

Veeco

2002 ANNUAL REPORT

GROWING OPPORTUNITIES  
IN NANOSCALE DIMENSIONS »»



Veeco is a leading provider of Metrology and Process Equipment solutions used by manufacturers in the data storage, semiconductor and telecommunications/wireless industries. Our products are critical enabling instruments used in the advancement of scientific research and nanotechnology. Veeco partners with our customers to deliver the enabling technology, experience and support they need to succeed.

In every market Veeco serves, our opportunities grow as dimensions are getting smaller.

The electronics industry continually requires new methods for nanofabrication so that it can build ever smaller, faster and less expensive devices. Manufacturers of semiconductor chips, data storage and telecommunications/wireless devices all rely on nano-sized innovations to create their leading edge products. Semiconductor linewidths are now smaller than 100 nanometers. Data storage and telecommunications require atomic layer deposition and etching. Around the globe, scientific researchers are creating a new, nanoscale world with Veeco's products.

Veeco's Metrology tools are used to measure at the nanoscale and our Process Equipment tools help to create nanoscale devices. Our over 1,000 employees are singularly driven to help Veeco capitalize on this nanoscale world.

# SOLUTIONS

FOR A NANOSCALE WORLD >>>

On the cover: Top image: Endothelial cells in liquid; Bottom image: AFM image of adenocarcinoma; Middle bar, from left to right: disk drive; semiconductor wafer; Optical Profiler image of a thin film magnetic head's air bearing surface; AFM image of tungsten plug after CMP.



## TO OUR SHAREHOLDERS

2002 was a challenging year for the overall economy, for Veeco and for our customers. While our diversification strategy has served us well for many years, 2002 was a unique time when all of our markets, with the exception of scientific research, experienced a severe and prolonged downturn. Although we are disappointed in our performance for the year, we have successfully implemented a significant cost-reduction program and have focused our new product development. We currently expect a return to profitability in 2003.

### 2002 FINANCIAL REVIEW

Veeco's sales for 2002 were \$298.9 million, a decrease of 33% from the \$449.3 million reported for 2001. Metrology sales were \$152.2 million in 2002 compared to \$172.0 million in 2001. Process Equipment sales were \$146.7 million in 2002 compared with \$277.3 million in 2001. Veeco's 2002 bookings were \$289.1 million compared to \$318.9 million in 2001. Metrology bookings in 2002 were \$154.1 million compared to \$145.0 million in 2001. Process Equipment bookings in 2002 were \$135.0 million compared with \$173.9 million in 2001.

Veeco reported an operating loss of \$137.9 million in 2002, compared to operating income of \$20.3 million in 2001. Excluding the 2002 restructuring, impairment and other charges of \$126.0 million, Veeco's EBITA (earnings before interest, taxes and amortization) for 2002 was \$1.3 million compared to \$58.0 million in 2001, which also excludes certain charges. Veeco's net loss for 2002 was \$123.7 million ((\$4.25) per share) compared to net income of \$10.3 million (\$0.39 per diluted share) in 2001. These charges in 2002 consisted of \$99.7 million in asset impairment charges (principally goodwill), \$15.0 million for the write-off of inventory, \$6.4 million for the write-off of FEI merger-related costs and \$4.9 million for business restructuring costs. While these charges were significant, we believe Veeco is now better positioned both operationally and financially. (Please see page 12 for additional financial highlights and GAAP (Generally Accepted Accounting Principles) reconciliation and the attached Form 10-K for detailed information on 2002 charges.)

We are hopeful that the worst is behind us, but we continue to see uncertainty in the timing of an end-market recovery. Veeco's customers are placing emphasis on purchases of "must have" next-generation technology and our priority is to ensure that our new product development roadmaps are aligned with customer requirements. We have maintained technology leadership in our core products.

### METROLOGY PROFITABILITY AND STRENGTH IN 2002

We are pleased with the performance of our Metrology group in 2002. Metrology remained profitable (delivering EBITA of \$25.9 million) despite a 12% decline in revenue, and reported a 6% increase in orders in 2002. Metrology's relative strength was driven largely by increased use of our atomic force microscope (AFM) products in both the scientific research sector and as a critical semiconductor metrology tool. Despite a weak overall capital funding environment, low semiconductor yields associated with 300mm and 0.13µm feature sizes continued to drive AFM technology buys for etch, Chemical Mechanical Planarization (CMP) and lithography applications. Our Metrology group has an aggressive new AFM/SPM (scanning probe microscope) product launch campaign for scientific research and nanotechnology applications scheduled for 2003 to allow further Veeco growth opportunities in this sector.

### PROCESS EQUIPMENT—REFOCUSED FOR PROFITABILITY

Our Process Equipment group had a difficult 2002 due to the severe downturn in data storage and telecommunications/wireless capital spending. Process Equipment sales decreased approximately 47% from 2001, contributing to a \$17.6 million loss in EBITA. In response to this performance, the majority of Veeco's cost-cutting actions were taken in the Process Equipment group.

We believe Process Equipment is poised for significant improvement in earnings in 2003 due to the cost-reduction actions which have resulted in a leaner operating structure. We also have initiated an aggressive new product launch plan for 2003 featuring new ion beam etch (IBE), ion beam deposition (IBD) and physical vapor deposition (PVD) solutions aligned to our customers' technology roadmaps. Despite current capital spending constraints, data storage customers continue to advance their 80GB and 120GB platter programs, and we are uniquely positioned with the industry's broadest line of etch and deposition products for their advanced thin film magnetic head requirements. In telecommunications/wireless, we see continued R&D and pilot line equipment purchases, in particular of our molecular beam epitaxy (MBE) systems associated with the growth of next-generation mobile cellular phone products.

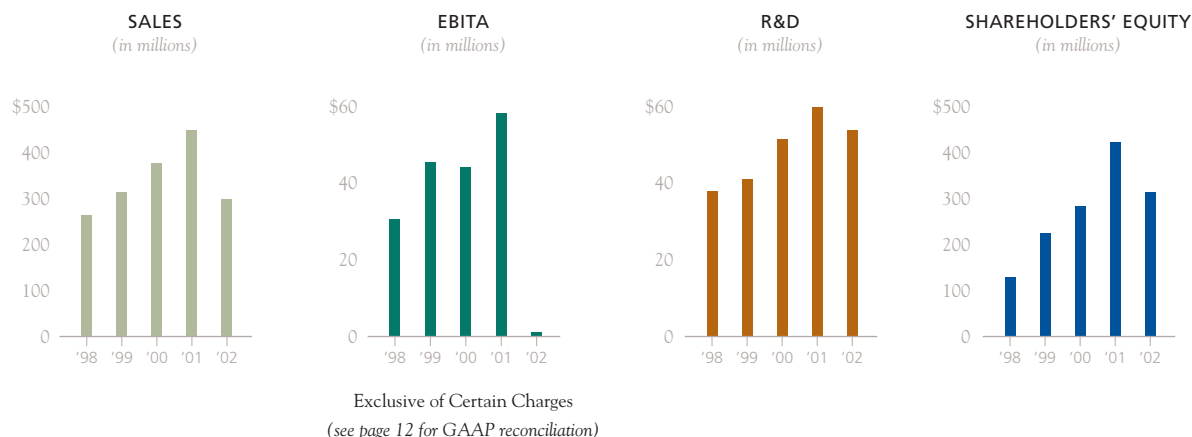
### RIGHT-SIZED FOR PROFITABILITY AND LEADERSHIP IN CORE PRODUCTS

Veeco's management took significant steps in 2002 to right-size our infrastructure for the realities of today's business environment. We have positioned our Company to be profitable in 2003. Our actions included a decrease in our workforce by nearly 30%, primarily centered on the Process Equipment group; the reduction or elimination of five of our manufacturing sites and selected sales locations; and the rationalization or discontinuance of certain product lines. These actions are expected to result in the reduction of Veeco's operating costs by approximately \$24 million in 2003.

In light of the continued economic uncertainty and weak capex environment, we remain focused on overall cost reductions and delivering improved earnings in 2003. While we expect a weak capital equipment market, Veeco will continue to invest in our core leadership products to meet our customers' next-generation product roadmaps. We are optimistic about Veeco's positioning for a recovery in our end-markets and excited about our new products for 2003. During the year, Veeco will be introducing new products in each of our core technology areas—AFM/SPM, optical interferometers, IBE, IBD and PVD.



*“ We have sized our company for profitability in 2003, and are optimistic about Veeco's positioning for a recovery in our end-markets. ”*



Our strategy for growth remains focused on capitalizing on opportunities in “nanoscale” markets and offering our customers a broad range of products designed to meet their development roadmaps.

As we begin 2003, we believe the current revenue rate is a low point for Veeco. Our future growth market opportunities will be tied to the:

- Continued adoption of Veeco’s automated, in-line metrology products for 0.13μm, copper and 300mm semiconductor fabs;
- Introduction of next-generation, higher capacity 80 and 120GB platters for hard disk drives, which will require the next phase of process equipment and metrology investment by thin film magnetic head manufacturers;
- Further development of extreme ultraviolet (EUV) photomasks, requiring additional purchases of Veeco deposition and metrology systems;
- Funding of nanoscience and nanotechnology, resulting in the continued purchases of our AFM/SPM instruments;
- Convergence of semiconductor and wireless devices, and the need for Veeco deposition solutions.

It is our intention to continue to broaden our product technology through internal development, strategic partnerships and acquisitions, and to utilize our global sales and service network to strengthen customer relationships.

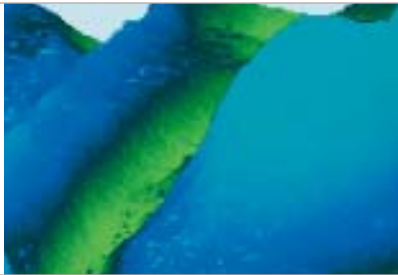
I am pleased to announce the promotion of Don Kania, Ph.D., to President of Veeco. Don joined Veeco in 1997 as our Chief Technology Officer and has served for three years as President of Veeco Metrology. This is an important step in strengthening our management team in anticipation of future growth for Veeco. Don has made significant contributions to Veeco’s success. We are confident that his industry expertise, operating skills, strong technology background and strategic vision will enable him to help lead Veeco in our next phase of growth.

We want to thank our employees, customers and shareholders for their continued support during a challenging 2002 and we reaffirm our commitment to growth.

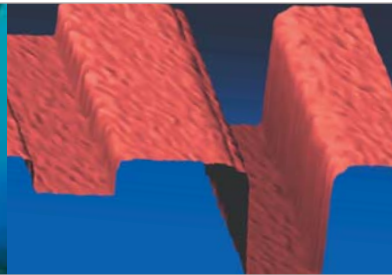
Edward H. Braun  
Chairman and Chief Executive Officer



Dimension X3D Atomic Force Microscope



AFM image of polysilicon lines

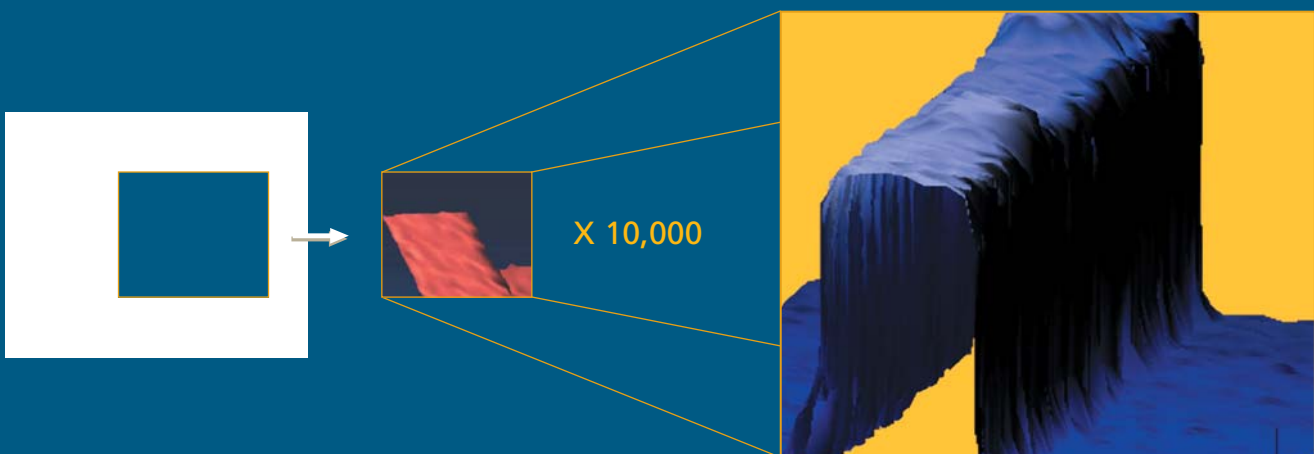


AFM image of phase shift mask etch profile



AFM image of a defect in quartz

With semiconductor linewidths now measured below 100 nanometers, today's chip manufacturers rely on nanoscale innovations to create their leading edge products. Veeco is well-positioned to capitalize on technology changes in the semiconductor industry, including smaller feature sizes, larger substrates (i.e., 300mm wafers), advanced lithography and CMP technologies, and the increased use of metrology in the manufacturing process.



A feature on a semiconductor wafer (far left) is scanned by a Veeco AFM (center photo). The resulting image is a 10,000-time three-dimensional magnification of the feature (right hand photo).

# MEASURING AT THE NANOSCALE

VEECO'S METROLOGY OPPORTUNITIES >>>

## SEMICONDUCTOR "TOOL OF CHOICE"

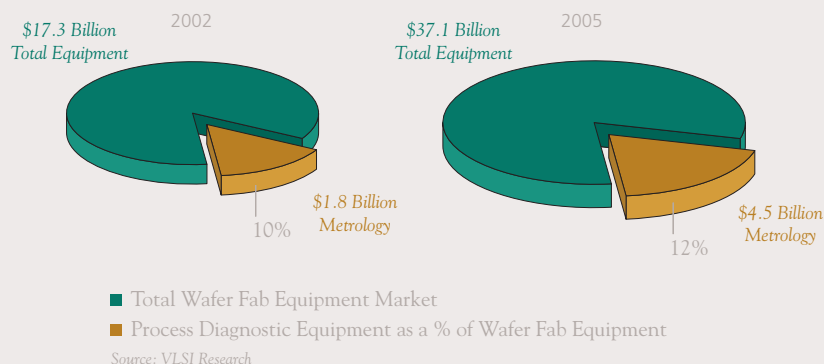
Veeco has successfully penetrated the semiconductor fab with our family of leadership Atomic Force Microscope (AFM) products with over 100 systems installed at leading semiconductor companies. Our Vx Series Atomic Force Profilers (AFP) combine AFM resolution with long-scan capability, and have become the "tool of choice" in many semiconductor fabs. These AFPs are widely used throughout the chip industry for non-destructive measurement and control of device features and test structures. AFPs' critical applications include trench and recess measurements, CMP, defect characterization and micro-roughness. In fact, *Semiconductor International Magazine* named the Dimension™ Vx330 as one of the top

20 outstanding products used in semiconductor manufacturing and related industries. Low yields continued to drive AFM technology buys throughout 2002 despite the overall weakness in capital spending by semiconductor device customers.

Reflecting the semiconductor industry's need for unprecedented levels of accuracy and productivity in metrology, in mid-2002 Veeco introduced our new Dimension X3D AFM. The Dimension X3D is the newest system in Veeco's line of non-destructive AFM metrology tools. The system complements Veeco's industry-renowned expertise in CMP applications, and extends the Company's metrology leadership into a larger lithography, etch and photomask marketplace.

Three dimensional AFMs will be used for semiconductor customers' next-generation process lines which will incorporate a broad range of new materials and require next-generation lithography. By combining the benefits of non-destructive AFM metrology with 3D resolution, the X3D gives our customers a clear advantage when it comes to achieving dimensional control of lithography and etch processes in wafer and photomask manufacturing. The Dimension X3D significantly expands the total available market for Veeco's metrology equipment.

METROLOGY SPENDING INCREASES  
WITH EACH TECHNOLOGY TRANSITION



WORLDWIDE  
SEMICONDUCTOR  
DEVICE SALES  
(in billions)



## ENABLING ADVANCES IN SCIENTIFIC RESEARCH

An exciting trend in the research industry is the growth in nanotechnology investment occurring at the scientific and university level. Nanotechnology is a field of science whose goal is to control individual atoms and molecules to potentially create computer chips and other devices that are thousands of times smaller than current technologies permit. Significant nanoscience funding from the U.S. and other countries is beginning to impact many industries—life sciences, data storage, semiconductor, telecommunications, materials sciences, and others. Veeco currently sells to nearly every major scientific or research organization engaged in the field of nanotechnology worldwide.

Veeco's Scanning Probe Microscopes (SPMs) are "enabling tools" for nanoscience and nanotechnology (according to nanotechnology pioneer George Whitesides of Harvard at the May, 2001 AAAS Nanotechnology Seminar), and

are the highest resolution measurement and imaging tools available today. Our Digital Instruments NanoScope® products are widely used by leading nanotechnology research centers worldwide and are considered the "industry standard." Veeco's newest instruments provide capabilities for manipulating materials and surfaces on the nanoscale and sensing chemical and biological species on the molecular scale.

Although topographic measurement of surface morphology at the micro- and nanoscale is the primary application, a variety of electrical measurements and force measurements are also widely utilized. Applications for research, process development, quality control and failure analysis include:

- Microelectronics—semiconductor devices, data storage heads and media, including topography, electrical and force measurements (dopants, film thickness, magnetic domains, etc.).

- Advanced Materials—including topography and molecular studies.
- Optical Telecommunications—lasers and other devices, including topography and electrical measurements.
- LifeSciences/Biotechnology—cells, tissues, DNA, proteins including topography and force measurements for single molecule interactions.
- Pharmaceuticals—drug delivery/encapsulation, drug discovery, crystallization.
- Nanomanipulation—forming structures at the nanoscale, manipulation of atoms and molecules.

Some of the many other applications for Veeco's instruments range from environmental studies to cosmetics and electrochemistry and more are emerging every day. In addition to our AFM/SPMs, Veeco offers a broad family of metrology solutions for the scientific researcher and industrial customer, including optical profilers, stylus profilers and laser interferometers.



