix in MBE products. The current-year period includes a reduction in gross profit of \$0.9 million related to the acquisition of Mill Lane. The reduction was the result of purchase accounting, which requires adjustments to capitalize inventory at fair value. This impact is reflected in cost of sales. Data Storage Process Equipment gross margins decreased from 39.5% in the prior-year period to 38.9%, due to favorable warranty and pricing in the prior-year period. Metrology gross margins decreased from 45.6% in the prior-year period to 45.2%, principally due to lower sales volume offset by a reduction in spending and favorable product mix.

Operating Expenses

Selling, general and administrative expenses increased by \$1.2 million, or 1.7%, from the prior-year period primarily due to increased bonus incentives and profit sharing as a result of better profitability performance, as well as an increase in non-cash compensation expense related to stock options and shares of restricted stock. This was partially offset by reductions in travel and entertainment expense and consulting services associated with our cost reduction initiatives. As a percentage of sales, selling, general and administrative expenses decreased from 23.4% in 2007 to 21.2% in 2008.

Research and development expense decreased \$1.2 million from the comparable 2007 period, primarily due to a more focused approach to data storage product development as a result of the decision made in the fourth quarter of 2007 by management to discontinue two product lines and consolidate facilities to better reflect the volume of business

Table of Contents

and industry growth rates. As a percentage of sales, research and development decreased from 15.7% in 2007 to 13.6% in 2008.

Amortization expense was \$7.5 million in the 2008 period, compared to \$8.2 million in 2007. The decrease was the result of certain technology-based intangible assets becoming fully amortized, offset by the amortization in the current period of intangibles acquired as part of the acquisition of Mill Lane.

During the nine months ended September 30, 2008, we recorded restructuring charges of \$7.0 million, of which \$4.1 million was incurred during the third quarter of 2008 and \$2.9 million was incurred during the first quarter of 2008. The third quarter restructuring charge consists of \$3.7 million associated with the acceleration of equity awards and other severance costs resulting from the mutually agreed upon termination of the employment agreement of our former CEO, as well as \$0.4 million for severance and lease-related charges in Metrology. The first quarter restructuring charge consisted of \$2.6 million of costs associated with the consolidation and relocation of our Corporate headquarters and \$0.3 million of personnel severance costs. Restructuring expense in 2007 of \$2.0 million consisted of personnel severance costs.

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

Interest Expense, Net

Net interest expense in the nine-month period ended September 30, 2008 was \$2.9 million, compared to \$2.3 million in the comparable 2007 period. This increase in net interest expense was due to a reduction in interest income resulting from lower interest rates.

Gain on Extinguishment of Debt

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

Income Taxes

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Income tax provision for the nine months ended September 30, 2008 was \$2.9 million compared to \$3.5 million in the comparable prior-year period, primarily as a result of a \$0.4 million decrease in the reserve relating to foreign unrecognized tax benefits as required by FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). The 2008 provision for income taxes included \$1.9 million relating to our foreign operations which continue to be profitable, and \$1.0 million relating to our domestic operations. The 2007 provision for income taxes included \$2.5 million relating to our foreign operations and \$1.0 million relating to our domestic operations.

Liquidity and Capital Resources

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

| | Nine Months Ended September 30, | |
|---|------------------------------------|------------|
| | 2008 | 2007 |
| Net cash provided by operating activities | \$ 22,420 | \$ 22,777 |
| Net cash used in investing activities | (21,296) | (6,543) |
| Net cash used in financing activities | (558) | (54,443) |
| Effect of exchange rates on cash and cash equivalents | 35 | (435) |
| Net change in cash and cash equivalents | 601 | (38,644) |
| Cash and cash equivalents at beginning of period | 117,083 | 147,046 |
| Cash and cash equivalents at end of period | \$ 117,684 | \$ 108,402 |

Table of Contents

We had a net increase in cash of \$0.6 million during the nine months ended September 30, 2008. Cash provided by operations was \$22.4 million for this period, as compared to \$22.8 million for the comparable 2007 period. Net income adjusted for non-cash items provided operating cash flows of \$29.0 million for the nine months ended September 30, 2008. Net cash provided by operations for the nine months ended September 30, 2008 was negatively impacted by a net change in net operating assets and liabilities of \$6.6 million. This was driven by a decrease in accounts payable and accrued expenses of approximately \$9.6 million and an increase of \$2.0 million in capitalized patent costs, partially offset by a decrease in accounts receivable of \$6.6 million. Due to the current global economic crisis, we cannot assure timely receipts of accounts receivable, due to cash constraints on our customers. As of September 30, 2008, we are not aware of any specific uncollectible accounts resulting from the current economic uncertainties and believe that related reserves are adequate to cover the uncertainties that exist.

