

VEECO INSTRUMENTS INC
Form 10-Q
October 29, 2014
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**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, 2014

OR

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

For the transition period from to .

Commission file number 0-16244

VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

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

11803
(Zip Code)

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

Website: **www.veeco.com**

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

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

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

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

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

40,217,447 shares of common stock were outstanding as of the close of business on October 24, 2014.

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Safe Harbor Statement

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

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

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- We face significant competition;
 - We depend on a limited number of customers, located primarily in a limited number of regions, which operate in highly concentrated industries;
 - Our sales cycle is long and unpredictable;
 - We are subject to internal control evaluations and attestation requirements of Section 404 of the Sarbanes-Oxley Act and any delays or difficulty in satisfying these requirements or negative reports concerning our internal controls could adversely affect our future results of operations and our stock price;
 - The price of our common shares may be volatile and could decline significantly;
 - Our inability to attract, retain, and motivate key employees could have a material adverse effect on our business;
 - We are subject to foreign currency exchange risks;
 - The enforcement and protection of our intellectual property rights may be expensive and could divert our limited resources;
 - We may be subject to claims of intellectual property infringement by others;
 - If we are subject to cyber-attacks we could incur substantial costs and, if such attacks are successful, could result in significant liabilities, reputational harm and disruption of our operations;
 - Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses;
 - We may be required to take additional impairment charges for goodwill and indefinite-lived intangible assets or definite-lived intangible and long-lived assets;
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- Changes in accounting pronouncements or taxation rules or practices may adversely affect our financial results;
- We are subject to risks of non-compliance with environmental, health and safety regulations;
- We have significant operations in locations which could be materially and adversely impacted in the event of a natural disaster or other significant disruption;
- We have adopted certain measures that may have anti-takeover effects which may make an acquisition of our Company by another company more difficult;
- New regulations related to conflict minerals will force us to incur additional expenses, may make our supply chain more complex, and may result in damage to our relationships with customers; and
- The matters set forth in this Report generally, including the risk factors set forth in Part II. Item 1A. Risk Factors.

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

Available Information

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

Internet Address

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

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

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--------------------------------------|---|------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net sales | \$ 93,341 | \$ 99,324 | \$ 279,304 | \$ 258,540 |
| Cost of sales | 60,783 | 69,016 | 182,296 | 171,040 |
| Gross profit | 32,558 | 30,308 | 97,008 | 87,500 |
| Operating expenses: | | | | |
| Selling, general and administrative | 21,712 | 19,650 | 65,270 | 59,077 |
| Research and development | 19,968 | 18,993 | 60,747 | 60,600 |
| Amortization | 3,149 | 855 | 8,951 | 2,566 |
| Restructuring | 2,317 | 1,240 | 3,510 | 1,771 |
| Asset impairment | 2,864 | | 2,864 | |
| Total operating expenses | 50,010 | 40,738 | 141,342 | 124,014 |
| Other operating, net | 36 | (493) | (334) | (141) |
| Changes in contingent consideration | | | (29,368) | |
| Operating income (loss) | (17,488) | (9,937) | (14,632) | (36,373) |
| Interest income (expense), net | 305 | 192 | 541 | 620 |
| Income (loss) before income taxes | (17,183) | (9,745) | (14,091) | (35,753) |
| Income tax provision (benefit) | (3,206) | (3,719) | (4,063) | (15,575) |
| Net income (loss) | \$ (13,977) | \$ (6,026) | \$ (10,028) | \$ (20,178) |
| Income (loss) per common share: | | | | |
| Basic: | | | | |
| Income (loss) | \$ (0.35) | \$ (0.16) | \$ (0.26) | \$ (0.52) |
| Diluted : | | | | |
| Income (loss) | \$ (0.35) | \$ (0.16) | \$ (0.26) | \$ (0.52) |
| Weighted average shares outstanding: | | | | |
| Basic | 39,401 | 38,841 | 39,317 | 38,774 |
| Diluted | 39,401 | 38,841 | 39,317 | 38,774 |

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

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Veeco Instruments Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

(Unaudited)

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|------------|--|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Net income (loss) | \$ (13,977) | \$ (6,026) | \$ (10,028) | \$ (20,178) |
| Other comprehensive income (loss), net of tax | | | | |
| Available-for-sale securities | | | | |
| Unrealized gain (loss) on available-for-sale securities | 6 | 225 | 127 | (15) |
| Benefit (provision) for income taxes | | (54) | | 25 |
| Less: Reclassification adjustments for gains included in net income (loss) | | (1) | (45) | (52) |
| Net unrealized gain (loss) on available-for-sale securities | 6 | 170 | 82 | (42) |
| Foreign currency translation | | | | |
| Foreign currency translation | (138) | (273) | (29) | (1,346) |
| Benefit (provision) for income taxes | | 176 | | (13) |
| Net foreign currency translation | (138) | (97) | (29) | (1,359) |
| Other comprehensive income (loss), net of tax | (132) | 73 | 53 | (1,401) |
| Comprehensive income (loss) | \$ (14,109) | \$ (5,953) | \$ (9,975) | \$ (21,579) |

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

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

| | September 30, 2014 (Unaudited) | December 31, 2013 |
|--|--------------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 264,008 | \$ 210,799 |
| Short-term investments | 222,954 | 281,538 |
| Restricted cash | 487 | 2,738 |
| Accounts receivable, net | 61,588 | 23,823 |
| Inventories | 46,594 | 59,726 |
| Deferred cost of sales | 7,434 | 724 |
| Prepaid expenses and other current assets | 43,898 | 22,579 |
| Assets held for sale | 2,653 | |
| Deferred income taxes | 8,384 | 11,716 |
| Total current assets | 658,000 | 613,643 |
| Property, plant and equipment at cost, net | 80,720 | 89,139 |
| Goodwill | 91,521 | 91,348 |
| Deferred income taxes | 397 | 397 |
| Intangible assets, net | 106,015 | 114,716 |
| Other assets | 19,745 | 38,726 |
| Total assets | \$ 956,398 | \$ 947,969 |
| Liabilities and equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 26,113 | \$ 35,755 |
| Accrued expenses and other current liabilities | 40,468 | 51,084 |
| Customer deposits and deferred revenue | 65,553 | 34,754 |
| Income taxes payable | 6,840 | 6,149 |
| Deferred income taxes | 159 | 159 |
| Current portion of long-term debt | 308 | 290 |
| Total current liabilities | 139,441 | 128,191 |
| Deferred income taxes | 19,741 | 28,052 |
| Long-term debt | 1,614 | 1,847 |
| Other liabilities | 3,484 | 9,649 |
| Total liabilities | 164,280 | 167,739 |
| Equity: | | |
| Preferred stock, 500,000 shares authorized; no shares issued and outstanding | | |
| Common stock; \$.01 par value; authorized 120,000,000 shares; 40,232,642 and 39,666,195 shares issued and outstanding in 2014 and 2013, respectively | 402 | 397 |
| Additional paid-in capital | 743,210 | 721,352 |
| Retained earnings | 43,832 | 53,860 |
| Accumulated other comprehensive income | 4,674 | 4,621 |
| Total equity | 792,118 | 780,230 |
| Total liabilities and equity | \$ 956,398 | \$ 947,969 |

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

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

| | Nine months ended September 30, | |
|---|------------------------------------|-------------|
| | 2014 | 2013 |
| Cash Flows from Operating Activities | | |
| Net income (loss) | \$ (10,028) | \$ (20,178) |
| Adjustments to reconcile net income (loss) to net cash from operating activities: | | |
| Depreciation and amortization | 17,649 | 12,080 |
| Deferred income taxes | (4,973) | (5,196) |
| Non-cash asset impairment | 2,864 | |
| Non-cash equity-based compensation | 14,303 | 9,054 |
| Provision (recovery) for bad debt | (1,833) | 5 |
| Gross profit from sales of lab tools | (2,435) | |
| Change in contingent consideration | (29,368) | |
| Excess tax benefits from equity-based compensation | | (485) |
| Other, net | | 15 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (36,149) | 25,095 |
| Inventories | 13,650 | 2,165 |
| Prepaid expenses and other current assets | (3,046) | (4,801) |
| Accounts payable | (9,679) | 2,307 |
| Accrued expenses, customer deposits, deferred revenue and other current liabilities | 41,630 | (15,235) |
| Income taxes payable | 691 | (821) |
| Other, net | 124 | 605 |
| Net cash provided by (used in) operating activities | (6,600) | 4,610 |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (10,476) | (7,976) |
| Proceeds from the liquidation of short-term investments | 216,050 | 422,903 |
| Payments for purchases of short-term investments | (157,733) | (553,217) |
| Payments for purchase of cost method investment | (2,388) | (1,594) |
| Proceeds from sale of lab tools | 7,034 | |
| Other | 126 | 25 |
| Net cash provided by (used in) investing activities | 52,613 | (139,859) |
| Cash Flows from Financing Activities | | |
| Proceeds from stock option exercises | 9,485 | 313 |
| Restricted stock tax withholdings | (1,925) | (2,358) |
| Excess tax benefits from equity-based compensation | | 485 |
| Repayments of long-term debt | (215) | (199) |
| Net cash provided by (used in) financing activities | 7,345 | (1,759) |
| Effect of exchange rate changes on cash and cash equivalents | (149) | 117 |
| Net increase (decrease) in cash and cash equivalents | 53,209 | (136,891) |
| Cash and cash equivalents as of beginning of period | 210,799 | 384,557 |
| Cash and cash equivalents as of end of period | \$ 264,008 | \$ 247,666 |
| Non-cash investing and financing activities | | |
| Settlement of stock option exercise (shares withheld) | \$ 1,334 | \$ |

