

MKS INSTRUMENTS INC  
Form 10-Q  
August 06, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, DC 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended June 30, 2013

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-23621

**MKS INSTRUMENTS, INC.**

(Exact name of registrant as specified in its charter)

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|                                                                                                    |                                                              |
|----------------------------------------------------------------------------------------------------|--------------------------------------------------------------|
| <b>Massachusetts</b><br>(State or other jurisdiction of<br>incorporation or organization)          | <b>04-2277512</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>2 Tech Drive, Suite 201, Andover, Massachusetts</b><br>(Address of principal executive offices) | <b>01810</b><br>(Zip Code)                                   |

**Registrant's telephone number, including area code (978) 645-5500**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

|                                                                                              |                                                    |
|----------------------------------------------------------------------------------------------|----------------------------------------------------|
| Large accelerated filer <input checked="" type="checkbox"/>                                  | Accelerated filer <input type="checkbox"/>         |
| Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

As of July 30, 2013, the registrant had 53,161,233 shares of common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## MKS INSTRUMENTS, INC.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(Unaudited)

|                                                                                                                                                                         | June 30,<br>2013 | December 31, 2012 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|-------------------|
| <b>ASSETS</b>                                                                                                                                                           |                  |                   |
| Current assets:                                                                                                                                                         |                  |                   |
| Cash and cash equivalents                                                                                                                                               | \$ 235,724       | \$ 287,588        |
| Short-term investments                                                                                                                                                  | 346,715          | 327,653           |
| Trade accounts receivable, net                                                                                                                                          | 95,771           | 82,060            |
| Inventories                                                                                                                                                             | 137,006          | 134,639           |
| Deferred income taxes                                                                                                                                                   | 8,046            | 8,194             |
| Other current assets                                                                                                                                                    | 38,426           | 28,048            |
| Total current assets                                                                                                                                                    | 861,688          | 868,182           |
| Property, plant and equipment, net                                                                                                                                      | 78,875           | 80,516            |
| Long-term investments                                                                                                                                                   | 15,788           | 12,158            |
| Goodwill                                                                                                                                                                | 150,012          | 150,733           |
| Intangible assets, net                                                                                                                                                  | 12,523           | 11,561            |
| Other assets                                                                                                                                                            | 11,461           | 11,692            |
| Total assets                                                                                                                                                            | \$ 1,130,347     | \$ 1,134,842      |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                                                             |                  |                   |
| Current liabilities:                                                                                                                                                    |                  |                   |
| Accounts payable                                                                                                                                                        | \$ 24,302        | \$ 16,803         |
| Accrued compensation                                                                                                                                                    | 19,318           | 20,955            |
| Income taxes payable                                                                                                                                                    | 3,269            | 4,148             |
| Other current liabilities                                                                                                                                               | 32,697           | 37,405            |
| Total current liabilities                                                                                                                                               | 79,586           | 79,311            |
| Other liabilities                                                                                                                                                       | 46,693           | 43,375            |
| Commitments and contingencies (Note 17)                                                                                                                                 |                  |                   |
| Stockholders' equity:                                                                                                                                                   |                  |                   |
| Preferred Stock, \$0.01 par value per share, 2,000,000 shares authorized; none issued and outstanding                                                                   |                  |                   |
| Common Stock, no par value, 200,000,000 shares authorized; 53,153,412 and 52,748,849 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively | 113              | 113               |
| Additional paid-in capital                                                                                                                                              | 723,360          | 718,005           |
| Retained earnings                                                                                                                                                       | 273,296          | 278,583           |
| Accumulated other comprehensive income                                                                                                                                  | 7,299            | 15,455            |
| Total stockholders' equity                                                                                                                                              | 1,004,068        | 1,012,156         |

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|                                            |              |              |
|--------------------------------------------|--------------|--------------|
| Total liabilities and stockholders' equity | \$ 1,130,347 | \$ 1,134,842 |
|--------------------------------------------|--------------|--------------|

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

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## MKS INSTRUMENTS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

## AND COMPREHENSIVE INCOME

(in thousands, except per share data)

(Unaudited)

|                                                                                                                       | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|-----------------------------------------------------------------------------------------------------------------------|-----------------------------|------------|---------------------------|------------|
|                                                                                                                       | 2013                        | 2012       | 2013                      | 2012       |
| Net revenues:                                                                                                         |                             |            |                           |            |
| Products                                                                                                              | \$ 132,541                  | \$ 148,851 | \$ 249,152                | \$ 313,339 |
| Services                                                                                                              | 24,387                      | 28,546     | 49,421                    | 54,926     |
| Total net revenues                                                                                                    | 156,928                     | 177,397    | 298,573                   | 368,265    |
| Cost of revenues:                                                                                                     |                             |            |                           |            |
| Cost of products                                                                                                      | 79,206                      | 84,622     | 149,781                   | 175,646    |
| Cost of services                                                                                                      | 15,764                      | 16,259     | 32,132                    | 32,312     |
| Total cost of revenues                                                                                                | 94,970                      | 100,881    | 181,913                   | 207,958    |
| Gross profit                                                                                                          | 61,958                      | 76,516     | 116,660                   | 160,307    |
| Research and development                                                                                              | 16,813                      | 15,591     | 32,061                    | 31,775     |
| Selling, general and administrative                                                                                   | 34,849                      | 32,582     | 68,982                    | 66,701     |
| Insurance reimbursement                                                                                               | (1,071)                     |            | (1,071)                   |            |
| Completed acquisition costs                                                                                           |                             | 377        | 171                       | 377        |
| Restructuring                                                                                                         | 198                         |            | 238                       |            |
| Amortization of intangible assets                                                                                     | 742                         | 119        | 1,176                     | 238        |
| Income from operations                                                                                                | 10,427                      | 27,847     | 15,103                    | 61,216     |
| Interest income                                                                                                       | 234                         | 200        | 539                       | 461        |
| Interest expense                                                                                                      | 23                          | 51         | 37                        | 60         |
| Income before income taxes                                                                                            | 10,638                      | 27,996     | 15,605                    | 61,617     |
| Provision for income taxes                                                                                            | 3,318                       | 9,424      | 2,524                     | 20,277     |
| Net income                                                                                                            | \$ 7,320                    | \$ 18,572  | \$ 13,081                 | \$ 41,340  |
| Other comprehensive income:                                                                                           |                             |            |                           |            |
| Changes in value of financial instruments designated as cash flow hedges, net of tax expense (benefit) <sup>(1)</sup> | 56                          | (522)      | 1,076                     | 114        |
| Foreign currency translation adjustments, net of tax of \$0 for the three and six months ended June 30, 2013 and 2012 | (836)                       | (4,353)    | (9,175)                   | (4,052)    |
| Unrealized (loss) on investments, net of tax (benefit) <sup>(2)</sup>                                                 | (36)                        | (25)       | (61)                      | (61)       |
| Total comprehensive income                                                                                            | \$ 6,504                    | \$ 13,672  | \$ 4,921                  | \$ 37,341  |
| Net income per share:                                                                                                 |                             |            |                           |            |
| Basic                                                                                                                 | \$ 0.14                     | \$ 0.35    | \$ 0.25                   | \$ 0.79    |

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|                                             |    |        |    |        |    |        |    |        |
|---------------------------------------------|----|--------|----|--------|----|--------|----|--------|
| Diluted                                     | \$ | 0.14   | \$ | 0.35   | \$ | 0.25   | \$ | 0.78   |
| Cash dividends per common share             | \$ | 0.16   | \$ | 0.15   | \$ | 0.32   | \$ | 0.30   |
| Weighted average common shares outstanding: |    |        |    |        |    |        |    |        |
| Basic                                       |    | 53,054 |    | 52,679 |    | 52,914 |    | 52,591 |
| Diluted                                     |    | 53,358 |    | 53,206 |    | 53,359 |    | 53,214 |

- (1) Tax expense (benefit) was \$56 and \$(330) for the three months ended June 30, 2013 and 2012, respectively. Tax expense was \$652 and \$89 for the six months ended June 30, 2013 and 2012, respectively.
- (2) Tax (benefit) was \$(36) and \$(16) for the three months ended June 30, 2013 and 2012, respectively. Tax (benefit) was \$(37) and \$(48) for the six months ended June 30, 2013 and 2012, respectively.

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

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## MKS INSTRUMENTS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

|                                                                                   | Six Months Ended June, |           |
|-----------------------------------------------------------------------------------|------------------------|-----------|
|                                                                                   | 2013                   | 2012      |
| Cash flows from operating activities:                                             |                        |           |
| Net income                                                                        | \$ 13,081              | \$ 41,340 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                        |           |
| Depreciation and amortization                                                     | 8,470                  | 6,557     |
| Stock-based compensation                                                          | 8,809                  | 7,079     |
| Provision for excess and obsolete inventory                                       | 7,372                  | 8,377     |
| Deferred income taxes                                                             | 2,845                  | 2,179     |
| Excess tax benefits from stock-based compensation                                 | (814)                  | (1,995)   |
| Other                                                                             | 1,001                  | 486       |
| Changes in operating assets and liabilities:                                      |                        |           |
| Trade accounts receivable                                                         | (16,345)               | 14,584    |
| Inventories                                                                       | (10,934)               | (1,044)   |
| Income taxes                                                                      | (3,645)                | 2,955     |
| Other current assets                                                              | (8,639)                | 4,022     |
| Accrued compensation and other liabilities                                        | (3,041)                | (1,180)   |
| Accounts payable                                                                  | 7,681                  | (1,365)   |
| Other non-current assets/liabilities                                              | (195)                  |           |
| Net cash provided by operating activities                                         | 5,646                  | 81,995    |
| Cash flows from investing activities:                                             |                        |           |
| Acquisition of business, net of cash acquired                                     | (2,058)                |           |
| Purchases of investments                                                          | (226,377)              | (199,576) |
| Maturities of investments                                                         | 156,306                | 124,583   |
| Sales of investments                                                              | 47,243                 | 121,441   |
| Purchases of property, plant and equipment                                        | (6,360)                | (8,012)   |
| Other                                                                             | (59)                   | (26)      |
| Net cash (used in) provided by investing activities                               | (31,305)               | 38,410    |
| Cash flows from financing activities:                                             |                        |           |
| Proceeds from short-term borrowings                                               | 6                      | 2,896     |
| Payments on short-term borrowings                                                 | (776)                  | (4,771)   |
| Repurchase of common stock                                                        | (2,875)                | (4,960)   |
| Net payments related to employee stock awards                                     | (2,426)                | (1,088)   |
| Dividend payments to common stockholders                                          | (16,951)               | (15,806)  |
| Excess tax benefits from stock-based compensation                                 | 814                    | 1,995     |
| Net cash (used in) financing activities                                           | (22,208)               | (21,734)  |
| Effect of exchange rate changes on cash and cash equivalents                      | (3,997)                | (2,371)   |
| (Decrease) increase in cash and cash equivalents                                  | (51,864)               | 96,300    |
| Cash and cash equivalents at beginning of period                                  | 287,588                | 312,916   |

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|                                            |            |            |
|--------------------------------------------|------------|------------|
| Cash and cash equivalents at end of period | \$ 235,724 | \$ 409,216 |
|--------------------------------------------|------------|------------|

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

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### MKS INSTRUMENTS, INC.

#### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

##### 1) Basis of Presentation

The terms "MKS" and the "Company" refer to MKS Instruments, Inc. and its subsidiaries. The interim financial data as of June 30, 2013 and for the three and six months ended June 30, 2013 and 2012 are unaudited; however, in the opinion of MKS, the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods. The consolidated balance sheet presented as of December 31, 2012 has been derived from the audited consolidated financial statements as of that date. The unaudited consolidated financial statements presented herein have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and note disclosures required by United States generally accepted accounting principles ("U.S. GAAP"). The consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the MKS Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission on February 26, 2013.

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments, including those related to revenue recognition, stock-based compensation, inventory, intangible assets, goodwill and other long-lived assets, acquisition expenses, income taxes and investments. 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.

##### 2) Recently Issued Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*. This ASU is intended to enhance the understanding of the effects of netting arrangements on an entity's financial statements, including financial instruments and derivative instruments that are either offset or subject to a master netting arrangement. The scope of this ASU includes derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and lending arrangements. In January 2013, the FASB issued ASU No. 2013-01 *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. This standard provided additional guidance on the scope of ASU No. 2011-11. The provisions of this ASU are effective for interim and annual periods beginning on or after January 1, 2013. The adoption of ASU No. 2011-11 did not have a material effect on the Company's consolidated financial statements.