Cash used in investing activities of \$21.3 million for the nine months ended September 30, 2008 resulted from the acquisition of Mill Lane, net of cash acquired, for \$11.0 million, as well as capital expenditures of \$10.4 million. During the fourth quarter of 2008, we expect to invest an estimated additional \$4.2 million in capital projects primarily related to engineering equipment and lab tools used in producing, testing and process development of our products and enhanced manufacturing facilities. Cash used in investing activities of \$6.5 million for the nine months ended September 30, 2007 resulted primarily from capital expenditures of \$6.8 million, partially offset by \$0.3 million in proceeds from the sale of property, plant, and equipment.

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Cash used in financing activities for the nine months ended September 30, 2008 totaled \$0.6 million, resulting from \$1.0 million in restricted stock tax withholdings and \$0.3 million in mortgage payments, offset by proceeds of \$0.7 million from common stock issuances resulting from stock option exercises. Cash used in financing activities for the nine months ended September 30, 2007 totaled \$54.4 million, primarily consisting of \$55.4 million used to repurchase a portion of our outstanding convertible subordinated notes (discussed below) and \$1.5 million in payments for debt issuance costs, partially offset by \$2.8 million from the issuance of common stock resulting from the exercise of employee stock options.

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

During the second quarter of 2007, we issued new convertible subordinated notes due 2012 (the New Notes) pursuant to privately negotiated exchange agreements with certain holders of the Old Notes. Under these agreements, such holders agreed to exchange \$118.8 million aggregate principal amount of the Old Notes for approximately \$117.8 million aggregate principal amount of New Notes due April 15, 2012. No net gain or loss was recorded on the exchange transactions since the carrying value of the Old Notes including unamortized deferred financing costs approximated the exchange value of the New Notes. Following the exchange transactions, approximately \$25.2 million of the Old Notes remained outstanding and are due in December 2008. We expect to pay off these Old Notes through the use of our available cash balances.

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

During the third quarter of 2007, we entered into the Credit Agreement with HSBC Bank, as administrative agent. The Credit Agreement provides for borrowings of up to \$100.0 million with an annual interest rate that is a floating rate equal to the prime rate of the agent bank. A LIBOR-based interest rate option is also provided. Borrowings may be used for general corporate purposes, including working capital requirements and acquisitions. The Credit Agreement contains certain restrictive covenants, and we are required to satisfy certain financial tests under the Credit Agreement. As of September 30, 2008, we are in compliance with all covenants. Substantially all of our domestic assets, other than real estate, have been pledged to secure our obligations under the New Credit Agreement. The revolving credit facility

Table of Contents

under the New Credit Agreement expires on March 31, 2012. As of September 30, 2008 and December 31, 2007, there were no borrowings or unsecured letters of credit outstanding. Since borrowing availability under the Credit Agreement is based upon earnings, the anticipated business downturn may have an impact on our borrowing availability and could potentially result in noncompliance with the restrictive covenants required by the Credit Agreement.

We believe that existing cash balances together with cash generated from operations and amounts available under the Credit Agreement will be sufficient to meet our projected working capital and other cash flow requirements for the next twelve months, as well as our contractual obligations. We believe we will be able to meet our obligation to repay the \$25.2 million outstanding Old Notes that mature on December 21, 2008 through the use of available cash, and to repay the \$117.8 million outstanding New Notes that mature on April 15, 2012 through a combination of conversion of the notes outstanding, refinancing, cash generated from operations, and other means.

During the second quarter of 2008, we acquired Mill Lane for \$11.0 million, net of cash acquired, plus potential future earn-out payments of up to \$19.0 million, contingent upon the future achievement of certain operating performance criteria. As of September 30, 2008, we have accrued \$3.5 million in earn-out payments due to revenues earned through the end of the third quarter of 2008, and we anticipate accruing approximately \$6.1 million during the fourth quarter of 2008. Payment for these earn-outs will be made in the first quarter of 2009. We believe we will be able to meet our obligation to pay these earn-out amounts to Mill Lane from the sources referred to above.

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

Application of Critical Accounting Policies

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

Revenue Recognition: We recognize revenue in accordance with the SEC Staff Accounting Bulletin No. 104, *Revenue Recognition*. Certain of our product sales are accounted for as multiple-element arrangements in accordance with Emerging Issues Task Force (EITF) 00-21, *Revenue Arrangements with Multiple Deliverables*. A multiple-element arrangement is a transaction which may involve the delivery or performance of multiple products, services, or rights to use assets, and performance may occur at different points in time or over different periods of time. We recognize revenue when persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collectability is reasonably assured. For products produced according to our published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment. For products produced according to a particular customer s specifications, revenue is recognized when the product has been tested, it has been demonstrated that it meets the customer s specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount of any customer retention (generally 10% to 20%), which is not payable by the customer until installation is completed and final customer acceptance is achieved. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% to 2% of the sales value of the related equipment. For new products, new applications of existing

Table of Contents

products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 80% to 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the amount billed at the time of shipment. The profit on the amount billed for these transactions is deferred and recorded as deferred profit in the accompanying condensed consolidated balance sheets. Service and maintenance contract revenues are recorded as deferred revenue, which is included in other accrued expenses, and recognized as revenue on a straight-line basis over the service period of the related contract.