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

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

Note 1 Basis of Presentation

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

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

Use of Estimates

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

Income (Loss) Per Common Share

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

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| | Three months ended September 30, | | Nine months ended September 30, | |
|---|-------------------------------------|--------|------------------------------------|--------|
| | 2014 | 2013 | 2014 | 2013 |
| Basic weighted average shares outstanding | 39,401 | 38,841 | 39,317 | 38,774 |
| Dilutive effect of stock options and restricted stock | | | | |
| Diluted weighted average shares outstanding | 39,401 | 38,841 | 39,317 | 38,774 |

Basic income (loss) per common share is computed using the basic weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is computed using the diluted weighted average number of common shares which include any common equivalent shares calculated to be outstanding during the period. For the three months and nine months ended September 30, 2014 and 2013, we reported a net loss, and accordingly, the basic and diluted weighted average shares outstanding are equal because any increase to basic weighted average shares outstanding would be antidilutive. As a result, for the three and nine months ended September 30, 2014, we excluded 0.6 million and 0.7 million common equivalent shares and for both the three and nine months ended September 30, 2013, we excluded 0.6 million common equivalent shares.

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Additionally, not included above were additional stock options and restricted stock outstanding that had exercise or grant prices in excess of the average market value of our common stock during the period and are therefore antidilutive. There were 1.8 million and 1.5 million of such underlying shares for the three and nine months ended September 30, 2014, respectively. There were 1.0 million and 1.1 million of such underlying shares for the three and nine months ended September 30, 2013, respectively.

Revenue Recognition

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

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

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

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

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

Our sales arrangements, including certain upgrades, generally include installation. The installation process is not deemed essential to the functionality of the equipment since it is not complex; that is, it does not require significant changes to the features or capabilities of the equipment or involve building elaborate interfaces or connections subsequent to factory

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

In Japan, where our contractual terms with customers generally specify title and risk and rewards of ownership transfer upon customer acceptance, revenue is recognized upon the receipt of written customer acceptance. During the fourth quarter of fiscal 2013, we began using a distributor for almost all of our product and service sales to customers in Japan. Title passes to the distributor upon shipment, however, due to customary local business practices, the risk and rewards of ownership of our system sales transfer to the end-customers upon their acceptance. As such, we recognize revenue upon receipt of written acceptance from the end customer.

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

Recent Accounting Pronouncements

Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern: In August 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The amendments in this ASU apply to all entities and provide guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern or to provide related footnote disclosures. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016; early application is permitted. We do not expect the application of this guidance to have a material impact on our consolidated financial statements.

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

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

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

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

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

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

Note 2 Business Combinations

On October 1, 2013 (the Acquisition Date), Veeco acquired 100% of the outstanding common shares and voting interest of Synos Technology, Inc. (Synos). The results of Synos' operations have been included in the consolidated financial statements since that date. Synos is an early stage manufacturer of fast array scanning atomic layer deposition (FAST-ALD) systems for Organic LED (OLED) and other applications.

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

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

consideration in the Consolidated Statement of Operations.

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

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

Note 3 Income Taxes

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

Our effective tax rate for the three months ended September 30, 2014 was a benefit of 18.7% compared to a benefit of 38.2% during the three months ended September 30, 2013. Our effective tax rate for the nine months ended September 30, 2014 was a benefit of 28.8% compared to a benefit of 43.6% during the nine months ended September 30, 2013. A tax benefit for each period was provided to the extent of future reversals of taxable temporary differences which relate primarily to non-tax deductible intangibles.

Our effective tax rate for 2014 differed from the U.S. federal statutory rate of 35% primarily related to our ability to recognize only a portion of the deferred tax assets on a more likely than not basis with respect to current year pre-tax operating losses. The effective tax rate for the nine months ended September 30, 2014 was also impacted by a discrete tax benefit in connection with the settlement of our 2010 IRS examination and because we did not provide a tax provision on the gain from the settlement of the contingent consideration related to the Synos acquisition.

Our effective tax rate for 2013 differed from the U.S. federal statutory rate as a result of the jurisdictional mix of earnings in our foreign locations, an income tax benefit related to the generation of current year research and development tax credits, and legislation enacted in the first quarter of 2013 which extended the Federal Research & Development Credit for both the 2012 and 2013 tax years.

We recently settled our 2010 IRS examination, resulting in the release of \$2.3 million of liabilities relating to uncertain tax positions. We were also notified that the IRS will commence an examination of our 2011 tax year beginning in the quarter ending December 31, 2014.

Note 4 Balance Sheet Information

Cash and Cash Equivalents

Cash and cash equivalents include cash and certain highly liquid investments. Highly liquid investments with maturities of three months or less when purchased may be classified as cash equivalents. Such items may include liquid money market accounts, U.S. treasuries, government

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agency securities and corporate debt. The investments that are classified as cash equivalents are carried at cost, which approximates fair value.

Short-Term Investments

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

| | September 30, 2014 | | | | |
|-------------------------------------|--------------------|---------------|---------------|----|----------------|
| | Amortized | Gains in | Losses in | | Estimated Fair |
| | Cost | Accumulated | Accumulated | | Value |
| | | Other | Other | | |
| | | Comprehensive | Comprehensive | | |
| | | Income | Income | | |
| U.S. treasuries | \$ 90,523 | \$ 35 | \$ (1) | \$ | 90,557 |
| Corporate debt | 69,109 | 93 | (4) | \$ | 69,198 |
| Government agency securities | 63,191 | 8 | | | 63,199 |
| Total available-for-sale securities | \$ 222,823 | \$ 136 | \$ (5) | \$ | 222,954 |

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During the three and nine months ended September 30, 2014, available-for-sale securities were liquidated for total proceeds of \$94.8 million and \$216.1 million, respectively. For the three and nine months ended September 30, 2014 there were minimal realized gains on these liquidations. During the three and nine months ended September 30, 2013, available-for-sale securities were liquidated for total proceeds of \$150.5 million and \$422.9 million, respectively. There were minimal gross realized gains on these sales for the three months ended September 30, 2013 and \$0.1 million of gross realized gains on these sales for the nine months ended September 30, 2013. The cost of securities liquidated is based on specific identification.

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

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

| | September 30, 2014 Less than 12 months | |
|-----------------|---|----------------------------|
| | Estimated Fair Value | Gross Unrealized Losses |
| U.S. treasuries | \$ 15,006 | \$ (1) |
| Corporate debt | 7,221 | (4) |
| Total | \$ 22,227 | \$ (5) |

| | December 31, 2013 Less than 12 months | |
|------------------|--|----------------------------|
| | Estimated Fair Value | Gross Unrealized Losses |
| Corporate debt | \$ 37,654 | \$ (36) |
| U. S. treasuries | 29,068 | (1) |
| Total | \$ 66,722 | \$ (37) |

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

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

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

| | September 30, 2014 |
|-------------------------------------|-----------------------------|
| | Estimated Fair Value |
| Due in one year or less | \$ 135,948 |
| Due in 1 - 2 years | 87,006 |
| Total available-for-sale securities | \$ 222,954 |

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

Restricted Cash

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

Accounts Receivable, Net

Accounts receivable are presented net of allowance for doubtful accounts of \$0.9 million and \$2.4 million as of September 30, 2014 and December 31, 2013, respectively. We evaluate the collectability of accounts receivable based on a combination of factors. In cases where we become aware of circumstances that may impair a customer's ability to meet its financial obligations subsequent to the original sale, we will record an allowance against amounts due, and thereby reduce the net recognized receivable to the amount we reasonably believe will be collected. For all other customers, we recognize an allowance for doubtful accounts based on the length of time the receivables are past due and consideration of other factors such as industry conditions, the current business environment and its historical experience.

