VEECO INSTRUMENTS INC
Form 10-Q
October 31, 2007

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2007**

**OR**

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

**For the transition period from to .**

**Commission file number 0-16244**

# VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

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

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

Website: **www.veeco.com**

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject

to such filing requirements for the past 90 days. Yes x No o

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

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

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

31,767,392 shares of common stock, $0.01 par value per share, were outstanding as of the close of business on October 29, 2007.

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**SAFE HARBOR STATEMENT**

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

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

We operate in an industry characterized by rapid technological change.

We face significant competition.

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

Our quarterly operating results fluctuate significantly.

Our outsourcing strategy could adversely affect our results of operations.

We rely on a limited number of suppliers.

Any difficulty or inability to attract, retain and motivate key employees could have a material adverse effect on our business.

We are exposed to the risks of operating a global business and the requirement to comply with laws and regulations of various jurisdictions such as import/export controls, which may not apply to our non-U.S. competitors.

We are subject to foreign currency exchange risks.

Our success depends on protection of our intellectual property rights.

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

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

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

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

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

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

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

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

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

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

**Available Information**

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

**Internet Address**

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

**VEECO INSTRUMENTS INC.**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements (Unaudited)**

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net sales | $ 97,718 | $ 112,369 | $ 295,653 | $ 317,922 |
| Cost of sales | 61,824 | 64,513 | 173,819 | 178,585 |
| Gross profit | 35,894 | 47,856 | 121,834 | 139,337 |
| Costs and expenses: | | | | |
| Selling, general and administrative expense | 22,723 | 22,296 | 69,347 | 68,622 |
| Research and development expense | 15,049 | 15,716 | 46,341 | 45,554 |
| Amortization expense | 1,959 | 4,025 | 8,236 | 12,029 |
| Restructuring expense | 529 | | 1,974 | |
| Write-off of purchased in-process technology | | 1,160 | | 1,160 |
| Other income, net | (179) | (310) | (605) | (243) |
| Total operating expenses | 40,081 | 42,887 | 125,293 | 127,122 |
| Operating (loss) income | (4,187) | 4,969 | (3,459) | 12,215 |
| Interest expense, net | 665 | 1,056 | 2,256 | 3,583 |
| Gain on extinguishment of debt | | | (738) | (330) |
| (Loss) income before income taxes and noncontrolling interest | (4,852) | 3,913 | (4,977) | 8,962 |
| Income tax provision | 954 | 612 | 3,490 | 2,878 |
| Noncontrolling interest | (123) | (1,207) | (482) | (1,207) |
| Net (loss) income | $ (5,683) | $ 4,508 | $ (7,985) | $ 7,291 |
| | | | | |
| Net (loss) income per common share | $ (0.18) | $ 0.15 | $ (0.26) | $ 0.24 |
| Diluted net (loss) income per common share | $ (0.18) | $ 0.14 | $ (0.26) | $ 0.23 |
| | | | | |
| Weighted average shares outstanding | 31,100 | 30,693 | 30,975 | 30,369 |
| Diluted weighted average shares outstanding | 31,100 | 31,393 | 30,975 | 31,100 |

*See accompanying notes.*

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

| | | September 30, 2007 (Unaudited) | | December 31, 2006 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 108,402 | $ | 147,046 |
| Accounts receivable, less allowance for doubtful accounts of $2,728 in 2007 and $2,683 in 2006 | | 68,603 | | 86,589 |
| Inventories | | 105,659 | | 100,355 |
| Prepaid expenses and other current assets | | 10,254 | | 9,378 |
| Deferred income taxes | | 2,605 | | 2,565 |
| Total current assets | | 295,523 | | 345,933 |
| Property, plant and equipment at cost, less accumulated depreciation of $93,559 in 2007 and $88,087 in 2006 | | 69,505 | | 73,510 |
| Goodwill | | 100,898 | | 100,898 |
| Purchased technology, less accumulated amortization of $71,119 in 2007 and $64,736 in 2006 | | 37,469 | | 43,852 |
| Other intangible assets, less accumulated amortization of $28,936 in 2007 and $26,740 in 2006 | | 23,754 | | 25,053 |
| Other assets | | 215 | | 354 |
| Total assets | $ | 527,364 | $ | 589,600 |
| | | | | |
| **Liabilities and shareholders equity** | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ | 35,619 | $ | 40,588 |
| Accrued expenses | | 50,369 | | 48,714 |
| Deferred profit | | 1,342 | | 251 |
| Income taxes payable | | 1,382 | | 2,723 |
| Current portion of long-term debt | | 5,434 | | 5,597 |
| Total current liabilities | | 94,146 | | 97,873 |
| Deferred income taxes | | 3,470 | | 2,423 |
| Long-term debt | | 146,450 | | 203,607 |
| Other non-current liabilities | | 1,716 | | 2,304 |
| | | | | |
| Noncontrolling interest | | 1,160 | | 1,642 |
| | | | | |
| Shareholders equity | | 280,422 | | 281,751 |
| Total liabilities and shareholders equity | $ | 527,364 | $ | 589,600 |

*See accompanying notes.*

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

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2007** | **2006** |
| **Operating activities** | | |
| Net (loss) income | $ (7,985) | $ 7,291 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | |
| Depreciation and amortization | 19,288 | 22,426 |
| Deferred income taxes | 1,111 | 291 |
| Gain on extinguishment of debt | (738) | (330) |
| Non-cash compensation expense for share-based payments | 3,490 | 1,443 |
| Noncontrolling interest in net loss of subsidiary | (482) | (1,207) |
| Gain on sale of property, plant and equipment | (79) | (27) |
| Write-off of purchased in-process technology | | 1,160 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 19,972 | 3,103 |
| Inventories | (4,801) | (14,691) |
| Accounts payable | (5,042) | 5,025 |
| Accrued expenses, deferred profit and other current liabilities | 524 | 3,159 |
| Other, net | (2,481) | (5,119) |
| Net cash provided by operating activities | 22,777 | 22,524 |
| | | |
| **Investing activities** | | |
| Capital expenditures | (6,854) | (12,473) |
| Proceeds from sale of property, plant and equipment | 311 | 35 |
| Payments for net assets of businesses acquired | | (3,068) |
| Net maturities of investments | | (128) |
| Net cash used in investing activities | (6,543) | (15,634) |
| | | |
| **Financing activities** | | |
| Proceeds from stock issuance | 2,781 | 15,082 |
| Repayments of long-term debt | (55,407) | (19,680) |
| Payments for debt issuance costs | (1,503) | |
| Other | (314) | |
| Net cash used in financing activities | (54,443) | (4,598) |
| Effect of exchange rates on cash and cash equivalents | (435) | (226) |
| Net change in cash and cash equivalents | (38,644) | 2,066 |
| Cash and cash equivalents at beginning of period | 147,046 | 124,499 |
| Cash and cash equivalents at end of period | $ 108,402 | $ 126,565 |
| | | |
| **Supplemental disclosure of non-cash investing and financing activities** | | |
| Exchange of convertible subordinated notes | $ 118,766 | $ |
| Transfers from property, plant and equipment to inventory | 473 | 1,515 |
| Transfers from inventory to property, plant and equipment | 78 | 743 |
| Acquisition of assets in connection with the consolidation of a variable interest entity | | 3,550 |
| Assumption of liabilities in connection with the consolidation of a variable interest entity | | 643 |

*See accompanying notes.*

**VEECO INSTRUMENTS INC. AND SUBSIDIARIES**
**Notes to Condensed Consolidated Financial Statements (Unaudited)**

**Note 1 Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. Operating results for the three and nine months ended September 30, 2007, are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006.

Consistent with prior years, the Company reports interim quarters, other than fourth quarters which 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 2007 interim quarter ends are April 1, July 1, and September 30. The 2006 interim quarter ends were April 2, July 2, and October 1. For ease of reference, the Company reports these interim quarter ends as March 31, June 30, and September 30 in its interim condensed consolidated financial statements.

*Net (Loss) Income Per Common Share*

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| | (In thousands ) | | | |
| Weighted average shares outstanding | 31,100 | 30,693 | 30,975 | 30,369 |
| Dilutive effect of stock options and restricted stock awards | | 700 | | 731 |
| Diluted weighted average shares outstanding | 31,100 | 31,393 | 30,975 | 31,100 |

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

During the three and nine month periods ended September 30, 2007, options to purchase 5.7 million shares of common stock (at prices ranging from $0.27 to $72.00 per share) that were outstanding were excluded from the computation of diluted earnings per share. During the comparable 2006 periods, options to purchase 2.9 million shares (at prices ranging from $23.11 to $72.00 per share) and 3.0 million shares (at

prices ranging from $22.63 to $72.00 per share) of common stock that were outstanding were excluded from the computation of diluted earnings per share. In the 2007 periods, the Company recorded net losses, so the effect of all options outstanding was anti-dilutive. In 2006, the exercise price of these options exceeded the average market price of the Company s common stock, thereby causing their effect to be anti-dilutive.