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

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

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

Warranty Costs: We estimate the costs that may be incurred under the warranty we provide and record a liability in the amount of such costs at the time the related revenue is recognized. Estimated warranty costs are determined by analyzing specific product and historical configuration statistics and regional warranty support costs. Our warranty obligation is affected by product failure rates, material usage and labor costs incurred in correcting product failures during the warranty period. As our customer engineers and process support engineers are highly trained and deployed globally, labor availability is a significant factor in determining labor costs. The quantity and availability of critical replacement parts is another significant factor in estimating warranty costs. Unforeseen component failures or exceptional component performance can also result in changes to warranty costs. If actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required.

Income Taxes: As part of the process of preparing our Consolidated Financial Statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax expense, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our Condensed Consolidated Balance Sheets. The carrying value of our deferred tax assets is adjusted by a valuation allowance to recognize the extent to which the future tax benefits will be recognized on a more likely than not basis. Our net deferred tax assets consist primarily of net operating loss and tax credit carryforwards, and timing differences between the book and

Table of Contents

tax treatment of inventory and other asset valuations. Realization of these net deferred tax assets is dependent upon our ability to generate future taxable income.

We record valuation allowances in order to reduce our deferred tax assets to the amount expected to be realized. In assessing the adequacy of recorded valuation allowances, we consider a variety of factors, including the scheduled reversal of deferred tax liabilities, future taxable income, and prudent and feasible tax planning strategies. Under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109), factors such as current and previous operating losses are given significantly greater weight than the outlook for future profitability in determining the deferred tax asset carrying value.

At September 30, 2008, we had a valuation allowance of approximately \$68.0 million against substantially all of our domestic net deferred tax assets, which consist of net operating loss and tax credit carryforwards, as well as temporary deductible differences. The valuation allowance was calculated in accordance with the provisions of SFAS 109, which places primary importance on our historical results of operations. Although our operating results in prior years were significantly affected by restructuring and other charges, our historical losses and the loss incurred in 2007 represent negative evidence sufficient to require a full valuation allowance under the provisions of SFAS 109. If we are able to realize part or all of the deferred tax assets in future periods, we will reduce our provision for income taxes with a release of the valuation allowance in an amount that corresponds with the income tax liability generated.

In July 2006, the FASB issued FIN 48, which became effective for us on January 1, 2007. FIN 48 addresses the determination of how tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, we must recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained under examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such uncertain tax positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution.

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

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

Recent Accounting Pronouncements

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

In December 2007, the FASB issued SFAS 141(R) and SFAS 160. Under SFAS 141(R), an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition date at fair value with limited exceptions. SFAS 141(R) also changes the accounting treatment for certain other items that relate to business combinations. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after January 1, 2009. The purpose of SFAS 160 is to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements. The most significant

Table of Contents

provisions of this statement result in changes to the presentation of noncontrolling interests in the consolidated financial statements. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of this statement will impact the manner in which we present noncontrolling interests, but will not impact our consolidated financial position or results of operations.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities* (SFAS 161). SFAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008 and requires comparative disclosures only for periods subsequent to initial adoption. The adoption of the provisions of SFAS 161 will not impact our consolidated financial position or results of operations.

In May 2008, the FASB issued FSP APB 14-1. The guidance is effective for fiscal years beginning after December 15, 2008 and interim periods within those years. FSP APB 14-1 will require issuers of convertible debt that can be settled in cash to separately account for (i.e. bifurcate) a portion of the debt associated with the conversion feature and reclassify this portion to stockholders' equity. The liability portion, which represents the fair value of the debt without the conversion feature, will be accreted to its face value over the life of the debt using the effective interest method, with the accretion expense recorded to interest. FSP APB 14-1 will be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on periods prior to those presented will be recognized as of the beginning of the first period presented. We expect the adoption of FSP APB 14-1 to have a material effect on our consolidated financial position, results of operations, and earnings per share. Effective as of the date of issuance of the New Notes, we will reclassify approximately \$16.3 million from long-term debt to additional paid-in capital, and as of the adoption of FSP APB 14-1 in the beginning of 2009, our accumulated deficit will reflect approximately \$4.8 million of debt accretion that occurred between the issuance date of the New Notes and the adoption date. Approximately \$3.2 to \$3.7 million of additional interest expense will be recorded annually from the adoption date through the maturity date of the convertible debt. This additional interest expense will not require the use of cash.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Our net sales to foreign customers represented approximately 66.4% and 64.9%, respectively, of our total net sales for the three months and nine months ended September 30, 2008, and 70.3% and 67.7%, respectively, for the comparable 2007 periods. We expect that net sales to foreign customers will continue to represent a large percentage of our total net sales. Our net sales denominated in foreign currencies represented approximately 13.2% and 13.9% of our total net sales for the three months and nine months ended September 30, 2008, respectively, and 21.1% and 20.7%, respectively, for the comparable 2007 periods.