On February 5, 2013, the FASB issued ASU No. 2013-02, *Other Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This ASU is intended to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income, by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. The provisions of this ASU are effective prospectively for interim and annual periods beginning after December 15, 2012. The adoption of ASU No. 2013-12 did not have a material effect on the Company's consolidated financial statements.

On July 18, 2013, the FASB issued ASU 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by unrecognized tax benefits. The provisions of this ASU are effective for interim and annual periods beginning on or after December 15, 2013. The adoption of ASU No. 2013-11 is not expected to have a material effect on the Company's consolidated financial statements.



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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

3) Investments

The fair value of short-term investments with maturities or estimated lives of less than one year consists of the following:

|                                 | June 30, 2013 | December 31, 2012 |
|---------------------------------|---------------|-------------------|
| Available-for-sale investments: |               |                   |
| Bankers' acceptance drafts      | \$ 145        | \$ 242            |
| Time deposits                   | 52,157        | 52                |
| Commercial paper                | 46,495        |                   |
| U.S. treasury obligations       | 5,004         | 13,054            |
| U.S. agency obligations         | 242,000       | 313,514           |
|                                 | 345,801       | 326,862           |
| Trading investments:            |               |                   |
| Mutual funds                    | 914           | 791               |
|                                 | \$ 346,715    | \$ 327,653        |

The fair value of long-term investments with maturities of more than one year consists of the following:

|                                 | June 30, 2013 | December 31, 2012 |
|---------------------------------|---------------|-------------------|
| Available-for-sale investments: |               |                   |
| Time deposits                   | \$ 54         | \$                |
| U.S. agency obligations         | 15,734        | 12,158            |
|                                 | \$ 15,788     | \$ 12,158         |

The following tables show the gross unrealized gains and (losses) aggregated by investment category for short-term and long-term available-for-sale investments:

|                            | Cost    | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Estimated<br>Fair Value |
|----------------------------|---------|------------------------------|---------------------------------|-------------------------|
| As of June 30, 2013:       |         |                              |                                 |                         |
| Short-term investments:    |         |                              |                                 |                         |
| Bankers' acceptance drafts | \$ 145  | \$                           | \$                              | \$ 145                  |
| Time deposits              | 52,157  |                              |                                 | 52,157                  |
| Commercial paper           | 46,495  |                              |                                 | 46,495                  |
| U.S. treasury obligations  | 5,003   | 1                            |                                 | 5,004                   |
| U.S. agency obligations    | 241,992 | 26                           | (18)                            | 242,000                 |

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\$ 345,792      \$    27      \$    (18)      \$ 345,801

Long-term investments:

|                         |          |    |     |          |
|-------------------------|----------|----|-----|----------|
| Time deposits           | \$    54 | \$ | \$  | \$    54 |
| U.S. agency obligations | 15,736   | 1  | (3) | 15,734   |

|                         |           |         |           |           |
|-------------------------|-----------|---------|-----------|-----------|
| U.S. agency obligations | \$ 15,790 | \$    1 | \$    (3) | \$ 15,788 |
|-------------------------|-----------|---------|-----------|-----------|

|                            | Cost       | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>(Losses) | Estimated<br>Fair Value |
|----------------------------|------------|------------------------------|---------------------------------|-------------------------|
| As of December 31, 2012:   |            |                              |                                 |                         |
| Short-term investments:    |            |                              |                                 |                         |
| Time deposits              | \$    52   | \$                           | \$                              | \$    52                |
| Bankers' acceptance drafts | 242        |                              |                                 | 242                     |
| U.S. treasury obligations  | 13,045     | 9                            |                                 | 13,054                  |
| U.S. agency obligations    | 313,262    | 258                          | (6)                             | 313,514                 |
|                            | \$ 326,601 | \$    267                    | \$    (6)                       | \$ 326,862              |

Long-term investments:

|                         |           |         |    |           |
|-------------------------|-----------|---------|----|-----------|
| U.S. agency obligations | \$ 12,156 | \$    2 | \$ | \$ 12,158 |
|-------------------------|-----------|---------|----|-----------|

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MKS INSTRUMENTS, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Interest income is accrued as earned. Dividend income is recognized as income on the date the stock trades ex-dividend. The cost of marketable securities sold is determined by the specific identification method. Realized gains or (losses) are reflected in income and were not material for the three and six months ended June 30, 2013 and 2012, respectively.

The gains and (losses) for trading investments were immaterial for the three and six months ended June 30, 2013 and 2012.

4) **Fair Value Measurements**

In accordance with the provisions of fair value accounting, a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability and defines fair value based upon an exit price model.

The fair value measurement guidance establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance describes three levels of inputs that may be used to measure fair value:

- Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities assessed at the measurement date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments or securities or derivative contracts that are valued using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.
- Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

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

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Assets and liabilities of the Company are measured at fair value on a recurring basis as of June 30, 2013 and are summarized as follows:

|                                          |                        | Fair Value Measurements at Reporting Date<br>Using                               |                                                           |                                                    |
|------------------------------------------|------------------------|----------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                          |                        | Quoted Prices in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Description                              | Total<br>June 30, 2013 |                                                                                  |                                                           |                                                    |
| Assets:                                  |                        |                                                                                  |                                                           |                                                    |
| Cash equivalents:                        |                        |                                                                                  |                                                           |                                                    |
| Money market funds                       | \$ 45,222              | \$ 45,222                                                                        | \$                                                        | \$                                                 |
| Bankers acceptance drafts                | 211                    |                                                                                  | 211                                                       |                                                    |
| Trading securities:                      |                        |                                                                                  |                                                           |                                                    |
| Mutual funds                             | 914                    | 914                                                                              |                                                           |                                                    |
| Available-for-sale securities:           |                        |                                                                                  |                                                           |                                                    |
| Bankers acceptance drafts                | 145                    |                                                                                  | 145                                                       |                                                    |
| Time deposits                            | 52,211                 |                                                                                  | 52,211                                                    |                                                    |
| Commercial paper                         | 46,495                 |                                                                                  | 46,495                                                    |                                                    |
| U.S. treasury obligations                | 5,004                  |                                                                                  | 5,004                                                     |                                                    |
| U.S. agency obligations                  | 257,734                | 238,534                                                                          | 19,200                                                    |                                                    |
| Derivatives currency forward contracts   | 1,598                  |                                                                                  | 1,598                                                     |                                                    |
| Total assets                             | \$ 409,534             | \$ 284,670                                                                       | \$ 124,864                                                | \$                                                 |
| Liabilities:                             |                        |                                                                                  |                                                           |                                                    |
| Derivatives currency forward contracts   | \$ 219                 | \$                                                                               | \$ 219                                                    | \$                                                 |
| Reported as follows:                     |                        |                                                                                  |                                                           |                                                    |
| Assets:                                  |                        |                                                                                  |                                                           |                                                    |
| Cash and cash equivalents <sup>(1)</sup> | \$ 45,433              | \$ 45,222                                                                        | \$ 211                                                    | \$                                                 |
| Short-term investments                   | 346,715                | 226,712                                                                          | 120,003                                                   |                                                    |
| Other current assets                     | 1,598                  |                                                                                  | 1,598                                                     |                                                    |
| Total current assets                     | \$ 393,746             | \$ 271,934                                                                       | \$ 121,812                                                | \$                                                 |
| Long-term investments                    | \$ 15,788              | \$ 12,736                                                                        | \$ 3,052                                                  | \$                                                 |
| Liabilities:                             |                        |                                                                                  |                                                           |                                                    |
| Other current liabilities                | \$ 219                 | \$                                                                               | \$ 219                                                    | \$                                                 |

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- (1) The cash and cash equivalent amounts presented in the table above do not include cash of \$188,029 and non-negotiable time deposits of \$2,262 as of June 30, 2013.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Assets and liabilities of the Company are measured at fair value on a recurring basis as of December 31, 2012 and are summarized as follows:

|                                          |                         | Fair Value Measurements at Reporting Date Using Quoted Prices in |                                               |                                           |
|------------------------------------------|-------------------------|------------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                          |                         | Active Markets for Identical Assets (Level 1)                    | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Description                              | Total December 31, 2012 |                                                                  |                                               |                                           |
| Assets:                                  |                         |                                                                  |                                               |                                           |
| Cash equivalents:                        |                         |                                                                  |                                               |                                           |
| Money market funds                       | \$ 51,291               | \$ 51,291                                                        | \$                                            | \$                                        |
| Bankers acceptance drafts                | 16                      |                                                                  | 16                                            |                                           |
| Trading securities:                      |                         |                                                                  |                                               |                                           |
| Mutual funds                             | 791                     | 791                                                              |                                               |                                           |
| Available-for-sale securities:           |                         |                                                                  |                                               |                                           |
| Bankers acceptance drafts                | 242                     |                                                                  | 242                                           |                                           |
| U.S. treasury obligations                | 13,054                  |                                                                  | 13,054                                        |                                           |
| U.S. agency obligations                  | 325,672                 | 295,665                                                          | 30,007                                        |                                           |
| Derivatives currency forward contracts   | 961                     |                                                                  | 961                                           |                                           |
| Total assets                             | \$ 392,027              | \$ 347,747                                                       | \$ 44,280                                     | \$                                        |
| Liabilities:                             |                         |                                                                  |                                               |                                           |
| Derivatives currency forward contracts   | \$ 1,310                | \$                                                               | \$ 1,310                                      | \$                                        |
| Reported as follows:                     |                         |                                                                  |                                               |                                           |
| Assets:                                  |                         |                                                                  |                                               |                                           |
| Cash and cash equivalents <sup>(1)</sup> | \$ 51,307               | \$ 51,291                                                        | \$ 16                                         | \$                                        |
| Short-term investments <sup>(2)</sup>    | 327,601                 | 284,298                                                          | 43,303                                        |                                           |
| Other current assets                     | 961                     |                                                                  | 961                                           |                                           |
| Total current assets                     | \$ 379,869              | \$ 335,589                                                       | \$ 44,280                                     | \$                                        |
| Long-term investments                    | \$ 12,158               | \$ 12,158                                                        | \$                                            | \$                                        |
| Liabilities:                             |                         |                                                                  |                                               |                                           |
| Other current liabilities                | \$ 1,310                | \$                                                               | \$ 1,310                                      | \$                                        |

(1) The cash and cash equivalent amounts presented in the table above do not include cash of \$185,143 and non-negotiable time deposits of \$51,138 as of December 31, 2012.

(2) The short-term investments presented in the table above do not include non-negotiable time deposits of \$52 as of December 31, 2012.

**Trading Mutual Fund Investments**

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Trading investments consist of certain U.S. and international equity mutual funds and government agency fixed income mutual funds.

### Bankers' Acceptance Drafts

Bankers' acceptance drafts are short-term credit investments created by a non-financial firm and guaranteed by a bank. These drafts are often traded at a discount from face value and may be traded on a secondary market.

### Available-For-Sale Investments

Available-for-sale investments consisted of time deposits and drafts denominated in the Euro currency, U.S. treasury obligations and U.S. agency obligations. The Company measures its debt and equity investments at fair value.

### Derivatives

As a result of the Company's global operating activities, the Company is exposed to market risks from changes in foreign currency exchange rates, which may adversely affect its operating results and financial position. When deemed appropriate, the Company minimizes its risks from foreign currency exchange rate fluctuations through the use of derivative financial instruments. The principal market in which the Company executes its foreign currency contracts is the institutional market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large commercial banks. The forward foreign currency exchange contracts are valued using broker quotations, or market transactions and are classified within Level 2 of the fair value hierarchy.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

5) Derivatives

The Company enters into derivative instruments for risk management purposes only, including derivatives designated as hedging instruments and those utilized as economic hedges. The Company operates internationally and, in the normal course of business, is exposed to fluctuations in interest rates and foreign exchange rates. These fluctuations can increase the costs of financing, investing and operating the business. The Company has used derivative instruments, such as forward contracts, to manage certain foreign currency exposure.

By nature, all financial instruments involve market and credit risks. The Company enters into derivative instruments with major investment grade financial institutions and no collateral is required. The Company has policies to monitor the credit risk of these counterparties. While there can be no assurance, the Company does not anticipate any material non-performance by any of these counterparties.