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

The effect of the assumed conversion of the Old Notes is approximately 0.7 million and 2.2 million common equivalent shares for the three and nine months ended September 30, 2007, respectively, and 5.2 million and 5.3 million for the comparable periods of 2006, respectively. The converted shares are anti-dilutive and, therefore, are not

included in the weighted shares outstanding for the three and nine months ended September 30, 2007 and 2006, respectively. The second quarter 2007 debt exchange, together with the $56 million in debt repurchases of Old Notes during the first quarter of 2007 reduced the effect on earnings per share of the assumed conversion of the Old Notes, which was calculated using the if converted method of accounting.

The New Notes meet the criteria for determining the effect of the assumed conversion using the treasury stock method of accounting, as long as the Company has the ability and the intent to settle the principal amount of the New Notes in cash. Under the terms of the New Notes, the Company may pay the principal amount of converted New Notes in cash or in shares of common stock. The Company has indicated that it intends to pay such amounts in cash. Using the treasury stock method, the impact of the assumed conversion of the New Notes is anti-dilutive for the three and nine months ended September 30, 2007, as the average stock price was below the conversion price of $27.23 for both periods. The effect of the assumed converted shares is dependent on the stock price at the time of the conversion. The maximum number of common equivalent shares issuable upon conversion inclusive of the maximum make whole provision is approximately 6.0 million.

*Income Taxes*

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

*Recent Accounting Pronouncements*

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

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

**Note 2 Share-Based Payments**

*Stock Option and Restricted Stock-Based Compensation*

Share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as expense over the employee requisite service period The following compensation expense was included in

the condensed consolidated statement of operations for the three and nine months ended September 30, 2007 and 2006 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2007** | **2006** | **2007** | **2006** |
| Share-based compensation expense | $ 1,505 | $ 722 | $ 3,490 | $ 1,442 |

As of September 30, 2007, the total unrecognized compensation cost related to nonvested stock awards is $10.3 million and to stock option awards is $3.7 million. The related weighted average period over which it is expected that such unrecognized compensation costs will be recognized is approximately 2.4 years for the nonvested stock awards and 2.5 years for option awards.

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

| | **Shares (In thousands)** | **Weighted-Average Grant-Date Fair Value** |
|---|---|---|
| Nonvested at beginning of year | 244 | $ 22.50 |
| Granted | 505 | 19.25 |
| Vested | (93) | 25.08 |
| Forfeited | (50) | 18.17 |
| Nonvested as of September 30, 2007 | 606 | 19.75 |

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

| | **Shares (In thousands)** | **Weighted-Average Exercise Price** | **Aggregate Intrinsic Value (In thousands)** | **Weighted-Average Remaining Contractual Life (in years)** |
|---|---|---|---|---|
| Outstanding at beginning of year | 6,363 | $ 25.58 | | |
| Granted | 603 | 19.58 | | |
| Exercised | (169) | 15.72 | | |
| Forfeited (including cancelled options) | (1,079) | 35.46 | | |
| Outstanding at September 30, 2007 | 5,718 | $ 23.37 | $ 6,049 | 3.1 |
| Options exercisable at September 30, 2007 | 5,011 | $ 23.86 | $ 5,748 | 2.6 |

**Note 3 Balance Sheet Information**

*Inventories*

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

| | September 30, 2007 | December 31, 2006 |
|---|---|---|
| | (In thousands ) | |
| Parts and components (1) | $ 60,121 | $ 60,249 |
| Work in process (1) | 32,192 | 27,961 |
| Finished goods | 13,346 | 12,145 |
| | $ 105,659 | $ 100,355 |

(1) The prior period has been reclassified to conform to current period presentation.

*Accrued Warranty*

The Company estimates the costs that may be incurred under the warranty it provides and recognizes a

liability in the amount of such costs at the time the related revenue is recognized. Factors that affect the Company s warranty liability include product failure rates, material usage and labor costs incurred in correcting product failures during the warranty period. The Company periodically assesses the adequacy of its recognized warranty liability and adjusts the amount as necessary. Changes in the Company s warranty liability during the nine months ended September 30, 2007 and 2006 are as follows:

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2007 | | 2006 | |
| | (In thousands) | | | |
| Balance as of January 1 | $ | 7,118 | $ | 6,671 |
| Warranties issued during the period | | 4,170 | | 5,088 |
| Settlements made during the period | | (4,788) | | (4,602) |
| Balance as of September 30 | $ | 6,500 | $ | 7,157 |

**Note 4 Segment Information**

The Company manages the business, reviews operating results, and assesses performance, as well as allocates resources, based upon two separate reporting segments. The Process Equipment segment combines the etch, deposition, dicing and slicing products sold mostly to data storage customers and the molecular beam epitaxy ( MBE ) and metal organic chemical vapor deposition ( MOCVD ) products primarily sold to high-brightness light emitting diode, solar, and wireless telecommunications customers. This segment has production facilities in Plainview, New York, Ft. Collins, Colorado, Camarillo, California, St. Paul, Minnesota and Somerset, New Jersey. The Metrology segment represents products that are used to provide critical surface measurements on items such as semiconductor devices and thin film magnetic heads, as well as biological, nanoscience, and material science samples, and includes the Company s broad line of atomic force microscopes, optical interferometers and stylus profilers sold to semiconductor customers, data storage customers and thousands of research facilities and scientific centers. This segment has production facilities in Camarillo and Santa Barbara, California and Tucson, Arizona.

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

The following tables present certain data pertaining to the reportable product segments of the Company and a reconciliation of EBITA to income (loss) before income taxes and noncontrolling interest for the three and nine months ended September 30, 2007 and 2006 and goodwill and total assets as of September 30, 2007 and December 31, 2006 (in thousands):

| | Process Equipment | Metrology | Unallocated Corporate Amount | Total |
|---|---|---|---|---|
| **Three Months Ended September 30, 2007** | | | | |
| Net sales | $ 62,923 | $ 34,795 | $ | $ 97,718 |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | $ 2,249 | $ (395) | $ (3,553) | $ (1,699) |
| Interest expense, net | | | 665 | 665 |
| Amortization expense | 1,444 | 399 | 116 | 1,959 |
| Restructuring expense | 159 | 46 | 324 | 529 |
| Income (loss) before income taxes and noncontrolling interest | $ 646 | $ (840) | $ (4,658) | $ (4,852) |

| Three Months Ended September 30, 2006 | Process Equipment | Metrology | Unallocated Corporate Amount | Total |
|---|---|---|---|---|
| Net sales | $ 71,375 | $ 40,994 | $ | $ 112,369 |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | $ 7,482 | $ 4,352 | $ (1,680) | $ 10,154 |
| Interest expense, net | | | 1,056 | 1,056 |
| Amortization expense | 3,333 | 433 | 259 | 4,025 |
| Write-off of purchased in-process technology | 1,160 | | | 1,160 |
| Income (loss) before income taxes and noncontrolling interest | $ 2,989 | $ 3,919 | $ (2,995) | $ 3,913 |

| Nine Months Ended September 30, 2007 | Process Equipment | Metrology | Unallocated Corporate Amount | Total |
|---|---|---|---|---|
| Net sales | $ 181,028 | $ 114,625 | $ | $ 295,653 |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | $ 11,842 | $ 4,015 | $ (9,106) | $ 6,751 |
| Interest expense, net | | | 2,256 | 2,256 |
| Amortization expense | 6,628 | 1,135 | 473 | 8,236 |
| Restructuring expense | 159 | 1,398 | 417 | 1,974 |
| Gain on extinguishment of debt | | | (738) | (738) |
| Income (loss) before income taxes and noncontrolling interest | $ 5,055 | $ 1,482 | $ (11,514) | $ (4,977) |

| Nine Months Ended September 30, 2006 | Process Equipment | Metrology | Unallocated Corporate Amount | Total |
|---|---|---|---|---|
| Net sales | $ 191,927 | $ 125,995 | $ | $ 317,922 |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | $ 17,159 | $ 16,280 | $ (8,035) | $ 25,404 |
| Interest expense, net | | | 3,583 | 3,583 |
| Amortization expense | 9,909 | 1,328 | 792 | 12,029 |
| Write-off of purchased in-process technology | 1,160 | | | 1,160 |
| Gain on extinguishment of debt | | | (330) | (330) |
| Income (loss) before income taxes and noncontrolling interest | $ 6,090 | $ 14,952 | $ (12,080) | $ 8,962 |

| | Process Equipment | Metrology | Unallocated Corporate Amount | Total |
|---|---|---|---|---|
| **As of September 30, 2007** | | | | |
| Goodwill | $ 71,530 | $ 29,368 | $ | $ 100,898 |
| Total assets | 272,842 | 127,069 | 127,453 | 527,364 |
| | | | | |
| **As of December 31, 2006** | | | | |
| Goodwill | $ 71,530 | $ 29,368 | $ | $ 100,898 |
| Total assets | 285,661 | 138,140 | 165,799 | 589,600 |

**Note 5 Income Taxes**

The provision for income taxes of $1.0 million for the three months ended September 30, 2007 included $0.6 million relating to Veeco s foreign operations, which continue to be profitable, and $0.4 million relating to the Company s domestic operations. The provision for income taxes of $3.5 million for the nine months ended September 30, 2007 included $2.5 million relating to Veeco s foreign operations and $1.0 million relating to the Company s domestic operations. Due to significant domestic net operating loss carry forwards, which are fully reserved by a valuation allowance, Veeco s domestic operations are not expected to incur significant income taxes for the foreseeable future.