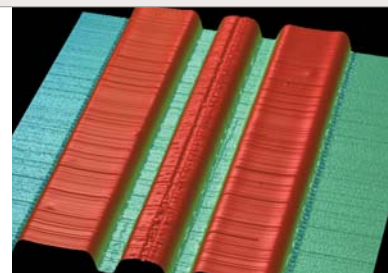
AFM image of DNA  
in biological cells



AFM image of *bdellovibrio bacteriovorus*  
and *E. coli*

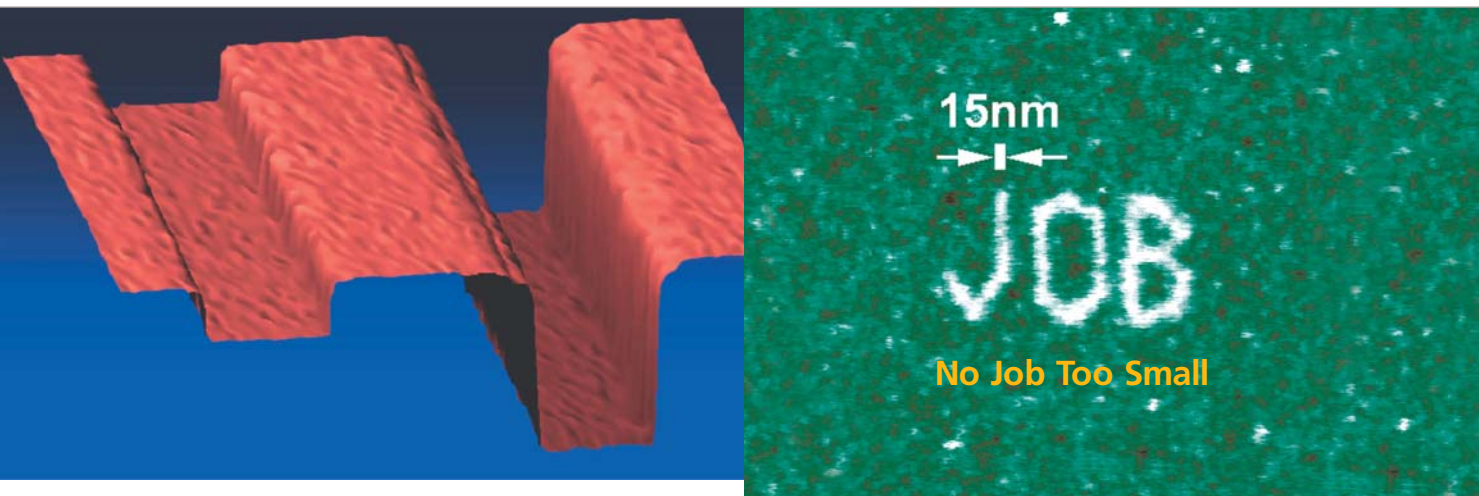


Optical Profiler image of defects  
on a micromirror



Stylus Profiler image of gold deposited  
on a ceramic substrate





Veeco's new NanoMan Nanomanipulation System. Image on right shows the word "JOB" written by NanoMan on epitaxial silicon. In advertisements, Veeco showed our research customers that "No Job is Too Small" for our NanoMan System.

In 2002, Veeco created several new metrology instruments specifically to meet the needs of scientific researchers. These included the NanoMan® and PicoForce®. NanoMan is the most advanced system commercially available for direct manipulation of nanoscale

objects, such as nanotubes and nanoparticles, and for high-definition nanolithography with a variety of "writing" techniques. Our PicoForce SPM system enables nanoscale biology and materials researchers to pull molecules and measure the force with excellent accuracy.

Veeco's strategy in scientific research and nanotechnology is two-fold: to continue to be a leading supplier of enabling tools to this field and to also pursue development projects with key nanoscience centers worldwide as they further define tomorrow's nanotechnology products.

*The U.S.'s National Science Foundation predicts that the total market for nanotech products and services will reach \$1 trillion by 2015.*



Source: National Nanoscience Institute

# CREATING NANOSCALE FEATURES

VEECO'S PROCESS EQUIPMENT OPPORTUNITIES >>>

## DATA STORAGE CONTINUES PACE OF TECHNOLOGY ADVANCES

Worldwide storage demand doubles every nine months, driven by intelligent internet storage, e-commerce, e-mail and new applications now reaching higher volume including TV set-top boxes, video-on-demand, digital cameras, auto navigation and music distribution. Hard disk drives have continued to provide the best value for mass storage dollars. The data storage industry continues to fund the development of new high density thin film head technology, increasing areal density every

year. The industry's scheduled introduction of new 80 and 120GB platters will require new process equipment and metrology.

In response to our customers' advanced technology requirements, Veeco is launching new NEXUS® ion beam etch, ion beam deposition and physical vapor deposition tools in 2003 which are aligned with our customers' next-generation hard drive roadmaps. We believe that our broad base of

technology, process support, complementary metrology solutions which help improve customer yields, and our close customer partnerships will allow us to continue to be the world's leading provider of equipment to the data storage industry. With the world's largest installed base of equipment, Veeco is uniquely positioned to help thin film magnetic head manufacturers define their next-generation processes.

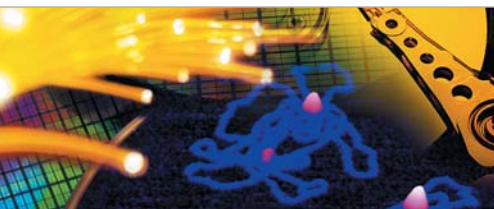
*New methods for nanofabrication will be needed to continue to build ever smaller, faster and less expensive data storage, semiconductor, telecommunications and wireless devices.*



NEXUS LDD-IBD System for EUV Lithography



NEXUS Cluster Tool for Thin Film Magnetic Heads



Veeco GEN2000 MBE System



NEXUS PVD Cluster Tool



NEXUS Cluster Tool featuring Ion Beam Deposition Module (left) and Ion Beam Etch Module (right)

### SEMICONDUCTOR PHOTOMASKS: A NEW VEECO OPPORTUNITY

In the semiconductor arena, Veeco has identified fabrication of advanced photomasks as an emerging market niche for our ion beam deposition products. As the feature sizes on semiconductor devices shrink, extreme ultraviolet (EUV) photomasks will be required

to pattern the wafers. In R&D work, it appears that ion beam deposition technology may be the best solution for controlling film purity and thickness for these advanced EUV photomasks. In 2002 Veeco sold NEXUS-LDD (low defect density) IBD systems to

leading photomask manufacturers. We also partnered with SEMATECH North, the new R&D facility located at Albany NanoTech in New York, for advanced photomask R&D efforts.

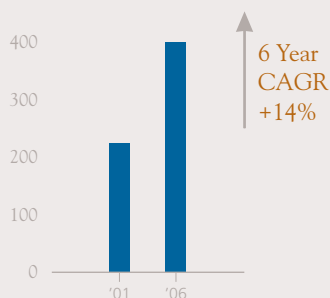
### THE FUTURE OF WIRELESS TELECOMMUNICATIONS

The telecommunications industry has seen the most severe downturn of Veeco's served markets. While we have not yet seen meaningful signs of improvement, we do believe that this industry will once again grow in the future from the convergence of optical telecommunications, wireless and silicon semiconductor devices to produce

dramatically cheaper, smaller and faster integrated components. Veeco has continued to receive orders for our market-leading molecular beam epitaxy (MBE) systems used in the creation of power amplifiers and in R&D sites worldwide by customers seeking to identify tomorrow's telecommunications and wireless devices. We currently expect to

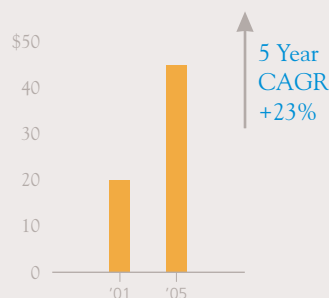
experience some growth in this market in 2003/2004 based on the wireless fidelity (WiFi) industry's transition to high frequency 5–6 GHz semiconductor compound material devices and next-generation cellular phones, requiring purchases of process equipment technologies.

**HARD DRIVE  
UNIT SHIPMENTS**  
(in millions)



Source: Gartner Dataquest

**WIRELESS CHIP  
MARKET**  
(in billions)



Source: Micrologic Research

# EXPANDING OUR HORIZONS

IN A NANOSCALE WORLD &gt;&gt;&gt;

As the world gets “smaller,” Veeco continues to put emphasis on serving our global customers—no matter where they are. In 2002, sales to international customers represented 53% of revenues and 58% of orders. Orders from both Japanese and Asia Pacific customers grew in 2002 in what was a very difficult year.

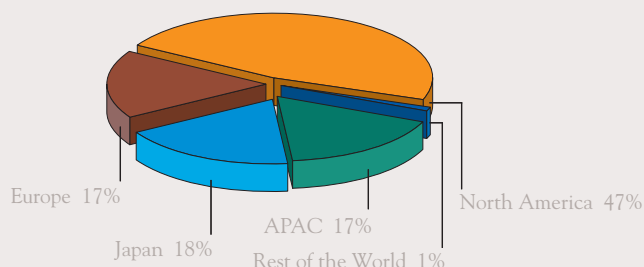
In Japan, Korea and Taiwan, Veeco continues to make further in-roads with our automated tools for semiconductor metrology. We continue to be a leading supplier of data storage equipment to customers in Southeast Asia. This region of the world has also experienced recent interest in Veeco’s telecommunications/ wireless products as well.

Veeco’s worldwide success in the R&D market was one of our most important developments. We experienced revenue growth in Europe, Japan and Asia Pacific. As we begin 2003, we are aligning our sales efforts to ensure that we maximize our global market opportunities.

China is an important new high growth market opportunity for Veeco. In November we opened our China Nanotechnology Center (CNC) facility in Beijing, China. The facility will be staffed with local scientists and engineers and equipped with Veeco’s latest AFMs and other advanced nanotechnology application modules. Veeco’s CNC is

jointly operated with the Institute of Chemistry of the Chinese Academy of Sciences (CAS). The CAS is a national institution for scientific research and promotes original scientific innovation and integration of key technologies. Professor Ma, of the Chinese Ministry of Science, stated in CMP Cientifica’s X Report that China sees the field of nanotechnology as one of the most important fields of research. In addition to the CNC in Beijing, Veeco has established sales and support offices in Shanghai and Beijing to support our existing and future customer base in the rapidly growing Chinese market.

VEECO 2002 SALES BY REGION







### VEECO'S WORLDWIDE REACH

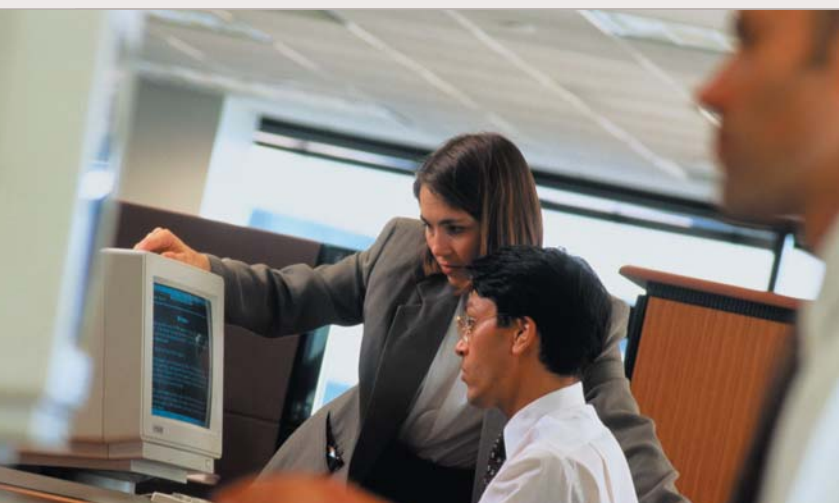
It is critical that Veeco not only sell our products worldwide, but service them as well. In 2003, we have placed additional emphasis on ensuring that we provide a world-class service organization. We have strengthened our senior management team dedicated to service and intend to grow this portion of our business.

Veeco has over 20 strategically located offices worldwide which work closely

with our customers to maximize uptime and minimize the cost of ownership of Veeco products. With 24-hour-per-day, seven-day-per-week service around the world, our customers can count on us to deliver the latest applications support and keep them running with maximum productivity. Veeco knows that customer satisfaction is the total measure of how equipment performs in the customers' applications. We support our customers

with installation and training, per-call service with guaranteed response time and strategic partnering to compress product development cycles. Our service programs are designed to ensure peak performance and top process efficiency to our customers—maximizing their investment and minimizing cost of ownership.

*The nanoscale unifies science and technology across disciplines (electronics, materials, life sciences); as a result, nanoscale research has become the greatest galvanizing force in science today.*



## FINANCIAL HIGHLIGHTS

(In thousands)

	Years ended December 31,				
	2002	2001	2000	1999	1998
<b>STATEMENT OF OPERATIONS DATA:</b>					
Net sales	\$ 298,885	\$ 449,251	\$ 376,113	\$ 312,446	\$ 263,411
EBITA	1,339	58,005	44,124	45,262	30,401

RECONCILIATION OF GAAP OPERATING (LOSS) INCOME TO  
INCOME EXCLUDING CERTAIN CHARGES BEFORE INTEREST AND INCOME TAXES

(In thousands)

	Years ended December 31,				
	2002	2001	2000	1999	1998
Operating (loss) income	\$(137,895)	\$ 20,325	\$ 7,138	\$ 39,709	\$ 21,837
Adjustments:					
Amortization expense	13,323	9,469	3,736	479	389
Asset impairment charges	99,663 <sup>(1)</sup>	3,418 <sup>(1)</sup>	3,722 <sup>(1)</sup>	—	—
Write-off of inventories	15,000	13,547	15,322	—	—
Merger and restructuring expenses	11,248 <sup>(2)</sup>	3,046 <sup>(3)</sup>	14,206 <sup>(4)</sup>	2,600 <sup>(4)</sup>	7,500 <sup>(4)</sup>
Write-off of deferred charges	—	—	—	—	675
Write-off of purchased in-process technology	—	8,200	—	2,474	—
Income excluding certain charges before interest and income taxes ("EBITA")	\$ 1,339	\$ 58,005	\$ 44,124	\$ 45,262	\$ 30,401

(1) Asset impairment charges consist of the write-down of goodwill of \$94.4 million in 2002 and \$2.5 million in 2001. In addition, asset impairment charges include a \$3.5 million write-down of buildings available for sale in 2002, as well as the write-down of other long-lived assets of \$1.8 million in 2002, \$0.9 million in 2001 and \$3.7 million in 2000.

(2) Merger and restructuring expenses in 2002 include \$5.4 million in personnel and business relocation costs, \$6.4 million of FEI merger-related expenses and \$0.3 million for a prepayment penalty on early extinguishment of debt, offset in part by \$0.8 million of income related to a settlement of a post-retirement benefit plan.

(3) Merger and restructuring expenses in 2001 include \$3.0 million related to personnel and business relocation costs.

(4) Merger and restructuring expenses relate to the mergers with CVC and Monarch in 2000, the merger with Ion Tech in 1999 and the merger with Digital Instruments in 1998.

NOTE—The above reconciliation is intended to present Veeco's operating results, excluding certain charges and related (benefit) provision for income taxes. This reconciliation is not in accordance with, or an alternative method for GAAP, and may be different from similar measures presented by other companies. Management of the Company evaluates performance of its business units based on EBITA and thus believes that the presentation of this financial measure provides useful information.

## VEECO PRODUCT AND MARKET MATRIX

(Approximate 2002 Sales—in millions)

	Total	Data Storage	Semiconductor	Telecom/Wireless	Scientific Research
Metrology	\$152	\$21	\$30	\$ 5	\$ 96
Process Equipment	\$147	75	9	39	24
Total Veeco	\$299M	\$96M	\$39M	\$44M	\$120M

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2002

OR

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

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

Commission file number 0-16244

**VEECO INSTRUMENTS INC.**

(Registrant)

**Delaware**

**11-2989601**

(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer Identification No.)

**100 Sunnyside Boulevard**

**11797**

**Woodbury, New York**

(Zip Code)

(Address of principal executive offices)

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

Website: **www.veeco.com**

Securities registered pursuant to Section 12(b) of the Act:

**None**

Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, par value \$.01 per share**

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 if disclosure of delinquent filers pursuant to Item 405 of Registration S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by references in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark if the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act) Yes ☒ No ☐

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based on the closing price of the Common Stock on June 28, 2002 as reported on The Nasdaq National Market, was approximately \$484,218,000. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded from this computation in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

At March 20, 2003, the Registrant had 29,225,051 outstanding shares of Common Stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 9, 2003 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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## SAFE HARBOR STATEMENT

This Annual Report on Form 10-K (the "Report") contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Discussions containing such forward-looking statements may be found in Items 1, 3, 7 and 7A hereof, as well as within this Report generally. In addition, when used in this Report, the words "believes," "anticipates," "expects," "estimates," "plans," "intends," and similar expressions are intended to identify forward-looking statements. All forward-looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from projected results. Factors that may cause these differences include, but are not limited to:

- the dependence on principal customers and the cyclical nature of the data storage, telecommunications/wireless, semiconductor, research and industrial industries,
- rapid technological change and risks associated with the acceptance of new products by individual customers and by the marketplace,
- fluctuations in quarterly operating results,
- risk of cancellation or rescheduling of orders,
- risks associated with evaluating and pursuing acquisition opportunities and integrating acquired businesses into our business,
- loss of key management or our inability to attract and retain sufficient numbers of managerial, engineering and other technical persons,
- the highly competitive nature of industries in which the Company operates,
- changes in foreign currency exchange rates, and
- matters set forth in this Report generally, including the risk factors set forth in "Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations".

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

### Available Information

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

### Internet Address

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



## **Item 1. Business.**

### **The Company**

Veeco Instruments Inc. (together with its consolidated subsidiaries, "Veeco", the "Company" or "we") designs, manufactures, markets and services a broad line of equipment primarily used by manufacturers in the data storage, semiconductor and telecommunications/wireless industries. These industries help create a wide range of information age products such as computer integrated circuits, personal computers, hard disk drives, network servers, fiber optic networks, digital cameras, wireless phones, TV set-top boxes and personal digital assistants. Our broad line of products featuring leading edge technology allows customers to improve time to market of next generation products. Veeco's products are also enabling advancements in the growing field of nanoscience and other areas of scientific and industrial research.

Our process equipment products precisely deposit or remove (etch) various materials in the manufacturing of advanced thin film magnetic heads (TFMHs) for the data storage industry, semiconductor deposition of mask reticles, and telecommunications/ wireless devices. Our metrology equipment is used to provide critical surface measurements on semiconductor devices and TFMHs. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality. Our metrology solutions are also key instruments used by many universities, scientific laboratories and industrial applications.

Demand for our products has been driven by the increasing miniaturization of microelectronic components; the need for manufacturers to meet reduced time-to-market schedules while ensuring the quality of those components; and, in the data storage industry, the introduction of giant magnetoresistive (GMR) and tunneling magnetoresistive (TMR) TFMHs which require additional manufacturing steps and the ability to conduct critical measurements for quality control and other purposes during the manufacturing process. The ability of Veeco's products to precisely deposit thin films, and/or etch sub-micron patterns and make critical surface measurements in these components enables manufacturers to improve yields and quality in the fabrication of advanced microelectronic devices.