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

Inventories

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

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| | September 30, 2014 | | December 31, 2013 |
|-----------------|-----------------------|----|----------------------|
| Materials | \$ 26,305 | \$ | 34,301 |
| Work in process | 15,169 | | 12,900 |
| Finished goods | 5,120 | | 12,525 |
| | \$ 46,594 | \$ | 59,726 |

Assets Held for Sale and Property, Plant and Equipment, Net

During the three and nine months ended September 30, 2014, we transferred \$2.7 million of assets from property, plant and equipment, net to assets held for sale. In conjunction with the transfer, these assets were evaluated for impairment in accordance with the accounting guidance. As a result, during the three and nine months ended September 30, 2014, we recognized an asset impairment charge of \$2.4 million and a corresponding reduction to property, plant and equipment of \$5.1 million. The \$2.4 million impairment charge consisted of \$1.6 million relating to our research and demonstration labs in Asia and \$0.8 million relating to vacant land in our LED and Solar segment. During the three and nine months ended September 30, 2014, we recognized an additional asset impairment charge of \$0.4 million relating to assets in our LED and Solar segment that we abandoned during the quarter.

As of September 30, 2014, we are holding \$2.9 million of tools that were previously used in our laboratories, for sale. These tools are carried in machinery and equipment, as a component of property, plant and equipment, net in our Consolidated Balance Sheets. These tools are the same type of tools we sell to our customers in the ordinary course of our business. During

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the nine months ended September 30, 2014, we converted and sold \$4.6 million of tools that we had previously used in our laboratories as Veeco Certified Equipment at an aggregate selling price of \$7.0 million which is included in revenue in our Consolidated Statements of Operations. We did not sell any of these tools during the three months ended September 30, 2014.

Intangible Assets, Net

During the three months ended September 30, 2014, we completed the \$5.1 million of in-process research and development acquired with our ALD business (see Note *Business Combinations*). No impairment was required, and as such, we will amortize this asset over a useful life of 13 years. During the three months ended September 30, 2014 we recognized amortization expense of approximately \$0.1 million relating to this asset.

Goodwill

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

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

Cost Method Investment

We maintain certain investments in support of our strategic business objectives, including a non-marketable cost method investment. Our ownership interest is less than 20% of the investee's voting stock and we do not exert significant influence, therefore the investment is recorded at cost. The carrying value of the investment was \$19.4 million and \$16.9 million at September 30, 2014 and December 31, 2013, respectively and is included in Other assets on the Consolidated Balance Sheet. The investment is subject to a periodic impairment review; however, there are no open-market valuations, and the impairment analysis requires significant judgment. This analysis includes assessment of the investee's financial condition, the business outlook for its products and technology, its projected results and cash flow, the likelihood of obtaining subsequent rounds of financing, and the impact of any relevant contractual equity preferences held by us or others. Fair value of the investment is not estimated unless there are identified events or changes in circumstances that could have a significant adverse effect on the fair value of the investment. No such events or circumstances are present.

Customer Deposits and Deferred Revenue

As of September 30, 2014 and December 31, 2013, we had customer deposits of \$35.8 million and \$27.5 million, respectively recorded as a component of customer deposits and deferred revenue.

Accrued Warranty

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

| | | September 30, | | |
|---------------------------------------|----|---------------|----|---------|
| | | 2014 | | 2013 |
| Balance as of the beginning of period | \$ | 5,662 | \$ | 4,942 |
| Warranties issued during the period | | 2,536 | | 2,778 |
| Settlements made during the period | | (3,160) | | (3,315) |
| Changes in estimate during the period | | 259 | | |
| Balance as of the end of period | \$ | 5,297 | \$ | 4,405 |

Mortgage Payable

We have a mortgage payable with approximately \$1.9 million and \$2.1 million outstanding as of September 30, 2014 and December 31, 2013, respectively. The mortgage accrues interest at an annual rate of 7.91%, and the final payment is due on

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January 1, 2020. Our estimate of the fair value of the mortgage as of September 30, 2014 and December 31, 2013 was approximately \$2.0 million and \$2.3 million, respectively. We believe the mortgage is a Level 3 liability in the fair-value hierarchy.

Accumulated Other Comprehensive Income

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

| | Gross | | Taxes | | Net |
|--|----------|----|-------|----|-------|
| As of September 30, 2014 | | | | | |
| Translation adjustments | \$ 5,689 | \$ | (392) | \$ | 5,297 |
| Minimum pension liability | (1,160) | | 424 | | (736) |
| Unrealized gain on available-for-sale securities | 131 | | (18) | | 113 |
| Accumulated other comprehensive income | \$ 4,660 | \$ | 14 | \$ | 4,674 |

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

Equity

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

| | For the nine months ended September 30, 2014 Shares |
|--|---|
| Restricted Stock | |
| Grants | 221 |
| Gross Vesting | 173 |
| Shares Withheld to Cover Taxes & Cancelled | (57) |
| Net Shares Vested | 116 |
| Stock Options | |
| Exercised | 402 |

Note 5 Segment Information

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We have five identified operating segments that we aggregate into two reportable segments: the VIBE and Mechanical operating segments which are reported in our Data Storage segment; and the metal organic chemical vapor deposition (MOCVD), molecular beam epitaxy (MBE) and atomic layer deposition (ALD) operating segments are reported in our LED & Solar segment. We manage the business, review operating results and assess performance, as well as allocate resources, based upon our operating segments that reflect the market focus of each business. The LED & Solar segment consists of MOCVD systems, MBE systems, thermal deposition sources, ALD technology and other types of deposition systems. These systems are primarily sold to customers in the LED, OLED and solar industries, as well as to scientific research customers. This segment has product development and marketing sites in Somerset, New Jersey, Poughkeepsie, New York, St. Paul, Minnesota, Fremont, California, and Korea. The Data Storage segment consists of the ion beam etch, ion beam deposition, diamond-like carbon, physical vapor deposition, and dicing and slicing products sold primarily to customers in the data storage industry. This segment has product development and marketing sites in Plainview, New York, Ft. Collins, Colorado and Camarillo, California. As of September 30, 2014, we are continuing the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and have begun consolidation of our Camarillo, California facility into the Plainview, New York facility.

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We evaluate the performance of our reportable segments based on income (loss) from operations before interest, income taxes, amortization and other items (segment profit (loss)), which is the primary indicator used to plan and forecast future periods. The presentation of this financial measure facilitates meaningful comparison with prior periods, as management believes segment profit (loss) reports baseline performance and thus provides useful information. Other items include restructuring expenses, asset impairment charges, equity-based compensation expense and other non-recurring items. The accounting policies of the reportable segments are the same as those described in the summary of critical accounting policies. Beginning in the third quarter of 2014, we began evaluating our reportable segments using segment profit (loss) before depreciation. Prior period segment profit (loss) reported below reflect this change for comparability.

The following table presents certain data pertaining to our reportable segments and a reconciliation of segment profit (loss) to income (loss) before income taxes for the three months ended September 30, 2014 and 2013, respectively (*in thousands*):

| | LED & Solar | Data Storage | Unallocated | Total |
|--|-------------|--------------|-------------|-------------|
| Three months ended September 30, 2014 | | | | |
| Net sales | \$ 76,850 | \$ 16,491 | \$ | \$ 93,341 |
| Segment profit (loss) | \$ 3,767 | \$ (1,417) | \$ (4,118) | \$ (1,768) |
| Interest income (expense), net | | | 305 | 305 |
| Depreciation | (2,267) | (417) | (216) | (2,900) |
| Amortization | (2,825) | (324) | | (3,149) |
| Equity-based compensation | (2,083) | (647) | (1,760) | (4,490) |
| Restructuring | (557) | (1,403) | (357) | (2,317) |
| Asset impairment | (2,799) | (65) | | (2,864) |
| Income (loss) before income taxes | \$ (6,764) | \$ (4,273) | \$ (6,146) | \$ (17,183) |
| Three months ended September 30, 2013 | | | | |
| Net sales | \$ 75,001 | \$ 24,323 | \$ | \$ 99,324 |
| Segment profit (loss) | \$ 801 | \$ 2,570 | \$ (5,210) | \$ (1,839) |
| Interest income (expense), net | | | 192 | 192 |
| Depreciation | (2,524) | (435) | (281) | (3,240) |
| Amortization | (531) | (324) | | (855) |
| Equity-based compensation | (1,016) | (439) | (1,308) | (2,763) |
| Restructuring | (793) | (447) | | (1,240) |
| Income (loss) before income taxes | \$ (4,063) | \$ 925 | \$ (6,607) | \$ (9,745) |