The Company hedges a portion of its forecasted foreign currency denominated intercompany sales of inventory, over a maximum period of eighteen months, using forward foreign exchange contracts accounted for as cash-flow hedges related to Japanese, South Korean, British and Euro currencies. To the extent these derivatives are effective in off-setting the variability of the hedged cash flows, and otherwise meet the hedge accounting criteria, changes in the derivatives' fair value are not included in current earnings but are included in other comprehensive income (OCI) in stockholders' equity. These changes in fair value will subsequently be reclassified into earnings, as applicable, when the forecasted transaction occurs. To the extent that a previously designated hedging transaction is no longer an effective hedge, any ineffectiveness measured in the hedging relationship is recorded currently in earnings in the period it occurs. The cash flows resulting from forward exchange contracts are classified in the consolidated statements of cash flows as part of cash flows from operating activities. The Company does not enter into derivative instruments for trading or speculative purposes.

To the extent the hedge accounting criteria is not met, the related foreign currency forward contracts are considered as economic hedges and changes in the fair value of these contracts are recorded immediately in earnings in the period in which they occur. These include hedges that are used to reduce exchange rate risks arising from the change in fair value of certain foreign currency denominated assets and liabilities (i.e., payables, receivables) and other economic hedges where the hedge accounting criteria were not met.

As of June 30, 2013 and December 31, 2012, the Company had outstanding forward foreign exchange contracts with gross notional values of \$30,887 and \$41,448, respectively. The following tables provide a summary of the primary net hedging positions and corresponding fair values held as of June 30, 2013 and December 31, 2012:

|                                 | June 30, 2013        |                                                |
|---------------------------------|----------------------|------------------------------------------------|
|                                 | Gross Notional Value | Fair Value <sup>(1)</sup><br>Asset/(Liability) |
| Currency Hedged (Buy/Sell)      |                      |                                                |
| U.S. Dollar/Japanese Yen        | \$ 11,005            | \$ 1,321                                       |
| U.S. Dollar/South Korean Won    | 14,276               | (23)                                           |
| U.S. Dollar/Euro                | 3,335                | (3)                                            |
| U.S. Dollar/U.K. Pound Sterling | 2,271                | 84                                             |
| <b>Total</b>                    | <b>\$ 30,887</b>     | <b>\$ 1,379</b>                                |

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

|                                 | December 31, 2012    |                                             |
|---------------------------------|----------------------|---------------------------------------------|
|                                 | Gross Notional Value | Fair Value <sup>(1)</sup> Asset/(Liability) |
| Currency Hedged (Buy/Sell)      |                      |                                             |
| U.S. Dollar/Japanese Yen        | \$ 13,992            | \$ 961                                      |
| U.S. Dollar/South Korean Won    | 19,374               | (1,180)                                     |
| U.S. Dollar/Euro                | 4,217                | (57)                                        |
| U.S. Dollar/U.K. Pound Sterling | 3,865                | (73)                                        |
| <b>Total</b>                    | <b>\$ 41,448</b>     | <b>\$ (349)</b>                             |

(1) Represents the fair value of the net asset / (liability) amount included in the consolidated balance sheets. The following table provides a summary of the fair value amounts of the Company's derivative instruments:

| Derivatives Designated as Hedging Instruments                                                 | June 30, 2013   | December 31, 2012 |
|-----------------------------------------------------------------------------------------------|-----------------|-------------------|
| <b>Derivative assets:</b>                                                                     |                 |                   |
| Forward exchange contracts                                                                    | \$ 1,598        | \$ 961            |
| <b>Derivative liabilities:</b>                                                                |                 |                   |
| Forward exchange contracts                                                                    | (219)           | (1,310)           |
| <b>Total net derivative asset (liability) designated as hedging instruments<sup>(1)</sup></b> | <b>\$ 1,379</b> | <b>\$ (349)</b>   |

(1) The derivative assets of \$1,598 and derivative liabilities of \$219 are classified in other current assets and other current liabilities, respectively, in the consolidated balance sheet as of June 30, 2013. The derivative assets of \$961 and derivative liabilities of \$1,310 are classified in other current assets and other current liabilities, respectively, in the consolidated balance sheet as of December 31, 2012. These foreign exchange contracts are subject to a master netting agreement with one financial institution. However, the Company has elected to record these contracts gross in the balance sheet.

The net amount of existing gains as of June 30, 2013 that are expected to be reclassified from accumulated OCI into earnings within the next twelve months is \$1,379.

The following table provides a summary of the gains (losses) on derivatives designated as hedging instruments:

|                                                                  | Three Months Ended June 30, |            | Six Months Ended June 30, |          |
|------------------------------------------------------------------|-----------------------------|------------|---------------------------|----------|
| Derivatives Designated as Cash Flow Hedging Relationships        | 2013                        | 2012       | 2013                      | 2012     |
| <b>Forward exchange contracts:</b>                               |                             |            |                           |          |
| Net gain (loss) recognized in OCI <sup>(1)</sup>                 | \$ (257)                    | \$ (1,065) | \$ 1,359                  | \$ 398   |
| Net gain (loss) reclassified from OCI into income <sup>(2)</sup> | \$ 602                      | \$ 74      | \$ 805                    | \$ (439) |

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- (1) Net change in the fair value of the effective portion classified in OCI.
- (2) Effective portion classified in cost of products for the three and six months ended June 30, 2013 and selling, general and administrative expenses for the three and six months ended June 30, 2012.

The following table provides a summary of gains on derivatives not designated as hedging instruments:

| Derivatives Not Designated as Hedging Instruments | Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|---------------------------------------------------|--------------------------------|------|------------------------------|------|
|                                                   | 2013                           | 2012 | 2013                         | 2012 |
| Forward exchange contracts:                       |                                |      |                              |      |
| Net gain recognized in income <sup>(1)</sup>      | \$ 163                         | \$   | \$ 654                       | \$   |

- (1) The Company has a forward foreign exchange contract that hedges an intercompany loan with its Korean subsidiary. This hedge does not qualify for hedge accounting and any gains (losses) are recorded immediately in selling, general and administrative expenses.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

6) Inventories

Inventories consist of the following:

|                 | June 30, 2013 | December 31, 2012 |
|-----------------|---------------|-------------------|
| Raw materials   | \$ 75,423     | \$ 76,610         |
| Work-in-process | 20,485        | 19,708            |
| Finished goods  | 41,098        | 38,321            |
|                 | \$ 137,006    | \$ 134,639        |

7) Acquisition

On March 12, 2013, the Company acquired Alter Power Systems S.r.l. ( Alter ), located in Reggio Emilia, Italy. The aggregate purchase price, net of cash acquired and after final debt and working capital adjustments was \$2,426. Total cash paid as of June 30, 2013, net of cash acquired of \$21 was \$2,058. During June 2013, one of two holdback provisions was met and the Company released \$123. The Company will pay the remaining \$368 subject to a final holdback provision being met. Alter develops advanced microwave power generators, components and systems for industrial microwave heating, microwave plasma coating and semiconductor applications. This acquisition strengthens the Company's existing microwave plasma expertise and product portfolio, and extends its opportunity into high growth, non-plasma microwave applications for industrial processes, food and beverage manufacturing and other markets.

The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of the acquisition:

|                                            |          |
|--------------------------------------------|----------|
| Current assets                             | \$ 1,053 |
| Property and equipment                     | 211      |
| Intangible assets                          | 2,806    |
| Other assets                               | 67       |
| Total assets acquired                      | 4,137    |
| Debt (Note 11)                             | 770      |
| Deferred taxes and other liabilities       | 920      |
| Total liabilities assumed                  | 1,690    |
| Total purchase price                       | 2,447    |
| Cash acquired                              | (21)     |
| Total purchase price, net of cash acquired | \$ 2,426 |

The intangible assets associated with the acquisition are not deductible for tax purposes. The following table reflects the allocation of the acquired intangible assets and related estimates of useful lives. These acquired intangibles will be amortized on a straight-line basis.

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|                              |                 |                    |
|------------------------------|-----------------|--------------------|
| Current developed technology | \$ 2,208        | 9 year useful life |
| Trade names                  | 598             | 3 year useful life |
|                              | <b>\$ 2,806</b> |                    |

The results of this acquisition were included in the Company's consolidated operations beginning on March 12, 2013. The pro forma consolidated statements reflecting the operating results of Alter, had it been acquired as of January 1, 2013, would not differ materially from the operating results of the Company as reported for the quarter ended March 31, 2013. Alter is included in the Company's Power and Reactive Gas Products group and the Advanced Manufacturing Capital Equipment reportable segment.

### 8) Goodwill and Intangible Assets Goodwill

The Company's methodology for allocating the purchase price relating to purchase acquisitions is determined through established and generally accepted valuation techniques. Goodwill is measured as the excess of the cost of the acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. The Company assigns assets

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

acquired (including goodwill) and liabilities assumed to one or more reporting units as of the date of acquisition. Typically acquisitions relate to a single reporting unit and thus do not require the allocation of goodwill to multiple reporting units. If the products obtained in an acquisition are assigned to multiple reporting units, the goodwill is distributed to the respective reporting units as part of the purchase price allocation process.

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The process of evaluating the potential impairment of goodwill and intangible assets requires significant judgment. The Company regularly monitors current business conditions and other factors including, but not limited to, adverse industry or economic trends, restructuring actions and lower projections of profitability that may impact future operating results.

As of October 31, 2012, the Company performed its annual impairment assessment of goodwill and determined that there was no impairment.

The changes in the carrying amount of goodwill and accumulated impairment (loss) during the six months ended June 30, 2013 and twelve months ended December 31, 2012 were as follows:

|                                                       | Gross<br>Carrying<br>Amount | 2013<br>Accumulated<br>Impairment<br>(Loss) | Net        | Gross<br>Carrying<br>Amount | 2012<br>Accumulated<br>Impairment<br>(Loss) | Net        |
|-------------------------------------------------------|-----------------------------|---------------------------------------------|------------|-----------------------------|---------------------------------------------|------------|
| Beginning balance at January 1                        | \$ 290,147                  | \$ (139,414)                                | \$ 150,733 | \$ 279,498                  | \$ (139,414)                                | \$ 140,084 |
| Acquired goodwill <sup>(1)</sup>                      |                             |                                             |            | 9,989                       |                                             | 9,989      |
| Foreign currency translation                          | (721)                       |                                             | (721)      | 660                         |                                             | 660        |
| Ending balance at June 30, 2013 and December 31, 2012 | \$ 289,426                  | \$ (139,414)                                | \$ 150,012 | \$ 290,147                  | \$ (139,414)                                | \$ 150,733 |

(1) In August 2012, the Company purchased Plasmart, Inc. for \$22,607, net of cash acquired. The Company recorded \$9,989 of goodwill in connection with the acquisition.