Veeco serves its worldwide customers through our global sales and service organization located throughout the United States, Europe, Japan and Asia Pacific. At December 31, 2002, Veeco had 1,067 employees, with manufacturing, research and development and engineering facilities located in New York, California, Minnesota, Colorado and Arizona.

Veeco was organized as a Delaware corporation in 1989.

### **Our Strategy**

Veeco's strategy is to:

- Capitalize on the long-term growth opportunities in the data storage and telecommunications/wireless industries by expanding process equipment and metrology solutions;
- Pursue focused market opportunities in the semiconductor industry in which Veeco has specific technology leadership;
- Pursue market opportunities in scientific research and capitalize on the growing worldwide investment in nanoscience and nanotechnology through the sale of Veeco's enabling metrology instruments;
- Pursue internal growth, as well as strategic acquisitions and, where appropriate, to further expand the Company's breadth of product line;

- Leverage Veeco's technology and strategic customer relationships and assist customers' time to market for their new products;
- Utilize the Company's industry-leading global sales and service network to further strengthen customer relationships.

## **Recent Events**

In October 2002, the Company announced a plan designed to reduce its operating costs by approximately \$24.0 million in 2003. The plan included layoffs of approximately 20% of its employees, primarily in the process equipment group, and the closure of certain facilities. As a result of these actions and due to the continued weakness in the Company's served markets and the uncertainty of their recovery, Veeco recorded a \$124.0 million charge in the fourth quarter of 2002. The charge consisted of a \$15.0 million write-off of inventory (included in cost of sales) in the process equipment group for the rationalization and discontinuance of certain product lines; \$2.6 million of severance and business relocation costs as a result of the workforce reduction and consolidation or elimination of certain facilities; \$6.4 million of costs related to the proposed merger with FEI Company ("FEI") (including investment banking, legal, accounting and other expenses related to the terminated merger agreement); \$0.3 million for a prepayment penalty on the early extinguishment of debt; and \$99.7 million in asset impairment charges, primarily in the process equipment group. The asset impairment charge includes \$94.4 million of impairment to goodwill, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142. The Company concluded that the goodwill arising from the acquisition of Applied Epi, Inc. ("Applied Epi"), which took place in September 2001, was significantly impaired due to the severe and continued weakness in the telecommunications/wireless industry and the uncertainty of its recovery. In addition to the goodwill impairment, asset impairment charges also included \$3.5 million for the impairment of two buildings (CVC, Inc. ("CVC") and Ion Tech, Inc. ("Ion Tech") facilities) and \$1.8 million for the impairment of other fixed assets due primarily to the closing of these facilities.

On January 9, 2003, the Company and FEI jointly announced the mutual termination of their merger agreement that was entered into on July 11, 2002. Veeco and FEI mutually determined not to proceed with the merger due to the difficult overall market and economic conditions, and the uncertain timing of an industry recovery.

## **Industry Background**

*General Introduction:* The market for microelectronic components continues to be driven by corporate and consumer use of information age products such as networked personal computers (PCs), servers and the Internet, among others. While the Company believes that the PC and server markets are the primary driver of disk drive unit growth, disk drives are also increasingly being used for emerging applications such as television set-top boxes, video-on-demand systems, and small electronic devices such as digital cameras and personal digital assistants.

Continued demand for smaller, faster and less expensive microelectronic components, particularly in the computer industry, has led to increasing miniaturization. This increasing miniaturization is achieved through an increased number of manufacturing steps involving greater use of precise etching and deposition equipment. In addition, metrology systems are used throughout the manufacturing process in order to monitor process accuracy, product quality, repeatability and to measure critical dimensions and other physical features such as film thickness, line width, step height, sidewall angle and surface roughness, thereby improving yields. Telecommunications/wireless components, semiconductor devices, TFMHs and other electronic components often consist of many intricate patterns on circuits or film layers. Depending upon the specific design of any given integrated circuit, a

variety of film thicknesses and a number of layers and film types will be used to achieve desired performance characteristics.

*Trends in the Data Storage Industry:* In order to satisfy market demand for devices with greater storage capacity, the data storage industry developed new head designs incorporating higher areal densities which enable storage of more data. The capacity of disk drives is largely determined by the capability of the magnetic recording heads, which read and write signals onto hard disks. In November 2002, Peripheral Research forecasted that GMR head production will grow from approximately 730 million heads in 2001 to 750 million heads in 2005. In November 2002, Gartner Dataquest forecasted that the volume shipments of hard drives will increase from 200 million units in 2001 to over 250 million units by 2006. The Company believes that despite capital spending constraints within the data storage industry, substantial investment continues to be made in GMR and more advanced technology. In 2003, Veeco intends to introduce several new Process Equipment products to respond to the data storage industry's continued technology advances.

*Trends in the Semiconductor Industry:* Current semiconductor industry technology trends include smaller feature sizes (sub-0.13 micron line widths), larger substrates (i.e., the transition to 300mm wafers) and the increased use of metrology in the manufacturing process. In fact, according to VLSI the percentage of capital expenditures being devoted to metrology tools by semiconductor manufacturers is the fastest growing part of the equipment business and VLSI forecasts that these expenditures will increase from approximately \$1.8 billion in 2002 (or 10% of the \$17.3 billion wafer fab equipment market) to approximately \$4.5 billion in 2005 (or 12% of the \$37.1 billion wafer fab equipment market). Semiconductor manufacturers use metrology tools in their wafer fabrication facilities to detect process deviations as early in the manufacturing process as possible. These tools are critical for yield enhancement resulting in cost reduction in this increasingly competitive environment. Veeco has sold over 100 automated Atomic Force Microscope (AFM) systems to be used in-line by manufacturers of semiconductor chips in their fabrication facilities.

Another trend in the semiconductor industry is that research and development expenditures by semiconductor companies and photomask manufacturers are increasing to extend the capabilities of photomasks, which are used to create intricate patterns on semiconductor wafers. One example of this is the investment being made to develop extreme ultraviolet processes to be used in the manufacturing of photomasks. Veeco has created metrology and selected process equipment products to respond to these industry trends, including our Dimension X3D AFM for photomask metrology and our NEXUS Low Defect Density (LDD) ion beam deposition (IBD) system for advanced photomask deposition.

*Trends in the Research Industry:* A meaningful trend in the research industry is the growth in nanotechnology investment occurring at the scientific and university level. Nanotechnology is a field of science whose goal is to control individual atoms and molecules to potentially create computer chips and other devices that are thousands of times smaller than current technologies permit. Nanoscience and nanotechnology have received significant funding from the U.S. and other countries, and are beginning to impact many industries, including life sciences, data storage, semiconductor, telecommunications and materials sciences. According to the National Nanotechnology Institute (NNI) (1/03) worldwide nanotechnology funding has increased from approximately \$400 million in 1997 to over \$2 billion in 2002. Evolution Capital, an industry research company based in the United Kingdom, forecasted in 2002 that nanotechnology would grow to be a \$1.5 trillion industry by 2010. Veeco's metrology instruments are used by nanotechnology researchers and Veeco currently sells to nearly every major scientific or research organization engaged in the field of nanotechnology. In 2002 Veeco introduced several new AFMs and Scanning Probe microscopes (SPMs) to respond to the growing need for specialized scientific research metrology tools and intends to introduce additional AFM and SPM products in 2003.

*Trends in the Telecommunications/Wireless Industry:* Beginning in 2001 and continuing through 2002, the telecommunications industry underwent a severe downturn caused by industry overcapacity, overly aggressive manufacturing ramps by device manufacturers, and a glut of optical components. Despite this downturn, Veeco continued to broaden its equipment solutions to this industry, expanding more into the wireless/active device segment. In September 2001 Veeco purchased Applied Epi, a leading supplier of MBE technology to the wireless device industry. Applied Epi's equipment is used to manufacture wireless devices such as power amplifiers, application specific integrated circuits (ASICs) for cell phones, PDAs and base stations. According to Micrologic Research, the worldwide wireless chip equipment market is forecasted to grow from approximately \$20 billion in 2001 to over \$40 billion in 2005. The Company believes that future growth in this industry will be tied to the trend toward convergence and integration of semiconductor, telecommunications and wireless devices to produce cheaper, faster integrated components. Despite the ongoing slump in the telecommunications/wireless market in 2002, Veeco has continued to receive technology buys from worldwide customers for R&D applications.

## Veeco's Products

Veeco offers two principal product lines: process equipment and metrology. Veeco divested its leak detection business in January 2000, and its remaining industrial measurement business (NeXray) in May 2002. Historical contribution to net sales by each of these product lines is shown below for the years indicated:

	Year ended December 31,		
	2002	2001	2000
	(Dollars in millions)		
Process Equipment.....	\$146.7	\$277.3	\$216.3
% of net sales .....	49.1%	61.7%	57.5%
Metrology.....	\$152.2	\$172.0	\$159.8
% of net sales .....	50.9%	38.3%	42.5%

See Note 8 to the Consolidated Financial Statements of the Company for additional information regarding the Company's reportable segments and sales by geographic location.

Below is a matrix indicating the markets Veeco's Process Equipment and Metrology product families are primarily sold to:

PROCESS EQUIPMENT	<i>Data Storage</i>	<i>Semiconductor</i>	<i>Telecom/Wireless</i>	<i>Scientific Research/ Industrial</i>
Ion Beam Deposition .....	X	X	X	
Ion Beam Etch.....	X		X	
Physical Vapor Deposition .....	X			
Molecular Beam Epitaxy .....		X	X	X
Diamond Like Carbon .....	X			
<b>METROLOGY</b>				
Atomic Force Microscopes (automated) .....	X	X		
Research AFMs and SPMs .....				X
Stylus Profilers.....	X	X		X
Optical Interferometers .....	X	X		X



## *Process Equipment*

Veeco produces and sells several types of process equipment able to precisely deposit or etch thin film products used in the manufacture of telecommunications components such as filters and lasers, data storage components such as TFMHs and specialty semiconductors such as GaAs (gallium arsenide) devices and MRAM (magnetic random access memory). Veeco's process equipment product line includes:

*Ion Beam Deposition (IBD) Systems:* Veeco's IBD systems utilize an ion beam to deposit precise layers of thin films and may be mated to Veeco's cluster system platform to allow either parallel or sequential etch/deposition processes. Ion beam deposition systems deposit high purity thin film layers and provide maximum uniformity and repeatability.

*Ion Beam Etch (IBE) Systems:* Veeco develops and produces ion beam etch systems which etch precise, complex features for use primarily by data storage and telecommunications device manufacturers in the fabrication of discrete and integrated microelectronic devices.

*Physical Vapor Deposition (PVD) Systems:* Veeco believes that its PVD system, which deposits greater than 20 types of materials, offer manufacturers the most flexible platform for developing next-generation data storage applications. The NEXUS PVD provides multiple targets, speeding the transition from development to high-volume production.

*Molecular Beam Epitaxy (MBE) Systems:* MBE is the process of precisely depositing epitaxially aligned atomically thin crystal layers, or epilayers, of elemental materials onto a substrate in an ultra-high vacuum environment. For many compound semiconductors, MBE is the critical first step of the fabrication process, ultimately determining device functionality and performance. The performance characteristics of compound semiconductors are dependent on the crystalline structure, chemical composition, number, and precise thickness of the epilayers. As a result, MBE is considered to be one of the highest value added steps in the production of compound semiconductors. Veeco provides a broad array of MBE components and systems.

*Diamond-Like Carbon (DLC) Deposition Systems:* Veeco's DLC deposition system deposits protective coatings on advanced TFMHs. The system consists of a single cassette vacuum loadlock and a high vacuum processing chamber with two ion beam sources.

## *Metrology*

Veeco's surface metrology product line includes atomic force/scanning probe microscopes, optical metrology tools and stylus profilers. These products offer a broad range of solutions to customers in the data storage and semiconductor industries, as well as versatile tools for use by research and development centers and universities.

### *Atomic Force/Scanning Probe Microscopes (AFM/SPMs)*

Veeco produces a broad range of AFM/SPM products designed for data storage, semiconductor, and research and other industrial applications. Veeco's Series Vx™ Atomic Force Profiler delivers a combination of atomic force resolution with long-scan capability, which is ideal for monitoring specific thin film process applications in semiconductor manufacturing and specific growth applications in semiconductor metrology, such as Chemical Mechanical Planarization (CMP). The Vx-330 has been sold into all major semiconductor fabs and is an award-winning tool (Semiconductor International Magazine 2001), and in 2002 Veeco introduced a next-generation 3D AFM for lithography applications. Veeco's NanoScope products are widely used by leading nanotechnology research centers worldwide. In 2002, Veeco introduced several new products, including the NanoMan and PicoForce systems, designed specifically for the nanoscience market.

The atomic force microscope "feels" the sample surface directly using a probe consisting of a very sharp tip mounted on a microscopic spring arm (a cantilever). The interaction of the probe with the surface is detected by measuring deflections of the cantilever with an optical beam system. AFMs permit resolution at the molecular level. Veeco developed some of the first AFMs used in commercial applications and most of the SPMs manufactured and sold by Veeco are AFMs. SPMs, and particularly AFMs, can directly measure both lateral and vertical shapes with nanometer resolution and with direct 3D capability. In contrast, light-based metrology instruments, including confocal microscopes, have limited lateral resolution for measurements of less than half the wavelength of light, or less than about 250 nanometers. In addition to topography, AFMs can also directly measure magnetic field (such as magnetic bits on a hard disk); electric field; hardness (such as thin film integrity); electric charge density (such as dopant concentrations in semiconductors); temperature (such as temperature distribution in disk drive recording head elements); and various chemical properties (such as the difference in binding preference among biological molecules). AFMs make these measurements on almost any surface; in air, vacuum or under fluids; and with minimal sample preparation.

### *Stylus Profilers*

Stylus profilers are used to produce cross-sectional representations and/or quantitative measurements, which are displayed on a video monitor. Veeco's stylus profiler systems utilize a precision translation stage which creates relative motion between the sample and a diamond tipped stylus. As the sample moves under the stylus, surface variations cause vertical translation of the stylus, which is tracked and measured. Stylus profilers are widely used for height, width, pitch and roughness measurements of features on semiconductor devices, magnetic and optical storage media (e.g., hard drives), flat panel displays and hybrid circuits. Veeco believes that its stylus profiler products are recognized for their accuracy, repeatability, ease of use and technology features, and are designed to meet a range of industry specifications and customer requirements.

### *Optical Metrology (Interferometry) Products*

Substantially all of Veeco's optical metrology instruments are designed to make non-contact surface measurements using interferometry technology. This process involves the use of either white light or laser sources to measure surface roughness and shape by creating interference patterns from the optical path difference between the test surface and a reference surface. Using a combination of phase shifting interferometry (PSI) and vertical scanning interferometry (VSI), these instruments are designed to rapidly and precisely measure and characterize a range of surface sizes and shapes. Veeco's major optical products include the *NT* family and *SP3000* and the *HD-Series* optical profilers. The *NT* family product line measures surface roughness, heights and shapes. The *HD-Series* instruments are a line of microstructure measurement equipment used by manufacturers of mass memory components including manufacturers of TFMHs, disks, drives and suspensions. *HD-Series* instruments are used for research and development, production control, process improvement, incoming parts inspection, final parts inspection and field failure analysis.

### **Service and Sales**

Veeco recognizes that its customer service organization is a significant factor in the Company's success. The Company provides service and support on a warranty, service contract or an individual service-call basis. Veeco also offers enhanced warranty coverage and services, including preventative maintenance plans, on-call and on-site service plans and other comprehensive service arrangements, product and application training, consultation services and a 24-hour hotline service for certain products. The Company believes that offering 24 hour, 7 day per week worldwide support creates stronger relationships with customers and provides a significant competitive advantage. Approximately

5.9% of Veeco's net sales for the year ended December 31, 2002 constituted revenues from service and support.

Veeco sells its products worldwide through various strategically located sales and service facilities located in the U.S., Europe, Asia Pacific, and Japan. As of December 31, 2002, Veeco employed 139 sales and marketing representatives, 150 field service representatives and 98 product support representatives. During the years ended December 31, 2002 and 2001, Veeco recorded approximately \$5.6 million and \$30.6 million in revenues from independent representatives, respectively, which represented approximately 2% and 7% of total consolidated revenues, respectively. During 2002 and 2001, revenues related to the sale of process equipment's units approximated \$1.7 million and \$18.4 million, respectively, and revenues related to the sale of metrology's units approximated \$3.9 million and \$12.2 million, respectively.

## **Customers**

Veeco sells its products to many of the world's major data storage, semiconductor and telecommunications/wireless component manufacturers, and to customers in other industries, research centers and universities. For the year ended December 31, 2002, 40% of Veeco's sales were to scientific research and industrial customers, 32% to data storage customers, 15% to telecommunications/wireless, and 13% to semiconductor customers. We rely on certain principal customers for a significant portion of our sales including Seagate Technology, Inc., which has been one of our largest customers during the last three years. Sales to Seagate accounted for 13%, 7%, and 18% of Veeco's total net sales in the years ended December 31, 2002, 2001, and 2000, respectively. If any principal customer discontinues its relationship with us or suffers economic setbacks, our business, prospects, financial condition and operating results could be materially and adversely affected.

## **Research and Development**

Veeco believes that continued and timely development of new products and enhancements to existing products are necessary to maintain its competitive position. Veeco works collaboratively with its customers to help ensure its technology and product roadmaps are aligned with customer requirements. Veeco's research and development programs are organized by product line; new products have been introduced into each of Veeco's product lines in each of the past three years.

Veeco's research and development expenses were approximately \$53.9 million, \$59.7 million and \$51.2 million, or approximately 18.0%, 13.3% and 13.6% of net sales, for the years ended December 31, 2002, 2001 and 2000, respectively. These expenses consisted primarily of salaries, project material and other product development and enhancement costs.

## **Manufacturing**

The Company's principal manufacturing activities, which consist principally of design, assembly, integration and test operations, are organized by product and take place at our facilities in Plainview, New York, Santa Barbara, California, Sunnyvale, California, Tucson, Arizona, Ft. Collins, Colorado, and St. Paul, Minnesota.

The Company's manufacturing and research and development functions are organized by product families. The Company believes that this organizational structure allows each product family manager to more closely monitor the products for which he is responsible, resulting in more efficient sales, marketing, manufacturing and research and development. The Company seeks to emphasize customer responsiveness, customer service, high quality products and a more interactive management style. By implementing these management philosophies, the Company believes that it has increased its competitiveness and positioned itself for future growth.