The Company adopted FIN 48 on January 1, 2007. As a result of adopting FIN 48, the Company recognized a $0.8 million increase to its reserves for uncertain tax positions during the first quarter of 2007, which was recorded as a reduction to the January 1, 2007 retained earnings balance. At the adoption date of January 1, 2007, the Company had approximately $2.3 million of unrecognized tax benefits, including the cumulative effect increase to its reserve for uncertain tax positions. For the three and nine months ended September 30, 2007, the Company recorded $0.1 million and $0.6 million, respectively, related to unrecognized tax benefits. As a result, the Company had $3.0 million of unrecognized tax benefits at September 30, 2007, all of which relate to positions taken on its foreign tax returns and represent the amount of unrecognized tax benefits that, if recognized, would favorably impact the effective income tax rate in future periods.

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

The Company is continuing its practice of recognizing interest and penalties related to income tax matters in income tax expense. The total accrual for interest and penalties related to uncertain tax positions was approximately $1.1 million as of September 30, 2007, which included $0.2 million accrued during the nine months ended September 30, 2007, the impact of which was to reduce net income by $0.2 million and earnings per diluted share by less than $0.01 for the nine months ended September 30, 2007.

**Note 6 Comprehensive (Loss) Income**

Total comprehensive (loss) income for the three and nine months ended September 30, 2007 and 2006 was as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net (loss) income | $ (5,683) | $ 4,508 | $ (7,985) | $ 7,291 |
| Foreign currency translation | 1,481 | (1,065) | 1,387 | 672 |
| Total comprehensive (loss) income | $ (4,202) | $ 3,443 | $ (6,598) | $ 7,963 |

**Note 7 Debt**

*Convertible Debt*

During the first quarter of 2007, the Company repurchased $56.0 million of its 4.125% convertible

subordinated notes (the Old Notes ) for $54.8 million, reducing the amount of the Old Notes outstanding from $200.0 million to $144.0 million. As a result of these repurchases, the Company recorded a net gain from the extinguishment of debt of $0.7 million.

On April 20, 2007, the Company issued new convertible subordinated notes (the New Notes ) pursuant to privately negotiated exchange agreements with certain holders of the Old Notes. Under these agreements, such holders agreed to exchange $106.4 million aggregate principal amount of the Old Notes for approximately $105.5 million aggregate principal amount of New Notes. On May 1, 2007, the Company issued an additional $12.3 million aggregate principal amount of New Notes in a second round of exchange transactions with the holders of $12.4 million of Old Notes. Following the exchange transactions, approximately $25.2 million of the Old Notes, with a conversion price of $38.51 per common share, remained outstanding. No net gain or loss was recorded on the exchange transactions since the carrying value of the Old Notes including unamortized deferred financing costs approximated the exchange value of the New Notes.

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

*Credit Agreement*

During the third quarter of 2007, the Company entered into a Credit Agreement with HSBC Bank USA, National Association, as administrative agent ( HSBC ), and the lenders named therein (the New Credit Agreement ). The New Credit Agreement amends and restates, and effectively replaces, the prior Credit Agreement, dated as of March 15, 2005, among the Company, HSBC and the lenders named therein (the Prior Credit Agreement ). The Prior Credit Agreement was set to expire on March 15, 2008.

The New Credit Agreement provides for revolving credit borrowings of up to $100.0 million. The annual interest rate under the New Credit Agreement is a floating rate equal to the prime rate of the agent bank. A LIBOR-based interest rate option is also provided. Borrowings may be used for general corporate purposes, including working capital requirements and acquisitions. The New Credit Agreement contains certain restrictive covenants substantially similar to those of the Prior Credit Agreement. These include limitations with respect to the incurrence of indebtedness, the payment of dividends, long-term leases, investments, mergers, acquisitions, consolidations and sales of assets. The Company is required to satisfy certain financial tests under the new Credit Agreement substantially similar to those of the prior Credit Agreement. Substantially all of the assets of the Company and its material domestic subsidiaries, other than real estate, have been pledged to secure the Company s obligations under the New Credit Agreement. The revolving credit facility under the New Credit Agreement expires on March 31, 2012. In connection with the New Credit Agreement, the Company paid approximately $0.2 million in fees, which will be amortized over the term of the agreement, along with the remaining deferred financing fees of less than $0.1 million associated with the Prior Credit Agreement. As of September 30, 2007 and December 31, 2006, there were no borrowings outstanding. Interest expense associated with the credit agreement recorded during the period was nominal and is included in accrued expenses as of September 30, 2007.

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

*Litigation*

As previously reported in Veeco s Annual Report on Form 10-K for the year ended December 31, 2006, Veeco and certain of its officers have been named as defendants in a securities class action lawsuit consolidated in August 2005 that is pending in federal court in the Southern District

of New York ( the Court ). The lawsuit arises out of the restatement in March 2005 of Veeco s financial statements for the quarterly periods and nine months ended September 30, 2004 as a result of the Company s discovery of certain improper accounting transactions at its TurboDisc business unit. On July 5, 2007, Veeco entered into a Memorandum of Understanding to settle and fully resolve this lawsuit for a payment of $5.5 million. Veeco expects that insurance proceeds will cover the settlement amount and any significant legal expenses related to the settlement. The settlement agreement is subject to court approval and would dismiss all pending claims against Veeco and the other defendants with no admission or finding of wrongdoing by Veeco or any of the other defendants, and Veeco and the other defendants would receive a full release of all claims pending in the litigation.

*2007 Restructuring Expenses*

In conjunction with a cost reduction plan, the Company recognized a restructuring charge of approximately $0.5 million and $2.0 million during the three months and nine months ended September 30, 2007, respectively, which was recorded as restructuring expense in the condensed consolidated statements of operations. The charge consisted of personnel severance costs for approximately 40 employees, or approximately 3% of total employees, which included management, administration and manufacturing employees companywide. As of September 30, 2007, approximately $0.9 million has been paid and approximately $1.1 million remains accrued. The remainder is expected to be paid over the next twelve to eighteen months.

The following is a reconciliation of the liability for the restructuring charge (in thousands):

| | Process Equipment | Metrology | Corporate | Total |
|---|---|---|---|---|
| Charged to accrual | $ 159 | $ 1,398 | $ 417 | $ 1,974 |
| Cash payments during 2007 | (93) | (692) | (70) | (855) |
| Balance as of September 30, 2007 | $ 66 | $ 706 | $ 347 | $ 1,119 |

**Note 9 Subsequent Events**

During the fourth quarter of 2007, the Company s Board of Directors approved a cost reduction plan that included a reduction in staff (employees, consultants and temporary workers), a reduction of discretionary expenses, realignment of the Company s sales organization to more closely match current market and regional opportunities, and consolidation of certain engineering groups. As a result, during the fourth quarter of 2007, the Company expects to reduce its employment level by approximately 100 employees and will recognize a restructuring charge of $5.0 million, comprised predominantly of severance costs for the related employees.

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

**Executive Summary**

Veeco designs, manufactures, markets and services a broad line of equipment primarily used by manufacturers in the data storage, scientific and industrial research, semiconductor, high-brightness light emitting diode ( HB-LED ) and wireless industries. These industries help create a wide range of information age products such as computer integrated circuits, personal computers, LEDs for backlighting and automotive applications, hard disk drives, network servers, digital cameras, wireless phones, TV set-top boxes, personal music/video players, and personal digital assistants. Veeco s broad line of products features leading edge technology and allows customers to improve time-to-market of their next generation products. Veeco s products are also enabling advancements in the growing fields of nanoscience, nanobiology, and other areas of scientific and industrial research.

Veeco s Process Equipment products precisely deposit or remove (etch) various materials in the manufacturing of thin film magnetic heads ( TFMHs ) for the data storage industry, HB-LED/wireless devices (such as power amplifiers and laser diodes), and semiconductor mask reticles. Veeco s Metrology equipment is used to provide critical surface measurements on semiconductor devices and TFMHs. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality. Veeco s Metrology solutions are also used by many universities, scientific laboratories, and industrial applications. Veeco sells its broad line of atomic force microscopes ( AFMs ), optical interferometers, and stylus profilers to thousands of universities, research facilities, and scientific centers worldwide.

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

**Highlights of the Third Quarter of 2007**

Revenue was $97.7 million, a 13% decrease from the third quarter of 2006.

Orders were $118.3 million, an increase of 3% from the third quarter of 2006.

Net loss was $(5.7) million, or $(0.18) per share, compared to net income of $4.5 million, or $0.14 per share, in the third quarter of 2006.