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The following table presents certain data pertaining to our reportable segments and a reconciliation of segment profit (loss) to income (loss) before income taxes for the nine months ended September 30, 2014 and 2013, respectively (*in thousands*):

| | LED & Solar | Data Storage | Unallocated | Total |
|---|-------------|--------------|-------------|-------------|
| Nine months ended September 30, 2014 | | | | |
| Net sales | \$ 224,759 | \$ 54,545 | \$ | \$ 279,304 |
| Segment profit (loss) | \$ 8,768 | \$ (1,634) | \$ (12,808) | \$ (5,674) |
| Interest income (expense), net | | | 541 | 541 |
| Depreciation | (6,760) | (1,191) | (747) | (8,698) |
| Amortization | (7,980) | (971) | | (8,951) |
| Equity-based compensation | (6,595) | (2,029) | (5,679) | (14,303) |
| Restructuring | (794) | (2,359) | (357) | (3,510) |
| Changes in contingent consideration | 29,368 | | | 29,368 |
| Asset impairment | (2,799) | (65) | | (2,864) |
| Income (loss) before income taxes | \$ 13,208 | \$ (8,249) | \$ (19,050) | \$ (14,091) |
| Nine months ended September 30, 2013 | | | | |
| Net sales | \$ 193,241 | \$ 65,299 | \$ | \$ 258,540 |
| Segment profit (loss) | \$ (2,327) | \$ 3,531 | \$ (14,671) | \$ (13,467) |
| Interest income (expense), net | | | 620 | 620 |
| Depreciation | (7,494) | (1,142) | (878) | (9,514) |
| Amortization | (1,595) | (971) | | (2,566) |
| Equity-based compensation | (3,042) | (1,057) | (4,956) | (9,055) |
| Restructuring | (1,216) | (497) | (58) | (1,771) |
| Income (loss) before income taxes | \$ (15,674) | \$ (136) | \$ (19,943) | \$ (35,753) |

The following table presents goodwill and total assets as of September 30, 2014 and December 31, 2013 (*in thousands*):

| | LED & Solar | Data Storage | Unallocated | Total |
|--|-------------|--------------|-------------|------------|
| <u>As of September 30, 2014</u> | | | | |
| Goodwill | \$ 91,521 | \$ | \$ | \$ 91,521 |
| Total assets | \$ 388,745 | \$ 33,936 | \$ 533,717 | \$ 956,398 |
| <u>As of December 31, 2013</u> | | | | |
| Goodwill | \$ 91,348 | \$ | \$ | \$ 91,348 |
| Total assets | \$ 359,464 | \$ 37,910 | \$ 550,595 | \$ 947,969 |

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

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

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

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

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

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

| | September 30, 2014 | | | Total |
|----------------------------------|--------------------|---------|---------|-----------|
| | Level 1 | Level 2 | Level 3 | |
| Cash and cash equivalents | | | | |
| U.S. treasuries | \$ 25,000 | \$ | \$ | \$ 25,000 |
| Commercial paper | | 3,999 | | 3,999 |
| Short-term investments | | | | |
| U.S. treasuries | 90,558 | | | 90,558 |
| Corporate debt | | 69,198 | | 69,198 |
| Government agency securities | | 63,198 | | 63,198 |

| | December 31, 2013 | | | Total |
|-------------------------------|-------------------|---------|---------|------------|
| | Level 1 | Level 2 | Level 3 | |
| Short-term investments | | | | |
| U.S. treasuries | \$ 130,977 | \$ | \$ | \$ 130,977 |
| Corporate debt | | 77,601 | | 77,601 |

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| | | |
|---------------------------------|----------|----------|
| Government agency securities | 61,013 | 61,013 |
| Commercial paper | 11,947 | 11,947 |
| Derivative instrument | 907 | 907 |
| Contingent consideration | (29,368) | (29,368) |

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

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

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facilitate identification and resolution of potentially erroneous prices. We review the information provided by the third-party service provider to record the fair value of our portfolio.

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

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

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

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

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

Note 7 Derivative Financial Instruments

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

During the three months ended December 31, 2013, we entered into an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates related to a particular receivable. The net fair value of these collars as of December 31, 2013 was approximately \$0.9 million. During the second quarter of 2014, the collars were closed and resulted in a realized gain of \$0.5 million. As of September 30, 2014, there were no outstanding derivative instruments.

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

| (in thousands) | Location of realized net gain (loss) and changes in the fair value of derivatives | Amount of realized net gain (loss) and changes in the fair value of derivatives | | | |
|------------------------------------|---|---|--------------------|---------------------------|--------------------|
| | | For the three months ended | | For the nine months ended | |
| | | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Foreign currency exchange forwards | Other operating, net | \$ | \$ (11) | \$ (89) | \$ 146 |
| Foreign currency collar | Other operating, net | | | (457) | |

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

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

During the first quarter of 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. We expect to substantially complete the consolidation by the end of 2014. As a result of these actions we notified 49 employees of their termination from the Company. During the three and nine months ended September 30, 2014, we recorded restructuring charges relating to these actions of \$0.7 million and \$1.9 million, consisting of personnel severance and related costs. We expect to incur approximately \$0.2 million and \$0.1 million of additional personnel severance and related costs in our Data Storage segment in the fourth quarter of 2014 and 2015, respectively, and a lease charge of approximately \$0.9 million in the fourth quarter of 2014, related to these actions. The reductions in headcount principally related to our Data Storage and MBE businesses.

During the three months ended September 30, 2014 the Company undertook additional restructuring activities, including the consolidation of our Camarillo, CA facility into our Plainview, New York facility and additional headcount reductions to help contain costs and further improve profitability. We expect to substantially complete the consolidation by the end of 2014. As a result of these actions we notified 44 additional employees of their termination from the Company. During the three and nine months ended September 30, 2014, we recorded restructuring charges relating to these actions of \$1.6 million, consisting of personnel severance and related costs. We expect to incur approximately \$2.1 million of additional personnel severance and related costs and a lease charge of approximately \$0.2 million, all of which are expected to be incurred in the fourth quarter of 2014. The reductions in head count principally related to our Data Storage businesses.

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During the three and nine months ended September 30, 2013, we took measures to improve profitability, including the restructuring of one of our international sales offices and consolidation of certain sales, business and administrative functions. As a result of these actions, we recorded restructuring charges of \$1.2 million and \$1.8 million, respectively.

Table of Contents*Restructuring Liability*

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

| | Balance as of January 1, 2014 | Rollforward of Restructuring Liability For the nine months ended September 30, 2014 | | | Balance as of September 30, 2014 | Short-term portion |
|---------------|----------------------------------|--|---------------|-------------|-------------------------------------|-----------------------|
| | | Expense Incurred | Cash Payments | Adjustments | | |
| 2012 | | | | | | |
| Restructuring | \$ 195 | \$ | \$ (195) | \$ | \$ | \$ |
| 2013 | | | | | | |
| Restructuring | 338 | | (338) | | | |
| 2014 | | | | | | |
| Restructuring | | 3,510 | (1,538) | | 1,972 | 1,972 |
| Total | \$ 533 | \$ 3,510 | \$ (2,071) | \$ | \$ 1,972 | \$ 1,972 |

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

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

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

Cumulative Translation Adjustment

During the second quarter of 2014, the Company began executing a plan to liquidate our foreign subsidiary in Japan. Subsequent to third quarter end, in October 2014, the liquidation was completed. As a result of this liquidation we expect to realize into income the balance of the CTA at the time of liquidation. The balance in the CTA account as of September 30, 2014 was approximately \$3.3 million. Upon liquidation during the three months ended December 31, 2014, we expect to record a gain of approximately \$3.1 million, inclusive of the gain from the CTA.

Legal Proceedings

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

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

Cautionary Statement Regarding Forward Looking Statements

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

You should not place undue reliance on any forward-looking statements, which speak only as of the dates they are made. When used in this Report, the words believes, anticipates, expects, estimates, plans, intends will and similar expressions are intended to identify forward-looking statements.

Executive Summary

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

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

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

After a long downturn in our MOCVD business, LED fab utilization rates have improved to high levels at most key accounts and LED lighting adoption is accelerating. Our customers are also reporting better market demand for LED backlighting products. MOCVD business conditions and bookings have improved from last year. Trends in the LED markets remain favorable, as indicated by our MOCVD nine month order and revenue patterns compared to last year. While quarterly MOCVD order patterns fluctuate, we see solid growth ahead. The timing and magnitude of key customer expansions could cause MOCVD orders to vary and be unpredictable on a quarterly basis. We continue to invest in MOCVD products and technology development to further improve our customers' cost of ownership and manufacturing capability. Competitive pricing pressure, which had a dramatic effect on our gross margins in 2013 and 2014, is also difficult to predict.

Our ALD business was acquired pre-revenue and thus has negatively impacted our earnings in 2013 and 2014. The timing of production ALD orders from our key customer could have a significant impact on our expected revenue growth. We do not expect to receive any ALD production orders in 2014.

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

Low growth is expected to continue in the hard drive industry; our customers have excess manufacturing capacity and they have only been making select technology purchases. Future demand for our Data Storage products is unclear and orders are expected to fluctuate from quarter to quarter.