Certain of the components and sub-assemblies included in the Company's products are obtained from a single source or a limited group of suppliers. Although the Company does not believe it is dependent upon any of these suppliers as a sole source or limited source for any critical components, the inability of the Company to develop alternative sources, if required, an inability to meet a demand, a prolonged interruption in supply or a significant increase in the price of one or more components could adversely affect the Company's operating results.

### **Backlog**

Veeco's backlog decreased from \$122.0 million at December 31, 2001 to \$89.1 million at December 31, 2002. Backlog adjustments for 2002 included order cancellations of \$20.9 million. The Company's backlog generally consists of product orders for which a purchase order has been received and which are scheduled for shipment within twelve months. Veeco schedules production of its systems based on order backlog and customer commitments. Because certain of the Company's orders require products to be shipped in the same quarter in which the order was received, and due to possible changes in delivery schedules, cancellations of orders and delays in shipment, the Company does not believe that the level of backlog at any point in time is an accurate indicator of the Company's future performance. Due to the current weak business environment, the Company may continue to experience cancellation and/or rescheduling of orders.

### **Competition**

In each of the markets that it serves, Veeco faces substantial competition from established competitors, some of which have greater financial, engineering, manufacturing and marketing resources than Veeco. In addition, many of Veeco's products face competition from alternative technologies, some of which are more established than those used in Veeco products. Significant factors for customer selection of metrology and process equipment tools include system performance, accuracy, repeatability, ease of use, reliability, cost of ownership, and technical service and support. Veeco believes it competes favorably on the basis of these factors in each market Veeco serves. None of Veeco's competitors competes with Veeco across all of Veeco's product lines.

Veeco competes with metrology product manufacturers such as KLA-Tencor, Seiko, Hitachi, Zygo Corporation and a variety of small manufacturers. Veeco competes with process equipment manufacturers such as Anelva, Unaxis, Hitachi, Nordiko, Riber, and Oxford Instruments.

### **Intellectual Property**

Veeco's success depends in part on its proprietary technology. Although Veeco attempts to protect its intellectual property rights through patents, copyrights, trade secrets and other measures, there can be no assurance that Veeco will be able to protect its technology adequately or that competitors will not be able to develop similar technology independently. Veeco believes that there is no single patent which is material to its operations.

Veeco has patents and exclusive and non-exclusive licenses to patents owned by others covering certain of its products, which Veeco believes provide it with a competitive advantage. Veeco has a policy of seeking patents on inventions concerning new products and improvements as part of its ongoing research, development and manufacturing activities. Veeco believes that there are no patents which are critical to its operations, and that the success of its business depends primarily on the technical expertise, innovation, and experience of its employees.

Veeco also relies upon trade secret protection for its confidential and propriety information. There can be no assurance that others will not independently develop substantially equivalent proprietary information and techniques or otherwise gain access to Veeco's trade secrets or that Veeco can meaningfully protect its trade secrets. In addition, the Company cannot be certain that it will not be

sued by third parties alleging that the Company has infringed their patents or other intellectual property rights. If any third party sues Veeco, the Company's business, results of operations or financial condition could be materially adversely affected.

Following the merger with Digital Instruments, in September 1998, Veeco and IBM entered into a cross license agreement providing for the grant by Veeco to IBM and the grant by IBM to Veeco of the non-exclusive right to make, use and sell AFM/SPM products utilizing technology covered by certain patents held by Veeco and IBM, respectively. The agreement is scheduled to expire in August 2003, although, the Company expects to negotiate an extension of this agreement with IBM prior to that time.

## Employees

At December 31, 2002, the Company had 1,067 employees, of which there were 259 in manufacturing and testing, 139 in sales and marketing, 150 in service, 98 in product support, 260 in engineering, research and development, and 161 in information technology, general administration and finance. The success of the Company's future operations depends in large part on the Company's ability to recruit and retain engineers, technicians and other highly-skilled professionals who are in considerable demand. There can be no assurance that the Company will be successful in retaining or recruiting key personnel. The Company believes that its relations with its employees are good.

Other than Edward H. Braun and John F. Rein, Jr., the Company's Chairman and Chief Executive Officer and the Company's Executive Vice President and Chief Financial Officer, respectively, the Company's executive officers are not, in general, subject to employment agreements or non-competition agreements with the Company.

## Item 2. Properties.

The Company's headquarters office and its principal manufacturing, research and development and sales and service facilities, as well as the approximate size and the segments which utilize such facilities, are:

<b>Owned Facilities Location</b>	<b>Approximate Size (sq. ft.)</b>	<b>Mortgaged</b>	<b>Use</b>
Fort Collins, CO (1) .....	47,000	No	Process Equipment
Rochester, NY (1) .....	90,000	No	Process Equipment
Plainview, NY .....	80,000	No	Process Equipment
Santa Barbara, CA .....	100,000	Yes	Metrology
St. Paul, MN .....	125,000	Yes	Process Equipment
Tucson, AZ (2) .....	110,000	No	Metrology

<b>Leased Facilities Location</b>	<b>Approximate Size (sq. ft.)</b>	<b>Lease Expires</b>	<b>Use</b>
Fremont, CA .....	14,000	2004	Process Equipment
San Diego, CA .....	11,000	2005	Metrology
Sunnyvale, CA .....	26,000	2003	Metrology
Woodbury, NY .....	32,000	2011	Headquarters

- (1) The land and building are classified as assets held for sale at December 31, 2002. See Note 7 to the Consolidated Financial Statements of the Company for further discussion.
- (2) The Company's optical metrology business utilizes approximately 75,000 square feet of this facility. The balance is available for expansion.

The Santa Barbara and St. Paul facilities are subject to mortgages, which at December 31, 2002, had outstanding balances of, \$6.3 million and \$4.2 million, respectively. The Company also leases small

offices in Chadds Ford, Pennsylvania and Edina, Minnesota, for sales and service. The Company's foreign subsidiaries lease space for use as sales and service centers in England, France, Germany, Ireland, Japan, Korea, Malaysia, Singapore, China and Taiwan. The Company believes its facilities are adequate to meet its current needs.

### **Item 3. Legal Proceedings.**

#### **Environmental**

The Company may, under certain circumstances, be obligated to pay up to \$250,000 in connection with the implementation of a comprehensive plan of environmental remediation at its Plainview, New York facility. The Company has been indemnified for any liabilities it may incur in excess of \$250,000 with respect to any such remediation. No comprehensive plan has been required to date. Even without consideration of such indemnification, the Company does not believe that any material loss or expense is probable in connection with any remediation plan that may be proposed.

The Company is aware that petroleum hydrocarbon contamination has been detected in the soil at the site of a facility leased by the Company in Santa Barbara, California. The Company has been indemnified for any liabilities it may incur which arise from environmental contamination at the site. Even without consideration of such indemnification, the Company does not believe that any material loss or expense is probable in connection with any such liabilities.

The former owner of the land and building in which the Company's Santa Barbara, California metrology operations are located has disclosed that there are hazardous substances present in the ground under the building. Management believes that the comprehensive indemnification clause that is part of the purchase contract provides adequate protection against any environmental issues that may arise.

#### **Non-Environmental**

On August 15, 2001, a lawsuit was commenced in the Superior Court of California, County of Santa Clara, by Toyo Corporation ("Toyo") against ThermoMicroscopes Corp. ("TM"), the Company, Thermo Spectra Corporation and Thermo Electron Corporation. The lawsuit related to a Distribution Agreement between Toyo and TM under which Toyo had been appointed the exclusive distributor for the sale of TM products in Japan. In the lawsuit, Toyo claimed, among other things, that TM breached the Distribution Agreement and that the Company, Thermo Spectra and Thermo Electron intentionally interfered with Toyo's contractual relationship with TM, in each case, by virtue of the sale of the outstanding shares of TM to the Company, which Toyo alleges constituted an assignment of the Distribution Agreement without Toyo's consent. In February 2003, the parties agreed in principle to settle the lawsuit, with the Company and Thermo Electron each making an equal payment to Toyo. The Company adequately provided for this liability in purchase accounting for the TM acquisition and thus the settlement of this lawsuit will not have an impact on the consolidated results of operations, nor will it have a material impact on the Company's consolidated balance sheet or its cash position. See Note 7 to the Consolidated Financial Statements of the Company for further discussion.

The Company is involved in various other legal proceedings arising in the normal course of its business. Based upon the advice of counsel, the Company does not believe that the ultimate resolution of these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

### **Item 4. Submission of Matters to a Vote of Security Holders.**

None.



## PART II

### Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The Company's Common Stock is quoted on The NASDAQ National Market under the symbol "VECO". The 2002 and 2001 high and low closing prices are as follows:

	2002		2001	
	High	Low	High	Low
First Quarter .....	\$39.12	\$25.01	\$64.13	\$36.13
Second Quarter.....	37.45	21.68	55.76	34.06
Third Quarter .....	24.26	11.17	41.21	21.10
Fourth Quarter.....	14.40	9.17	37.92	24.42

On March 20, 2003, the closing price for the Company's Common Stock on the NASDAQ National Market was \$17.34. As of March 20, 2003, the Company had approximately 211 shareholders of record.

In December 2001 and January 2002, the Company issued \$220.0 million of 4.125% convertible subordinated notes, which are due in 2008, in a private placement. The notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of common stock at a conversion price of \$38.51 per share. The Company pays interest on these notes on June 21 and December 21 of each year. The notes will mature on December 21, 2008. The total \$220.0 million of convertible subordinated notes are convertible into approximately 5,712,800 shares of Veeco Common Stock, which number is subject to adjustment in the event of stock splits and certain other transactions.

The Company has not paid dividends on the Common Stock. The Company intends to retain future earnings, if any, for the development of its business and, therefore, does not anticipate that the Board of Directors will declare or pay any dividends on the Common Stock in the foreseeable future. In addition, the provisions of the Company's current credit facility limits the Company's ability to pay dividends. The Board of Directors will determine future dividend policy based on the Company's consolidated results of operations, financial condition, capital requirements and other circumstances.

The following table gives information about our Common Stock that may be issued under our equity compensation plans as of December 31, 2002. See Note 5 to the Consolidated Financial Statements included herein for information regarding the material features of these plans.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders.....	4,895,663(A)	\$31.591	909,435
Equity compensation plans not approved by security holders.....	916,995(B)	\$26.738	139,686
Total .....	5,812,658		1,049,121

(A) Includes 82,867 stock options assumed in connection with the acquisition of CVC on May 10, 2000, which merger was approved by stockholders.

(B) Includes 387,514 stock options assumed in connection with the acquisition of Applied Epi, Inc. on September 17, 2001.

## Item 6. Selected Consolidated Financial Data.

The financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with the Company's Consolidated Financial Statements and notes thereto included elsewhere in this Form 10-K.

	Years ended December 31,				
	2002	2001	2000	1999	1998
	(In thousands, except per share data)				
<b>Statement of Operations Data(1),(2),(3):</b>					
Net sales.....	\$298,885	\$449,251	\$376,113	\$312,446	\$263,411
Cost of sales.....	183,042(4)	260,148(5)	219,578(6)	164,783	145,286
Gross profit.....	115,843	189,103	156,535	147,663	118,125
Costs and expenses.....	142,827	154,114	131,469	102,880	88,113
Merger and restructuring expenses.....	11,248(4)	3,046(5)	14,206(6)	2,600(7)	7,500(7)
Write-off of purchased in-process technology.....	—	8,200(5)	—	2,474(8)	—
Write-off of deferred charges.....	—	—	—	—	675
Asset impairment charges.....	99,663(4)	3,418(5)	3,722(6)	—	—
Operating (loss) income.....	(137,895)	20,325	7,138	39,709	21,837
Interest expense (income), net.....	6,002	(577)	(1,307)	(695)	2,185
(Loss) income from continuing operations before income taxes.....	(143,897)	20,902	8,445	40,404	19,652
Income tax (benefit) provision.....	(20,513)	6,020	5,780	15,302	6,012
(Loss) income from continuing operations.....	(123,384)	14,882	2,665	25,102	13,640
Discontinued operations:					
Loss from operations, net of taxes.....	—	(2,450)	(2,163)	(1,387)	(3)
Loss on disposal, net of taxes.....	(346)	(2,123)	—	(1,734)	—
Loss from discontinued operations, net of taxes.....	(346)	(4,573)	(2,163)	(3,121)	(3)
Cumulative effect of change in accounting principle, net of taxes (9).....	—	—	(18,382)	—	—
Net (loss) income.....	<u>\$ (123,730)</u>	<u>\$10,309</u>	<u>\$ (17,880)</u>	<u>\$21,981(10)</u>	<u>\$13,637(10)</u>
<b>(Loss) income per common share:</b>					
(Loss) income per common share from continuing operations.....	\$(4.24)	\$0.57	\$0.11	\$1.22	\$0.73
Loss from discontinued operations.....	(0.01)	(0.17)	(0.09)	(0.15)	(0.00)
Cumulative effect of change in accounting principle.....	—	—	(0.77)	—	—
Net (loss) income per common share.....	<u>\$(4.25)</u>	<u>\$0.40</u>	<u>\$(0.75)</u>	<u>\$1.07(10)</u>	<u>\$0.73(10)</u>
<b>Diluted (loss) income per common share from continuing operations.....</b>					
.....	\$(4.24)	\$0.56	\$0.11	\$1.17	\$0.70
Loss from discontinued operations.....	(0.01)	(0.17)	(0.09)	(0.15)	(0.00)
Cumulative effect of change in accounting principle.....	—	—	(0.73)	—	—
Diluted net (loss) income per common share.....	<u>\$(4.25)</u>	<u>\$0.39</u>	<u>\$(0.71)</u>	<u>\$1.02(10)</u>	<u>\$0.70(10)</u>
Weighted average shares outstanding.....	29,096	25,937	23,805	20,604	18,775
Diluted weighted average shares outstanding.....	29,096	26,355	25,128	21,461	19,436

	Years ended December 31,				
	2002	2001	2000	1999	1998
	(In thousands, except per share data)				
<b>Balance Sheet Data(1),(2),(3):</b>					
Cash, cash equivalents and short-term investments .....	\$214,295	\$203,154	\$90,314	\$80,739	\$23,599
Goodwill.....	30,658	125,585	9,481	6,500	4,187
Working capital.....	351,106	358,023	220,463	171,977	97,977
Total assets.....	606,818	755,519	422,525	338,744	213,177
Long-term debt (including current installments).....	230,585	219,063	16,062	38,704	35,865
Shareholders' equity .....	307,573	423,971	282,908	223,944	127,719

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- (1) During December 2001, the Company classified its industrial measurement operating segment as a discontinued operation. The Statement of Operations and Balance Sheet data for all years presented have been restated accordingly. See Note 7 to the Consolidated Financial Statements.
- (2) Prior to the merger with Veeco on May 5, 2000, CVC's fiscal year end was September 30. Therefore the Statement of Operations data for 1999 and 1998 was derived from CVC's financial statements for the respective twelve months ended September 30. In addition, the Balance Sheet data for 1999 and 1998 was derived from CVC's balance sheet as of September 30.
- (3) Prior to the merger with Veeco on November 4, 1999, Ion Tech's fiscal year end was June 30. In connection with the merger, the financial results of Ion Tech were recast for 1998 to conform to Veeco's December 31 year-end.
- (4) Veeco incurred merger, restructuring and asset impairment charges of \$126.0 million during the year ended December 31, 2002. Of these charges, \$99.7 million related to asset impairment charges (\$94.4 million for goodwill impairment, \$3.5 million for impairment of land and buildings and \$1.8 million for impairment of other fixed assets), \$15.0 million was associated with the write-off of inventory (included in cost of sales), \$6.4 million was due to the write-off of costs associated with the termination of the FEI merger agreement, \$5.4 million was for severance and business relocation costs and \$0.3 related to a prepayment penalty for the early extinguishment of debt. The merger and restructuring charges are offset in part by approximately \$0.8 million of income related to the settlement of a post-retirement benefit plan of the process equipment segment. See Note 7 to the Consolidated Financial Statements.
- (5) Veeco incurred merger and restructuring charges of \$28.2 million during the year ended December 31, 2001. Of these charges, \$13.6 million related to the write-off of inventory (included in cost of sales), \$8.2 million related to the write-off of purchased in-process technology (\$7.0 million resulting from the acquisition of Applied Epi and \$1.2 million from the acquisition of TM), \$3.0 million represented restructuring costs and \$3.4 million was for the write-down of long-lived assets. See Note 7 to the Consolidated Financial Statements.
- (6) Veeco incurred merger and reorganization charges of \$33.3 million during the year ended December 31, 2000, of which \$33.0 million related to the merger with CVC. Of these charges, \$15.3 million related to a write-off of inventory (included in cost of sales), \$14.0 million represented merger and reorganization costs (of which \$9.2 million related to investment banking, legal and other transaction costs and \$4.8 million pertained to duplicate facility and personnel costs) and \$3.7 million was for the write-off of long-lived assets. See Note 2 to the Consolidated Financial Statements.

- (7) During 1999, Veeco recorded charges of \$2.6 million related to merger expenses in connection with the merger with Ion Tech. In 1998, Veeco recorded merger and reorganization expenses of \$7.5 million related to the merger with Digital Instruments.
- (8) During 1999, Veeco recorded a \$2.5 million charge related to the write-off of purchased in-process technology (\$1.3 million related to the acquisition of OptiMag Inc. ("OptiMag") and \$1.2 million related to CVC's acquisition of Commonwealth Scientific Corporation).
- (9) Effective January 1, 2000, Veeco changed its method of accounting for revenue recognition in accordance with SAB 101.
- (10) Veeco adopted SAB 101 effective January 1, 2000. Had this adoption taken place on January 1, 1998, net income, net income per common share and diluted net income per common share on a pro forma basis would have been as follows:

	1999	1998
Net income .....	\$13,695	\$12,682
Net income per common share .....	\$0.66	\$0.68
Diluted net income per common share .....	\$0.64	\$0.65

## Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations.

### Overview

Veeco designs, manufactures, markets and services a broad line of equipment primarily used by manufacturers in the data storage, semiconductor and telecommunications/wireless industries. Veeco's instruments are also enabling advancements in the growing field of nanoscience and other areas of scientific and industrial research. Our process equipment products precisely deposit or remove (etch) various materials in the manufacturing of advanced TFMHs for the data storage industry, semiconductor deposition of mask reticles, and telecommunications/wireless devices. Our metrology equipment is used to provide critical surface measurements on semiconductor devices and TFMHs. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality. Our metrology solutions are also key instruments used by many universities, scientific laboratories and industrial applications.

During the past several years, Veeco has strengthened both the process equipment product line and the metrology product line through strategic acquisitions.