Gross margins were 36.7%, compared to 42.6% in the third quarter of 2006.

**Highlights of the First Nine Months of 2007**

Revenue was $295.7 million, a 7% decrease from the first nine months of 2006.

Orders were $336.7 million, a decrease of 13% from the first nine months of 2006.

Net loss was $(8.0) million, or $(0.26) per share, compared to net income of $7.3 million, or $0.23 per share, in the first nine months of 2006.

Gross margins were 41.2%, compared to 43.8% in the first nine months of 2006.

**Current Business Conditions**

Veeco reported revenue of $97.7 million for the three months ended September 30, 2007, a 13% decrease from the prior year. Veeco expects continued fluctuations in data storage and semiconductor capital expenditure purchases as customers reassess their production ramps and timing of new technology transition plans. Veeco s revenues were in line with guidance of $92 million to $97 million; however, the Company continued to experience field acceptance delays of new data storage systems. In addition to the challenges in data storage, weakness in Veeco s semiconductor business also negatively impacted revenue and profitability.

Veeco s orders for the three months ended September 30, 2007 were $118.3 million, an increase of 3% from the $114.8 million reported in the same three-month period of 2006. Third quarter orders in the HB-LED/wireless segment remain strong at $43.6 million, up 26% sequentially and 49% from last year s third quarter. This increased order rate compared to the prior year reflects positive customer interest in Veeco s next generation K-Series metal organic chemical vapor deposition ( MOCVD ) tools, which were introduced in December 2006 and provide significant

advantages in uniformity and throughput to Veeco s older tools and those of its competitors. End market demand for this product line remains strong due to emerging LED applications such as PC backlighting and automotive applications. Veeco s data storage orders decreased 15% sequentially and 22% from last year s third quarter. While Veeco s data storage customers are undergoing a period of consolidation and Veeco often has limited visibility to their spending patterns, the Company believes that longer-term industry requirements for increased areal density and consumer electronic expansion will drive future investment in perpendicular head technology and conversion to larger wafer size. The weakest order segment for Veeco during the third quarter was semiconductor, down 22% sequentially and 54% from last year s third quarter. Veeco is in the process of beta testing its next generation automated AFM product, and currently expects the introduction of this product to help improve Veeco s semiconductor order and revenue stream in 2008.

Technology changes are continuing in all of Veeco s markets: the continued increase of 80 GB hard drives, the investment in 120 GB hard drives, and the transition to perpendicular recording in data storage; the increased usage of mini drives in consumer electronic applications; the reduction of feature sizes in the semiconductor industry to 45 nanometer and below; the growing applications in HB-LED such as automotive, architectural lighting, and backlighting for laptops; and emerging opportunities in the solar industry, which utilize Veeco s existing deposition and metrology technologies. Veeco believes that these trends, together with the continued funding of nanoscience research, will prompt customers to seek its next-generation solutions to address their manufacturing and technology challenges. In addition, consumer spending on many types of electronics has increased, and various worldwide economies, such as those in the Asia-Pacific region, are experiencing growth.

**Outlook**

The Company reviews a number of indicators to evaluate the strength of its markets going forward, such as plant utilization trends, capacity requirements and capital spending trends. Veeco is currently forecasting an increase in revenues on a sequential basis for the fourth quarter of 2007, with expectations for revenues to be in the range of approximately $104 million to $112 million, with bookings of $105 million to $115 million. Fourth quarter 2007 profitability is forecasted to improve from the weak third quarter levels on improved volume and pricing in both Process Equipment and Metrology. Additionally, management has initiated the first phase of a multi-quarter turn-around plan to improve Veeco s profitability through a combination of increased focus on its best growth opportunities, gross margin improvement and expense reduction and containment. While Veeco has a strong pipeline of new products for the data storage, HB-LED, semiconductor and scientific research markets, many of these are in the early stages of shipments and there is uncertainty associated with customer acceptance and the Company s ability to recognize revenue upon shipment of the products. The Company s current expectations for the fourth quarter, which are subject to uncertainties such as the timing of customer acceptance of shipped products, would bring revenue for the full year to approximately $400 million to $408 million, down approximately 10% from 2006.

The Company anticipates ending the year with significant backlog, which will set the stage for an improved 2008. This forecast is supported by favorable growth trends specifically in the HB-LED/wireless market driven by the Company s unique MOCVD and MBE technologies and LED applications, as well as early penetration in specific solar applications. The Company also anticipates the positive trend in scientific research to continue due to strong customer acceptance of several new instrumentation products.

During the fourth quarter of 2007, the Company engaged in a cost reduction plan that included a reduction in staff (employees, consultants and temporary workers), a reduction of discretionary expenses, the realignment of the Company s sales organization to more closely match current market and regional opportunities, and consolidation of certain engineering groups. As a result, during the fourth quarter of 2007, the Company expects to reduce its employment level by approximately 100 employees and will recognize a restructuring charge of $5.0 million, comprised predominantly of severance costs for the related employees. Additional restructuring charges in the range of $8.0 million to 13.0 million could potentially impact fourth quarter 2007 and first quarter 2008 earnings, depending upon the timing and extent of additional actions under consideration. Management expects that these potential additional charges will not result in a significant outlay of cash in the near term.

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**Results of Operations:**

***Three Months Ended September 30, 2007 and 2006***

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

The following tables show the details of Veeco s condensed consolidated statements of operations, percentages of sales and comparisons between the three months ended September 30, 2007 and 2006 and the analysis of sales and orders for the same periods by segment, industry, and region (in thousands):

| | Three Months Ended September 30, | | | | Dollar Change |
|---|---|---|---|---|---|
| | 2007 | | 2006 | | |
| Net sales | $ 97,718 | 100.0% | $ 112,369 | 100.0% | $ (14,651) |
| Cost of sales | 61,824 | 63.3 | 64,513 | 57.4 | (2,689) |
| Gross profit | 35,894 | 36.7 | 47,856 | 42.6 | (11,962) |
| Operating expenses: | | | | | |
| Selling, general and administrative expense | 22,723 | 23.3 | 22,296 | 19.9 | 427 |
| Research and development expense | 15,049 | 15.4 | 15,716 | 14.0 | (667) |
| Amortization expense | 1,959 | 2.0 | 4,025 | 3.6 | (2,066) |
| Write-off of purchased in-process technology | | | 1,160 | 1.0 | (1,160) |
| Restructuring expense | 529 | 0.5 | | | 529 |
| Other income, net | (179) | (0.2) | (310) | (0.3) | 131 |
| Total operating expenses | 40,081 | 41.0 | 42,887 | 38.2 | (2,806) |
| Operating (loss) income | (4,187) | (4.3) | 4,969 | 4.4 | (9,156) |
| Interest expense, net | 665 | 0.7 | 1,056 | 0.9 | (391) |
| (Loss) income before income taxes and noncontrolling interest | (4,852) | (5.0) | 3,913 | 3.5 | (8,765) |
| Income tax provision | 954 | 0.9 | 612 | 0.5 | 342 |
| Noncontrolling interest | (123) | (0.1) | (1,207) | (1.0) | 1,084 |
| Net (loss) income | $ (5,683) | (5.8)% | $ 4,508 | 4.0% | $ (10,191) |

| | Sales | | | | Orders | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Three Months Ended September 30, | | Dollar and Percentage Change Year to Year | | Three Months Ended September 30 | | Dollar and Percentage Change Year to Year | | Book to Bill Ratio | |
| | 2007 | 2006 | | | 2007 | 2006 | | | 2007 | 2006 |
| **Segment Analysis** | | | | | | | | | | |
| Process Equipment | $ 62,923 | $ 71,375 | $ (8,452) | (11.8)% | $ 80,918 | $ 74,806 | $ 6,112 | 8.2% | 1.29 | 1.05 |
| Metrology | 34,795 | 40,994 | (6,199) | (15.1) | 37,399 | 40,042 | (2,643) | (6.6) | 1.08 | 0.98 |
| Total | $ 97,718 | $ 112,369 | $ (14,651) | (13.0)% | $ 118,317 | $ 114,848 | $ 3,469 | 3.0% | 1.21 | 1.02 |
| **Industry Analysis** | | | | | | | | | | |
| Data Storage | $ 29,340 | $ 45,410 | $ (16,070) | (35.4)% | $ 35,207 | $ 45,345 | $ (10,138) | (22.4)% | 1.20 | 1.00 |
| HB-LED/wireless | 31,495 | 27,657 | 3,838 | 13.9 | 43,636 | 29,207 | 14,429 | 49.4 | 1.39 | 1.06 |
| Semiconductor | 11,804 | 15,978 | (4,174) | (26.1) | 6,489 | 14,193 | (7,704) | (54.3) | 0.55 | 0.89 |
| Research and Industrial | 25,079 | 23,324 | 1,755 | 7.5 | 32,985 | 26,103 | 6,882 | 26.4 | 1.32 | 1.12 |
| Total | $ 97,718 | $ 112,369 | $ (14,651) | (13.0)% | $ 118,317 | $ 114,848 | $ 3,469 | 3.0% | 1.21 | 1.02 |
| **Regional Analysis (1)** | | | | | | | | | | |
| North America | $ 29,014 | $ 41,921 | $ (12,907) | (30.8)% | $ 48,196 | $ 45,349 | $ 2,847 | 6.3% | 1.66 | 1.08 |
| Europe | 18,244 | 14,882 | 3,362 | 22.6 | 22,220 | 15,558 | 6,662 | 42.8 | 1.22 | 1.05 |
| Japan | 12,585 | 7,718 | 4,867 | 63.1 | 12,330 | 13,226 | (896) | (6.8) | 0.98 | 1.71 |
| Asia-Pacific | 37,875 | 47,848 | (9,973) | (20.8) | 35,571 | 40,715 | (5,144) | (12.6) | 0.94 | 0.85 |
| Total | $ 97,718 | $ 112,369 | $ (14,651) | (13.0)% | $ 118,317 | $ 114,848 | $ 3,469 | 3.0% | 1.21 | 1.02 |

(1) The prior period has been reclassified to conform to the current period presentation.