**Intangible Assets**

Components of the Company's intangible assets are comprised of the following:

| As of June 30, 2013:                                      | Gross      | Accumulated<br>Amortization | Foreign<br>Currency<br>Translation | Net       |
|-----------------------------------------------------------|------------|-----------------------------|------------------------------------|-----------|
| Completed technology <sup>(1)</sup>                       | \$ 84,292  | \$ (77,786)                 | (56)                               | \$ 6,450  |
| Customer relationships                                    | 14,571     | (9,357)                     | (38)                               | 5,176     |
| Patents, trademarks, trade names and other <sup>(1)</sup> | 25,636     | (24,749)                    | 10                                 | 897       |
|                                                           | \$ 124,499 | \$ (111,892)                | \$ (84)                            | \$ 12,523 |

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- (1) In March 2013, the Company purchased Alter for \$2,447. The Company recorded \$2,806 of separately identified intangible assets, of which \$2,208 was completed technology and \$598 was trademarks and trade names.

| As of December 31, 2012:                   | Gross      | Accumulated<br>Amortization | Foreign<br>Currency<br>Translation | Net       |
|--------------------------------------------|------------|-----------------------------|------------------------------------|-----------|
| Completed technology                       | \$ 82,084  | \$ (77,243)                 | \$ 254                             | \$ 5,095  |
| Customer relationships                     | 14,571     | (8,886)                     | 312                                | 5,997     |
| Patents, trademarks, trade names and other | 25,038     | (24,587)                    | 18                                 | 469       |
|                                            | \$ 121,693 | \$ (110,716)                | \$ 584                             | \$ 11,561 |

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

Aggregate amortization expense related to acquired intangibles for the three and six months ended June 30, 2013 were \$742 and \$1,176, respectively. Aggregate amortization expense related to acquired intangibles for the three and six months ended June 30, 2012 were \$119 and \$238, respectively. Estimated amortization expense for each of the remaining fiscal years is as follows:

| Year             | Amount |
|------------------|--------|
| 2013 (remaining) | \$ 794 |
| 2014             | 1,627  |
| 2015             | 1,611  |
| 2016             | 1,445  |
| 2017             | 1,411  |
| 2018             | 1,402  |
| Thereafter       | 4,233  |

9) Other Assets

|                                   | June 30, 2013    | December 31, 2012 |
|-----------------------------------|------------------|-------------------|
| <b>Other Current Assets:</b>      |                  |                   |
| Income tax receivable             | \$ 13,520        | \$ 12,768         |
| Other                             | 24,906           | 15,280            |
| <b>Total other current assets</b> | <b>\$ 38,426</b> | <b>\$ 28,048</b>  |
| <b>Other Assets:</b>              |                  |                   |
| Deferred tax assets, net          | \$ 9,613         | \$ 9,497          |
| Other                             | 1,848            | 2,195             |
| <b>Total other assets</b>         | <b>\$ 11,461</b> | <b>\$ 11,692</b>  |

10) Other Liabilities

|                                        | June 30, 2013    | December 31, 2012 |
|----------------------------------------|------------------|-------------------|
| <b>Other Current Liabilities:</b>      |                  |                   |
| Product warranties                     | \$ 7,175         | \$ 8,266          |
| Deferred revenue                       | 6,318            | 9,280             |
| Other                                  | 19,204           | 19,859            |
| <b>Total other current liabilities</b> | <b>\$ 32,697</b> | <b>\$ 37,405</b>  |

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### Other Liabilities:

|                              |               |               |
|------------------------------|---------------|---------------|
| Long-term income tax payable | \$ 21,683     | \$ 20,880     |
| Accrued compensation         | 20,109        | 18,750        |
| Other                        | 4,901         | 3,745         |
| <br>Total other liabilities  | <br>\$ 46,693 | <br>\$ 43,375 |

### 11) Debt

The Company's Japanese subsidiary has lines of credit and short-term borrowing arrangements with two financial institutions which, generally expire and are renewed at three month intervals. The lines of credit provide for aggregate borrowings as of June 30, 2013 of up to an equivalent of \$24,457 U.S. dollars. One of the borrowing arrangement's interest rate is based on the Tokyo Interbank Offer Rate at the time of borrowing and the other is based on the Japanese Short-term Prime Lending Rate. There were no borrowings outstanding under these arrangements at June 30, 2013 and December 31, 2012.

The Company also had various lines of credit and short and long-term borrowing arrangements as a result of its acquisitions of Plasmart, Inc. in 2012 and Alter in March 2013. There were \$791 borrowings outstanding under these arrangements at March 31, 2013 and none outstanding at December 31, 2012, respectively. All of these lines of credit and borrowing arrangements have been paid off and terminated in the second quarter of 2013. There were no outstanding balances at June 30, 2013.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

**12) Product Warranties**

The Company provides for the estimated costs to fulfill customer warranty obligations upon the recognition of the related revenue. While the Company engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, the Company's warranty obligation is affected by shipment volume, product failure rates, utilization levels, material usage, and supplier warranties on parts delivered to the Company. Should actual product failure rates, utilization levels, material usage, or supplier warranties on parts differ from the Company's estimates, revisions to the estimated warranty liability would be required. The product warranty liability is included in other current liabilities in the consolidated balance sheets.

Product warranty activities were as follows:

|                                      | Six Months Ended June 30, |          |
|--------------------------------------|---------------------------|----------|
|                                      | 2013                      | 2012     |
| Balance at January 1                 | \$ 8,266                  | \$ 8,315 |
| Provision for product warranties     | 1,251                     | 2,886    |
| Direct charges to warranty liability | (2,206)                   | (2,475)  |
| Foreign currency translation         | (136)                     |          |
| Balance at June 30                   | \$ 7,175                  | \$ 8,726 |

**13) Income Taxes**

The Company's effective tax rate for the three and six months ended June 30, 2013 was 31.2% and 16.2%, respectively. The Company's effective tax rate for the three and six months ended June 30, 2012 was 33.7% and 32.9%, respectively. The effective tax rates for the six months ended June 30, 2013 and 2012, and related income tax expense were lower than the U.S. statutory tax rate primarily due to the geographic mix of income and profits earned by the Company's international subsidiaries being taxed at rates lower than the U.S. statutory rate. Additionally, certain tax incentives realized by the Company were recognized as discrete events during the quarter ended March 31, 2013. These incentives were reinstated under The American Taxpayer Relief Act of 2012 that was signed into law on January 2, 2013.

At June 30, 2013, the total amount of gross unrecognized tax benefits, which excludes interest and penalties, was approximately \$41,964. At December 31, 2012, the total amount of gross unrecognized tax benefits, which excludes interest and penalties, was approximately \$40,674. The net increase from December 31, 2012 was attributable to an increase in reserves for existing uncertain tax positions. If these benefits were recognized in a future period, the timing of which is not estimable, the net unrecognized tax benefit of \$20,481, excluding interest and penalties, would impact the Company's effective tax rate as of June 30, 2013. The Company accrues interest expense and, if applicable, penalties for any uncertain tax positions. Interest and penalties are classified as a component of income tax expense. At June 30, 2013 and December 31, 2012, the Company had accrued interest on unrecognized tax benefits of approximately \$1,968 and \$1,571, respectively.

The Company and its subsidiaries are subject to examination by federal, state and foreign tax authorities. The Internal Revenue Service commenced an examination of the Company's U.S. federal tax filings for open tax years 2007 through 2009 during the quarter ended June 30, 2012. The statute of limitations for the Company's tax filings varies by tax jurisdiction between fiscal years 2006 through present.

While the Company believes it has adequately provided for all tax positions, amounts asserted by taxing authorities could materially differ from the Company's accrued positions as a result of uncertain and complex application of tax regulations. Additionally, the recognition and measurement of certain tax benefits include estimates and judgment by management and inherently includes subjectivity. Accordingly, the Company may record additional provisions or benefits due to U.S. federal, state, and foreign tax-related matters in the future as it revises

estimates or settles or otherwise resolves the underlying matters.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

14) Net Income Per Share

The following table sets forth the computation of basic and diluted net income per share:

|                                                                  | Three Months Ended<br>June 30, |                   | Six Months Ended<br>June 30, |                   |
|------------------------------------------------------------------|--------------------------------|-------------------|------------------------------|-------------------|
|                                                                  | 2013                           | 2012              | 2013                         | 2012              |
| <b>Numerator:</b>                                                |                                |                   |                              |                   |
| Net income                                                       | \$ 7,320                       | \$ 18,572         | \$ 13,081                    | \$ 41,340         |
| <b>Denominator:</b>                                              |                                |                   |                              |                   |
| Shares used in net income per common share basic                 | 53,054,000                     | 52,679,000        | 52,914,000                   | 52,591,000        |
| <b>Effect of dilutive securities:</b>                            |                                |                   |                              |                   |
| Stock options, restricted stock and employee stock purchase plan | 304,000                        | 527,000           | 445,000                      | 623,000           |
| <b>Shares used in net income per common share diluted</b>        | <b>53,358,000</b>              | <b>53,206,000</b> | <b>53,359,000</b>            | <b>53,214,000</b> |
| <b>Net income per common share:</b>                              |                                |                   |                              |                   |
| Basic                                                            | \$ 0.14                        | \$ 0.35           | \$ 0.25                      | \$ 0.79           |
| Diluted                                                          | \$ 0.14                        | \$ 0.35           | \$ 0.25                      | \$ 0.78           |

Basic earnings per share ( EPS ) is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding (using the treasury stock method) if securities containing potentially dilutive common shares (stock options and restricted stock units) had been converted to such common shares, and if such assumed conversion is dilutive.

As of June 30, 2013, stock options and restricted stock units relating to an aggregate of approximately 1,083,000 shares were outstanding. For the three and six months ended June 30, 2013, the potential dilutive effect of approximately 102,000 and 100,000 weighted-average shares, respectively, of restricted stock units and stock options were excluded from the computation of diluted weighted-average shares outstanding as the shares would have an anti-dilutive effect on EPS.

As of June 30, 2012, stock options and restricted stock units relating to an aggregate of approximately 1,277,000 shares were outstanding. For the three and six months ended June 30, 2012, the potential dilutive effect of 479,000 and 288,000 weighted-average shares, respectively, of restricted stock units and stock options were excluded from the computation of diluted weighted-average shares outstanding as the shares would have an anti-dilutive effect on EPS.

15) Stockholder s Equity  
Stock Repurchase Program

On July 25, 2011, the Company s Board of Directors approved a share repurchase program for the repurchase of up to an aggregate of \$200,000 of its outstanding common stock from time to time in open market purchases, privately negotiated transactions or through other appropriate

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means. The timing and quantity of any shares repurchased depends upon a variety of factors, including business conditions, stock market conditions and business development activities, including, but not limited to, merger and acquisition opportunities. These repurchases may be commenced, suspended or discontinued at any time without prior notice.

During the six months ended June 30, 2013, the Company repurchased 107,000 shares of its common stock for \$2,875, or an average price of \$26.87 per share.

### Cash Dividends

Holders of the Company's common stock are entitled to receive dividends when they are declared by the Company's Board of Directors. During the six months ended June 30, 2013, the Board of Directors authorized two quarterly dividends of \$0.16 per share, which totaled \$16,951 or \$0.32 per share. During the six months ended June 30, 2012, the Board of Directors declared two quarterly dividends of \$0.15 per share, which totaled \$15,806 or \$0.30 per share.

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### MKS INSTRUMENTS, INC.

#### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

On July 29, 2013, our Board of Directors declared a quarterly cash dividend of \$0.16 per share to be paid on September 13, 2013 to shareholders of record as of August 30, 2013. Future dividend declarations, if any, as well as the record and payment dates for such dividends, are subject to the final determination of the Company's Board of Directors.

#### 16) Business Segment, Geographic Area, Product and Significant Customer Information

The Company has four reportable segments based upon the manner in which information is produced internally and provided to the Company's chief operating decision-maker (CODM).

The Company develops, manufactures, sells and services products that measure, control, power and monitor critical parameters of advanced manufacturing processes. The Company's CODM utilizes consolidated financial information to make decisions about allocating resources and assessing performance for the entire Company. In addition, certain disaggregated financial information is also provided to the CODM. Based upon the information provided to the CODM, the Company has determined it has eight operating segments and four reportable segments.

The eight operating segments are PFMC Products, Controls Products, ASTeX Products, ENI Products, HPS Products (Vacuum Products), Analytical Solutions Group, Europe Region Sales & Service and Asia Region Sales & Service.

PFMC Products, Controls Products, ASTeX Products, ENI Products and HPS Products comprise a single reportable segment due to the similarities of the operating segments. This reportable segment, Advanced Manufacturing Capital Equipment, includes the development, manufacturing, sales and servicing of instruments and control products, power and reactive gas products, and vacuum products, all of which are utilized in semiconductor processing and other similar advanced manufacturing processes. Sales in this segment include both external sales and intercompany sales (which are stated at agreed upon transfer prices). External sales of these products made in Europe or Asia are reported as sales in the Europe Region Sales & Service or Asia Region Sales & Service segments.

Analytical Solutions Group, Asia Region Sales & Service and Europe Region Sales & Service are each separate reportable segments. The Company has reported corporate expenses and certain intercompany pricing transactions in a Corporate, Eliminations and Other reconciling column. The Analytical Solutions Group includes gas composition analysis and information technology products. The Europe and Asia region sales and service segments mainly resell and service the Advanced Manufacturing Capital Equipment and Analytical Solutions Group products sold in their respective regions.

MKS derives the segment results directly from the manner in which results are reported in its management reporting system. The accounting policies MKS uses to derive reportable segment results are substantially the same as those used for external reporting purposes except that a substantial portion of the sales of the Advanced Manufacturing Capital Equipment and Analytical Solutions Group segments are intercompany sales to the regions at tax-based transfer prices and certain significant costs, including stock-based compensation and management incentive compensation, are not allocated to the segments and are included in Corporate, Eliminations and Other. The CODM reviews several metrics of each operating segment, including net revenues and gross profit (loss).