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We have been working to streamline our business operations and reduce our expense structure, enabling investments in high growth opportunities such as LED and OLED display. These activities are expected to reduce Veeco's operating expenses in the near future.

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

As of September 30, 2014, Veeco had approximately 750 employees (including temporary employees) to support our customers through product and process development, training, manufacturing, and sales and service sites in the U.S., South Korea, Taiwan, China, Singapore, Europe and other locations.

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

The following table summarizes certain key financial information for the periods indicated below (*in thousands, except percentage and per share data*):

| | For the three months ended | | Percentage change period to period |
|--|----------------------------|-----------------------|---------------------------------------|
| | 2014 | September 30, 2013 | |
| Orders | \$ 107,292 | \$ 91,482 | 17.3% |
| Net sales | \$ 93,341 | \$ 99,324 | -6.0% |
| Gross profit | \$ 32,558 | \$ 30,308 | 7.4% |
| Gross margin | 34.9% | 30.5% | |
| Selling, general and administrative expenses | \$ 21,712 | \$ 19,650 | 10.5% |
| Research and development expenses | \$ 19,968 | \$ 18,993 | 5.1% |
| Net income (loss) | \$ (13,977) | \$ (6,026) | 131.9% |
| Diluted net income (loss) per share | \$ (0.35) | \$ (0.16) | 118.8% |

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

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

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

| | For the three months ended | | | | Dollar and | | |
|-------------------------------------|----------------------------|----------|---------------|------|-------------------|------------------|-------------------|
| | 2014 | | September 30, | | Percentage Change | | |
| | | | | 2013 | | Period to Period | |
| Net sales | \$ | 93,341 | 100.0% | \$ | 99,324 | 100.0% | \$ (5,983) (6.0)% |
| Cost of sales | | 60,783 | 65.1% | | 69,016 | 69.5% | (8,233) (11.9)% |
| Gross profit | | 32,558 | 34.9% | | 30,308 | 30.5% | 2,250 7.4% |
| Operating expenses: | | | | | | | |
| Selling, general and administrative | | 21,712 | 23.3% | | 19,650 | 19.8% | 2,062 10.5% |
| Research and development | | 19,968 | 21.4% | | 18,993 | 19.1% | 975 5.1% |
| Amortization | | 3,149 | 3.4% | | 855 | 0.9% | 2,294 268.3% |
| Restructuring | | 2,317 | 2.5% | | 1,240 | 1.2% | 1,077 86.9% |
| Asset impairment | | 2,864 | 3.1% | | | 0.0% | 2,864 * |
| Total operating expenses | | 50,010 | 53.6% | | 40,738 | 41.0% | 9,272 22.8% |
| Other operating, net | | 36 | 0.0% | | (493) | (0.5)% | 529 * |
| Operating income (loss) | | (17,488) | (18.7)% | | (9,937) | (10.0)% | (7,551) 76.0% |
| Interest income (expense), net | | 305 | 0.3% | | 192 | 0.2% | 113 58.9% |
| Income (loss) before income taxes | | (17,183) | (18.4)% | | (9,745) | (9.8)% | (7,438) 76.3% |
| Income tax provision (benefit) | | (3,206) | (3.4)% | | (3,719) | (3.7)% | 513 (13.8)% |
| Net income (loss) | \$ | (13,977) | (15.0)% | \$ | (6,026) | (6.1)% | \$ (7,951) 131.9% |

* Not Meaningful

Net Sales

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

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| | Net Sales | | | | Dollar and | | |
|-----------------------------------|-----------|--|-----------|------------------|---------------------------------------|---------|--|
| | 2014 | For the three months ended September 30, Percent of Total | 2013 | Percent of Total | Percentage Change Period to Period | | |
| Segment Analysis | | | | | | | |
| LED & Solar | \$ 76,850 | 82.3% | \$ 75,001 | 75.5% | \$ 1,849 | 2.5% | |
| Data Storage | 16,491 | 17.7% | 24,323 | 24.5% | (7,832) | (32.2)% | |
| Total | \$ 93,341 | 100.0% | \$ 99,324 | 100.0% | \$ (5,983) | (6.0)% | |
| Regional Analysis | | | | | | | |
| Americas (1) | \$ 11,182 | 12.0% | \$ 18,536 | 18.7% | \$ (7,354) | (39.7)% | |
| Europe, Middle East and Africa | 9,079 | 9.7% | 3,822 | 3.8% | 5,257 | 137.5% | |
| Asia Pacific | 73,080 | 78.3% | 76,966 | 77.5% | (3,886) | (5.0)% | |
| Total | \$ 93,341 | 100.0% | \$ 99,324 | 100.0% | \$ (5,983) | (6.0)% | |

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

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

Orders increased 17.3% to \$107.3 million from \$91.5 million in the comparable prior period. LED & Solar orders increased 26.4% to \$92.9 million, principally due to MOCVD system and service orders, as certain of our LED customers are making capacity additions. Data Storage orders decreased 19.9% to \$14.4 million from the comparable prior period as our customers continue to have excess manufacturing capacity and have only been making select technology purchases.

Our book-to-bill ratio for the three months ended September 30, 2014, which is calculated by dividing bookings recorded in a given time period by revenue recognized in the same time period, was 1.15 to 1. Our backlog as of September 30, 2014 was \$176.8 million, compared to \$143.3 million as of December 31, 2013. During the three months ended September 30, 2014, there were minimal backlog adjustments. Our backlog consists of orders for which we received a firm purchase order, a customer-confirmed shipment date within twelve months and a deposit, where required. As of September 30, 2014, we had customer deposits of \$35.8 million.

Gross Profit

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

| | For the three months ended | | Dollar and Percentage Change Period to Period | |
|-----------------------------|----------------------------|-----------------------|--|---------|
| | 2014 | September 30, 2013 | | |
| Gross profit - LED & Solar | \$ 26,522 | \$ 20,171 | \$ 6,351 | 31.5% |
| <i>Gross margin</i> | 34.5% | 26.9% | | |
| Gross profit - Data Storage | \$ 6,036 | \$ 10,137 | \$ (4,101) | (40.5)% |
| <i>Gross margin</i> | 36.6% | 41.7% | | |
| Gross profit - Total Veeco | \$ 32,558 | \$ 30,308 | \$ 2,250 | 7.4% |
| <i>Gross margin</i> | 34.9% | 30.5% | | |

LED & Solar gross margins increased principally due to a favorable mix of products and favorable warranty spending, partially offset by decreases associated with higher inventory reserves and unfavorable overhead rates. Data Storage gross margins decreased primarily due to reduced sales volume, partially offset by favorable service spending.

Selling, General and Administrative Expenses

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

| | For the three months ended September 30, | | | Dollar and Percentage Change Period to Period | | |
|-------------------------------------|---|--------|------|--|----------|-------|
| | 2014 | | 2013 | | | |
| Selling, general and administrative | \$ | 21,712 | \$ | 19,650 | \$ 2,062 | 10.5% |
| <i>Percentage of net sales</i> | | 23.3% | | 19.8% | | |

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

Table of Contents*Research and Development Expenses*

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

| | For the three months ended September 30, | | | Dollar and Percentage Change Period to Period | |
|--------------------------------|---|-----------|----|--|------|
| | 2014 | 2013 | | | |
| Research and development | \$ 19,968 | \$ 18,993 | \$ | 975 | 5.1% |
| <i>Percentage of net sales</i> | 21.4% | 19.1% | | | |

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

Amortization

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

| | For the three months ended September 30, | | | Dollar and Percentage Change Period to Period | |
|--------------------------------|---|--------|----|--|--------|
| | 2014 | 2013 | | | |
| Amortization | \$ 3,149 | \$ 855 | \$ | 2,294 | 268.3% |
| <i>Percentage of net sales</i> | 3.4% | 0.9% | | | |

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

Restructuring

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

| | For the three months ended September 30, | | | Dollar and Percentage Change Period to Period | |
|--|---|------|--|--|--|
| | 2014 | 2013 | | | |

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| | | | | | | | |
|--------------------------------|----|-------|----|-------|----|-------|-------|
| Restructuring | \$ | 2,317 | \$ | 1,240 | \$ | 1,077 | 86.9% |
| <i>Percentage of net sales</i> | | 2.5% | | 1.2% | | | |

During the first quarter of 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. As a result of these actions we notified 49 employees of their termination from the Company. During the three months ended September 30, 2014, we recorded restructuring charges relating to these actions of \$0.7 million, consisting of personnel severance and related costs.