Net sales of $97.7 million for the third quarter of 2007 were down $14.7 million, or 13.0%, compared to the third quarter of 2006. By segment, Process Equipment sales were down $8.5 million, or 11.8%. The decrease in Process Equipment sales is primarily due to a decrease in sales to the data storage market. Partially offsetting this decline was a continued increase in sales to the HB-LED/wireless market. Metrology sales declined $6.2 million, or 15.1%, primarily due to decreased purchases of optical metrology products in the data storage market and automated AFM products in the semiconductor market. By region, in the third quarter of 2007, net sales increased by 63.1% and 22.6% in Japan and Europe, respectively, while sales in North America and Asia-Pacific declined by 30.8% and 20.8%, respectively. The Company believes that quarter-to-quarter variations in the geographic distribution of sales will continue.

Orders of $118.3 million for the third quarter of 2007 represented an increase of $3.5 million, or 3.0%, from the comparable 2006 period. By segment, the 8.2% increase in Process Equipment orders was primarily due to a $9.8 million increase in orders for MBE equipment and $9.1 million for MOCVD equipment, driven by the high growth currently being seen in the HB-LED/wireless, solar, and scientific research markets, offset by a decrease in orders for other process equipment as a result of a decrease in customer demand in the data storage industry. The 6.6% decrease in Metrology orders was driven by a 22% decrease in orders for optical metrology products, principally to data storage customers.

The Company s book-to-bill ratio for the third quarter of 2007, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period, was 1.21, an increase from the comparable 2006 period. During the quarter ended September 30, 2007, the Company experienced no significant net backlog adjustments or order cancellations. However, the Company did experience rescheduling of order delivery dates by customers. Due to changing business conditions and customer requirements, the Company may continue to experience cancellations and/or rescheduling of orders.

Gross profit for the quarter ended September 30, 2007 was 36.7%, compared to 42.6% in the third quarter of 2006. Process Equipment sales represented 64.4% of total sales for the third quarter of 2007, up slightly from 63.5% in the prior year period. Metrology sales accounted for 35.6% of total sales for the third quarter of 2007, down from 36.5% in the prior year period. Process Equipment gross margins decreased to 33.5% from 38.1% in the prior year period, primarily due to a decline in the margin for Ion Beam products resulting from a lower volume of products sold and an unfavorable product mix as compared to the prior year period. This decrease is partially offset by an improvement in MOCVD product gross margins to 33.6% from 26.9% in the prior year period due to favorable pricing of new products sold in the current period. Metrology gross margins decreased to 42.6% from 50.3%, principally due to lower sales volume of optical metrology and automated AFM products and less favorable pricing of and overhead spending on the AFM products sold to scientific and research customers.

Selling, general and administrative expenses increased to $22.7 million, or 23.3% of net sales, in the third quarter of 2007, compared with $22.3 million, or 19.9% of net sales, in the comparable prior year period. The increase is attributable to executive stay and sign-on bonuses and an increase in non-cash stock-based compensation expense, offset by a decrease in sales commissions related to a reduction in domestic sales.

Research and development expense totaled $15.0 million in the third quarter of 2007, a decrease of $0.7 million from the third quarter of 2006, primarily due to prior year product development efforts for Process Equipment products that were released during 2007. As a percentage of sales, research and development increased to 15.4% in the third quarter of 2007, from 14.0% in the third quarter of 2006.

Amortization expense was $2.0 million in the third quarter of 2007, compared to $4.0 million in the third quarter of 2006. The decrease was principally due to certain technology-based intangibles becoming fully amortized during the second quarter of 2007.

During the third quarter of 2006, the Company finalized its purchase accounting for its acquisition of 19.9% of the stock of Fluens Corporation ( Fluens ), determining that Fluens is a variable interest entity and the Company is its primary beneficiary as defined by Financial Accounting Standards Board ( FASB ) Financial Interpretation ( FIN ) 46R, *Consolidation of Variable Interest Entities (revised December 2003) an interpretation of ARB No. 51.* As such, the Company has consolidated the results of Fluens operations from the acquisition date, and has attributed

the 80.1% portion that is not owned by Veeco to noncontrolling interest in the Company s consolidated financial statements (see below). As part of this acquisition accounting, the Company recorded $1.2 million of in-process technology, which was written off during the third quarter of 2006. No such costs were recorded during the third quarter of 2007.

The restructuring expense of $0.5 million for the quarter ended September 30, 2007, consisted of personnel severance costs incurred throughout the Company.

Net interest expense in the third quarter of 2007 was $0.7 million, compared to $1.1 million in the third quarter of 2006. This reduction in net interest expense is the result of less net debt outstanding during the period.

The income tax provision for the quarter ended September 30, 2007 was $1.0 million compared to $0.6 million in the third quarter of 2006. The 2007 provision for income taxes included $0.6 million relating to Veeco s foreign operations, which continue to be profitable, and $0.4 million relating to the Company s domestic operations. Due to significant domestic net operating loss carry forwards, which are fully reserved by a valuation allowance, Veeco s domestic operations are not expected to incur significant income taxes for the foreseeable future. The 2006 provision for income taxes included $0.2 million relating to Veeco s foreign operations and $0.4 million relating to the Company s domestic operations. The increase to the income tax provision is due to an increase in taxable income relating to the Company s foreign operations.

Noncontrolling interest was a credit to income of $0.1 million for the three months ended September 30, 2007, and a credit of $1.2 million for the comparable period in the prior year. As the Company is the primary beneficiary of Fluens, a variable interest entity, it is required to consolidate Fluens and eliminate the portion of its results attributable to noncontrolling interests. As a result, the Company eliminates from its net income 80.1% of Fluens operating losses. The credit in the prior comparable period includes the elimination of 80.1% of the write-off of in-process technology recorded in the 2006 third quarter.

***Nine Months Ended September 30, 2007 and 2006***

The following tables show the details of Veeco s condensed consolidated statements of operations, percentages of sales and comparisons between the nine months ended September 30, 2007 and 2006 and the analysis of sales and orders for the same periods by segment, industry and region (in thousands):

| | Nine Months Ended September 30, | | | Dollar Change |
|---|---|---|---|---|
| | 2007 | | 2006 | | |
| Net sales | $ 295,653 | 100.0% | $ 317,922 | 100.0% | $ (22,269) |
| Cost of sales | 173,819 | 58.8 | 178,585 | 56.2 | (4,766) |
| Gross profit | 121,834 | 41.2 | 139,337 | 43.8 | (17,503) |
| Operating expenses: | | | | | |
| Selling, general and administrative expense | 69,347 | 23.4 | 68,622 | 21.5 | 725 |
| Research and development expense | 46,341 | 15.7 | 45,554 | 14.3 | 787 |
| Amortization expense | 8,236 | 2.8 | 12,029 | 3.8 | (3,793) |
| Restructuring expense | 1,974 | 0.7 | | | 1,974 |
| Write-off of purchased in-process technology | | | 1,160 | 0.4 | (1,160) |
| Other income, net | (605) | (0.2) | (243) | (0.0) | (362) |
| Total operating expenses | 125,293 | 42.4 | 127,122 | 40.0 | (1,829) |
| Operating income | (3,459) | (1.2) | 12,215 | 3.8 | (15,674) |
| Interest expense, net | 2,256 | 0.7 | 3,583 | 1.1 | (1,327) |
| Gain on extinguishment of debt | (738) | (0.2) | (330) | (0.1) | (408) |
| (Loss) income before income taxes and noncontrolling interest | (4,977) | (1.7) | 8,962 | 2.8 | (13,939) |
| Income tax provision | 3,490 | 1.2 | 2,878 | 0.9 | 612 |
| Noncontrolling interest | (482) | (0.2) | (1,207) | (0.4) | 725 |
| Net (loss) income | $ (7,985) | (2.7)% | $ 7,291 | 2.3% | $ (15,276) |