## Results of Operations

The following table sets forth, for the periods indicated, the relationship (in percentages) of selected items of Veeco's consolidated Statements of Operations to its total net sales:

	Year ended December 31,		
	2002	2001	2000
Net sales .....	100.0%	100.0%	100.0%
Cost of sales .....	61.2	57.9	58.4
Gross profit .....	38.8	42.1	41.6
Operating expenses:			
Selling, general and administrative expense .....	25.4	18.3	20.1
Research and development expense .....	18.0	13.3	13.6
Amortization expense .....	4.5	2.1	1.0
Other (income) expense, net .....	(0.1)	0.6	0.2
Merger and restructuring expenses .....	3.8	0.7	3.8
Write-off of purchased in-process technology .....	—	1.8	—
Asset impairment charges .....	33.3	0.8	1.0
Total operating expenses .....	84.9	37.6	39.7
Operating (loss) income .....	(46.1)	4.5	1.9
Interest expense .....	3.5	0.5	0.7
Interest income .....	(1.5)	(0.7)	(1.0)
(Loss) income from continuing operations before income taxes .....	(48.1)	4.7	2.2
Income tax (benefit) provision .....	(6.8)	1.4	1.5
(Loss) income from continuing operations .....	(41.3)	3.3	0.7
Loss from discontinued operations, net of taxes .....	(0.1)	(1.0)	(0.6)
Cumulative effect of change in accounting principle, net of taxes .....	—	—	(4.9)
Net (loss) income .....	<u>(41.4%)</u>	<u>2.3%</u>	<u>(4.8%)</u>

## Years Ended December 31, 2002 and 2001

Net sales were \$298.9 million for the year ended December 31, 2002, representing a decrease of \$150.4 million, or 33%, when compared to the year ended December 31, 2001. Sales in the U.S., Europe, Japan and Asia Pacific, accounted for 47%, 17%, 18% and 18%, respectively, of the Company's net sales for the year ended December 31, 2002. Sales in the U.S. decreased by approximately \$103.3 million from 2001. The decrease in U.S. sales is primarily attributable to an \$87.9 million decrease in process equipment sales, due primarily to a decline of \$53.8 million in sales of ion beam deposition products to the optical telecommunications industry, as well as a decrease of \$45.0 million in sales of etch and deposition products to the data storage industry. The decrease in U.S. process equipment sales is offset slightly by a \$10.9 million increase in the sale of molecular beam epitaxy (MBE) equipment to the telecommunications and research industries by the Company's Applied Epi subsidiary, which was acquired in September 2001, in a transaction accounted for as a purchase. U.S. metrology sales decreased by \$15.4 million from 2001, primarily as a result of a \$5.5 million decline in the sale of AFMs to semiconductor customers, as well as a \$9.3 million decrease in the sale of SLC products to data storage customers. European sales decreased by \$29.0 million when compared to the prior year, which is primarily attributable to a \$28.2 million drop in process equipment sales consisting principally of a decrease in sales of etch and deposition products to data storage customers. Metrology sales in Europe decreased by 4%, or \$1.3 million. Although European sales of AFMs decreased by \$2.5 million, this was offset in part by a \$1.2 million increase in the sale of optical

interferometry products to the semiconductor and optical telecommunications industries. Sales in Japan decreased by \$36.6 million from 2001. The decrease is principally a result of a \$30.9 million decline in process equipment sales. Sales to data storage customers dropped by \$19.2 million, while sales to the telecommunications industry declined by \$13.5 million. This was partially offset by a \$1.8 million increase in MBE sales to telecommunications and research customers. Metrology sales in Japan decreased by \$5.7 million, primarily as a result of a \$4.5 million decrease in AFM sales, as well as a \$1.2 million decrease in optical metrology sales, particularly to semiconductor and telecommunications customers. Sales in Asia Pacific increased by \$15.7 million over the comparable 2001 period, principally as a result of a \$17.0 million increase in the sale of etch and deposition products to data storage customers, offset in part by a \$3.8 million decrease in sales of ion beam deposition products to telecommunications customers. Metrology sales in Asia Pacific also increased by \$2.0 million over 2001, due to a \$4.6 million increase in sales of optical metrology products to data storage customers, as well as a \$2.6 million increase in sales of optical interferometry products to semiconductor and telecommunications customers, offset by a \$5.2 million decrease in sales of AFMs, principally to the semiconductor industry. The Company believes that there will continue to be quarter-to-quarter variations in the geographic concentration of sales.

Process equipment sales in 2002 were severely affected by the downturn in the data storage and telecommunications industries, causing a decrease of \$130.5 million from prior year sales of \$277.3 million. This was due to a \$72.1 million drop in etch and deposition product sales, principally to the data storage market, as well as a \$71.2 million decrease in optical filter deposition sales to the telecommunications industry. MBE sales, primarily to research and wireless telecommunications customers were \$30.5 million during the year ended December 31, 2002, compared to \$17.8 million in 2001. Metrology sales were also affected, primarily by the downturn in the semiconductor industry causing a decrease of \$19.8 million from \$172.0 million in the year ended December 31, 2001. This decrease is attributable to a \$17.2 million decrease in the sale of AFMs, primarily to the semiconductor and research/industrial industries, as well as a \$4.5 million decrease in optical interferometry sales, predominantly to the data storage and semiconductor industries. The decrease in metrology sales was partially offset by a \$1.9 million increase in the sale of optical metrology products.

Veeco received \$289.1 million of orders for the year ended December 31, 2002, representing a 9% decrease from \$318.9 million of orders in the comparable 2001 period. Process equipment orders decreased by \$38.9 million to \$135.0 million, primarily due to the continued downturn in the data storage and telecommunications industries. Orders for etch and deposition equipment, sold primarily to the data storage industry, decreased \$34.1 million, from the prior year, while orders for optical filter deposition equipment decreased \$27.0 million from the comparable 2001 period. The decrease in process equipment orders is offset in part by a \$22.2 million increase in MBE orders, primarily to telecommunications and research customers. Metrology orders increased by \$9.1 million to \$154.1 million, reflecting a 6% increase in orders for AFMs as well as a 5% increase in orders for optical metrology products. The book-to-bill ratio for the year ended December 31, 2002, which is calculated by dividing orders received in a given time period by revenue recognized in that same time period, was 0.97 to 1.

For the year ended December 31, 2002, the Company experienced order cancellations of \$20.9 million, the majority of which related to the data storage and optical telecommunications market. The Company also experienced rescheduling of order delivery dates by customers. Due to the weak business environment, the Company may continue to experience cancellation and/or rescheduling of orders.

During the years ended December 31, 2002 and 2001, the Company incurred merger and restructuring charges of \$126.0 million and \$28.2 million, respectively, of which \$15.0 million, or 5.0% of net sales, and \$13.6 million, or 3.0% of net sales, respectively, related to the write off of inventory, which is included in cost of sales. Gross profit for the year ended December 31, 2002, decreased to



38.8% from 42.1% in 2001. Excluding the merger and restructuring charges in both years, gross profit as a percentage of net sales decreased to 43.8% from 45.1%. The decreased gross margin is primarily due to the significant volume decrease from the prior year, particularly in process equipment sales.

Selling, general and administrative expenses of \$75.9 million, or 25.4% of sales, for the year ended December 31, 2002 represented a decrease of \$6.5 million, or 8%, from \$82.4 million in 2001. The expense is higher as a percentage of sales due to the 33% decrease in sales volume from 2001. The dollar decrease is principally attributable to a decrease in selling and commission expense resulting from the decreased sales volume, as well as cost reduction efforts implemented by the Company. The decrease is partially offset by a \$6.1 million increase in selling, general and administrative expenses of the Applied Epi and TM subsidiaries, both of which were acquired by the Company during the third quarter of 2001.

Research and development expense for the year ended December 31, 2002, of \$53.9 million represented a decrease of \$5.8 million, or 10%, from the comparable period of 2001, due primarily to cost reduction efforts implemented by the Company in all product areas, except for AFM. This decrease is offset in part by the impact of \$4.3 million in research and development expense of Applied Epi and TM.

Amortization expense for the year ended December 31, 2002, of \$13.3 million represented an increase of \$3.9 million from the comparable period of 2001, due primarily to the intangible assets acquired during the third quarter of 2001 in connection with the Applied Epi and TM acquisitions. This amount is offset in part by \$1.5 million of reduced amortization expense related to the accounting requirement to no longer amortize goodwill, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, which became effective on January 1, 2002. Under SFAS No. 142, goodwill is to be reviewed annually for impairment. As previously mentioned, the Company recorded a goodwill impairment charge of \$94.4 million in the fourth quarter of 2002.

In conjunction with the plan announced by the Company in October 2002 to reduce operating costs by \$24.0 million in 2003, as well as the continued weakness in the Company's served markets and the uncertainty of their recovery, the Company recorded merger and restructuring charges of approximately \$124.0 million during the fourth quarter of 2002. The \$24.0 million in future cost savings is expected to affect each of the four quarters of 2003. In addition, it is anticipated that of the \$24.0 million in cost savings, approximately \$8.0 million is to reduce cost of sales, and approximately \$16.0 million will reduce operating expenses, including selling, general and administrative expenses. Of the \$124.0 million charge, approximately \$4.2 million will require future cash outlays. The \$124.0 million charge consisted of a \$15.0 inventory write-down (included in cost of sales) in the process equipment segment, due to rationalization and discontinuance of certain product lines, \$2.6 million of personnel costs and business relocation, \$6.4 million of merger-related expenses, \$0.3 million for a prepayment penalty on early extinguishment of debt and \$99.7 million in asset impairment charges, primarily in the process equipment segment. The \$99.7 million in asset impairment charges included a \$94.4 million write-down of goodwill, \$3.5 million for the impairment of two buildings and \$1.8 million for the impairment of other fixed assets (see Note 1 to the Consolidated Financial Statements of the Company).

In light of current economic conditions, as well as the significant decline in process equipment sales, the Company implemented a plan to rationalize certain product lines, which required discontinuance or modification of several products. As a result of the significant reduction in sales volume and the rationalization of product lines, excess plant capacity existed. Part of the plan to reduce future operating costs consisted of consolidation or elimination of certain facilities resulting in the reduction of excess capacity. The plan includes closing two process equipment manufacturing facilities, in Fort Collins, Colorado and Rochester, New York. The manufacturing activities of the Rochester facility ceased as of December 31, 2002, and the manufacturing activities of the Fort Collins facility are in the process of being phased out. The manufacturing at both of these sites will be transferred to the Company's Plainview, New York facility. As a result of this reorganization, the Company recorded an inventory write-down of approximately \$15.0 million. In connection with these actions, certain products sold to the data storage industry were discontinued. These products include certain physical vapor deposition equipment. A portion of this product line's inventory is not useable and thus has been written-off by the Company. The \$15.0 million charge also consists of the discontinuance or modification of certain telecommunications product lines, due to the continued decline in the telecommunications industry. This industry has seen a significant decline due to excess of fiber optic capacity created by telephonic carriers as well as current economic conditions, which have resulted in a significant decrease in capital spending.

The \$2.6 million charge for personnel costs and business relocation includes severance costs of approximately \$1.6 million and business relocation costs of approximately \$1.0 million. The severance charges relate to a workforce reduction of approximately 180 employees, located in all operations of the Company. The majority of the job classifications affected were in production, purchasing, engineering, service, sales and marketing and were concentrated in the process equipment segment. Business relocation costs of \$1.0 million include costs related to rental payments and/or lease termination fees on lease agreements relating to locations vacated by the Company. In addition, the business relocation costs include operating costs of the Rochester facility that has ceased manufacturing operations. These operating costs will be incurred while the building is being marketed for sale. As of December 31, 2002, approximately \$1.0 million in termination benefits has been paid and approximately \$0.6 million remains accrued, which will be paid by the third quarter of 2003. As of December 31, 2002, approximately \$0.1 million of business relocation costs has been paid and approximately \$0.9 million remains accrued. Of the \$0.9 million remaining, approximately \$0.2 million is expected to be paid in the first quarter of 2003, \$0.5 million is expected to be paid by the end of 2003 and approximately \$0.2 million in the aggregate is anticipated to be paid monthly through the third quarter of 2005.

On July 11, 2002, the Company entered into a merger agreement with FEI, headquartered in Hillsboro, Oregon. On January 8, 2003, the agreement was terminated. Veeco incurred approximately \$6.4 million in expenses related to the proposed merger with FEI. Merger-related costs were accounted for as an asset, and the Company intended to allocate these direct costs to the purchase price of the acquisition. However, due to the termination of the merger agreement, these costs were written off. These costs include legal, accounting, tax, investment banking and regulatory fees and printing costs. As of December 31, 2002, \$3.7 million of these costs have been paid and approximately \$2.7 million remains accrued, which will be paid in the first quarter of 2003.

In conjunction with the restructuring in the process equipment segment and the closure of two manufacturing facilities, the Company has classified the two facilities as held for sale as of December 31, 2002. In accordance with SFAS No. 144, these facilities are measured at the lower of their carrying amount or fair value less cost to sell. Accordingly, an impairment charge of \$3.5 million was recorded by the Company. Fair value was determined by the Company based upon recent market data. Land, buildings and other fixed assets held for sale of approximately \$10.2 million are included in prepaid expenses and other current assets in the accompanying Consolidated Balance Sheet at

December 31, 2002. The sale of these two facilities is expected to occur by the end of 2003. Certain machinery and equipment and furniture and fixtures with a net book value of \$1.8 million, the majority of which is a result of the closing of the Rochester facility, were deemed to have no future value and, thus, the Company has written off those assets and has included this charge in asset impairment in the accompanying Consolidated Statement of Operations for the year ended December 31, 2002.

As a result of the Rochester facility being available for sale, the Company paid down a term loan and mortgage related to the building. Due to the prepayment of the term loan, the Company was required to pay a penalty of approximately \$0.3 million in December 2002, which is included in the merger and restructuring charge in the accompanying Consolidated Statement of Operations for the year ended December 31, 2002.

During the three months ended September 30, 2002, the Company incurred a restructuring charge of approximately \$0.9 million related to cost reduction efforts in response to continuing poor industry conditions and the decreased level of new orders. The \$0.9 million charge includes severance related costs for approximately 40 management and manufacturing employees principally located in the process equipment segment. As of December 31, 2002, approximately \$0.4 million has been expended and approximately \$0.5 million remains accrued, which is anticipated to be paid in the first quarter of 2003. This charge is offset in part by approximately \$0.8 million of income related to the settlement of a post-retirement benefit plan of the process equipment segment.

During the three months ended June 30, 2002, the Company incurred a restructuring charge of approximately \$1.1 million related to the reductions in work force announced in the fourth quarter of 2001 and the first quarter of 2002. The \$1.1 million charge includes severance related costs for approximately 30 employees, which included both management and manufacturing employees principally located in the process equipment segment. As of December 31, 2002, approximately \$0.6 million has been expended and approximately \$0.5 million remains accrued, which is expected to be paid in the first quarter of 2003.

During the three months ended March 31, 2002, the Company incurred a restructuring charge of \$0.8 million related to the reduction in work force announced in the fourth quarter of 2001. This charge includes severance related costs for approximately 60 employees, which included both management and manufacturing employees located at the Company's Minnesota metrology and New York process equipment operations. As of December 31, 2002, this accrual was fully expended.

Other income, net, for the year ended December 31, 2002 improved to \$0.3 million over the comparable 2001 period from other expense, net, of \$2.5 million, due to a decrease in foreign currency exchange losses, which occurred principally in the first quarter of 2001.

Interest expense, net, of \$6.0 million for the year ended December 31, 2002, increased \$6.6 million from the comparable 2001 period as a result of the issuance of \$220.0 million of 4.125% convertible subordinated notes, which occurred in December 2001 and January 2002.

Income taxes for the year ended December 31, 2002 amounted to a benefit of \$20.5 million, or 14% of loss before income taxes, as compared with income tax expense of \$6.0 million, or 29% of income before income taxes in 2001. The lower effective tax rate for 2002 is due to approximately \$94.4 million of non-deductible charges related to the write-down of goodwill under SFAS No. 142.

In connection with the sale of its industrial measurement segment in May 2002, the Company recorded an additional \$0.3 million loss on the disposal of the discontinued operations during the year ended December 31, 2002, net of approximately \$0.2 million of taxes.

## **Years Ended December 31, 2001 and 2000**

Net sales were \$449.3 million for the year ended December 31, 2001, representing an increase of \$73.1 million, or 19%, when compared to the year ended December 31, 2000. Sales in the U.S., Europe, Japan and Asia Pacific, accounted for 54%, 18%, 20% and 8%, respectively, of the Company's net sales for the year ended December 31, 2001. Sales in the U.S. increased by approximately \$53.8 million from 2000. The increase in U.S. sales is primarily attributable to a \$46.3 million increase in process equipment sales, due to increased etch and deposition equipment sales to the data storage industry, as well as increased sales of optical filter deposition products to the telecommunications industry. Sales of MBE equipment have also contributed to the increase in U.S. process equipment sales by approximately \$9.8 million over the comparable 2000 period, which have no comparable MBE sales. European sales increased by \$26.0 million, or 48%, when compared to the prior year. This increase is primarily a result of a 53% increase in process equipment sales. The 53% increase is a result of a \$6.4 million increase in etch and deposition products sold primarily to the data storage industry, a \$1.4 million increase in sales of optical filter deposition products sold principally to the telecommunications industry and \$7.4 million of sales of MBE equipment sold mainly to the telecommunications industry. Metrology sales in Europe increased by 43%, which was principally the result of an increase of \$12.3 million, or 59%, in AFM sales to the semiconductor and research/industrial industries. Of the \$12.3 million, \$1.6 million was attributable to sales from the Company's TM Microscopes subsidiary, which was acquired in July of 2001 using the purchase method of accounting, and therefore there were no comparable sales in 2000. The 59% increase was slightly offset by a \$1.5 million decline in optical metrology sales of interferometry products to the data storage and semiconductor industries. Sales in Japan increased by \$9.9 million over the prior year, primarily as a result of increased metrology sales of 47% for AFMs and 22% for optical metrology products. Japan's process equipment sales remained relatively flat compared to the prior 2000 period. Sales in Asia Pacific decreased by \$16.9 million over the comparable 2000 period, as a result of decreased sales in optical metrology products. This decrease resulted from the decline in sales of the slider level crown (SLC) product line of approximately \$15.6 million to data storage customers over the prior comparable period, which was partially offset by an increase in AFM sales. The Company believes that there will continue to be quarter-to-quarter variations in the geographic concentration of sales.