During the three months ended September 30, 2014 the Company undertook additional restructuring activities, including the consolidation of our Camarillo, CA facility into our Plainview, New York facility and additional headcount reductions to help contain costs and further improve profitability. As a result of these actions we notified 44 additional employees of their termination from the Company. During the three months ended September 30, 2014, we recorded restructuring charges relating to these actions of \$1.6 million, consisting of personnel severance and related costs. (See Note *Commitments, Contingencies and Other Matters* for further information)

During the three months ended September 30, 2013, we took measures to improve profitability, including the restructuring of one of our international sales offices and consolidation of certain sales, business and administrative functions. As a result of these actions, we recorded restructuring charges of \$1.2 million.

Table of Contents*Asset Impairment*

| | For the three months ended September 30, | | Dollar and Percentage Change Period to Period | |
|-------------------------|---|------|--|---|
| | 2014 | 2013 | | |
| Asset Impairment | \$ 2,864 | \$ | \$ 2,864 | * |
| Percentage of net sales | 3.1% | | 0.0% | |

* Not Meaningful

During the three months ended September 30, 2014, we transferred \$2.7 million of assets from property, plant and equipment to assets held for sale. In conjunction with the transfer, these assets were evaluated for impairment in accordance with the accounting guidance. As a result, during the three months ended September 30, 2014, we recognized asset impairment charges of \$2.4 million and a corresponding reduction to property, plant and equipment of \$5.1 million. The \$2.4 million impairment charge consisted of \$1.6 million relating to our research and demonstration labs in Asia and \$0.8 million relating to vacant land in our LED and Solar segment. We recognized an additional asset impairment charge of \$0.4 million relating to assets in our LED and Solar segment that we abandoned during the quarter.

Income Taxes

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

| | For the three months ended September 30, | | Dollar and Percentage Change Period to Period | |
|--------------------------------|---|------------|--|---------|
| | 2014 | 2013 | | |
| Income tax provision (benefit) | \$ (3,206) | \$ (3,719) | \$ 513 | (13.8)% |
| Effective tax rate | 18.7% | 38.2% | | |

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

For the three months ended September 30, 2014, our effective tax rate differed from the U.S. federal statutory rate of 35% primarily related to our ability to recognize only a portion of the deferred tax assets on a more likely than not basis with respect to current year pre-tax operating losses. The effective tax rate for the three months ended September 30, 2014, was also impacted by a discrete tax benefit in connection with settlement of our 2010 IRS examination.

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

development tax credits.

Our unrecognized tax benefits include amounts related to various U.S federal, state and local, and foreign tax issues. We believe that it is reasonably possible that a decrease of between \$5.0 million and \$6.0 million in unrecognized tax benefits may be necessary as we currently expect the Singapore Economic Development Board's approval of amendments to our Development and Expansion Incentive under the International Headquarters Award. The decrease will have a favorable impact on our effective tax rate.

We recently settled our 2010 IRS examination, resulting in the release of \$2.3 million of liabilities relating to uncertain tax positions. We were also notified that the IRS will commence an examination of our 2011 tax year during the quarter ending December 31, 2014.

Table of Contents**Nine Months Ended September 30, 2014 and 2013**

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

| | For the nine months ended September 30, | | | | Dollar and Percentage Change Period to Period | |
|-------------------------------------|--|---------|-------------|---------|---|---------|
| | 2014 | | 2013 | | | |
| Net sales | \$ 279,304 | 100.0% | \$ 258,540 | 100.0% | \$ 20,764 | 8.0% |
| Cost of sales | 182,296 | 65.3% | 171,040 | 66.2% | 11,256 | 6.6% |
| Gross profit | 97,008 | 34.7% | 87,500 | 33.8% | 9,508 | 10.9% |
| Operating expenses: | | | | | | |
| Selling, general and administrative | 65,270 | 23.4% | 59,077 | 22.9% | 6,193 | 10.5% |
| Research and development | 60,747 | 21.7% | 60,600 | 23.4% | 147 | 0.2% |
| Amortization | 8,951 | 3.2% | 2,566 | 1.0% | 6,385 | 248.8% |
| Restructuring | 3,510 | 1.3% | 1,771 | 0.7% | 1,739 | 98.2% |
| Asset impairment | 2,864 | 1.0% | | 0.0% | 2,864 | * |
| Total operating expenses | 141,342 | 50.6% | 124,014 | 48.0% | 17,328 | 14.0% |
| Other operating, net | (334) | (0.1)% | (141) | (0.1)% | (193) | 136.9% |
| Changes in contingent consideration | (29,368) | (10.5)% | | 0.0% | (29,368) | * |
| Operating income (loss) | (14,632) | (5.2)% | (36,373) | (14.1)% | 21,741 | (59.8)% |
| Interest income (expense), net | 541 | 0.2% | 620 | 0.2% | (79) | (12.7)% |
| Income (loss) before income taxes | (14,091) | (5.0)% | (35,753) | (13.8)% | 21,662 | (60.6)% |
| Income tax provision (benefit) | (4,063) | (1.5)% | (15,575) | (6.0)% | 11,512 | (73.9)% |
| Net income (loss) | \$ (10,028) | (3.6)% | \$ (20,178) | (7.8)% | \$ 10,150 | (50.3)% |

* Not Meaningful

Net Sales

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

| Segment Analysis | Net Sales For the nine months ended September 30, | | | | Dollar and Percentage Change Period to Period | |
|-------------------|--|------------------|------------|------------------|---|---------|
| | 2014 | Percent of Total | 2013 | Percent of Total | | |
| LED & Solar | \$ 224,759 | 80.5% | \$ 193,241 | 74.7% | \$ 31,518 | 16.3% |
| Data Storage | 54,545 | 19.5% | 65,299 | 25.3% | (10,754) | (16.5)% |
| Total | \$ 279,304 | 100.0% | \$ 258,540 | 100.0% | \$ 20,764 | 8.0% |
| Regional Analysis | | | | | | |

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| | | | | | | | | | |
|--------------------------------|----|---------|--------|----|---------|--------|----|----------|---------|
| Americas (1) | \$ | 33,472 | 12.0% | \$ | 43,613 | 16.9% | \$ | (10,141) | (23.3)% |
| Europe, Middle East and Africa | | 25,398 | 9.1% | | 15,304 | 5.9% | | 10,094 | 66.0% |
| Asia Pacific | | 220,434 | 78.9% | | 199,623 | 77.2% | | 20,811 | 10.4% |
| Total | \$ | 279,304 | 100.0% | \$ | 258,540 | 100.0% | \$ | 20,764 | 8.0% |

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

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

Orders increased 27.2% to \$313.9 million from \$246.7 million in the comparable prior period. LED & Solar orders increased 49.6% to \$260.7 million, principally due to MOCVD system orders, as certain of our LED customers are making capacity additions. Data Storage orders decreased 26.4% to \$53.2 million from the comparable prior period as our customers have excess manufacturing capacity and they have only been making select technology purchases.

Our book-to-bill ratio for the nine months ended September 30, 2014, which is calculated by dividing bookings recorded in a given time period by revenue recognized in the same time period, was 1.12 to 1. Our backlog as of September 30, 2014 was \$176.8 million, compared to \$143.3 million as of December 31, 2013. During the nine months ended September 30, 2014, we recorded backlog adjustments of approximately \$1.2 million related to orders that no longer met our booking criteria. Our backlog consists of orders for which we received a firm purchase order, a customer-confirmed shipment date within twelve months and a deposit, where required. As of September 30, 2014, we had customer deposits of \$35.8 million.

Gross Profit

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

| | For the nine months ended | | Dollar and Percentage Change Period to Period | |
|-----------------------------|---------------------------|-----------------------|--|---------|
| | 2014 | September 30, 2013 | | |
| Gross profit - LED & Solar | \$ 76,865 | \$ 60,505 | \$ 16,360 | 27.0% |
| <i>Gross margin</i> | 34.2% | 31.3% | | |
| Gross profit - Data Storage | \$ 20,143 | \$ 26,995 | \$ (6,852) | (25.4)% |
| <i>Gross margin</i> | 36.9% | 41.3% | | |
| Gross profit - Total Veeco | \$ 97,008 | \$ 87,500 | \$ 9,508 | 10.9% |
| <i>Gross margin</i> | 34.7% | 33.8% | | |

LED & Solar gross margins increased from the comparable prior period primarily due to higher MOCVD sales volume, a favorable mix of products and favorable warranty spending, partially offset by unfavorable overhead rates, primarily driven by our ALD business, and higher inventory reserves. Data Storage gross margins decreased principally due to reduced sales volume, higher inventory reserves and unfavorable overhead rates, partially offset by favorable warranty and service spending.