The following is net revenues by reportable segment:

|                                          | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|------------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                          | 2013                           | 2012       | 2013                         | 2012       |
| Advanced Manufacturing Capital Equipment | \$ 124,876                     | \$ 134,601 | \$ 230,205                   | \$ 277,824 |
| Analytical Solutions Group               | 13,508                         | 16,727     | 27,904                       | 32,521     |

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|                                                         |            |            |            |            |
|---------------------------------------------------------|------------|------------|------------|------------|
| Europe Region Sales & Service Operations <sup>(1)</sup> | 11,803     | 12,449     | 22,851     | 24,656     |
| Asia Region Sales & Service Operations <sup>(1)</sup>   | 49,566     | 63,783     | 96,709     | 135,882    |
| Corporate, Eliminations and Other                       | (42,825)   | (50,163)   | (79,096)   | (102,618)  |
|                                                         | \$ 156,928 | \$ 177,397 | \$ 298,573 | \$ 368,265 |

- (1) The Europe and Asia foreign sales and service operations do not represent total geographical Europe and Asia financial information. These sales and service operations mainly represent the sales from the resale and service of Advanced Manufacturing Capital Equipment and Analytical Solutions Group products in their respective regions. The Advanced Manufacturing Capital Equipment and Analytical Solutions Group segments both have sales in each region. Accordingly, total geographical sales include sales from multiple reportable segments.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following is gross profit by reportable segment:

|                                                         | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|---------------------------------------------------------|--------------------------------|-----------|------------------------------|------------|
|                                                         | 2013                           | 2012      | 2013                         | 2012       |
| Advanced Manufacturing Capital Equipment                | \$ 43,660                      | \$ 48,858 | \$ 78,496                    | \$ 106,695 |
| Analytical Solutions Group                              | 7,033                          | 8,284     | 14,481                       | 16,384     |
| Europe Region Sales & Service Operations <sup>(1)</sup> | 3,387                          | 3,742     | 6,578                        | 7,745      |
| Asia Region Sales & Service Operations <sup>(1)</sup>   | 10,954                         | 11,851    | 19,786                       | 19,113     |
| Corporate, Eliminations and Other                       | (3,076)                        | 3,781     | (2,681)                      | 10,370     |
|                                                         | \$ 61,958                      | \$ 76,516 | \$ 116,660                   | \$ 160,307 |

- (1) The Europe and Asia foreign sales and service operations do not represent total geographical Europe and Asia financial information. These sales and service operations mainly represent the sales from the resale and service of Advanced Manufacturing Capital Equipment and Analytical Solutions Group products in their respective regions. The Advanced Manufacturing Capital Equipment and Analytical Solutions Group segments both have sales in each region. Accordingly, total geographical sales include sales from multiple reportable segments. The following is capital expenditures by reportable segment for the three and six months ended June 30, 2013 and 2012:

|                                   | Product Groups                                 |                               | Foreign Sales & Service Operations |        | Corporate,<br>Eliminations<br>and Other | Total    |
|-----------------------------------|------------------------------------------------|-------------------------------|------------------------------------|--------|-----------------------------------------|----------|
|                                   | Advanced<br>Manufacturing<br>Capital Equipment | Analytical<br>Solutions Group | Europe                             | Asia   |                                         |          |
| Three Months Ended June 30, 2013: |                                                |                               |                                    |        |                                         |          |
| Capital expenditures              | \$ 2,094                                       | \$ 29                         | \$ 98                              | \$ 133 | \$ 650                                  | \$ 3,004 |

|                                 |          |        |        |        |          |          |
|---------------------------------|----------|--------|--------|--------|----------|----------|
| Six Months Ended June 30, 2013: |          |        |        |        |          |          |
| Capital expenditures            | \$ 4,706 | \$ 140 | \$ 113 | \$ 196 | \$ 1,205 | \$ 6,360 |

|                                   | Product Groups                                 |                               | Foreign Sales & Service Operations |        | Corporate,<br>Eliminations<br>and Other | Total    |
|-----------------------------------|------------------------------------------------|-------------------------------|------------------------------------|--------|-----------------------------------------|----------|
|                                   | Advanced<br>Manufacturing<br>Capital Equipment | Analytical<br>Solutions Group | Europe                             | Asia   |                                         |          |
| Three Months Ended June 30, 2012: |                                                |                               |                                    |        |                                         |          |
| Capital expenditures              | \$ 1,464                                       | \$ 300                        | \$ 29                              | \$ 124 | \$ 1,528                                | \$ 3,445 |

|                                 |          |        |       |        |          |          |
|---------------------------------|----------|--------|-------|--------|----------|----------|
| Six Months Ended June 30, 2012: |          |        |       |        |          |          |
| Capital expenditures            | \$ 4,639 | \$ 415 | \$ 74 | \$ 417 | \$ 2,467 | \$ 8,012 |



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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

The following is depreciation and amortization by reportable segment for the three and six months ended June 30, 2013 and 2012:

|                                   | Product Groups                                 |                               | Foreign Sales & Service Operations |        | Corporate,<br>Eliminations<br>and Other | Total    |
|-----------------------------------|------------------------------------------------|-------------------------------|------------------------------------|--------|-----------------------------------------|----------|
|                                   | Advanced<br>Manufacturing<br>Capital Equipment | Analytical<br>Solutions Group | Europe                             | Asia   |                                         |          |
| Three Months Ended June 30, 2013: |                                                |                               |                                    |        |                                         |          |
| Depreciation and amortization     | \$ 3,071                                       | \$ 307                        | \$ 81                              | \$ 288 | \$ 631                                  | \$ 4,378 |
| Six Months Ended June 30, 2013:   |                                                |                               |                                    |        |                                         |          |
| Depreciation and amortization     | \$ 5,958                                       | \$ 604                        | \$ 174                             | \$ 582 | \$ 1,152                                | \$ 8,470 |

|                                   | Product Groups                                 |                               | Foreign Sales & Service Operations |        | Corporate,<br>Eliminations<br>and Other | Total    |
|-----------------------------------|------------------------------------------------|-------------------------------|------------------------------------|--------|-----------------------------------------|----------|
|                                   | Advanced<br>Manufacturing<br>Capital Equipment | Analytical<br>Solutions Group | Europe                             | Asia   |                                         |          |
| Three Months Ended June 30, 2012: |                                                |                               |                                    |        |                                         |          |
| Depreciation and amortization     | \$ 2,263                                       | \$ 236                        | \$ 103                             | \$ 423 | \$ 389                                  | \$ 3,414 |
| Six Months Ended June 30, 2012:   |                                                |                               |                                    |        |                                         |          |
| Depreciation and amortization     | \$ 4,388                                       | \$ 467                        | \$ 203                             | \$ 793 | \$ 706                                  | \$ 6,557 |

The following is segment assets by reportable segment:

|                                    | Product Groups                                 |                               | Foreign Sales & Service Operations |           | Corporate,<br>Eliminations<br>and Other | Total      |
|------------------------------------|------------------------------------------------|-------------------------------|------------------------------------|-----------|-----------------------------------------|------------|
|                                    | Advanced<br>Manufacturing<br>Capital Equipment | Analytical<br>Solutions Group | Europe                             | Asia      |                                         |            |
| June 30, 2013:                     |                                                |                               |                                    |           |                                         |            |
| Segment assets:                    |                                                |                               |                                    |           |                                         |            |
| Accounts receivable <sup>(1)</sup> | \$ 13,151                                      | \$ 4,004                      | \$ 6,741                           | \$ 36,644 | \$ 35,231                               | \$ 95,771  |
| Inventory                          | 111,253                                        | 4,090                         | 3,614                              | 26,217    | (8,168)                                 | 137,006    |
| Total segment assets               | \$ 124,404                                     | \$ 8,094                      | \$ 10,355                          | \$ 62,861 | \$ 27,063                               | \$ 232,777 |

|  | Product Groups                                 |                               | Foreign Sales & Service Operations |      | Corporate,<br>Eliminations<br>and Other | Total |
|--|------------------------------------------------|-------------------------------|------------------------------------|------|-----------------------------------------|-------|
|  | Advanced<br>Manufacturing<br>Capital Equipment | Analytical<br>Solutions Group | Europe                             | Asia |                                         |       |

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December 31, 2012:

Segment assets:

|                                    |            |          |          |           |           |            |
|------------------------------------|------------|----------|----------|-----------|-----------|------------|
| Accounts receivable <sup>(1)</sup> | \$ 9,644   | \$ 5,889 | \$ 5,813 | \$ 32,088 | \$ 28,626 | \$ 82,060  |
| Inventory                          | 108,397    | 3,841    | 3,691    | 29,534    | (10,824)  | 134,639    |
| Total segment assets               | \$ 118,041 | \$ 9,730 | \$ 9,504 | \$ 61,622 | \$ 17,802 | \$ 216,699 |

(1) A significant portion of segment receivables are facilitated at the Company's shared services center at the Corporate location.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

A reconciliation of segment assets to consolidated total assets is as follows:

|                                           | June 30, 2013 | December 31, 2012 |
|-------------------------------------------|---------------|-------------------|
| Total segment assets                      | \$ 232,777    | \$ 216,699        |
| Cash and cash equivalents and investments | 598,227       | 627,399           |
| Other current assets                      | 46,472        | 36,242            |
| Property, plant and equipment, net        | 78,875        | 80,516            |
| Goodwill and intangible assets, net       | 162,535       | 162,294           |
| Other assets                              | 11,461        | 11,692            |
| Consolidated total assets                 | \$ 1,130,347  | \$ 1,134,842      |

**Worldwide Product Information**

Because the reportable segment information above does not reflect worldwide sales of the Company's products, the Company groups its products into four groups of similar products based upon the similarity of product function. Worldwide net revenue for each group of products is as follows:

|                                     | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|-------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                     | 2013                           | 2012       | 2013                         | 2012       |
| Instruments and Control Products    | \$ 65,638                      | \$ 71,589  | \$ 124,114                   | \$ 147,888 |
| Power and Reactive Gas Products     | 57,760                         | 70,267     | 109,823                      | 147,833    |
| Vacuum Products                     | 19,242                         | 17,695     | 35,490                       | 37,723     |
| Analytical Solutions Group Products | 14,288                         | 17,846     | 29,146                       | 34,821     |
|                                     | \$ 156,928                     | \$ 177,397 | \$ 298,573                   | \$ 368,265 |

Sales of Instruments and Control Products, Power and Reactive Gas Products and Vacuum Products are included in the Company's Advanced Manufacturing Capital Equipment Products segment as well as in the foreign sales and service operations because the products are sold through the foreign sales and service operations in their respective regions. Sales of the Analytical Solutions Group products are included in the Analytical Solutions Group segment as well as in the foreign sales and service operations because the products are sold through the foreign sales and service operations in their respective regions.

**Geographic**

Information about the Company's operations in different geographic regions is presented in the tables below. Net revenues to unaffiliated customers are based on the location in which the sale originated. Transfers between geographic areas are at negotiated transfer prices and have been eliminated from consolidated net revenues.

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|                                  | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|----------------------------------|--------------------------------|------------|------------------------------|------------|
|                                  | 2013                           | 2012       | 2013                         | 2012       |
| Net revenues:                    |                                |            |                              |            |
| United States                    | \$ 86,851                      | \$ 91,075  | \$ 161,418                   | \$ 186,179 |
| Korea                            | 16,507                         | 18,625     | 30,106                       | 39,181     |
| Japan                            | 12,589                         | 19,419     | 26,418                       | 52,852     |
| Europe                           | 18,722                         | 22,474     | 37,525                       | 44,459     |
| Asia (excluding Korea and Japan) | 22,259                         | 25,804     | 43,106                       | 45,594     |
|                                  | \$ 156,928                     | \$ 177,397 | \$ 298,573                   | \$ 368,265 |

|                                   | June 30, 2013 | December 31, 2012 |
|-----------------------------------|---------------|-------------------|
| Long-lived assets: <sup>(1)</sup> |               |                   |
| United States                     | \$ 62,404     | \$ 62,203         |
| Europe                            | 5,086         | 5,844             |
| Asia                              | 13,232        | 14,664            |
|                                   | \$ 80,722     | \$ 82,711         |

(1) Long-lived assets include property, plant and equipment, net and certain other long-term assets.

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## MKS INSTRUMENTS, INC.