Process equipment sales of \$277.3 million for the year ended December 31, 2001, increased \$61.0 million, or 28%, over the prior year, due partially to a \$27.9 million increase in optical filter deposition sales to the telecommunications industry. Etch and deposition product sales, principally to the data storage market, also increased by \$15.3 million over the prior year. MBE sales, as a result of the Applied Epi acquisition, were \$17.8 million during the year ended December 31, 2001. Metrology sales of \$172.0 million for the year ended December 31, 2001 increased by \$12.2 million from the year ended December 31, 2000, reflecting a 37% increase in the sale of AFMs, primarily to the semiconductor and research/industrial industries, offset by a 39% decrease in sales of optical metrology products, which was attributable to the above mentioned decrease in sales of the SLC product line to data storage customers and a \$10.0 million decrease in interferometry sales, for the most part to the data storage and semiconductor industries, from the year ended December 31, 2000.

Veeco received \$318.9 million of orders for the year ended December 31, 2001, representing a 47% decrease from \$596.8 million of orders in the comparable 2000 period. Process equipment orders decreased 56% to \$173.9 million, primarily due to the significant business downturn in the telecommunications industry. Orders for optical filter deposition equipment decreased \$161.4 million from the comparable 2000 period. Orders for etch and deposition equipment, sold primarily to the data storage industry, decreased by \$73.3 million from the prior year. Metrology orders decreased 28% to \$145.0 million, reflecting a 16% decrease in orders for AFMs as well as a 50% decrease in orders for optical metrology products. The order declines are a result of the general economic slowdown that has

had a very significant impact on the telecommunications, data storage and semiconductor markets that the Company serves. The book-to-bill ratio for the year ended December 31, 2001 was 0.71 to 1.

For the year ended December 31, 2001, the Company experienced order cancellations of \$136.3 million, of which approximately \$110.0 million related to the optical telecommunications market, for which Veeco is a significant supplier.

From 1999 through the beginning of 2001, the telecommunications industry experienced rapid and unprecedented growth. In connection with this growth, telecommunications companies spent billions of dollars installing long haul optical networks in order to meet growing telecommunications needs. These networks use a technology called Dense Wavelength Division Multiplexing ("DWDM"). Certain of Veeco's Ion Beam Systems are used to manufacture DWDM filters, which create multiple optical channels that can be carried by optical fiber. During this period DWDM filters were in extremely high demand, which created a worldwide shortage. In order to keep up with this demand, optical telecommunications customers placed numerous multi-unit system orders that were to be shipped over multiple quarters.

In early 2001, it became apparent that many of these optical telecommunications customers had accumulated too much debt and constructed too many optical networks. This caused these companies to reduce their capital spending, and as a result, demand for the filters started to evaporate. Many customers cancelled a majority of their multi-unit orders. By the end of the second quarter of 2001, a substantial amount of the backlog for systems used for manufacturing DWDM filters had been cancelled.

During the years ended December 31, 2001 and 2000, the Company incurred merger and restructuring charges of \$28.2 million and \$33.0 million, respectively, of which \$13.6 million, or 3.0% of net sales, and \$15.3 million, or 4.1% of net sales, respectively, related to the write off of inventory, which is included in cost of sales. Gross profit for the year ended December 31, 2001 increased to 42.1% from 41.6% in 2000. Excluding the merger and restructuring charges in both years, gross profit as a percentage of net sales decreased slightly to 45.1% from 45.7% due primarily to a mix change resulting in an increase in process equipment sales with lower average gross margins, as well as a decline in optical metrology sales.

Selling, general and administrative expenses of \$82.4 million for the year ended December 31, 2001 increased by \$6.8 million compared to \$75.6 million in 2000. The dollar increase is related to increased sales volume, primarily in the AFM product line and deposition equipment for optical filters.

Research and development expense for the year ended December 31, 2001 of \$59.7 million, increased by \$8.5 million over the comparable period of 2000, due primarily to additional research and development in certain Ion Tech and AFM product areas, as well as the inclusion of the newly acquired businesses of Applied Epi and TM, which were not included in Veeco's spending in 2000.

Amortization expense for the year ended December 31, 2001, of \$9.5 million, increased by \$5.7 million over the comparable period of 2000, due to the intangible assets acquired in connection with Applied Epi and TM acquisitions.

Other expense, net for the year ended December 31, 2001 increased \$1.6 million over the comparable 2000 period, due to the impact of foreign currency exchange losses, principally in the first quarter of 2001.

During the year ended December 31, 2001, the Company recorded restructuring charges of approximately \$20.0 million in response to the significant downturn in the telecommunications industry and the overall weak business environment. This downturn has affected Veeco's customers' ability to purchase capital equipment and is evidenced by a significant decline in the order rate for the Company's products. The \$20.0 million charge consisted of a \$13.6 million write-off of inventory

(included in cost of sales) related to order cancellations and the rationalization of certain product lines, \$3.0 million related to personnel costs and business relocation and \$3.4 million was for the write-down of long-lived assets. Of the \$13.6 million write-off of inventory, approximately \$9.6 million was associated with the Company's process equipment segment, which sells primarily to the telecommunications and data storage industries and approximately \$4.0 million related to Veeco's metrology segment, which sells mainly to the semiconductor, research and data storage industries. During the year, Veeco experienced a significant amount of order cancellations for products for which many of the raw materials had been purchased prior to the cancellation date due to the amount of lead-time necessary to build many of these tools. The \$3.0 million charge for personnel and business relocation costs principally relates to plant consolidations and a workforce reduction of approximately 230 employees, located in all operations of the Company. The majority of the job classifications that were eliminated included manufacturing, sales and marketing, due to the downturn in the economy. As of December 31, 2002, approximately \$2.5 million of personnel and business relocation costs have been paid and approximately \$0.5 million remains accrued. Of this \$0.5 million liability, approximately \$0.3 million relates to rental payments on a lease agreement for space the Company has vacated and will be paid over the next three years and \$0.2 million relates to termination costs that will be paid in the first quarter of 2003. The write-down of long-lived assets to estimated fair value related primarily to the write-off of goodwill and intangible assets acquired in connection with the SLC product line of approximately \$2.5 million, which has been phased out, as well as the write-down of certain machinery and equipment of approximately \$0.9 million, which was deemed to have no future value.

In connection with the Applied Epi acquisition, the Company recorded a \$7.0 million write-off of the fair values of acquired in-process technology projects that had not reached technological feasibility and had no alternative uses. Accordingly, this amount was expensed at the acquisition date. Applied Epi's in-process technology value is comprised of programs related to research systems, production systems, performance products and metal organic chemical vapor deposition (MOCVD) systems that were approximately 40%, 40%, 50% and 25% complete, respectively, at the date of acquisition. The value assigned to purchased in-process technology was determined by using the income approach, which involves estimating the discounted after-tax cash flows attributable to projects, based on the projects' stage of completion. The rate used to discount net cash flows to their present value was 25%. As of December 31, 2002, programs related to both research and performance products are 100% complete. As of December 31, 2002, programs related to production systems are 59% complete, with one program being cancelled and one program being postponed due to current market and business conditions. With regard to the MOCVD systems, due to the current market and business conditions and as a result of the Company's reorganization in the process equipment segment (see Note 7), these programs have been abandoned by the Company.

In connection with the TM acquisition, approximately \$1.2 million of the purchase price was allocated to in-process technology projects for projects that had not reached technological feasibility and had no alternative future uses and thus, the amounts were expensed as of the date of acquisition. On the date of acquisition, the majority of TM's in-process technology value was comprised of the Fanou project (which included the Aurora III product), which was approximately 90% complete, with the remainder completed in the first quarter of 2002. The value assigned to purchased in-process technology was determined by using the income approach and the rate used to discount net cash flows to their present value was 28%. The actual results of the Fanou project did not differ materially from the underlying assumptions used by the Company.

Expenditures to complete both Applied Epi's and TM's projects are subject to change, given the uncertainties of the development process, and no assurances can be given that deviations from these estimates will not occur. Additionally, the projects will require maintenance R&D after they have reached a state of technological and commercial feasibility. There are risks associated with these



projects, and there is no assurance that these projects will meet with technological or commercial success.

In May 2002, the Company sold the remainder of the industrial measurement business. This segment was comprised of the x-ray fluorescence thickness measurement systems. In January 2000, the Company sold its leak detection business, which was part of this segment. Accordingly, the Company has classified the industrial measurement business as a discontinued operation. Sales for the industrial measurement business totaled \$6.0 million, \$10.6 million and \$17.1 million for the years ended December 31, 2001, 2000 and 1999, respectively. During the year ended 2001, the Company recorded a loss on disposal of discontinued operations of \$2.1 million, which is net of income taxes of \$1.5 million and includes the write-off of approximately \$1.0 million of goodwill that was previously allocated to this segment. During 1999, the Company incurred a loss on disposal of its leak detection business of \$1.7 million, which is net of income taxes of \$0.8 million. Loss from discontinued operations for the years ended December 31, 2001, 2000 and 1999 was \$2.5 million, \$2.2 million and \$1.4 million, respectively, which is net of income taxes of \$1.7 million, \$1.5 million and \$0.6 million, respectively. The assets sold included accounts receivable, inventories, prepaid expenses and other current assets and fixed assets and included certain liabilities assumed by the purchaser. The net assets held for sale of approximately \$4.6 million were included in prepaid expenses and other current assets in the accompanying Consolidated Balance Sheet at December 31, 2001.

Income taxes for the year ended December 31, 2001 amounted to \$6.0 million, or 29% of income from continuing operations before income taxes as compared with \$5.8 million, or 68% in 2000. The higher effective tax rate for 2000 is due to approximately \$10.0 million of non-deductible charges related to the \$33.0 million merger and restructuring charges incurred in conjunction with the merger with CVC.

### **Liquidity and Capital Resources**

Although the Company experienced an operating cash use of \$(2.2) million during 2002, funds from the sale of its industrial measurement business of \$3.7 million, as well as proceeds from the sale of property, plant and equipment of \$1.8 million and funds from financing activities, including the issuance of a \$20.0 million over-allotment of subordinated debt and the proceeds from the exercise of stock options and stock issuances under the Company's employee stock purchase plan, were sufficient to fund capital expenditures and debt repayments. The ratio of current assets to current liabilities was 6.2 at the end of 2002, compared with 4.4 at the end of 2001. The Company's primary source of funds at December 31, 2002, consisted of \$214.3 million of cash and cash equivalents. This amount represents an increase of \$11.1 million from the December 31, 2001 balance of \$203.2 million.

Cash used by operations totaled \$2.2 million during the year ended December 31, 2002. This amount consisted primarily of the net loss of \$123.7 million plus non-cash charges for depreciation and amortization, net loss on the disposal of discontinued operations, non-cash restructuring and other expenses, and a stock option income tax benefit aggregating \$144.1 million, as well as a decrease in accounts receivable and inventory of \$25.0 million and \$3.6 million, respectively. Accounts receivable decreased due to the decrease in sales during the fourth quarter of 2002. Receivables generally are due within 30-60 days, other than customers in Japan where payment terms range from 90-150 days. These items were offset by decreases in accounts payable and accrued expenses, deferred profit and other current liabilities and an increase in deferred taxes of \$7.0 million, \$28.1 million and \$22.6 million, respectively. Deferred profit for the year ended December 31, 2002, decreased by \$8.6 million, primarily as a result of revenue recognition on tools that received final customer acceptance, as well as a decrease in the number of tools that are deferred as of December 31, 2002, due to a lower level of sales and product mix that impacts timing of revenue recognition. Accrued expenses and other current liabilities (excluding deferred profit) decreased \$19.5 million, primarily as a result of a \$4.8 million decrease in customer deposits and royalties, a \$3.9 million decrease in accrued installation and

warranty, and \$3.8 million of tax payments made during the year related to sales and foreign taxes. In addition, accrued expenses decreased as a result of a \$1.4 million decline in accrued bonuses and commission expense related to the decline in sales volume and orders, as well as a \$1.5 million decrease in other employee benefits due to the reduction in workforce previously discussed.

Cash flows from investing activities of \$2.9 million for the year ended December 31, 2002 are a result of the proceeds from the sale of the Company's industrial measurement business of \$3.7 million, which closed in May 2002, proceeds from the sale of property, plant and equipment of \$1.8 million and net maturities of long-term investments of \$6.0 million, offset by capital expenditures of \$8.6 million.

In December 2001, the Company issued \$200.0 million of 4.125% convertible subordinated notes, and in January 2002, the Company issued an additional \$20.0 million of notes pursuant to an over-allotment option. The notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of common stock at a conversion price of \$38.51 per share. The Company pays interest on these notes on June 21 and December 21 of each year. The notes will mature on December 21, 2008. In connection with this offering, the Company purchased approximately \$25.9 million of U.S. government securities, which have been pledged to the trustee under the indenture, as security for the exclusive benefit of the holders of the notes. These securities will be sufficient to provide for the payment in full of the first six scheduled interest payments due on the notes and thus represent restricted investments. The balance of these pledged securities as of December 31, 2002 was \$17.5 million. Except with respect to these pledged securities, the notes are subordinated in right of payment to all other indebtedness of the Company. The notes are repayable upon certain change of control events and upon the acceleration of certain other indebtedness for money borrowed of the Company. After the third anniversary of issuance, the notes may be redeemed at the option of the Company at the redemption prices set forth in the indenture relating to the notes.

Cash flows provided by financing activities totaled \$12.0 million. The generation of cash from financing activities in 2002 primarily resulted from the \$20.0 million subordinated debt over-allotment option exercise in January 2002, as well as \$1.2 million from stock issuance, offset in part by \$9.8 million of repayments of long term debt and debt issuance costs.

On April 19, 2001, the Company entered into a \$100 million revolving credit facility (as amended, the "Facility"). The Facility's interest rate is a floating rate based on the prime rate of the lending banks and is adjustable to a maximum rate of  $\frac{1}{4}\%$  above the prime rate in the event the Company's ratio of debt to cash flows exceeds a defined amount. A LIBOR based interest rate option is also provided. The Facility has a term of four years and borrowings under the Facility may be used for general corporate purposes, including working capital and acquisitions. The Facility contains certain restrictive covenants, which among other things, impose limitations with respect to the incurrence of indebtedness, the payment of dividends, long-term leases, investments, mergers, acquisitions, consolidations and sales of assets. The Company is also required to satisfy certain financial tests and the accounts receivable of the Company and its material domestic subsidiaries are pledged to secure the Company's obligations under the Facility. In connection with a recent amendment of the Facility, certain financial covenants were amended to allow for the fourth quarter 2002 restructuring charges as well as certain definitions were amended. As of December 31, 2002, and for all prior periods, the Company was in compliance with the covenants set forth in the Facility. As of December 31, 2002, there were no borrowings outstanding under the Facility, and the Company was contingently liable for letters of credit of approximately \$3.3 million issued under the Facility.

In October 2002, the Company repaid one of its mortgages upon maturity in the amount of approximately \$2.0 million.

In February 2003, in connection with a lawsuit commenced by Toyo, the Company agreed in principle to settle the lawsuit (see Note 7 of the Consolidated Financial Statements of the Company for further discussion).

At December 31, 2002, Veeco's contractual cash obligations and commitments relating to its debt obligations and lease payments are as follows (in thousands):

<u>Contractual Obligations</u>	<u>Total</u>	<u>Less than 1 year</u>	<u>1-3 years</u>	<u>4-5 years</u>	<u>After 5 years</u>
Long-term debt.....	\$230,585	\$312	\$691	\$5,975	\$223,607
Operating leases.....	14,917	3,134	4,147	3,400	4,236
Letters of credit.....	3,283	3,283	—	—	—
	<u>\$248,785</u>	<u>\$6,729</u>	<u>\$4,838</u>	<u>\$9,375</u>	<u>\$227,843</u>

The Company believes that existing cash balances together with cash generated from operations and amounts available under the Company's \$100.0 million Facility will be sufficient to meet the Company's projected working capital and other cash flow requirements for the next twelve months, as well as the Company's contractual obligations, detailed in the above table, over the next five years.

### **Application of Critical Accounting Policies**

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

*Revenue Recognition:* Effective January 1, 2000 the Company changed its method of accounting for revenue recognition in accordance with Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*. The Company recognizes revenue when persuasive evidence of an arrangement exists, the seller's price is fixed or determinable and collectibility is reasonably assured. For products produced according to the Company's published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment. For products produced according to a particular customer's specifications, revenue is recognized when the product has been tested and it has been demonstrated that it meets the customer's specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount of any customer retention (generally 10% to 20%), which is not payable by the customer until installation is completed and final customer acceptance is achieved. The amount of customer retention is recorded in accounts receivable with a corresponding liability recorded in deferred profit. At December 31, 2002 and 2001, \$1.4 million and \$3.3 million, respectively, are recorded in accounts receivable and deferred profit pertaining to customer retentions. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% to 2% of the sales value of the related equipment. For new applications of the Company's products, for new products or for products with substantive customer acceptance provisions where performance

cannot be fully assessed prior to meeting customer specifications at the customer site, revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 80% to 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the entire contract amount. The profit on these transactions is deferred and recorded as deferred profit in the accompanying balance sheets. At December 31, 2002 and 2001, \$4.6 million and \$11.2 million, respectively, are recorded in deferred profit pertaining to shipments where revenue recognition has been deferred. Service and maintenance contract revenues are recorded as deferred revenue, which is included in other accrued expenses, and recognized as revenue on a straight-line basis over the service period of the related contract. The Company provides for warranty costs at the time the related revenue is recognized.

*Inventory Valuation:* Inventories are stated at the lower of cost (principally first-in, first-out method) or market. Management evaluates the need to record adjustments for impairment of inventory on a quarterly basis. The Company's policy is to assess the valuation of all inventories, including raw materials, work-in-process, finished goods and spare parts. Obsolete inventory or inventory in excess of management's estimated usage for the next 18 to 24 month's requirements is written-down to its estimated market value, if less than its cost. Inherent in the estimates of market value are management's estimates related to Veeco's future manufacturing schedules, customer demand, technological and/or market obsolescence, possible alternative uses and ultimate realization of excess inventory.

*Goodwill and Indefinite-Lived Intangible Asset Impairment:* The Company has significant intangible assets related to goodwill and other acquired intangibles. In assessing the recoverability of the Company's goodwill and other indefinite-lived intangible assets, the Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If it is determined that impairment indicators are present and that the assets will not be fully recoverable, their carrying values are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic or anticipated decline in revenue or operating profit, adverse legal or regulatory developments, accumulation of costs significantly in excess of amounts originally expected to acquire the asset and a material decrease in the fair value of some or all of the assets. Assets are grouped at the lowest levels for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Changes in strategy and/or market conditions could significantly impact these assumptions, and thus Veeco may be required to record impairment charges for these assets not previously recorded. The Company completed the first of the required impairment tests on goodwill and indefinite lived intangible assets in the first quarter of 2002. Based upon the judgment of management, it was determined that there was no impairment to goodwill or intangibles with indefinite lives as of January 1, 2002. During the fourth quarter of 2002, management determined that due to the continued weakness in the telecommunications industry and the uncertainty of the timing and speed of recovery, impairment indicators were present. Under SFAS No. 142, if impairment indicators are present, the fair value of the reporting unit must be determined. Based upon the judgment of management, goodwill arising from the September 2001 Applied Epi acquisition, which constitutes the telecommunications reporting unit, included in the process equipment operating segment, was deemed significantly impaired. As a result, the Company recorded an impairment charge of \$94.4 million and has written down goodwill related to the telecommunications reporting unit to approximately \$7.5 million as of December 31, 2002.