| | Sales | | | | Orders | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Nine Months Ended September 30, | | Dollar and Percentage Change Year to Year | | Nine Months Ended September 30, | | Dollar and Percentage Change Year to Year | | Book to Bill Ratio | |
| | 2007 | 2006 | | | 2007 | 2006 | | | 2007 | 2006 |
| **Segment Analysis** | | | | | | | | | | |
| Process Equipment | $ 181,028 | $ 191,927 | $ (10,899) | (5.7)% | $ 227,285 | $ 252,608 | $ (25,323) | (10.0)% | 1.26 | 1.32 |
| Metrology | 114,625 | 125,995 | (11,370) | (9.0) | 109,392 | 132,142 | (22,750) | (17.2) | 0.95 | 1.05 |
| Total | $ 295,653 | $ 317,922 | $ (22,269) | (7.0)% | $ 336,677 | $ 384,750 | $ (48,073) | (12.5)% | 1.14 | 1.21 |
| **Industry Analysis** | | | | | | | | | | |
| Data Storage | $ 96,006 | $ 138,598 | $ (42,592) | (30.7)% | $ 105,944 | $ 187,177 | $ (81,233) | (43.4)% | 1.10 | 1.35 |
| HB-LED/wireless | 78,240 | 61,177 | 17,063 | 27.9 | 117,008 | 80,939 | 36,069 | 44.6 | 1.50 | 1.32 |
| Semiconductor | 32,755 | 39,735 | (6,980) | (17.6) | 26,562 | 44,288 | (17,726) | (40.0) | 0.81 | 1.11 |
| Research and Industrial | 88,652 | 78,412 | 10,240 | 13.1 | 87,163 | 72,346 | 14,817 | 20.5 | 0.98 | 0.92 |
| Total | $ 295,653 | $ 317,922 | $ (22,269) | (7.0)% | $ 336,677 | $ 384,750 | $ (48,073) | (12.5)% | 1.14 | 1.21 |
| **Regional Analysis (1)** | | | | | | | | | | |
| North America | $ 95,516 | $ 109,180 | $ (13,664) | (12.5)% | $ 121,696 | $ 138,251 | $ (16,555) | (12.0)% | 1.27 | 1.27 |
| Europe | 53,199 | 49,332 | 3,867 | 7.8 | 63,396 | 42,374 | 21,022 | 49.6 | 1.19 | 0.86 |
| Japan | 43,732 | 34,016 | 9,716 | 28.6 | 42,125 | 44,400 | (2,275) | (5.1) | 0.96 | 1.31 |
| Asia-Pacific | 103,206 | 125,394 | (22,188) | (17.7) | 109,460 | 159,725 | (50,265) | (31.5) | 1.06 | 1.27 |
| Total | $ 295,653 | $ 317,922 | $ (22,269) | (7.0)% | $ 336,677 | $ 384,750 | $ (48,073) | (12.5)% | 1.14 | 1.21 |

(1) The prior period has been reclassified to conform to the current period presentation.

Net sales of $295.7 million for the nine months ended September 30, 2007 were down $22.3 million, or 7.0%, compared to the nine months ended September 30, 2006. By segment, Process Equipment sales were down $10.9 million, or 5.7%. The decrease in Process Equipment sales is primarily due to a decrease in sales to customers in the data storage industry. Partially offsetting this decline was an increase in sales to the HB-LED/wireless market. Metrology sales decreased $11.4 million, or 9.0%, primarily due to decreased purchases of optical metrology products in the data storage market and automated AFM products in the semiconductor market. By region, in the nine months ended September 30, 2007, net sales increased by 28.6% in Japan and 7.8% in Europe, while sales in Asia-Pacific and North America declined 17.7% and 12.5%, respectively. The Company believes that there will continue to be period-to-period variations in the geographic distribution of sales.

Orders of $336.7 million for the nine months ended September 30, 2007 represented a decrease of $48.1 million, or 12.5%, from the comparable 2006 period. By segment, the 10.0% decrease in Process Equipment orders was primarily due to a $49.5 million decrease in orders for Ion Beam equipment as a result of a decrease in customer demand in the data storage industry, partially offset by a $30.8 million increase in MOCVD orders resulting from an increase in purchases in the HB-LED/wireless market. The 17.2% decrease in Metrology orders was primarily due to a $13.5 million decrease in orders for optical metrology products, principally to data storage customers, and a $10.8 million decrease in orders for automated AFM products, principally to semiconductor customers.

The Company s book-to-bill ratio for the nine months ended September 30, 2007, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period, was 1.14, a decrease from the comparable 2006 period. The Company s backlog as of September 30, 2007 was $181.6 million, compared to $140.8 million as of December 31, 2006. During the nine months ended September 30, 2007, the Company did not experience significant net backlog adjustments or order cancellations. However, the Company did experience rescheduling of order delivery dates by customers. Due to changing business conditions and customer requirements, the Company may continue

to experience cancellations and/or rescheduling of orders.

Gross profit for the nine months ended September 30, 2007 was 41.2%, compared to 43.8% in the comparable prior year period. Process Equipment sales represented 61.2% of total sales for the nine months ended September 30, 2007, up from 60.4% in the prior year period. Metrology sales accounted for 38.8% of total sales for the nine months ended September 30, 2007, down from 39.6% in the comparable prior year period. Process Equipment gross margin was consistent with the prior year period. However, included in the margin was a significant improvement in MOCVD product gross margins from 23.0% in the prior year to 37.2% in the current year due to an increase in sales volume, as well as a significant improvement in mix and price. This was offset by a decrease in the margin for Ion Beam products from 46.9% in the 2006 period to 41.2% in the current comparable period due to an unfavorable product mix, as well as the decrease in sales to customers in the data storage market. Metrology gross margins decreased to 45.6% from

51.4%, principally due to less favorable product mix in AFM products sold to scientific and research customers and lower sales volume of automated AFM and optical metrology products.

Selling, general and administrative expenses were $69.3 million, or 23.4% of sales, in the nine months ended September 30, 2007, compared with $68.6 million, or 21.5% of sales, in the comparable prior year period. The $0.7 million increase is primarily attributable to an increase in non-cash compensation expense related to stock options and restricted shares and an increase in selling expense due primarily to an investment in the AFM product line for life sciences applications. This is partially offset by a reduction in management incentive bonus expense and legal fees, as well as reduced sales commissions related to the reduction in domestic sales.

Research and development expense totaled $46.3 million in the nine months ended September 30, 2007, an increase of $0.8 million from the comparable prior year period, driven by an investment in life sciences applications in AFM as well as new product development efforts in the Company s MOCVD product platform for HB-LED/wireless applications and automated AFM products for the semiconductor industry. This is partially offset by a decrease in research and development expense in Ion Beam products from the prior comparable period, due to the release of these products during 2007. As a percentage of sales, research and development expense increased to 15.7% in the nine months ended September 30, 2007, from 14.3% in the comparable prior year period.

Amortization expense was $8.2 million in the nine months ended September 30, 2007, compared to $12.0 million in the comparable prior year period. The decrease was due to certain technology-based intangibles becoming fully amortized during the second quarter of 2007.

The restructuring expense of $2.0 million for the nine months ended September 30, 2007, consisted of personnel severance costs incurred throughout the Company during the second and third quarters of 2007.

During the third quarter of 2006, the Company finalized its purchase accounting for its acquisition of 19.9% of the stock of Fluens determining that Fluens is a variable interest entity and the Company is its primary beneficiary. As such, the Company has consolidated the results of Fluens operations from the acquisition date, and has attributed the 80.1% portion that is not owned by Veeco to noncontrolling interest in the Company s consolidated financial statements. As part of this acquisition accounting, the Company recorded $1.2 million of in-process technology, which was written off during the third quarter of 2006. No such costs were recorded during 2007.

Net interest expense in the nine months ended September 30, 2007 was $2.3 million compared to $3.6 million in the comparable prior year period. This reduction in net interest expense is the result of less net debt outstanding during the period.

During the nine months ended September 30, 2007, the Company repurchased $56.0 million of its convertible subordinated notes, reducing the amount outstanding from $200.0 million to $144.0 million. The repurchase amount was $55.1 million in cash, of which $54.8 million related to principal and $0.3 million related to accrued interest. As a result of the repurchase, the Company recorded a net gain from the extinguishment of debt in the amount of $0.7 million. In the comparable 2006 period, the Company repurchased $20.0 million of its convertible subordinated notes reducing the amount outstanding from $220.0 million to $200.0 million. As a result of these repurchases, the Company recorded a net gain from the extinguishment of debt in the amount of $0.3 million.

The income tax provision for the nine months ended September 30, 2007 was $3.5 million compared to $2.9 million in the comparable prior year period. The 2007 provision for income taxes included $2.5 million relating to Veeco s foreign operations, which continue to be profitable, and $1.0 million relating to the Company s domestic operations. Due to significant domestic net operating loss carry forwards, which are fully reserved by a valuation allowance, Veeco s domestic operations are not expected to incur significant income taxes for the foreseeable future. The 2006 provision for income taxes included $1.9 million relating to Veeco s foreign operations and $1.0 million relating to the Company s domestic operations.