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(in thousands, except share and per share data)

**Major Customers**

The Company had two customers with net revenues greater than 10% of total net revenues in the periods shown as follows:

|            | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|------------|--------------------------------|-------|------------------------------|-------|
|            | 2013                           | 2012  | 2013                         | 2012  |
| Customer A | 18.8%                          | 14.9% | 16.8%                        | 14.7% |
| Customer B | 11.9%                          | 11.3% | 10.8%                        | 11.0% |

17) **Commitments and Contingencies**

In the third quarter of 2012, we incurred \$5.3 million in charges to settle litigation with former shareholders of one of our former subsidiaries. This litigation was long-standing and the decision to reach a settlement was made to eliminate future legal expenses related to the suit. In the second quarter of 2013, we recovered \$1.1 million from our insurance company relating to the 2012 litigation settlement.

The Company is subject to various legal proceedings and claims, which have arisen in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's results of operations, financial condition or cash flows.

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### **MKS INSTRUMENTS, INC.**

#### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). When used herein, the words believes, anticipates, plans, expects, estimates, would, will, intends and similar expressions are intended to identify forward-looking statements. These forward-looking statements reflect management's current opinions and are subject to certain risks and uncertainties that could cause results to differ materially from those stated or implied. While we may elect to update forward looking statements in the future, we specifically disclaim any obligation to do so even if our estimates or expectations change. Risks and uncertainties include, but are not limited to those discussed in our Annual Report on Form 10-K for the year ended December 31, 2012 in the section entitled Risk Factors as referenced in Part II, Item 1A Risk Factors of this Quarterly Report on Form 10-Q.

#### **Overview**

We are a global provider of instruments, subsystems and process control solutions that measure, control, power, monitor and analyze critical parameters of advanced manufacturing processes to improve process performance and productivity. We also provide services relating to the maintenance and repair of our products, software maintenance, installation services and training.

Our products are derived from our core competencies in pressure measurement and control, materials delivery, gas composition analysis, control and information technology, power and reactive gas generation and vacuum technology. Our products are used in diverse markets, applications and processes. Our primary served markets are manufacturers of capital equipment for semiconductor devices, and for other thin film applications including flat panel displays, solar cells and light emitting diodes (LEDs), data storage media and other advanced coatings. We also leverage our technology into other markets with advanced manufacturing applications including medical equipment, pharmaceutical manufacturing, energy generation and environmental monitoring.

We have a diverse base of customers that includes manufacturers of semiconductor capital equipment and semiconductor devices, thin film capital equipment used in the manufacture of flat panel displays, LEDs, solar cells, data storage media and other coating applications; and other industrial, medical, pharmaceutical manufacturing, energy generation, environmental monitoring and other advanced manufacturing companies, as well as university, government and industrial research laboratories. For the six months ended June 30, 2013 and 2012, approximately 65% and 65% of our net revenues, respectively, were to semiconductor capital equipment manufacturers and semiconductor device manufacturers. We expect that sales to semiconductor capital equipment manufacturers and semiconductor device manufacturers will continue to account for a substantial portion of our sales.

We have four reportable segments: Advanced Manufacturing Capital Equipment, Analytical Solutions Group, Europe Region Sales & Service and Asia Region Sales & Service. The Advanced Manufacturing Capital Equipment segment includes the development, manufacture, sales and servicing of instruments and control products, power and reactive gas products, materials delivery products and vacuum products, all of which are utilized in semiconductor processing and other similar advanced manufacturing processes. Sales in this segment include both external sales and intercompany sales (which are recorded at agreed upon transfer prices). External sales of these products made in Europe or Asia are reported as sales in the Europe Region Sales & Service or Asia Region Sales & Service segments. The Analytical Solutions Group includes gas composition analysis, information technology products and custom fabrication services. The Europe and Asia region sales and service segments mainly resell and service the Advanced Manufacturing Capital Equipment and Analytical Solutions Group products sold into their respective regions.

Net revenues to semiconductor capital equipment manufacture and semiconductor device manufacture customers declined by 20% for the six months ended June 30, 2013 compared to the same period in the prior year. Throughout most of the second half of 2012, we witnessed a drop in semiconductor capital spending, but conditions stabilized in the fourth quarter of 2012 and our semiconductor net revenues have increased sequentially in the first two quarters of 2013. The semiconductor capital equipment industry is subject to rapid demand shifts, which are difficult to predict, and we are uncertain as to the timing or extent of future demand or any future weakness in the semiconductor capital equipment industry.

Our net revenues sold to other advanced markets, which exclude semiconductor capital equipment and semiconductor device product applications, declined by 18% for the six months ended June 30, 2013 compared to the same period for the prior year. This decline was primarily caused by a significant decrease in our solar product revenues, which declined by 76% for the six months ended June 30, 2013, as this industry has contracted over the past two years due to oversupply.

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A significant portion of our net revenues is to customers in international markets. For the six months ended June 30, 2013 and 2012, international net revenues accounted for approximately 46% and 49% of our net revenues, respectively. A significant portion of our international net revenues were in Japan and Korea. We expect that international net revenues will continue to represent a significant percentage of our total net revenues.

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On March 12, 2013, we completed our acquisition of Alter Power Systems S.r.l. ( Alter ) located in Reggio Emilia, Italy. Alter develops advanced microwave power generators, components and systems for industrial microwave heating, microwave plasma coating and semiconductor applications. The purchase price net of cash acquired and after final debt and working capital adjustments, was \$2.4 million. Total cash paid as of June 30, 2013, net of cash acquired was \$2.1 million. During June 2013, one of two holdback provisions was met and we released an additional \$0.1. We will pay the remaining \$0.4 subject to a final holdback provision being met.

**Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. There have been no material changes in our critical accounting policies since December 31, 2012. For further information, please see the discussion of critical accounting policies in our Annual Report on Form 10-K for the year ended December 31, 2012 in the section captioned Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates.

**Results of Operations**

The following table sets forth, for the periods indicated, the percentage of total net revenues of certain line items included in MKS' consolidated statements of operations and comprehensive income data.

|                                            | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|--------------------------------------------|--------------------------------|-------|------------------------------|-------|
|                                            | 2013                           | 2012  | 2013                         | 2012  |
| Net revenues:                              |                                |       |                              |       |
| Product                                    | 84.5%                          | 83.9% | 83.4%                        | 85.1% |
| Services                                   | 15.5                           | 16.1  | 16.6                         | 14.9  |
| Total net revenues                         | 100.0                          | 100.0 | 100.0                        | 100.0 |
| Cost of revenues:                          |                                |       |                              |       |
| Cost of product revenues                   | 50.5                           | 47.7  | 50.2                         | 47.7  |
| Cost of service revenues                   | 10.0                           | 9.2   | 10.7                         | 8.8   |
| Total cost of revenues                     | 60.5                           | 56.9  | 60.9                         | 56.5  |
| Gross profit                               | 39.5                           | 43.1  | 39.1                         | 43.5  |
| Research and development                   | 10.7                           | 8.8   | 10.7                         | 8.6   |
| Selling, general and administrative        | 22.2                           | 18.3  | 23.1                         | 18.1  |
| Insurance reimbursement                    | (0.6)                          |       | (0.4)                        |       |
| Completed acquisition costs                |                                | 0.2   | 0.1                          | 0.1   |
| Restructuring                              | 0.1                            |       | 0.1                          |       |
| Amortization of intangible assets          | 0.4                            | 0.1   | 0.4                          | 0.1   |
| Income from operations                     | 6.7                            | 15.7  | 5.1                          | 16.6  |
| Interest income, net                       | 0.1                            | 0.1   | 0.1                          | 0.1   |
| Income from operations before income taxes | 6.8                            | 15.8  | 5.2                          | 16.7  |
| Provision for income taxes                 | 2.1                            | 5.3   | 0.8                          | 5.5   |
| Net income                                 | 4.7%                           | 10.5% | 4.4%                         | 11.2% |

**Net Revenues**

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| <i>(dollars in millions)</i> | Three Months Ended June 30, |                 |                | Six Months Ended June 30, |                 |                |
|------------------------------|-----------------------------|-----------------|----------------|---------------------------|-----------------|----------------|
|                              | 2013                        | 2012            | % Change       | 2013                      | 2012            | % Change       |
| Product                      | \$ 132.5                    | \$ 148.9        | (11.0)%        | \$ 249.2                  | \$ 313.3        | (20.5)%        |
| Service                      | 24.4                        | 28.5            | (14.6)         | 49.4                      | 55.0            | (10.0)         |
| <b>Total net revenues</b>    | <b>\$ 156.9</b>             | <b>\$ 177.4</b> | <b>(11.5)%</b> | <b>\$ 298.6</b>           | <b>\$ 368.3</b> | <b>(18.9)%</b> |

Product revenues decreased \$16.4 million and \$64.1 million during the three and six months ended June 30, 2013, compared to the same periods in the prior year. Product revenues from customers in the semiconductor markets decreased by 8.6% and 21.0% for the three and six months ended June 30, 2013, compared to the same periods in the prior year, while product revenues to customers in our non-semiconductor markets decreased by 15.5% and 19.5% for the same periods. The decrease in the semiconductor markets we serve was mainly the result of a volume decreases throughout 2012. The decrease in the non-semiconductor markets was primarily caused by decreases in the solar markets, as this industry has contracted over the past two years due to oversupply.

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Service revenues consisted mainly of fees for services relating to the maintenance and repair of our products and software services, installation and training. Service revenues decreased \$4.1 million and \$5.6 million during the three and six months ended June 30, 2013, compared to the same period in the prior year, consistent with the decreases in product revenues.

Total international net revenues, including product and service, were \$70.1 million and \$137.2 million for the three and six months ended June 30, 2013, or 44.7% and 45.9% of net revenues, compared to \$86.3 million and \$182.1 million for the three and six months ended June 30, 2012, or 48.7% and 49.4% of net revenues, respectively. The decrease in the three and six month periods is mainly attributable to a decrease in sales in Japan, which has been impacted by decreasing volumes as well as a weakening in the Japanese Yen.

The following is our net revenues by reportable segment (dollars in millions):

|                                          | Three Months Ended June 30, |          |          | Six Month Ended June 30, |          |          |
|------------------------------------------|-----------------------------|----------|----------|--------------------------|----------|----------|
|                                          | 2013                        | 2012     | % Change | 2013                     | 2012     | % Change |
| Net revenues:                            |                             |          |          |                          |          |          |
| Advanced Manufacturing Capital Equipment | \$ 124.9                    | \$ 134.6 | (7.2)%   | \$ 230.2                 | \$ 277.8 | (17.1)%  |
| Analytical Solutions Group               | 13.5                        | 16.7     | (19.2)   | 27.9                     | 32.5     | (14.2)   |
| Europe Region Sales & Service            | 11.8                        | 12.4     | (5.2)    | 22.9                     | 24.7     | (7.3)    |
| Asia Region Sales & Service              | 49.5                        | 63.8     | (22.3)   | 96.7                     | 135.9    | (28.8)   |
| Corporate, Eliminations and Other        | (42.8)                      | (50.1)   | 14.6     | (79.1)                   | (102.6)  | 22.9     |
| Total net revenues                       | \$ 156.9                    | \$ 177.4 | (11.5)%  | \$ 298.6                 | \$ 368.3 | (18.9)%  |

Net revenues for the Asia Region Sales & Service segment decreased 22.3% and 28.8% for the three and six months ended June 30, 2013, which is higher than the decreases in consolidated revenues, mainly as a result of lower semiconductor revenue volumes in Japan as well as a weakening in the Japanese Yen during 2013. Net revenues for the Advanced Manufacturing Capital Equipment segment decreased 7.2% and 17.1%, which is slightly lower than the decreases in consolidated revenues, mainly due to an increase of 3.5% in revenues from our top two customers for the three months ended June 30, 2013 compared to the same period in the prior year. These customers are mainly in the semiconductor market.

The decrease in net revenues of 5.2% and 7.3% in the Europe Region Sales & Service segment and 19.2% and 14.2% for the Analytical Solutions Group segment for the three and six months ended June 30, 2013, compared to the same period in the prior year was mainly due to the fact that these two product groups do not sell as much to the semiconductor markets and had increases in the general industrial markets, related to specific customers, which offset decreases in other advanced markets. As these segments are much smaller than the Advanced Manufacturing Capital Equipment segment and Asia Region Sales & Service segment, a small dollar change can cause the percentage change to significantly increase or decrease.