*Long Lived Asset Impairment:* The carrying values of long-lived assets are periodically reviewed to determine if any impairment indicators are present. If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining depreciation period, their carrying values are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic or

anticipated decline in revenue or operating profit, adverse legal or regulatory developments, accumulation of costs significantly in excess of amounts originally expected to acquire the asset and a material decrease in the fair value of some or all of the assets. Assets are grouped at the lowest level for which there is identifiable cash flows that are largely independent of the cash flows generated by other asset groups. During 2002, \$5.3 million in fixed asset impairment charges were recorded by the Company, in conjunction with the restructuring in the process equipment segment. The Company recorded \$0.9 million of fixed asset impairment charges in 2001. Assumptions utilized by management in reviewing for impairment of long-lived assets could be effected by changes in strategy and/or market conditions which may require Veeco to record additional impairment charges for these assets, as well as impairment charges on other long-lived assets not previously recorded. During December 2001, approximately \$2.5 million of intangible assets were written off in connection with a phased out product line.

### **Risk Factors That May Impact Future Results**

In addition to the other information set forth herein, the following risk factors should be carefully considered by shareholders of and by potential investors in the Company.

**We depend on the microelectronics industry. The cyclical nature of the data storage, telecommunications/wireless, semiconductor, research and industrial industries directly affects our business.**

Veeco's business depends in large part upon the capital expenditures of data storage, telecommunications/wireless and semiconductor manufacturers, as well as research and industrial customers, which accounted for the following percentages of our net sales for the periods indicated:

	<u>Year ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Data Storage.....	32%	31%	44%
Telecommunications/Wireless.....	15%	30%	23%
Semiconductor .....	13%	17%	14%
Research and Industrial.....	40%	22%	19%

The data storage, telecommunications/wireless, semiconductor, research and industrial industries are cyclical. These industries have experienced significant economic downturns at various times in the last decade, characterized by diminished product demand, accelerated erosion of average selling prices and production overcapacity. A downturn in one or more of these industries or the businesses of one or more of our customers could have a material adverse effect on our business, prospects, financial condition and operating results.

The current global downturn in general economic conditions and in the markets for our customers' products is resulting in a reduction in demand for some of our products. We have experienced the effects of the global economic downturn in many areas of our business. During this downturn and any subsequent downturns we cannot assure you that our sales or margins will not decline. As a capital equipment provider, our revenues depend in large part on the spending patterns of our customers, who often delay expenditures or cancel orders in reaction to variations in their businesses or general economic conditions. Because a high proportion of our costs are fixed, our ability to reduce expenses quickly in response to revenue short-falls is limited. In a prolonged economic downturn, we may not be able to reduce our significant fixed costs, such as continued investment in research and development or capital equipment requirements. In addition, during an economic downturn we may experience delays in collecting receivables, which may impose constraints on our working capital.

**Our customers may be adversely affected by rapid technological change and we may be unable to maintain timely product introduction.**

The data storage, telecommunications/wireless, semiconductor manufacturing, research and industrial industries are subject to rapid technological change and new product introductions and enhancements. Our ability to remain competitive will depend in part upon our ability to develop in a timely and cost effective manner new and enhanced systems at competitive prices and to accurately predict technology transitions. In addition, new product introductions or enhancements by our competitors could cause a decline in sales or loss of market acceptance of our existing products. Increased competitive pressure could also lead to intensified price competition resulting in lower margins, which could materially and adversely affect our business, prospects, financial condition and operating results. Our success in developing, introducing and selling new and enhanced systems depends upon a variety of factors, including:

- our product offerings,
- timely and efficient completion of product design and development,
- timely and efficient implementation of manufacturing processes,
- effective sales, service and marketing, and
- product performance in the field.

Because new product development commitments must be made well in advance of sales, new product decisions must anticipate both the future demand for the products under development and the equipment required to produce such products. We cannot be certain that we will be successful in selecting, developing, manufacturing and marketing new products or in enhancing existing products.

The process of developing new high technology capital equipment products and services is complex and uncertain, and failure to anticipate customers' changing needs and emerging technological trends accurately and to develop or obtain appropriate intellectual property could significantly harm our results of operations. We must make long-term investments and commit significant resources before knowing whether our predictions will eventually result in products that the market will accept. We have invested significant resources in the development of certain products utilizing physical vapor deposition technology, which has been slow to gain customer acceptance. Further, after a product is developed, we must be able to manufacture sufficient volumes quickly and at low costs. To accomplish this, we must accurately forecast volumes, mix of products and configurations that meet customer requirements, and we may not succeed.

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

We rely on certain principal customers for a significant portion of our sales. Based on net sales, Seagate Technology, Inc. is our top customer. The following table sets forth the percentage of our net sales to Seagate (our only customer with sales greater than 10% in any of the past three years) for the following periods:

	<u>Year Ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Seagate .....	13%	7%	18%

If any principal customer discontinues its relationship with us or suffers economic setbacks, our business, prospects, financial condition and operating results could be materially and adversely affected. Our ability to increase sales in the future will depend in part upon our ability to obtain orders from new customers. We cannot be certain that we will be able to do so. In addition, because a relatively small number of large manufacturers, many of whom are our customers, dominate the industries in



which they operate, it may be especially difficult for us to replace these customers if we lose their business. A substantial portion of orders in our backlog are orders from our principal customers.

**Because we do not have long-term contracts with our customers, our customers may cease purchasing our products at any time if we fail to meet their needs.**

We do not have long-term contracts with our customers. As a result, our agreements with our customers do not provide any assurance of future sales. Accordingly:

- our customers can cease purchasing our products at any time without penalty,
- our customers are free to purchase products from our competitors,
- we are exposed to competitive price pressure on each order, and
- our customers are not required to make minimum purchases.

If we do not succeed in obtaining new sales orders from new or existing customers, it will have a negative impact on our results of operations.

**Our quarterly operating results fluctuate significantly.**

Our quarterly results have fluctuated significantly in the past and we expect this trend to continue. Factors which affect our quarterly results include:

- cyclical patterns of capital spending by customers,
- changes in the market for personal computers, network servers, telecommunication/wireless devices or other products incorporating telecommunications/wireless, data storage or semiconductor/research technology,
- market acceptance of our systems and our customers' products,
- specific economic conditions in the telecommunications/wireless, data storage or semiconductor/research industries,
- our acquisitions and financings,
- changes in product mix,
- the timing of significant orders and customer acceptance of our products,
- the introduction of new products and technological innovations by us and our competitors,
- production and quality problems and resulting shipment delays,
- changes in the cost of materials, and
- disruption in our sources of supply.

Many of these factors are beyond our control. If our new orders, net sales or operating results in a particular quarter do not meet expectations, our stock price may be adversely affected.

**Our business and financial results for a particular period could be materially and adversely affected if orders are cancelled or rescheduled or if an anticipated order for even one system is not received in time to permit shipping during the period.**

Customer purchase orders are subject to cancellation or rescheduling by the customer, generally with limited or no penalties. In addition, Veeco has, in limited circumstances, permitted major customers to return previously shipped products in order to maintain business relationships with such customers. Therefore, backlog or the amount of purchase orders at any particular date is not

necessarily indicative of actual sales for any succeeding period. In addition, we derive a substantial portion of our net sales in any fiscal period from the sale of a relatively small number of high-priced systems. As a result, the timing of recognition of revenue for a single transaction could have a material effect on our sales and operating results for a particular fiscal period. Backlog adjustments for the year ended December 31, 2002 included order cancellations of \$20.9 million.

**Variations in the amount of time it takes for us to sell our systems may cause fluctuations in our operating results.**

Historically, we have experienced long and unpredictable sales cycles. Variations in the length of our sales cycles could cause our net sales, and therefore our business, financial condition, operating results and cash flows, to fluctuate widely from period to period. These variations often are based upon factors partially or completely outside our control. The factors that affect the length of time it takes us to complete a sale depend upon many elements, including:

- the efforts of our sales force and our independent sales representatives,
- the history of previous sales to a customer,
- the complexity of the customer's manufacturing processes,
- the internal technical capabilities and sophistication of the customer, and
- the capital expenditure budget cycle of our customers.

As a result of these and a number of other factors that influence our sales cycles with particular customers, the period between our initial contact with a potential customer and the time when we recognize revenue from that customer, if ever, varies widely. Our sales cycle typically can range up to twelve months. Sometimes our sales cycle can be much longer, particularly during an economic downturn or when the sales cycle involves developing new applications for our systems and technology. During these cycles, we commit substantial resources to our sales efforts before receiving any revenue, and we may never receive any revenue from a customer despite these sales efforts.

In addition to lengthy and sometimes unpredictable sales cycles, the build cycle, or the time it takes us to build a product to customer specifications, typically ranges from one to six months. During this period, the customer may cancel its order, although generally it will be required to pay us a fee based on which stage of the build cycle we have completed.

For many of our products, after a customer purchases one of our systems we provide an acceptance period during which the customer may evaluate the performance of the system and potentially reject the system. In addition, customers often evaluate the performance of one of our systems for a lengthy period before purchasing any additional systems. The number of additional products a customer may purchase from us, if any, often depends on many factors that are difficult for us to predict accurately, including a customer's capacity requirements and changing market conditions for its products. As a result of these evaluation periods and other factors, the period between a customer's initial purchase and subsequent purchases, if any, often varies widely, and variations in length of this period can cause further fluctuations in our operating results.

**Our strategy of pursuing acquisitions subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses into our business.**

We have considered numerous acquisition opportunities and completed several significant acquisitions during the past five years. In addition, we may consider acquisitions of, or significant investments in, other businesses in the future. Acquisitions involve numerous risks, many of which are unpredictable and beyond our control, including:

- difficulties and increased costs in connection with integration of the personnel, operations, technologies and products of acquired companies,
- diversion of management's attention from other operational matters while evaluating and pursuing the acquisition as well as while integrating the business once acquired,
- the inability to retain the key employees of acquired companies, especially if the acquired business is to be relocated or the responsibilities of such key employees are to be changed,
- lack of synergy, or inability to realize expected synergies, resulting from the acquisition, and
- acquired assets becoming impaired as a result of technological advancements or worse-than-expected performance by the acquired company, which could require us to record a charge to earnings for such impairment.

Our inability to effectively manage these acquisition risks could materially and adversely affect our business, prospects, financial condition and operating results.

In addition, if we issue equity securities to pay for an acquisition, the ownership percentage of our then-existing shareholders would be reduced and the value of the shares held by our then-existing shareholders could be diluted, which could affect the trading price of our common stock and of the subordinated notes. If we use cash to pay for an acquisition, the payment could significantly reduce the cash that would be available to fund our operations or to use for other purposes, including making payments on the subordinated notes. Also, acquisition financing may not be available on favorable terms or at all. Future acquisitions may also require us to assume contingent liabilities that could have a material adverse effect on our business, prospects, financial condition or operating results.

**The loss of key management or our inability to attract and retain sufficient numbers of managerial, engineering and other technical personnel could have a material adverse effect on our business.**

Our continued success depends, in part, upon key managerial, engineering and technical personnel as well as our ability to continue to attract and retain additional personnel. In particular, we depend on our Chairman and Chief Executive Officer, Edward H. Braun. The loss of key personnel could have a material adverse effect on our business, prospects, financial condition or operating results. We may not be able to retain our key managerial, engineering and technical employees. Our growth is dependent on our ability to attract new highly skilled and qualified technical personnel, in addition to personnel that can implement and monitor our financial and managerial controls and reporting systems. Attracting qualified personnel is difficult, and we cannot assure you that our recruiting efforts to attract and retain these personnel will be successful.

**We cannot be certain that we will be able to compete successfully in our highly competitive industries.**

The industries in which we operate are intensely competitive. Established companies, both domestic and foreign, compete with each of our product lines. Many of our competitors have greater financial, engineering, manufacturing and marketing resources than us. A substantial investment is required by customers to install and integrate capital equipment into a production line. As a result, once a manufacturer has selected a particular vendor's capital equipment, we believe that the manufacturer generally relies upon that equipment for the specific production line application and

frequently will attempt to consolidate its other capital equipment requirements with the same vendor. Accordingly, if a particular customer selects a competitor's capital equipment, we expect to experience difficulty selling to that customer for a significant period of time. We believe that our ability to compete successfully depends on a number of factors both within and outside of our control, including:

- price,
- product quality,
- breadth of product line,
- system performance,
- cost of ownership,
- global technical service and support, and
- success in developing or otherwise introducing new products.

We cannot be certain that we will be able to compete successfully in the future.

**We are exposed to the risks of operating a global business, including risks associated with exchange rate fluctuations and legal and regulatory changes.**

We are exposed to foreign currency exchange rate risks that are inherent in our anticipated sales, sales commitments and assets and liabilities that are denominated in currencies other than the United States dollar. Failure to sufficiently hedge or otherwise manage foreign currency risks properly could adversely affect our revenues and gross margins. We also are exposed to interest rate risks inherent in our debt obligations and investment portfolios.

In 2002, approximately 53% of our total net sales were generated from sales outside the United States, and in 2001 approximately 46% our total net sales were generated from sales outside the United States. We expect sales from non-U.S. markets to continue to represent a significant, and possibly increasing portion of our total sales in the future. Our non-U.S. sales and operations are subject to risks inherent in conducting business abroad, many of which are outside our control, including:

- periodic economic downturns and unstable political environments,
- longer sales cycles,
- multiple, conflicting and changing governmental laws and regulations,
- protectionist laws and business practices that favor local companies,
- price and currency exchange controls,
- fluctuations in the relative values of currencies,
- difficulties protecting intellectual property,
- unexpected changes in trading policies, regulatory requirements, tariffs and other barriers, and
- difficulties in managing a global enterprise, including staffing, collecting accounts receivable, managing distributors and representatives and repatriation of earnings.

Changes in the relative values of currencies occur from time to time and may, in some instances, have a material effect on our results of operations. In particular, a weakening of the euro or the yen could result in a weakening of our overall financial results. Although we attempt to mitigate our exposure to fluctuations in currency exchange rates, these hedging activities may not always be available or adequate to eliminate, or even mitigate, the impact of our exchange rate exposure. As a result of

this exchange rate exposure, as well as the other factors listed above, we may experience a material adverse effect upon our business, prospects, financial condition and operating results.

We do not have any derivative financial instruments for speculative or trading purposes. We enter into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany balances and other known currency exposures. The average notional amount of such contracts was approximately \$1.9 million for the year ended December 31, 2002. As of December 31, 2002, we did not have any open forward contracts. We estimate that based upon our balance sheet at December 31, 2002, a 10% change in foreign exchange rates impact operating loss by approximately \$0.6 million.

**Our operating results are influenced by the performance of Asian economies, which have experienced significant downturns during the past few years.**

In recent years, Asian economies (including Japan) have been highly volatile and recessionary, resulting in significant fluctuations in local currencies and other instabilities. Approximately 36% of our sales in 2002 and approximately 28% of our sales in 2001 were derived from this region. Instabilities in Asian economies (including Japan) may continue and recur again in the future, which could have a material adverse effect on our business, prospects, financial condition and operating results. Our exposure to the business risks presented by Asian economies (including Japan) will increase to the extent we continue to expand our operations in that region.

**We may be subject to claims of intellectual property infringement.**

Several of our competitors hold patents covering a variety of technologies included in some of our products. In addition, some of our customers may use our microelectronics products for applications that are similar to those covered by these patents. From time to time, we and our customers have received correspondence from our competitors claiming that some of our products, as used by our customers, may be infringing one or more of these patents. As of the date of this filing, none of these allegations has resulted in litigation. Competitors or others may, however, assert infringement claims against us or our customers in the future with respect to current or future products or uses, and these assertions may result in costly litigation or require us to obtain a license to use intellectual property rights of others. If claims of infringement are asserted against our customers, those customers may seek indemnification from us for damages or expenses they incur.

If we become subject to infringement claims, we will evaluate our position and consider the available alternatives, which may include seeking licenses to use the technology in question or defending our position. These licenses, however, may not be available on satisfactory terms or at all. If we are not able to negotiate the necessary licenses on commercially reasonable terms or successfully defend our position, it could have a material adverse effect on our business, prospects, financial condition and operating results.

**We are exposed to the risks that third parties may violate our proprietary rights and our intellectual property rights may not be well protected in foreign countries.**

Our success depends on the protection of our proprietary rights. In our industry, intellectual property is an important asset that is always at risk of infringement. We incur costs to obtain and maintain patents and defend our intellectual property. We rely upon the laws of the United States and of other countries in which we develop, manufacture or sell our products to protect our proprietary rights. However, these proprietary rights may not provide the competitive advantages that we expect, or other parties may challenge, invalidate or circumvent these rights.

Further, our efforts to protect our intellectual property may be less effective in some countries where intellectual property rights are not as well protected as in the United States. Many U.S.

companies have encountered substantial problems in protecting their proprietary rights against infringement in foreign countries. We derived approximately 53% of our sales from foreign countries in 2002, and approximately 46% of our sales from foreign countries in 2001. If we fail to adequately protect our intellectual property in these countries, it could be easier for our competitors to sell competing products.

Infringement of our proprietary rights by a third party could result in lost market and sales opportunities, as well as increased costs of litigation.

**We rely on a limited number of parts, components and equipment manufacturers. Failure of any of these suppliers to perform in a timely or quality manner could negatively impact revenues.**

Failure of critical suppliers of parts, components and manufacturing equipment to deliver sufficient quantities in a timely and cost-effective manner could negatively affect our business. We currently use numerous vendors to supply parts, components and subassemblies for the manufacture and support of our products. However, some key parts may be obtained only from a single supplier or a limited group of suppliers.

We also rely on a limited number of equipment manufacturers to develop and supply the equipment used to manufacture our products. The failure of these manufacturers to develop or deliver equipment on a timely basis could have a material adverse effect on the business and results of operations. In addition, as a result of the small number of equipment suppliers, we may be more exposed to future cost increases for this equipment.