Selling, General and Administrative Expenses

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

| | For the nine months ended September 30, | | | Dollar and Percentage Change Period to Period | | |
|-------------------------------------|--|--------|------|--|----------|-------|
| | 2014 | | 2013 | | | |
| Selling, general and administrative | \$ | 65,270 | \$ | 59,077 | \$ 6,193 | 10.5% |
| <i>Percentage of net sales</i> | | 23.4% | | 22.9% | | |

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

Table of Contents*Research and Development Expenses*

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

| | For the nine months ended September 30, | | | | Dollar and Percentage Change Period to Period | | |
|--------------------------------|--|--------|------|--------|--|-----|------|
| | 2014 | | 2013 | | | | |
| Research and development | \$ | 60,747 | \$ | 60,600 | \$ | 147 | 0.2% |
| <i>Percentage of net sales</i> | | 21.7% | | 23.4% | | | |

Research and development expenses remained flat. The additional research and development costs from our ALD business, were offset by a reduction in spending in our other product lines. We continue to focus our research and development expenses on projects in areas we anticipate to be high-growth. We selectively funded these product development activities which resulted in lower professional consulting expense, as well as reduced spending for project materials and personnel and personnel-related costs.

Amortization

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

| | For the nine months ended September 30, | | | | Dollar and Percentage Change Period to Period | | |
|--------------------------------|--|-------|------|-------|--|-------|--------|
| | 2014 | | 2013 | | | | |
| Amortization | \$ | 8,951 | \$ | 2,566 | \$ | 6,385 | 248.8% |
| <i>Percentage of net sales</i> | | 3.2% | | 1.0% | | | |

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

Restructuring

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

| | For the nine months ended September 30, | | | | Dollar and Percentage Change Period to Period | |
|--|--|--|------|--|--|--|
| | 2014 | | 2013 | | | |

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| | | | | | | | |
|--------------------------------|----|-------|----|-------|----|-------|-------|
| Restructuring | \$ | 3,510 | \$ | 1,771 | \$ | 1,739 | 98.2% |
| <i>Percentage of net sales</i> | | 1.3% | | 0.7% | | | |

During the first quarter of 2014, we announced the consolidation of our Ft. Collins, Colorado facility into our Plainview, New York facility and took additional measures to improve profitability in a challenging business environment. As a result of these actions we notified 49 employees of their termination from the Company. During the nine months ended September 30, 2014, we recorded restructuring charges relating to these actions of \$1.9 million, consisting of personnel severance and related costs.

During the third quarter of 2014 the Company undertook additional restructuring activities, including the consolidation of our Camarillo, CA facility into our Plainview, New York facility and additional headcount reductions to help contain costs and further improve profitability. As a result of these actions we notified 44 additional employees of their termination from the Company. During the nine months ended September 30, 2014, we recorded restructuring charges relating to these actions of \$1.6 million, consisting of personnel severance and related costs. (See Note *Commitments, Contingencies and Other Matters* for further information)

During the nine months ended September 30, 2013, we took measures to improve profitability, including the restructuring of one of our international sales offices and consolidation of certain sales, business and administrative functions. As a result of these actions, we recorded restructuring charges of \$1.8 million.

Table of Contents*Asset Impairment*

| | For the nine months ended September 30, | | | Dollar and Percentage Change Period to Period | |
|--------------------------------|--|-------|------|--|---------|
| | 2014 | | 2013 | | |
| Asset Impairment | \$ | 2,864 | \$ | \$ | 2,864 * |
| <i>Percentage of net sales</i> | | 1.0% | | 0.0% | |

* Not Meaningful

During the nine months ended September 30, 2014, we transferred \$2.7 million of assets from property, plant and equipment to assets held for sale. In conjunction with the transfer, these assets were evaluated for impairment in accordance with the accounting guidance. As a result, during the nine months ended September 30, 2014, we recognized asset impairment charges of \$2.4 million and a corresponding reduction to property, plant and equipment of \$5.1 million. The \$2.4 million impairment charge consisted of \$1.6 million relating to our foreign research and demonstration labs in Korea and Taiwan, respectively, and \$0.8 million relating to vacant land in our MBE business. We recognized an additional asset impairment charge of \$0.4 million relating to assets in our LED and Solar segment that we abandoned during the quarter.

Changes in Contingent Consideration

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

| | For the nine months ended September 30, | | | Dollar and Percentage Change Period to Period | |
|-------------------------------------|--|----------|------|--|------------|
| | 2014 | | 2013 | | |
| Changes in contingent consideration | \$ | (29,368) | \$ | \$ | (29,368) * |
| <i>Percentage of net sales</i> | | (10.5)% | | 0.0% | |

* Not Meaningful

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

We estimate the fair value of acquisition-related contingent consideration based on management's probability-weighted present value of the consideration expected to be transferred during the remainder of the earn-out period, based on the forecast related to the milestones. The fair value of the contingent consideration is reassessed by us on a quarterly basis using additional information as it becomes available. Any change in the fair value of an acquisition's contingent consideration liability results in a gain or loss that is recorded in the earnings of that period. As of

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March 31, 2014, we determined that the agreed upon post-closing milestones were not met or are not expected to be achieved and therefore reversed the remaining \$29.4 million fair value of the liability of the contingent consideration and recorded it as a change in contingent consideration in the Consolidated Statement of Operations.

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

Income Taxes

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

| | For the nine months ended | | | | Dollar and Percentage Change Period to Period | |
|--------------------------------|---------------------------|---------|------|----------|--|----------------|
| | September 30, | | 2013 | | | |
| | 2014 | | 2013 | | | |
| Income tax provision (benefit) | \$ | (4,063) | \$ | (15,575) | \$ | 11,512 (73.9)% |
| <i>Effective tax rate</i> | | 28.8% | | 43.6% | | |

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

For the nine months ended September 30, 2014, our effective tax rate differed from the U.S. federal statutory rate of 35% primarily related to our ability to recognize only a portion of the deferred tax assets on a more likely than not basis with respect to current year pre-tax operating losses. The effective tax rate for the nine months ended September 30, 2014, was also impacted by a discrete tax benefit in connection with settlement of our 2010 IRS examination and because we did not provide a tax provision on the gain from the settlement of the contingent consideration related to the Synos acquisition.

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

Our unrecognized tax benefits include amounts related to various U.S. federal, state and local, and foreign tax issues. We believe that it is reasonably possible that a decrease of between \$5.0 million and \$6.0 million in unrecognized tax benefits may be necessary as we currently expect the Singapore Economic Development Board's approval amendments to our Development and Expansion Incentive under the International Headquarters Award. The decrease will have a favorable impact on our effective tax rate.

We recently settled our 2010 IRS examination resulting in the release of \$2.3 million of liabilities relating to uncertain tax positions. We were also notified that the IRS will commence an examination of our 2011 tax year during the quarter ending December 31, 2014.

Table of Contents**Liquidity and Capital Resources**

Our cash and cash equivalents, restricted cash and short-term investments consist of the following (*in thousands*):

| | September 30, 2014 | December 31, 2013 |
|--|-----------------------|----------------------|
| Cash and cash equivalents | \$ 264,008 | \$ 210,799 |
| Short-term investments | 222,954 | 281,538 |
| Restricted cash | 487 | 2,738 |
| Cash, cash equivalents, short-term investments and restricted cash | \$ 487,449 | \$ 495,075 |

As of September 30, 2014 and December 31, 2013, cash and cash equivalents of \$161.4 million and \$150.6 million, respectively, were held outside the United States. Liquidity is affected by many factors, some of which are based on normal ongoing operations of our business and some of which arise from fluctuations related to global economics and markets. Cash balances are generated and held in many locations throughout the world. It is our current intent to permanently reinvest our funds from Singapore, China, Taiwan, South Korea and Malaysia outside of the United States and our current plans do not demonstrate a need to repatriate them to fund our United States operations. As of September 30, 2014, we had \$135.7 million in cash held offshore on which we would have to pay significant United States income taxes to repatriate in the event that we need the funds for our operations in the United States. Additionally, local government regulations may restrict our ability to move cash balances to meet cash needs under certain circumstances. We currently do not expect such regulations and restrictions to impact our ability to make acquisitions, pay vendors, or conduct operations throughout the global organization. As of September 30, 2014 and December 31, 2013, our restricted cash was in Germany and our short-term investments were in the United States. We believe that our projected cash flow from operations combined with our cash and short term investments will be sufficient to meet our projected working capital and other cash flow requirements for the next twelve months, as well as our contractual obligations.

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

Cash Flows from Operating Activities

| | |
|---|-------------|
| Net income (loss) | \$ (10,028) |
| Non-cash items: | |
| Change in contingent consideration | (29,368) |
| Depreciation and amortization | 17,649 |
| Non-cash equity-based compensation | 14,303 |
| Other | (6,377) |
| Changes in operating assets and liabilities: | |
| Accounts receivable | (36,149) |
| Inventories | 13,650 |
| Accounts payable | (9,679) |
| Accrued expenses, customer deposits, deferred revenue and other current liabilities | 41,630 |
| Other | (2,231) |
| Net cash provided by (used in) operating activities | \$ (6,600) |

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The primary cash drivers of the \$6.6 million use of cash from operations were:

- A \$36.1 million use of cash due to the increase in accounts receivable, primarily due to longer than average payment terms and the timing of invoicing to customers resulting in more receivables remaining outstanding at the end of the quarter;
- A \$9.7 million use of cash due to the decrease in accounts payable primarily driven by reduced purchasing activity and timing of vendor payments;
- A \$13.7 million generation of cash due to the decrease in inventory due to our reduced purchasing activity; and
- A \$41.6 million generation of cash due to the increase in accrued expenses primarily driven by increases in payroll related accruals, customer deposits and deferred revenue.