**Gross Profit**

|                                               | Three Months Ended June 30, |       |                 | Six Months Ended June 30, |       |                 |
|-----------------------------------------------|-----------------------------|-------|-----------------|---------------------------|-------|-----------------|
|                                               | 2013                        | 2012  | % Points Change | 2013                      | 2012  | % Points Change |
| Gross profit as a percentage of net revenues: |                             |       |                 |                           |       |                 |
| Product                                       | 40.2%                       | 43.1% | (2.9)%          | 39.9%                     | 43.9% | (4.0)%          |
| Service                                       | 35.4                        | 43.0  | (7.6)           | 35.0                      | 41.2  | (6.2)           |
| Total gross profit percentage                 | 39.5%                       | 43.1% | (3.6)%          | 39.1%                     | 43.5% | (4.4)%          |

Gross profit on product revenues decreased by 2.9% for the three months ended June 30, 2013, compared to the same period in the prior year. The decrease is primarily due to unfavorable product mix of 4.0% and unfavorable foreign exchange of 0.2%. These decreases were partially offset by lower excess and obsolete inventory charges of 0.8% and lower warranty charges of 0.7%.

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Gross profit on product revenues decreased by 4.0% for the six months ended June 30, 2013, compared to the same period in the prior year. The decrease is primarily due to unfavorable product mix of 3.9% and unfavorable revenue volume of 2.0%. These decreases were partially offset by an increase in gross profit due to lower overhead spending of 0.6% and lower warranty and excess and obsolete inventory charges of 1.1%.

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Cost of service revenues, which includes salaries and related expenses and other fixed costs, consists primarily of providing services for repair and software services and training.

Gross profit on service revenues decreased by 7.6% for the three months ended June 30, 2013, compared to the same period in the prior year. The decrease is primarily due to unfavorable revenue volume of 3.1%, unfavorable product mix of 2.1%, unfavorable foreign exchange of 1.1% and higher overhead charges of 0.8%.

Gross profit on service revenues decreased by 6.2% for the six months ended June 30, 2013, compared to the same period in the prior year. The decrease is primarily due to higher overhead charges of 2.2%, unfavorable product mix of 1.8%, unfavorable revenue volume of 1.4% and unfavorable foreign exchange of 0.5%.

The following is gross profit as a percentage of net revenues by reportable segment:

|                                          | Three Months Ended June 30, |       |                 | Six Months Ended June 30, |        |                 |
|------------------------------------------|-----------------------------|-------|-----------------|---------------------------|--------|-----------------|
|                                          | 2013                        | 2012  | % Points Change | 2013                      | 2012   | % Points Change |
| Gross profit:                            |                             |       |                 |                           |        |                 |
| Advanced Manufacturing Capital Equipment | 35.0%                       | 36.3% | (1.3)%          | 34.1%                     | 38.4%  | (4.3)%          |
| Analytical Solutions Group               | 52.1                        | 49.5  | 2.6             | 51.9                      | 50.4   | 1.5             |
| Europe Region Sales & Service            | 28.7                        | 30.1  | (1.4)           | 28.8                      | 31.4   | (2.6)           |
| Asia Region Sales & Service              | 22.1                        | 18.6  | 3.5             | 20.5                      | 14.1   | 6.4             |
| Corporate, Eliminations and Other        | 7.2                         | (7.5) | 14.7            | 3.4                       | (10.1) | 13.5            |
| Total gross profit                       | 39.5%                       | 43.1% | (3.6)%          | 39.1%                     | 43.5%  | (4.4)%          |

Gross profit for the Advanced Manufacturing Capital Equipment segment decreased 1.3% and 4.3% for the three and six months ended June 30, 2013, compared to the same periods in the prior year. The decreases are primarily related to unfavorable product mix and lower revenue volumes, partially offset by lower warranty costs.

Gross profit for the Analytical Solutions Group increased 2.6% and 1.5% for the three and six months ended June 30, 2013, compared to the same periods in the prior year. The increases are primarily related to favorable mix and lower warranty charges, partially offset by lower revenue volumes.

Gross profit for the Europe Region Sales & Service operations decreased 1.4% and 2.6% for the three and six months ended June 30, 2013, compared to the same periods in the prior year. The decrease for the three months ended June 30, 2013 is primarily related to unfavorable product mix and higher warranty charges, partially offset by lower overhead charges. The decrease for the six months ended June 30, 2013 is primarily related to unfavorable product mix and higher excess and obsolete inventory charges.

Gross profit for the Asia Region Sales & Service operations increased 3.5% and 6.4% for the three and six months ended June 30, 2013, compared to the same periods in the prior year. The increases are primarily related to favorable product mix, partially offset by unfavorable foreign exchange and lower revenue volumes.

## Research and Development

|                                                                                                                                                                                                                                                                                                     | Three Months Ended June 30, |         |          | Six Months Ended June 30, |         |          |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------|---------|----------|---------------------------|---------|----------|
| (dollars in millions)                                                                                                                                                                                                                                                                               | 2013                        | 2012    | % Change | 2013                      | 2012    | % Change |
| Research and development expenses                                                                                                                                                                                                                                                                   | \$ 16.8                     | \$ 15.6 | 7.8%     | \$ 32.1                   | \$ 31.8 | 0.9%     |
| Research and development expenses increased \$1.2 million for the three months ended June 30, 2013, compared to the same period in the prior year. This increase includes an increase of \$0.8 million in compensation related expenses and an increase of \$0.5 million in patent related expense. |                             |         |          |                           |         |          |

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Research and development expense was flat for the six months ended June 30, 2013, compared to the same period in the prior year.

Our research and development is primarily focused on developing and improving our instruments, components, subsystems and process control solutions to improve process performance and productivity.

We have thousands of products and our research and development efforts primarily consist of a large number of projects related to these products, none of which is individually material to us. Current projects typically have durations of 3 to 30 months depending upon whether

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the product is an enhancement of existing technology or a new product. Our current initiatives include projects to enhance the performance characteristics of older products, to develop new products and to integrate various technologies into subsystems. These projects support in large part, the transition in the semiconductor industry to smaller integrated circuit geometries and in the flat panel display and solar markets to larger substrate sizes, which require more advanced process control technology. Research and development expenses consist primarily of salaries and related expenses for personnel engaged in research and development, fees paid to consultants, material costs for prototypes and other expenses related to the design, development, testing and enhancement of our products as well as legal costs associated with maintaining and defending our intellectual property.

We believe that the continued investment in research and development and ongoing development of new products are essential to the expansion of our markets, and we expect to continue to make significant investment in research and development activities. We are subject to risks if products are not developed in a timely manner, due to rapidly changing customer requirements and competitive threats from other companies and technologies. Our success primarily depends on our products being designed into new generations of equipment for the semiconductor industry and other advanced technology markets. We develop products that are technologically advanced so that they are positioned to be chosen for use in each successive generation of semiconductor capital equipment. If our products are not chosen to be designed into our customers products, our net revenues may be reduced during the lifespan of those products.

**Selling, General and Administrative**

| (dollars in millions)                        | Three Months Ended June 30, |         |          | Six Months Ended June 30, |         |          |
|----------------------------------------------|-----------------------------|---------|----------|---------------------------|---------|----------|
|                                              | 2013                        | 2012    | % Change | 2013                      | 2012    | % Change |
| Selling, general and administrative expenses | \$ 34.8                     | \$ 32.6 | 7.0%     | \$ 69.0                   | \$ 66.7 | 3.4%     |

Selling, general and administrative expenses increased by \$2.2 million for the three months ended June 30, 2013. This increase includes a \$2.6 million increase in salaries and compensation related expenses, mainly related to the timing of stock compensation expense, and a \$0.8 million increase due to unfavorable changes in foreign exchange. These increases are partially offset by a decrease of \$1.1 million in consulting and professional fees.

Selling, general and administrative expenses increased by \$2.3 million for the six months ended June 30, 2013. This increase includes a \$2.8 million increase in salaries and compensation related expense mainly related to the timing of stock compensation expense and a \$0.7 million increase due to changes in foreign exchange. These increases are partially offset by a decrease of \$1.3 million in consulting and professional fees.

**Insurance reimbursement**

| (dollars in millions)   | Three Months Ended June 30, |      |          | Six Months Ended June 30, |      |          |
|-------------------------|-----------------------------|------|----------|---------------------------|------|----------|
|                         | 2013                        | 2012 | % Change | 2013                      | 2012 | % Change |
| Insurance reimbursement | \$ (1.1)                    | \$   | 100%     | \$ (1.1)                  | \$   | 100%     |

In the third quarter of 2012, we incurred \$5.3 million in charges to settle litigation with former shareholders of one of our former subsidiaries. This litigation was long standing and the decision to reach a settlement was made to eliminate future legal expenses related to the suit. In the second quarter of 2013, we recovered \$1.1 million from our insurance company relating to the 2012 litigation settlement.

**Completed Acquisition Costs**

| (dollars in millions)       | Three Months Ended June 30, |        |          | Six Months Ended June 30, |        |          |
|-----------------------------|-----------------------------|--------|----------|---------------------------|--------|----------|
|                             | 2013                        | 2012   | % Change | 2013                      | 2012   | % Change |
| Completed acquisition costs | \$                          | \$ 0.4 | (100.0)% | \$ 0.2                    | \$ 0.4 | (54.6)%  |

We incurred \$0.2 million of acquisition costs in the six months ended June 30, 2013 related to the acquisition of Alter in March 2013. These costs are comprised of legal fees.

We incurred \$0.4 million of acquisition costs in the three and six months ended June 30, 2012 related to the acquisition of Plasmart, Inc. ( Plasmart ) in 2012. These costs are comprised of investment banking fees, legal fees and due diligence fees.

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## Restructuring

| (dollars in millions) | Three Months Ended June 30, |      |          | Six Months Ended June 30, |      |          |
|-----------------------|-----------------------------|------|----------|---------------------------|------|----------|
|                       | 2013                        | 2012 | % Change | 2013                      | 2012 | % Change |
| Restructuring         | \$ 0.2                      | \$   | 100.0%   | \$ 0.2                    | \$   | 100.0%   |

The restructuring charges for the three and six months ended June 30, 2013 are primarily for severance costs related to the consolidation of two sites.

**Table of Contents****Amortization of Intangible Assets**

| (dollars in millions)             | Three Months Ended June 30, |        |          | Six Months Ended June 30, |        |          |
|-----------------------------------|-----------------------------|--------|----------|---------------------------|--------|----------|
|                                   | 2013                        | 2012   | % Change | 2013                      | 2012   | % Change |
| Amortization of intangible assets | \$ 0.7                      | \$ 0.1 | 523.5%   | \$ 1.2                    | \$ 0.2 | 394.1%   |

Amortization expense for the three and six months ended June 30, 2013 increased by \$0.6 million and \$1.0 million, compared to the same periods in the prior year. These increases are primarily attributed to increased intangible assets from our August 2012 Plasmart acquisition and our March 2013 acquisition of Alter, offset by intangible assets that became fully amortized.

**Interest Income, Net**

| (dollars in millions) | Three Months Ended June 30, |        |          | Six Months Ended June 30, |        |          |
|-----------------------|-----------------------------|--------|----------|---------------------------|--------|----------|
|                       | 2013                        | 2012   | % Change | 2013                      | 2012   | % Change |
| Interest income, net  | \$ 0.2                      | \$ 0.1 | 41.6%    | \$ 0.5                    | \$ 0.4 | 25.2%    |

Interest income, net increased slightly for the three and six months ended June 30, 2013, compared to the same periods in the prior year, resulting from changes in our investment portfolio.

**Provision for Income Taxes**

| (dollars in millions)      | Three Months Ended June 30, |        |          | Six Months Ended June 30, |         |          |
|----------------------------|-----------------------------|--------|----------|---------------------------|---------|----------|
|                            | 2013                        | 2012   | % Change | 2013                      | 2012    | % Change |
| Provision for income taxes | \$ 3.3                      | \$ 9.4 | (64.8)%  | \$ 2.5                    | \$ 20.3 | (87.6)%  |

Our effective tax rate for the three and six months ended June 30, 2013 was 31.2% and 16.2%, respectively. Our effective tax rate for the three and six months ended June 30, 2012 was 33.7% and 32.9%. The effective tax rates for the six months ended June 30, 2013 and 2012 and related income tax expense were lower than the U.S. statutory tax rate primarily due to the geographic mix of income and profits earned by our international subsidiaries being taxed at rates lower than the U.S. statutory rate. Additionally, certain tax incentives realized by the Company were recognized as discrete events during the quarter ended March 31, 2013. These incentives were reinstated under The American Taxpayer Relief Act of 2012 that was signed into law on January 2, 2013.