Noncontrolling interest was a credit to income of $0.5 million for the nine months ended September 30, 2007 and a credit of $1.2 million in the comparable prior year period. As the Company is the primary beneficiary of Fluens, a variable interest entity, it is required to consolidate Fluens and eliminate the portion of its results attributable to noncontrolling interests. As a result, the Company eliminates from its net income 80.1% of Fluens operating losses. The credit in the prior comparable period includes the elimination of 80.1% of the write-off of in-process technology recorded in the 2006 third quarter.

**Liquidity and Capital Resources**

Historically, Veeco s principal capital requirements have included the funding of acquisitions and capital expenditures. The Company traditionally has generated cash from operations and debt and stock issuances. Veeco s ability to generate sufficient cash flows from operations is dependent on the continued demand for the Company s products and services. A summary of the current period cash flow activity is as follows (in thousands):

| | Nine Months Ended September 30, | | | |
|---|---|---|---|---|
| | | 2007 | | 2006 |
| Net (loss) income | $ | (7,985) | $ | 7,291 |
| | | | | |
| Net cash provided by operating activities | $ | 22,777 | $ | 22,524 |
| Net cash used in investing activities | | (6,543) | | (15,634) |
| Net cash used in financing activities | | (54,443) | | (4,598) |
| Effect of exchange rates on cash and cash equivalents | | (435) | | (226) |
| Net change in cash and cash equivalents | | (38,644) | | 2,066 |
| Cash and cash equivalents at beginning of period | | 147,046 | | 124,499 |
| Cash and cash equivalents at end of period | $ | 108,402 | $ | 126,565 |

The Company had a net decrease in cash of $38.6 million for the nine months ended September 30, 2007 from December 31, 2006, primarily due to the repurchase of $56.0 million of its 4.125% convertible subordinated notes due 2008 (the Old Notes ). Cash provided by operations was $22.8 million for this period, as compared to cash provided by operations of $22.5 million for the comparable 2006 period. Net (loss) income adjusted for non-cash items provided operating cash flows of $14.6 million for the nine months ended September 30, 2007, compared to $31.0 million for the comparable 2006 period. Net cash provided by operations for the nine months ended September 30, 2007 was favorably impacted by a decrease in net operating assets and liabilities of $8.2 million. Accounts receivable decreased $20.0 million during the nine months ended September 30, 2007, due to a $25.4 million reduction in sales when comparing the fourth quarter of 2006 to the third quarter of 2007, and favorable cash collections during 2007. Inventories increased by approximately $4.8 million during the same period, principally due to an increase in work in process and finished goods inventories for systems to be shipped during the fourth quarter of 2007 and the first quarter of 2008 in the Process Equipment segment. Accounts payable decreased $5.0 million during the nine months ended September 30, 2007, due to the timing of payments.

Cash used in investing activities of $6.5 million for the nine months ended September 30, 2007, was driven by capital expenditures of $6.8 million, partially offset by $0.3 million in proceeds from the sale of property, plant and equipment. During the fourth quarter of 2007, the Company expects to invest an additional $5.3 million in capital equipment primarily related to engineering equipment and lab tools used in enhancing, testing and process development of Veeco s products.

Cash used in financing activities for the nine months ended September 30, 2007, totaled $54.4 million, primarily consisting of $55.4 million used to repurchase a portion of the Company s Old Notes and pay down other existing long-term debt and $1.5 million in payments for debt issuance costs, partially offset by $2.8 million from the issuance of common stock resulting from the exercise of employee stock options. The debt repurchase reduced the amount of Old Notes outstanding to $144.0 million and the Company recorded a net gain of $0.7 million.

In April and May of 2007, the Company issued new notes pursuant to privately negotiated exchange agreements with certain holders of the Old Notes. Under these agreements, such holders agreed to exchange $118.8 million aggregate principal amount of the Old Notes for approximately $117.8 million aggregate principal amount of a new series of 4.125% convertible subordinated notes due April 15, 2012 (the "New Notes"). Following the exchange transactions, approximately $25.2 million of the Old Notes, with a conversion price of $38.51 per common share, remained outstanding. No net gain or loss was recorded on the exchange transactions since the carrying value of the Old Notes, including unamortized deferred financing costs, approximated the exchange value of the New Notes.

The New Notes initially will be convertible into 36.7277 shares of common stock per $1,000 principal amount of New Notes (equivalent to a conversion price of $27.23 per share or a premium of 38% over the closing market price for Veeco's common stock on April 16, 2007). Holders may convert the New Notes at any time during the period beginning on January 15, 2012 through the close of business on the second day prior to April 15, 2012 and

earlier upon the occurrence of certain events including Veeco's common stock trading at prices 130% over the conversion price for a specified period.

During the third quarter of 2007, the Company entered into a Credit Agreement with HSBC. The New Credit Agreement amends and restates, and effectively replaces, the Prior Credit Agreement, dated as of March 15, 2005, with HSBC, which was set to expire on March 15, 2008. The New Credit Agreement provides for revolving credit borrowings of up to $100.0 million. The annual interest rate under the New Credit Agreement is a floating rate equal to the prime rate of the agent bank. A LIBOR-based interest rate option is also provided. Borrowings may be used for general corporate purposes, including working capital requirements and acquisitions. The New Credit Agreement contains certain restrictive covenants substantially similar to those of the Prior Credit Agreement. These include limitations with respect to the incurrence of indebtedness, the payment of dividends, long-term leases, investments, mergers, acquisitions, consolidations and sales of assets. The Company is required to satisfy certain financial tests under the new Credit Agreement substantially similar to those of the prior Credit Agreement. Substantially all of the assets of the Company and its material domestic subsidiaries, other than real estate, have been pledged to secure the Company s obligations under the New Credit Agreement. The revolving credit facility under the New Credit Agreement expires on March 31, 2012. As of September 30, 2007, there were no borrowings outstanding under the New Credit Agreement.

The Company believes that existing cash balances together with cash generated from operations and amounts available under the Company s new revolving credit facility will be sufficient to meet the Company s projected working capital and other cash flow requirements for the next twelve months, as well as the Company s contractual obligations, over the next two years. The Company believes it will be able to meet its obligation to repay the outstanding $25.2 million of the Old Notes that mature on December 21, 2008 through cash on hand and cash generated from operations. The Company believes it will be able to meet its obligation to repay the outstanding $117.8 million of the New Notes due in April 2012 through a combination of refinancing, cash generated from operations and/or other means.

In 2006, Veeco purchased 19.9% of the common stock of Fluens. Veeco and Fluens are jointly developing a next-generation process for high-rate deposition of aluminum oxide for data storage applications. If this development is successful and upon the satisfaction of certain additional conditions by May 2009, Veeco will be obligated to purchase the balance of the outstanding stock of Fluens for $3.5 million and pay an earn-out. Approximately 31% of Fluens is owned by a Vice President of one of Veeco s business units.

During the fourth quarter of 2007, the Company expects to recognize $5.0 million of severance charges related to a cost reduction plan. Of this total amount, approximately $1.4 million will be paid out during the fourth quarter of 2007, with the remainder paid out over the next twelve months.

**Application of Critical Accounting Policies**

*General:* Veeco s discussion and analysis of its financial condition and results of operations are based upon the Company s condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Veeco to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, management evaluates its estimates and judgments, including those related to bad debts, inventories, intangible assets and other long-lived assets, income taxes, warranty obligations, restructuring costs and contingent 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. The Company considers certain accounting policies related to revenue recognition, the valuation of inventories, the impairment of goodwill and indefinite-lived intangible assets, the impairment of long-lived assets, warranty costs, the accounting for taxes and share-based compensation to be critical policies due to the estimation processes involved in each.

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

For products manufactured according to the Company's published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment. For products produced according to a particular customer's specifications, revenue is recognized when the product has been tested, it has been demonstrated that it meets the customer's specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount of any customer retention (generally 10% to 20%), which is not payable by the customer until installation is completed and final customer acceptance is achieved. Installation is not deemed to be essential to the functionality of the equipment

since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% to 2% of the sales value of the related equipment.

For new products, new applications of existing products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 80% to 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the amount billed at the time of shipment. The profit on the amount billed for these transactions is deferred and recorded as deferred profit in the accompanying condensed consolidated balance sheets. At September 30, 2007 and December 31, 2006, $1.3 million and $0.3 million, respectively, are recorded in deferred profit.

Service and maintenance contract revenues are recorded as deferred revenue, which is included in other accrued expenses, and recognized as revenue on a straight-line basis over the service period of the related contract.

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

*Goodwill and Indefinite-Lived Intangible Asset Impairment:* The Company has significant intangible assets related to goodwill and other acquired intangibles. In assessing the recoverability of the Company's goodwill and other indefinite-lived intangible assets, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If it is determined that impairment indicators are present and that the assets will not be fully recoverable, their carrying values are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic or anticipated decline in revenue or operating profit, adverse legal or regulatory developments, and a material decrease in the fair value of some or all of the assets. Assets are grouped at the lowest levels for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Changes in strategy and/or market conditions could significantly impact these assumptions, and thus Veeco may be required to record impairment charges for those assets not previously recorded.