Table of Contents*Cash Flows from Investing Activities*

| | | |
|---|----|-----------|
| Proceeds from the liquidation of short-term investments | \$ | 216,050 |
| Payments for purchases of short-term investments | | (157,733) |
| Other | | (5,704) |
| Net cash provided by (used in) investing activities | \$ | 52,613 |

The primary cash driver of the \$52.6 million generation of cash from investing was due to the net liquidation of short-term investments during the period.

Cash Flows from Financing Activities

| | | |
|---|----|---------|
| Proceeds from stock option exercises | \$ | 9,485 |
| Other | | (2,140) |
| Net cash provided by (used in) financing activities | \$ | 7,345 |

The primary cash driver of the \$7.3 million generation of cash from financing was a \$9.5 million generation of cash due to stock option exercises.

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

In October 2014 the Company filed a net operating loss carryback claim of approximately \$20 million. This receivable is reflected in Prepaid and other current assets in our Consolidated Balance Sheet as of September 30, 2014. We expect to receive payment of the refund claim within the next twelve months.

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Off-Balance Sheet Arrangements and Contractual Obligations

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

Long-Term Debt

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

Lease Commitments

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

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

Letters of Credit and Bank Guarantees

Letters of credit and bank guarantees are issued by a bank on our behalf as needed. As of September 30, 2014, we had letters of credit outstanding of \$0.6 million and bank guarantees outstanding of \$1.0 million, of which, \$0.5 million is collateralized against cash that is restricted from use. As of September 30, 2014, we had \$44.4 million of unused lines of credit available. The line of credit is available to draw upon to cover performance bonds as required by our customers.

Purchase Commitments

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Purchase commitments are primarily for inventory used in manufacturing our products. It has been our practice not to enter into purchase commitments extending beyond one year. As of September 30, 2014, we have \$111.5 million in open purchase commitments and \$11.9 million of offsetting supplier deposits.

Other Obligations

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

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Application of Critical Accounting Policies

General

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

Revenue Recognition

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

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

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

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

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

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

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

In Japan, where our contractual terms with customers generally specify title and risk and rewards of ownership transfer upon customer acceptance, revenue is recognized upon the receipt of written customer acceptance. During the fourth quarter of fiscal 2013, we began using a distributor for almost all of our product and service sales to customers in Japan. Title passes to the distributor upon shipment, however, due to customary local business practices, the risk and rewards of ownership of our system sales transfer to the end-customers upon their acceptance. As such, we recognize revenue upon receipt of written acceptance from the end customer.

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

Short-Term Investments

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

Inventory Valuation

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

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

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

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shipment date within the next twelve months. Historically, the variability of these estimates of future product demand has been impacted by backlog cancellations or modifications resulting from unanticipated changes in technology or customer demand.

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

Goodwill and Indefinite-Lived Intangible Asset Impairment

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

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

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

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

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

Definite-Lived Intangible and Long-Lived Assets

Definite-lived intangible assets consist of purchased technology, customer-related intangible assets, patents, trademarks, covenants not-to-compete, software licenses and deferred financing costs. Purchased technology consists of the core proprietary manufacturing technologies associated with the products and offerings obtained through acquisition and are initially recorded at fair value. Customer-related intangible assets, patents, trademarks, covenants not-to-compete and software licenses that are obtained in an acquisition are initially recorded at fair value. Other software licenses and deferred financing costs are initially

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recorded at cost. Intangible assets with definitive useful lives are amortized using the straight-line method over their estimated useful lives for periods ranging from 2 years to 17 years.

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

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

Accounting for Acquisitions

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

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

Fair Value Measurements

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

Warranty Cost

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

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Income Taxes

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

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

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

Equity-Based Compensation

We grant equity-based awards, such as stock options, restricted stock, restricted stock units or performance-based restricted stock units, to certain key employees to create clear and meaningful alignment between compensation, shareholder return and, in the case of performance-based awards, the achievement of specific objectives. Our equity-based awards also enable our employees to develop and maintain a stock ownership position further aligning their interests with shareholders. Equity-based awards vest over time and, in the case of performance-based restricted stock units, only after first being earned. Vesting is subject to the recipient's continued employment, thus acting as a significant incentive for the employee to remain with the Company.

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

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

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

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

We estimate forfeitures using our historical experience, which is adjusted over the requisite service period based on the extent

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to which actual forfeitures differ or are expected to differ, from such estimates. Because of the significant amount of judgment used in these calculations, it is reasonably likely that circumstances may cause the estimate to change.

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

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

With respect to grants of performance based awards, we assess the probability that such performance criteria will be met in order to determine the compensation expense. Compensation expense is recognized on the accelerated attribution model, where each tranche of the award is treated as a separate award for purposes of expense recognition. If that assessment of the probability of the performance condition being met changes, we would recognize the impact of the change in estimate in the period of the change.

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

Recent Accounting Pronouncements

Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern: In August 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-15, *Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The amendments in this ASU apply to all entities and provide guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern or to provide related footnote disclosures. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2016; early application is permitted. We do not expect the application of this guidance to have a material impact on our consolidated financial statements.

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

Revenue from Contracts with Customers: In May 2014, the FASB issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (Topic 606). ASU No. 2014-09 requires that an entity recognize revenue to depict the transfer of promised goods or services

to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard outlines a five-step model to be used to make the revenue recognition determination and requires new financial statement disclosures. The standard is effective for interim and annual periods beginning after December 15, 2016 and allows entities to choose among different transition alternatives. We are evaluating the impact of adopting the standard on our consolidated financial statements and related financial statement disclosures, and we have not yet determined which method of adoption will be selected.

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

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We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

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

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

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Net sales to foreign customers represented approximately 88.0% of our total net revenues for both the three and nine months ended September 30, 2014, and 81.3% and 83.1% for the comparable 2013 periods. We expect that net sales to foreign customers will continue to represent a large percentage of our total net sales. Our net sales denominated in foreign currencies represented approximately 3.1% and 9.4% of our total sales for the three and nine months ended September 30, 2014 respectively, and 2.9% and 3.2% for the comparable 2013 periods. The significant increase in percentage of net sales in foreign currency during the nine months ended September 30, 2014 was driven by a few large sales, aggregating approximately \$16.4 million, that were denominated in Japanese Yen. The related receivable was fully collected during the second quarter of 2014. We had an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates related to these receivables while they remained outstanding.

During the three months ended December 31, 2013, we entered into an economic hedge in the form of Japanese Yen collars to minimize our exposure to changes in foreign currency exchange rates. The net fair value of these collars as of December 31, 2013 was approximately \$0.9 million. During the second quarter of 2014, the collars were closed and resulted in a realized gain of \$0.5 million.

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

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

| | | | | | | |
|------------------------------------|----------------------|----|----|-------|----|-----|
| Foreign currency exchange forwards | Other operating, net | \$ | \$ | (11) | \$ | 146 |
| Foreign currency collar | Other operating, net | | | (457) | | |

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

We centrally manage our investment portfolios considering investment opportunities and risk, tax consequences and overall financing strategies. Our investment portfolio includes fixed-income securities with a fair value of approximately \$223.0 million as of September 30, 2014. An immediate 100 basis point increase in interest rates may result in a decrease in the fair value of the September 30, 2014 portfolio of approximately \$1.2 million. While an increase in interest rates may reduce the fair value of the investment portfolio, it is unlikely that we will realize the losses in our Consolidated Statements of Operations unless the individual fixed-income securities are sold prior to recovery or the loss is determined to be other-than-temporary.

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Item 4. Controls and Procedures

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

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

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

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings

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

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

Item 1A. Risk Factors

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

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

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Table of Contents**Item 6. Exhibits**

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

| Number | Description | Incorporated by Reference to the Following Document: |
|---------|--|--|
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934. | * |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934. | * |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |
| 101.INS | XBRL Instance | ** |
| 101.SCH | XBRL Schema | ** |
| 101.PRE | XBRL Presentation | ** |
| 101.CAL | XBRL Calculation | ** |
| 101.DEF | XBRL Definition | ** |
| 101.LAB | XBRL Label | ** |

* Filed herewith

** Filed herewith electronically

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SIGNATURES

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

Date: October 29, 2014

Veeco Instruments Inc.

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

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

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