At June 30, 2013, our total amount of gross unrecognized tax benefits, which excludes interest and penalties, was approximately \$42.0 million. At December 31, 2012, our total amount of gross unrecognized tax benefits, which excludes interest and penalties, was approximately \$40.7 million. The net increase from December 31, 2012 was attributable to an increase in reserves for existing uncertain tax positions. If these benefits were recognized in a future period, the timing of which is not estimable, the net unrecognized tax benefit of \$20.5 million, excluding interest and penalties, would impact our effective tax rate as of June 30, 2013. We accrue interest expense and, if applicable, penalties for any uncertain tax positions. Interest and penalties are classified as a component of income tax expense. At June 30, 2013 and December 31, 2012, we had accrued interest on unrecognized tax benefits of approximately \$2.0 million and \$1.6 million, respectively.

We and our subsidiaries are subject to examination by federal, state and foreign tax authorities. The Internal Revenue Service commenced an examination of our U.S. federal tax filings for open tax years 2007 through 2009 during the quarter ended June 30, 2012. The statute of limitations for our tax filings varies by tax jurisdiction between fiscal years 2006 through present.

Our future effective income tax rate depends on various factors, such as tax legislation and the geographic composition of our pre-tax income. We monitor these factors and timely adjust our effective tax rate accordingly. Additionally, the effective tax rate could be adversely affected by changes in the valuation of deferred tax assets and liabilities. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate sufficient future taxable income in the United States. While we believe we have adequately provided for all tax positions, amounts asserted by taxing authorities could materially differ from our accrued positions as a result of uncertain and complex application of tax regulations. Additionally, the recognition and measurement of certain tax benefits include estimates and judgment by management and inherently includes subjectivity. Accordingly, we could record additional provisions or benefits due to U.S. federal, state, and foreign tax-related matters in the future as we revise estimates or settle or otherwise resolve the underlying matters.



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### **Liquidity and Capital Resources**

Cash and cash equivalents and short-term investments totaled \$582.4 million at June 30, 2013 compared to \$615.2 million at December 31, 2012. The decrease in cash and cash equivalents and short-term investments was mainly attributable to our net cash used in investing activities and financing activities as a result of net purchases of investments, dividend payments to our common stockholders and capital expenditures.

Net cash provided by operating activities was \$5.6 million for the six months ended June 30, 2013 and resulted mainly from net income of \$13.1 million, which included non-cash charges of \$24.7 million and changes in working capital of \$35.1 million. The increase in working capital was primarily due to an increase in trade accounts receivable of \$16.3 million, an increase in inventory of \$10.9 million as business levels increased, an increase in other current assets of \$8.6 million, an increase in income taxes of \$3.6 million, a decrease in accrued compensation and other liabilities of \$3.0 million partially offset by an increase in accounts payable of \$7.7 million.

Net cash provided by operating activities was \$82.0 million for the six months ended June 30, 2012 and resulted mainly from net income of \$41.3 million, which included non-cash charges of \$22.0 million and a decrease in working capital of \$18.0 million. The decrease in working capital consisted primarily of a \$14.6 million decrease in trade accounts receivable and a \$4.0 million decrease in other current assets.

Net cash used in investing activities of \$31.3 million for the six months ended June 30, 2013, resulted primarily from \$22.8 million in net purchases of short-term and long-term investments, and \$6.4 million in purchases of production related equipment and \$2.1 million from the acquisition of Alter. Net cash provided by investing activities of \$38.4 million for the six months ended June 30, 2012, resulted primarily from net maturities and sales of \$46.4 million of short-term and long-term investments partially offset by \$8.0 million in purchases of production related equipment.

Net cash used in financing activities was \$22.2 million for the six months ended June 30, 2013 and consisted primarily of \$17.0 million of dividend payments made to common stockholders, \$2.9 million related to the repurchase of common stock and \$2.4 million of net payments related to employee stock awards. Net cash used in financing activities was \$21.7 million for the six months ended June 30, 2012 and consisted primarily of \$15.8 million of dividend payments made to common stockholders, \$5.0 million related to the repurchase of common stock and \$1.9 million of net payments made on short-term borrowings.

Our Japanese subsidiary has lines of credit and short-term borrowing arrangements with two financial institutions which, generally expire and are renewed at three month intervals. The lines of credit provide for aggregate borrowings as of June 30, 2013 of up to an equivalent of \$24.5 million U.S. dollars. One of the borrowing arrangement's interest rate is based on the Tokyo Interbank Offer Rate at the time of borrowing and the other is based on the Japanese Short-term Prime Lending Rate. There were no borrowings outstanding under these arrangements at June 30, 2013 and December 31, 2012.

We also had various lines of credit and short and long-term borrowing arrangements as a result of our acquisitions of Plasmart in 2012 and Alter in March 2013. There were \$0.7 million borrowings outstanding under these arrangements at March 31, 2013 and none outstanding at December 31, 2012, respectively. All of these lines of credit and borrowing arrangements have been paid off and terminated in the second quarter of 2013. There were no outstanding balances at June 30, 2013.

On July 25, 2011, our Board of Directors approved a share repurchase program for the repurchase of up to an aggregate of \$200 million of our outstanding common stock from time to time in open market purchases, privately negotiated transactions or through other appropriate means. The timing and quantity of any shares repurchased depends upon a variety of factors, including business conditions, stock market conditions and business development activities, including but not limited to merger and acquisition opportunities. These repurchases may be commenced, suspended or discontinued at any time without prior notice. During the six months ended June 30, 2013, we repurchased approximately 107,000 shares of our common stock for \$2.9 million at an average price of \$26.87 per share.

During the six months ended June 30, 2013, our Board of Directors declared two quarterly dividends of \$0.16 per share that totaled \$17.0 million.

On July 29, 2013, the Board of Directors declared a quarterly cash dividend of \$0.16 per share to be paid on September 13, 2013 to stockholders of record as of August 30, 2013. Future dividend declarations, if any, as well as the record and payment dates for such dividends, are subject to the final determination of our Board of Directors.

Our total cash and cash equivalents and short-term marketable investments at June 30, 2013 consisted of \$322 million held in the U.S. and \$260 million held by our foreign subsidiaries, substantially all of which would be subject to tax in the U.S. if returned to the U.S.. We believe our existing U.S. cash and short-term investment balances are adequate to meet domestic operating needs, including estimated working capital,

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planned capital expenditure requirements and any future cash dividends, if declared, or share repurchases in the next twelve months and foreseeable future.

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### **Off-Balance Sheet Arrangements**

We do not have any financial partnerships with unconsolidated entities, such as entities often referred to as structured finance, special purpose entities or variable interest entities, which are often established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. Accordingly, we have no off-balance sheet arrangements that have or are reasonably expected to have a current or future effect on our financial condition, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

### **Recently Issued Accounting Pronouncements**

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*. This ASU is intended to enhance the understanding of the effects of netting arrangements on an entity's financial statements, including financial instruments and derivative instruments that are either offset or subject to a master netting arrangement. The scope of this ASU includes derivatives, sale and repurchase agreements, reverse sale and repurchase agreements, and securities borrowing and lending arrangements. In January 2013, the FASB issued ASU No. 2013-01 *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. This standard provided additional guidance on the scope of ASU 2011-11. The provisions of this ASU are effective for interim and annual periods beginning on or after January 1, 2013. The adoption of ASU No. 2011-11 did not have a material effect on our consolidated financial statements.

On February 5, 2013, the FASB issued ASU No. 2013-02, *Other Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This ASU is intended to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income, by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. The provisions of this ASU are effective prospectively for interim and annual periods beginning after December 15, 2012. The adoption of ASU No. 2013-02 did not have a material effect on our consolidated financial statements.

On July 18, 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. Under the new standard, unrecognized tax benefits will be netted against all available same-jurisdiction loss or other tax carryforwards that would be utilized, rather than only against carryforwards that are created by unrecognized tax benefits. The provisions of this ASU are effective for interim and annual periods beginning on or after December 15, 2013. The adoption of ASU No. 2013-11 is not expected to have a material effect on our consolidated financial statements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Information concerning market risk is contained in the section entitled *Quantitative and Qualitative Disclosures About Market Risk* contained in our Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission on February 26, 2013. As of June 30, 2013, there were no material changes in our exposure to market risk from December 31, 2012.

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### **ITEM 4. CONTROLS AND PROCEDURES.**

#### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2013. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer 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 and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2013, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure.

#### **Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS.**

We are subject to various legal proceedings and claims, which have arisen in the ordinary course of business.

In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our results of operations, financial condition or cash flows.

### **ITEM 1A. RISK FACTORS.**

Information regarding risk factors affecting the Company's business are discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 in the section entitled Risk Factors. There have been no material changes from the risks disclosed therein.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

The following table sets forth certain information with respect to repurchases of our common stock during the three months ended June 30, 2013.

**ISSUER PURCHASES OF EQUITY SECURITIES**

| Period  |                | Total Number<br>of<br>Shares Purchased | Average Price Paid per<br>Share | Total Number<br>of<br>Shares Purchased as<br>Part of Publicly<br>Announced Plans or<br>Programs <sup>(1)(2)</sup> | Approximate Dollar<br>Value of Shares that<br>May Yet Be Purchased<br>Under the Plans or<br>Programs <sup>(1)</sup> |
|---------|----------------|----------------------------------------|---------------------------------|-------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|
| April 1 | April 30, 2013 | 44,000                                 | \$ 26.23                        | 44,000                                                                                                            | \$ 183,671,000                                                                                                      |
| May 1   | May 31, 2013   | 2,000                                  | \$ 26.29                        | 2,000                                                                                                             | \$ 183,618,000                                                                                                      |
| June 1  | June 30, 2013  |                                        |                                 |                                                                                                                   | \$ 183,618,000                                                                                                      |
| Total   |                | 46,000                                 |                                 | 46,000                                                                                                            |                                                                                                                     |

- (1) On July 25, 2011, our Board of Directors approved a share repurchase program (the Program) for the repurchase of up to an aggregate of \$200 million of our common stock from time to time in open market purchases, privately negotiated transactions or through other appropriate means, which we announced on July 27, 2011. The timing and quantity of any shares repurchased depends upon a variety of factors, including business conditions, stock market conditions and business development activities, including but not limited to merger and acquisition opportunities. These repurchases may be commenced, suspended or discontinued at any time without prior notice.
- (2) We have repurchased approximately 627,000 shares of our common stock pursuant to the Program since its adoption.

**ITEM 6. EXHIBITS.**

| Exhibit No.        | Exhibit Description                                                                                                                                                           |
|--------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1 <sup>(1)</sup> | Restated Articles of Organization                                                                                                                                             |
| 3.2 <sup>(2)</sup> | Articles of Amendment, as filed with the Secretary of State of Massachusetts on May 18, 2001                                                                                  |
| 3.3 <sup>(3)</sup> | Articles of Amendment, as filed with the Secretary of State of Massachusetts on May 16, 2002                                                                                  |
| 3.4 <sup>(4)</sup> | Amended and Restated By-Laws                                                                                                                                                  |
| 31.1               | Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended                                     |
| 31.2               | Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended                                     |
| 32.1               | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS            | XBRL Instance Document.                                                                                                                                                       |
| 101.SCH            | XBRL Taxonomy Extension Schema Document.                                                                                                                                      |
| 101.CAL            | XBRL Taxonomy Calculation Linkbase Document.                                                                                                                                  |
| 101.LAB            | XBRL Taxonomy Labels Linkbase Document.                                                                                                                                       |
| 101.PRE            | XBRL Taxonomy Presentation Linkbase Document.                                                                                                                                 |

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101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

- (1) Incorporated by reference to Exhibit 3.1 to the Registration Statement on Form S-4 (File No. 333-49738) filed with the Securities and Exchange Commission on November 13, 2000.
- (2) Incorporated by reference to Exhibit 3.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2001.
- (3) Incorporated by reference to Exhibit 3.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.
- (4) Incorporated by reference to Exhibit 3.3 to the Registration Statement on Form S-1 filed with the Securities and Exchange Commission on January 28, 1999, as amended.

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SIGNATURE

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.

MKS INSTRUMENTS, INC.

August 6, 2013

By: /s/ Seth H. Bagshaw  
Seth H. Bagshaw  
Vice President, Chief Financial Officer and Treasurer  
(Principal Financial Officer)