*Long-Lived Asset Impairment:* The carrying values of long-lived assets are periodically reviewed to determine if any impairment indicators are present. If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining depreciation period, their carrying values are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic or anticipated decline in revenue or operating profit, adverse legal or regulatory developments, and a material decrease in the fair value of some or all of the assets. Assets are grouped at

the lowest level for which there is identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Assumptions utilized by management in reviewing for impairment of long-lived assets could be effected by changes in strategy and/or market conditions which may require Veeco to record additional impairment charges for these assets, as well as impairment charges on other long-lived assets not previously recorded.

*Warranty Costs:* The Company estimates the costs that may be incurred under the warranty it provides and records 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. The Company s warranty obligation is affected by product failure rates, material usage, and labor costs incurred in correcting product failures during the warranty period. As the Company's customer engineers and process support engineers are highly trained and deployed globally, labor availability is a significant factor in determining labor costs. The quantity and availability of critical replacement parts is another significant factor in estimating warranty costs. Unforeseen component failures or exceptional component performance can also result in changes to warranty costs. If actual warranty costs differ substantially from the Company s estimates, revisions to the estimated warranty liability would be required.

*Income Taxes:* As part of the process of preparing Veeco s condensed consolidated financial statements, the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves

estimating the actual current tax expense, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the Company s condensed consolidated balance sheets. The carrying value of deferred tax assets is adjusted by a valuation allowance to recognize the extent to which the future tax benefits will be recognized on a more likely than not basis. Veeco s net deferred tax assets consist primarily of net operating loss and tax credit carryforwards, and timing differences between the book and tax treatment of inventory and other asset valuations. Realization of these net deferred tax assets is dependent upon the Company s ability to generate future taxable income.

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

At September 30, 2007, the Company had a valuation allowance of approximately $68.5 million against substantially all of its domestic net deferred tax assets, which consist of net operating loss and tax credit carryforwards, as well as temporary deductible differences. The valuation allowance was calculated in accordance with the provisions of SFAS 109, which place primary importance on the Company s historical results of operations. Although the Company s results in prior years were significantly affected by restructuring and other charges, the Company s historical losses and the losses incurred in 2005 and 2004 represent negative evidence sufficient to require a full valuation allowance under the provisions of SFAS 109. If the Company is able to realize part or all of the deferred tax assets in future periods, it will reduce its provision for income taxes with a release of the valuation allowance in an amount that corresponds with the income tax liability generated.

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

*Share-Based Compensation:* In 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* ( SFAS 123(R) ), which is a revision of Statement of Financial Accounting Standards No. 123 ( SFAS 123 ), *Accounting for Stock-Based Compensation*, supersedes Accounting Principles Board No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ) and amends Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows* ( SFAS 95 ). Generally, the approach in SFAS 123(R) is similar to the approach described in SFAS 123. However, SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS 123(R) was adopted using the modified prospective method of application, which requires the recognition of compensation expense on a prospective basis. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in the pro forma disclosures in periods reported prior to the adoption of SFAS 123(R).

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Under SFAS 123(R), the Company is required to record the fair value of stock-based compensation awards as an expense. In order to determine the fair value of stock options on the grant date, the Company applies the Black-Scholes option-pricing model. Inherent in the model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a level of judgment which make them critical accounting estimates. Since the fourth quarter of 2005, the Company has used an expected stock-price volatility assumption that is a combination of both historical and implied volatilities of the underlying stock, which is obtained from public data sources. Prior to that time, the Company based this assumption solely on historical volatility. The Company considers the exercise behavior of past grants and models the pattern of aggregate exercises in determining the expected weighted-average option life.

**Recent Accounting Pronouncements**

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

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

In July 2007, the FASB issued an Exposure Draft on Proposed FASB Staff Position (FSP) No. APB 14-a, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (including partial cash settlement).* The FSP will impact the accounting for certain structured convertible debt instruments that allow settlement in any combination of cash and shares at the issuer s option. The FSP would require bifurcation of a component of the debt associated with the conversion feature, reclassification of that component to stockholders equity, and then accretion of the resulting discount on the debt over the remaining life of the obligation resulting in interest expense equal to the issuer s nonconvertible debt borrowing rate. The intent is that the amount allocated to equity represents the interest cost that was paid for the conversion option. The proposed FSP would make any final guidance effective for fiscal years beginning after December 15, 2007, would not permit early application, and would be applied retrospectively to all periods presented. The Company has reviewed the impact of the proposed FSP and has determined that if the guidance is issued as currently proposed, it would result in a non-cash increase in interest expense, which could have a material impact on net income.

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

Veeco s net sales to foreign customers represented approximately 71.1% and 68.4% of Veeco s total net sales for the three and nine months ended September 30, 2007, respectively, and 63.9% and 67.0% for the comparable 2006 periods, respectively. The Company expects that net sales to foreign customers will continue to represent a large percentage of Veeco s total net sales. Veeco s net sales denominated in foreign currencies represented approximately 21.1% and 20.7% of Veeco s total net sales for the three and nine months ended September 30, 2007, respectively, and 12.5% and 15.1% for the comparable 2006 periods, respectively.

The condensed consolidated results of operations for the three and nine months ended September 30, 2007 include aggregate foreign currency losses of less than $0.1 million and approximately $0.3 million, respectively. Included in those losses were losses of less than $0.1 million and approximately $0.1 million, respectively, related to forward contracts. The 2006 condensed consolidated results of operations include aggregate foreign currency impact of a gain of approximately $0.1 million and a loss of approximately $0.3 million for the three and nine months ended September 30, 2006, respectively. Included in this impact were losses of approximately $0.3 million and $0.2 million,

respectively, related to forward hedge contracts.

Veeco is exposed to financial market risks, including changes in foreign currency exchange rates. The changes in currency exchange rates that have the largest impact on translating Veeco s international operating profit are the Japanese Yen and the Euro. Veeco uses derivative financial instruments to mitigate these risks. Veeco does not use derivative financial instruments for speculative or trading purposes. The Company generally enters into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known currency exposures. The average notional amount of such contracts was approximately $3.0 million for both the three and nine months ended September 30, 2007. As of September 30, 2007, the Company had entered into one forward contract for the month of October.

Assuming third quarter 2007 variable debt and investment levels, the effect of a one-point change in interest rates would not have a material effect on net interest expense.

**Item 4. Controls and Procedures.**

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

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

The Company is presently in the process of implementing new company-wide integrated applications software and, as of September 30, 2007, has completed the conversion to this new platform in ten of Veeco s business locations with the remainder expected to be completed by the first half of 2008. As a result, certain changes have been made to the Company s internal controls, which management believes will strengthen the Company s internal control structure. There have been no other significant changes in our internal controls or other factors during the fiscal quarter ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

**Part II. OTHER INFORMATION**

**Item 1. Legal Proceedings.**

As previously reported, Veeco and certain of its officers have been named as defendants in a securities class action lawsuit consolidated in August 2005 that is pending in federal court in the Southern District of New York ( the Court ). The lawsuit arises out of the restatement in March 2005 of Veeco s financial statements for the quarterly periods and nine months ended September 30, 2004 as a result of the Company s discovery of certain improper accounting transactions at its TurboDisc business unit. On July 5, 2007, Veeco entered into a Memorandum of Understanding to settle and fully resolve this lawsuit for a payment of $5.5 million. Veeco expects that insurance proceeds will cover the settlement amount and any significant legal expenses related to the settlement. The settlement agreement is subject to court approval and would dismiss all pending claims against Veeco and the other defendants with no admission or finding of wrongdoing by Veeco or any of the other defendants, and Veeco and the other defendants would receive a full release of all claims pending in the litigation.

**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, 2006. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K.

**Item 6. Exhibits.**

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

| Number | Description | Incorporated by Reference to the Following Document: |
|---|---|---|
| 10.1 | Credit Agreement, dated as of August 20, 2007, by and among Veeco Instruments Inc., HSBC Bank USA, National Association, as administrative agent, and the lenders named therein. | * |
| 10.2 | Amendment and Reaffirmation dated August 20, 2007 of Security Agreement dated as of March 15, 2005 among Veeco Instruments Inc., the subsidiaries of Veeco named therein and HSBC Bank USA, National Association, as administrative agent. | * |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934. | * |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities and Exchange Act of 1934. | * |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | * |

* Filed herewith

**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 30, 2007

| | Veeco Instruments Inc. |
|---|---|
| By: | /s/ JOHN R. PEELER<br>John R. Peeler<br>*Chief Executive Officer* |
| By: | /s/ JOHN F. REIN, JR.<br>John F. Rein, Jr.<br>*Executive Vice President, Chief Financial Officer*<br>*and Secretary* |

**INDEX TO EXHIBITS**

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