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

We are exposed to financial market risks, including changes in foreign currency exchange rates. The changes in currency exchange rates that have the largest impact on translating our international operating profit are the Japanese Yen and the Euro. We use derivative financial

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instruments to mitigate these risks. We do not use derivative financial instruments for speculative or trading purposes. We generally enter into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known currency exposures. The average notional amount of such contracts was approximately \$0.6 million and \$1.8 million, respectively, for the three months and nine months ended September 30, 2008. On September 25, 2008 we entered into two forward contracts for the month of October with a total notional amount of approximately \$3.5 million. The fair values of these contracts at inception were zero, which did not significantly change at September 30, 2008. We do not anticipate any significant future loss from fluctuations in currency exchange rates, as our hedging strategy is designed to minimize the risk of such fluctuations.

Table of Contents

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

Item 4. Controls and Procedures.

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

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

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

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

On August 11, 2008, we announced that we had settled the patent litigation which we had brought in 2003 in the United States District Court for the Central District of California against Asylum Research Corporation, a privately-held company founded by former Veeco employees. In the lawsuit, we had alleged that the manufacture, use, and sale of Asylum's MFP-3D AFM constituted willful infringement of five patents owned by us, as well as other claims. In the settlement, Veeco and Asylum agreed to drop all pending claims against each other and agreed to a five year, worldwide cross license of each company's patents and a mutual covenant not to sue on patents either party has a right to assert. Asylum made a net payment to Veeco and will pay an ongoing royalty to Veeco for the five-year term of the cross license. As part of the settlement, Asylum acknowledged the validity of the Veeco patents asserted in the case. During the case, we capitalized legal costs incurred to defend our patents and are now amortizing these capitalized costs over the remaining lives of these patents. Payments received from Asylum have been and will continue to be netted against the capitalized legal costs upon receipt.

Item 1A. Risk Factors.

In addition to the information regarding risk factors that appears in the Safe Harbor Statement at the beginning of this Quarterly Report on Form 10-Q and in Part I Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2007, we have noted the following significant risk factor as of September 30, 2008:

The recent turmoil in the world's credit markets may have a protracted adverse impact on capital spending in the markets we serve and, as a result, could have a material adverse effect on our business and our results of operations.

We are exposed to the risks associated with the volatility of the U.S. and global economies. In October 2008, the global financial markets experienced significant losses due to failures of many dominant financial institutions. The governments of the United States and several foreign countries instituted a bailout plan to assist many banks and lenders through the economic crisis. This crisis results in a lack of visibility regarding whether or when there will be sustained

Table of Contents

growth periods for sales of our products and uncertainty regarding the amount of sales, since many of our customers rely on lending arrangements and/or have limited resources to finance capital technology expenditures. In addition, it is expected that this crisis and economic uncertainty will result in decreased consumer business and government spending, which will likely reduce the need our customers have for our products. Slow or negative growth in the global economy may continue to materially and adversely affect our business, financial condition and results of operations for the foreseeable future. Our results of operations would be further adversely affected if we were to experience lower than anticipated order levels, cancellations of orders in backlog, extended customer delivery requirements, or pricing pressure as a result of a slowdown. Any negative effect on our earnings may affect our borrowing availability and potentially result in noncompliance with the restrictive covenants of our existing credit agreement.

Item 6. Exhibits.

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

| Number | Description | Incorporated by Reference to the Following Document: |
|--------|--|---|
| 3.1 | Fourth Amended and Restated Bylaws of the Company, effective October 23, 2008 | Current Report on Form 8-K filed October 27, 2008, Exhibit 3.1 |
| 10.1 | Amendment to Employment Agreement dated as of September 12, 2008 between John F. Rein, Jr. and Veeco Instruments Inc. | * |
| 10.2 | Amendment to Employment Agreement dated as of September 12, 2008 between Robert P. Oates and Veeco Instruments Inc. | * |
| 10.3 | Senior Executive Change in Control Policy effective as of September 12, 2008 | * |
| 10.4 | Service Agreement effective July 24, 2008 between Edward H. Braun and Veeco Instruments Inc. | Quarterly Report on Form 10-Q for the quarter ended June 30, 2008, Exhibit 10.1 |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934. | * |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934. | * |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |

* Filed herewith

Table of Contents

SIGNATURES

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

Date: October 29, 2008

Veeco Instruments Inc.

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

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

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