**We may not obtain sufficient affordable funds to fund our future needs for manufacturing capacity and research and development.**

We need to continue to make significant capital expenditures to continue and expand our operations and to enhance our manufacturing capability to keep pace with rapidly changing technologies. Also, our industry is characterized by the need for continued investment in research and development. If we fail to invest sufficiently in research and development, our products could become less attractive to potential customers. As a result of our emphasis on research and development and technological innovation, our operating costs may increase in the future. We expect our research and development expenses to increase as a percentage of our net sales for the foreseeable future. During the past few years, the markets for equity and debt securities have fluctuated significantly, especially with respect to technology-related companies, and during some periods offerings of those securities have been extremely difficult to complete. As a result, in the future we may not be able to obtain the additional funds required to fund our operations and invest sufficiently in research and development on reasonable terms, or at all. Such a lack of funds could have a material adverse effect on our business, prospects, financial condition and operating results.

**Terrorist acts and acts of war may seriously harm our business and revenues, costs and expenses and financial condition.**

Terrorist acts or acts of war (wherever located around the world) may cause damage or disruption to our company, our employees, facilities, partners, suppliers, distributors and customers, which could significantly impact our revenues, costs and expenses and financial condition. The terrorist attacks that took place in the United States on September 11, 2001 were unprecedented events that have created many economic and political uncertainties, some of which may materially harm our business and results of operations. The potential for future terrorist attacks, the national and international responses to terrorist attacks, and other acts of war or hostility have created many economic and political uncertainties, which could adversely affect the business and results of operations in ways that cannot

presently be predicted. We will be largely uninsured for losses and interruptions caused by terrorist acts and acts of war.

**Unforeseen environmental costs could impact our future net earnings.**

Some of our operations will use substances regulated under various federal, state and international laws governing the environment. We could be subject to liability for remediation if we do not handle these substances in compliance with applicable laws. It is our policy to apply strict standards for environmental protection to sites inside and outside the United States, even when not subject to local government regulations. We will record a liability for environmental remediation and related costs when we consider the costs to be probable and the amount of the costs can be reasonably estimated.

**Our articles of incorporation, by-laws, shareholder rights plan and Delaware law may have anti-takeover effects which will make an acquisition of our company by another company more difficult.**

Our board of directors has the authority to issue up to 500,000 shares of preferred stock and to fix the rights, preferences, privileges and restrictions, including voting rights, of these shares without any further vote or action by the holders of our common stock. We have designated 30,000 of those shares as Series A Junior Preferred Stock for potential issuance under our shareholder rights plan described below. The rights of the holders of any preferred stock that may be issued in the future may adversely affect the rights of the holders of our common stock. The issuance of the preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock, thereby delaying, deferring or preventing a change in control of Veeco that a holder of our common stock might consider in its best interest. Furthermore, such preferred stock may have other rights, including economic rights senior to our common stock and, as a result, the issuance of the preferred stock could have a material adverse effect on the market value of our common stock.

Our board of directors is divided into three classes of directors with staggered terms. The existence of a classified board may render certain hostile takeovers more difficult and make it more difficult for a third party to acquire control of Veeco in certain instances, thereby delaying, deferring or preventing a change in control of Veeco that a holder of our common stock might consider in its best interest. Further, if shareholders are dissatisfied with the policies and/or decisions of our board of directors, the existence of a classified board will make it more difficult for the shareholders to change the composition (and therefore the policies) of our board of directors in a relatively short period of time.

We have adopted a shareholder rights plan, under which we have granted to our shareholders rights to purchase shares of junior participating preferred stock. These rights could generally discourage a merger or tender offer for our common stock that is not approved by our board of directors by increasing the cost of effecting any such transaction and, accordingly, could have an adverse impact on a takeover attempt that a shareholder of Veeco might consider to be in its best interest.

Furthermore, we have adopted and may in the future adopt certain other measures that may have the effect of delaying, deferring or preventing a change in control of Veeco. Certain of such measures may be adopted without any further vote or action by the holders of our common stock. These measures may have anti-takeover effects, which may delay, defer or prevent a takeover attempt that a holder of our common stock might consider in its best interest. In addition, certain other provisions of our certificate of incorporation and bylaws relating to, without limitation, (a) actions required to be taken at a meeting of shareholders rather than by written consent, (b) the percentage of shareholders required to call a special meeting of shareholders, (c) a limitation on the maximum number of directors, (d) removal of directors only for "cause," and (e) the percentage of shareholders required to approve amendments to our bylaws, may have anti-takeover effects, which may delay, defer or prevent a takeover attempt that a holder of our common stock might consider in its best interest.

We are subject to the provisions of Section 203 of the General Corporation Law of the State of Delaware, which prohibits a Delaware corporation from engaging in any "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. A "business combination" includes mergers, asset sales as well as certain transactions resulting in a financial benefit to the interested stockholder. Subject to certain exceptions, an "interested stockholder" is a person who, together with affiliates and associates, owns, or within three years did own, 15% or more of the corporation's voting stock. The operation of Section 203 may have anti-takeover effects, which may delay, defer or prevent a takeover attempt that a holder of our common stock might consider in its best interest.

#### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk.**

##### *Market Risk*

The principal market risks (i.e. the risk of loss arising from adverse changes in market rates and prices) to which the Company is exposed are:

- rates on debt and short-term and long-term investment portfolios, and
- exchange rates, generating translation and transaction gains and losses.

##### *Interest Rates*

Veeco centrally manages its debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. Veeco's investment portfolios consist of cash equivalents and obligations of U.S. government agencies. These investments in obligations of the U.S. government are considered held to maturity securities. Accordingly, the amounts are carried at amortized cost. Assuming year-end 2002 variable debt and investment levels, a one-point change in interest rates would not have a material impact on net interest expense. In December 2001 and January 2002, the Company issued \$220.0 million of 4.125% convertible subordinated notes. The notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of common stock at a conversion price of \$38.51 per share. The Company pays interest on these notes on June 21 and December 21 of each year. Interest payments commenced on June 21, 2002 (see Note 3 to the Company's Consolidated Financial Statements). The notes will mature on December 21, 2008. After the third anniversary of the issuance, the notes may be redeemed at the option of the Company, at the redemption prices set forth in the indenture.

##### *Foreign Operations*

Operating in international markets involves exposure to movements in currency exchange rates, which are volatile at times. The economic impact of currency exchange rate movements on Veeco is complex because such changes are often linked to variability in real growth, inflation, interest rates, governmental actions and other factors. These changes, if material, could cause the Company to adjust its financing and operating strategies. Consequently, isolating the effect of changes in currency does not incorporate these other important economic factors.

Veeco's net sales to foreign customers represented approximately 53% of Veeco's total net sales in 2002, 46% in 2001 and 50% in 2000. The Company expects that net sales to foreign customers will continue to represent a large percentage of Veeco's total net sales. Veeco's net sales denominated in foreign currencies represented approximately 17% of Veeco's total net sales in 2002, 15% in 2001 and 9% in 2000. The aggregate foreign exchange gains (losses) included in determining consolidated results of operations were \$0.1 million, \$(1.9) million and \$(0.8) million in 2002, 2001 and 2000, respectively. In 2002 and 2001, the foreign currency exchange gain (loss) is net of approximately \$(1.0) and



\$0.4 million of realized hedging (losses) gains, respectively, which were recorded and included in other (income) expense, net. As of December 31, 2002, approximately \$0.3 million of losses related to forward contracts are included in accrued expenses and have been subsequently paid in January 2003. As of December 31, 2002, there were no open forward contracts. Veeco is exposed to financial market risks, including changes in foreign currency exchange rates. To mitigate these risks, Veeco uses derivative financial instruments. Veeco does not use derivative financial instruments for speculative or trading purposes. The Company enters into monthly forward contracts to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known currency exposures. The average notional amount of such contracts was approximately \$1.9 million for the year ended December 31, 2002. The change in currency exchange rate that has the largest impact on translating Veeco's international operating (loss) profit are the Japanese Yen and the Euro. The Company estimates that based upon its balance sheet at December 31, 2002, a 10% change in foreign exchange rates impact operating loss by approximately \$0.6 million. The Company believes that this quantitative measure has inherent limitations because, as discussed in the first paragraph of this section, it does not take into account any governmental actions or changes in either customer purchasing patterns or our financing and operating strategies.

## Item 8. Financial Statements and Supplementary Data.

The consolidated financial statements of the Company are listed in the Index to Consolidated Financial Statements and Financial Statement Schedule filed as part of this Form 10-K.

### Quarterly Results of Operations

The following table presents selected financial data for each quarter of fiscal 2002 and 2001. Although unaudited, this information has been prepared on a basis consistent with the Company's audited financial statements and, in the opinion of the Company's management, reflects all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of this information in accordance with generally accepted accounting principles. Such quarterly results are not necessarily indicative of future results of operations and should be read in conjunction with the audited financial statements of the Company and the notes thereto.

### Quarterly Statements of Operations (In thousands):

	Fiscal 2002					Fiscal 2001				
	Q1	Q2	Q3	Q4(1)	Year	Q1(2)	Q2(2)	Q3(2)	Q4(1)	Year
Net sales .....	\$80,149	\$77,339	\$72,753	\$68,644	\$298,885	\$125,386	\$112,095	\$114,276	\$97,494	\$449,251
Cost of sales .....	46,414	42,137	38,405	56,086	183,042	66,696	58,956	63,896	70,600	260,148
Gross profit .....	33,735	35,202	34,348	12,558	115,843	58,690	53,139	50,380	26,894	189,103
Costs and expenses .....	36,162	36,150	36,325	34,190	142,827	39,083	36,626	37,519	40,886	154,114
Merger and restructuring expenses .....	837	1,050	83	9,278	11,248	—	1,000	—	2,046	3,046
Write-off of purchased in-process technology .....	—	—	—	—	—	—	—	8,200	—	8,200
Asset impairment charges .....	—	—	—	99,663	99,663	—	—	—	3,418	3,418
Operating (loss) income .....	(3,264)	(1,998)	(2,060)	(130,573)	(137,895)	19,607	15,513	4,661	(19,456)	20,325
Interest expense (income) .....	1,486	1,477	1,388	1,651	6,002	(767)	(397)	(263)	850	(577)
(Loss) income from continuing operations, before income taxes .....	(4,750)	(3,475)	(3,448)	(132,224)	(143,897)	20,374	15,910	4,924	(20,306)	20,902
Income tax (benefit) provision .....	(1,598)	(1,856)	(1,366)	(15,693)	(20,513)	7,158	5,435	2,727	(9,300)	6,020
(Loss) income from continuing operations ..	(3,152)	(1,619)	(2,082)	(116,531)	(123,384)	13,216	10,475	2,197	(11,006)	14,882
Loss from discontinued operations, net of taxes .....	—	—	—	—	—	(343)	(475)	(349)	(1,283)	(2,450)
Loss on disposal of discontinued operations, net of taxes .....	(346)	—	—	—	(346)	—	—	—	(2,123)	(2,123)
Net (loss) income .....	<u>\$(3,498)</u>	<u>\$(1,619)</u>	<u>\$(2,082)</u>	<u>\$(116,531)</u>	<u>\$(123,730)</u>	<u>\$12,873</u>	<u>\$10,000</u>	<u>\$1,848</u>	<u>\$(14,412)</u>	<u>\$10,309</u>

## Quarterly Statements of Operations:

	Fiscal 2002					Fiscal 2001				
	Q1	Q2	Q3	Q4	Year	Q1(2)	Q2(2)	Q3(2)	Q4	Year
<b>(Loss) income per common share:</b>										
(Loss) income per common share from continuing operations	\$(0.11)	\$(0.06)	\$(0.07)	\$(4.00)	\$(4.24)	\$0.54	\$0.42	\$0.09	\$(0.38)	\$0.57
Loss on discontinued operations.....	(0.01)	—	—	—	(0.01)	(0.02)	(0.02)	(0.02)	(0.12)	(0.17)
Net (loss) income per common share .....	<u>\$(0.12)</u>	<u>\$(0.06)</u>	<u>\$(0.07)</u>	<u>\$(4.00)</u>	<u>\$(4.25)</u>	<u>\$0.52</u>	<u>\$0.40</u>	<u>\$0.07</u>	<u>\$(0.50)</u>	<u>\$0.40</u>
Diluted (loss) income per common share from continuing										
operations .....	\$(0.11)	\$(0.06)	\$(0.07)	\$(4.00)	\$(4.24)	\$0.52	\$0.42	\$0.09	\$(0.38)	\$0.56
Loss on discontinued operations.....	(0.01)	—	—	—	(0.01)	(0.01)	(0.02)	(0.02)	(0.12)	(0.17)
Diluted net (loss) income per common share.....	<u>\$(0.12)</u>	<u>\$(0.06)</u>	<u>\$(0.07)</u>	<u>\$(4.00)</u>	<u>\$(4.25)</u>	<u>\$0.51</u>	<u>\$0.40</u>	<u>\$0.07</u>	<u>\$(0.50)</u>	<u>\$0.39</u>
Weighted average shares outstanding .....	29,021	29,083	29,137	29,142	29,096	24,678	24,767	25,413	28,853	25,937
Diluted weighted average shares outstanding .....	29,021	29,083	29,137	29,142	29,096	25,230	25,215	25,669	28,853	26,355

- (1) In December 2002 and December 2001, the Company incurred charges of \$15.0 million and \$13.6 million, respectively, for the write-off of inventory (see Note 7 to the Company's Consolidated Financial Statements). These charges are included in cost of sales.
- (2) During December 2001, the Company discontinued its industrial measurement operating segment. As a result, the quarterly information for the first three quarters of 2001 noted above has been restated from that previously filed on the Quarterly Reports on Form 10-Q. See Note 7 to the Consolidated Financial Statements.

A variety of factors influence the level of the Company's net sales in a particular quarter including economic conditions in the semiconductor, data storage and optical/wireless telecommunications industries, the timing of significant orders, shipment delays, specific feature requests by customers, the introduction of new products by the Company and its competitors, production and quality problems, changes in material costs, disruption in sources of supply, seasonal patterns of capital spending by customers, and other factors, many of which are beyond the Company's control. In addition, the Company derives a substantial portion of its revenues from the sale of products which have an average selling price in excess of \$750,000. As a result, the timing of recognition of revenue from a single transaction could have a significant impact on the Company's net sales and operating results in any given quarter.

## Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

## PART III

## Item 10. Directors and Executive Officers of the Registrant.

Reference is made to the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the end of the Registrant's fiscal year for information concerning directors and executive officers of the Registrant.

## Item 11. Executive Compensation.

Reference is made to the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the end of the Registrant's fiscal year for information concerning executive compensation.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.**

Reference is made to the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the end of the Registrant's fiscal year for information concerning security ownership of each person known by the Company to own beneficially more than 5% of the outstanding shares of Common Stock, of each director of the Company and all executive officers and directors as a group.

**Item 13. Certain Relationships and Related Transactions.**

Reference is made to the Registrant's definitive proxy statement to be filed with the Securities and Exchange Commission within 120 days after the end of the Registrant's fiscal year for information concerning certain relationships and related transactions.

**Item 14. Controls and Procedures.**

The Company's senior management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-14 and 15d-14 under the Securities Exchange Act of 1934 (the "Exchange Act")) designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

The Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures under the supervision of and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, within 90 days prior to the filing date of this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic Securities and Exchange Commission filings.

Subsequent to that evaluation there have been no significant changes in our internal controls or other factors that could significantly affect these controls after such evaluation.

**PART IV****Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K.**

- (a) The Registrant's financial statements together with a separate table of contents are annexed hereto. The financial statement schedule is listed in the separate table of contents annexed hereto.
- (b) Reports on Form 8-K.

The Registrant filed a Current Report on Form 8-K on December 17, 2002 announcing that the Company and FEI Company would not be able to complete the previously announced merger by December 31, 2002.

The Registrant filed a Current Report on Form 8-K on January 17, 2003 regarding the mutual termination of the merger agreement between Veeco and FEI Company.

(c) Exhibits

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

Number	Exhibit	Incorporated by Reference to the Following Documents
2.1	Agreement and Plan of Merger, dated as of September 6, 2001, among Veeco Instruments Inc., Veeco Acquisition Corp., Applied Epi, Inc., the shareholders of Applied Epi, Inc. listed on the signature pages thereto and Paul E. Colombo, as Stockholders' Representative.	Current Report on Form 8-K, filed September 14, 2001, Exhibit 99.1
3.1	Amended and Restated Certificate of Incorporation of the Company dated December 1, 1994, as amended June 2, 1997 and July 25, 1997.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 1997, Exhibit 3.1
3.2	Amendment to Certificate of Incorporation of Veeco dated May 29, 1998.	Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 3.2
3.3	Amendment to Certificate of Incorporation of Veeco dated May 5, 2000.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000, Exhibit 3.1
3.4	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of Veeco.	Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2001, Exhibit 3.1
3.5	Third Amended and Restated Bylaws of the Company, effective October 26, 2000.	Registration Statement on Form S-8 (File No. 333-49476), filed November 7, 2000, Exhibit 4.3
4.1	Rights Agreement, dated as of March 13, 2001, between Veeco Instruments Inc. and American Stock Transfer and Trust Company, as Rights Agent, including the form of the Certificate of Designation, Preferences and Rights setting forth the terms of the Series A Junior Participating Preferred Stock, par value \$0.01 per share, as Exhibit A, the form of Rights Certificates as Exhibit B and the Summary of Rights to Purchase Preferred Stock as Exhibit C.	Registration Statement on Form 8-A dated March 15, 2001, Exhibit 1
4.2	Amendment to Rights Agreement, dated as of September 6, 2001, between Veeco Instruments Inc. and American Stock Transfer and Trust Company, as rights agent.	Current Report on Form 8-K, filed September 21, 2001, Exhibit 4.1
4.3	Amendment No 2 to Rights Agreement, dated as of July 11, 2002, between Veeco Instruments Inc. and American Stock Transfer and Trust Company, as rights agent.	Current Report on Form 8-K, filed July 12, 2002, Exhibit 4.1
4.4	Indenture between Veeco and State Street Bank and Trust Company, N.A., as trustee, dated December 21, 2001, relating to the 4 <sup>1</sup> / <sub>8</sub> % convertible subordinated notes due 2008.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 4.1

Number	Exhibit	Incorporated by Reference to the Following Documents
10.1	Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2001, Exhibit 10.1
10.2	Amendment and Waiver dated as of September 17, 2001 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 10.1
10.3	Consent and Second Amendment dated as of December 21, 2001 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Annual Report on Form 10-K for the Year Ended December 31, 2001, Exhibit 10.3
10.4	Third Amendment dated as of February 7, 2002 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Annual Report on Form 10-K for the Year Ended December 31, 2001, Exhibit 10.4
10.5	Fourth Amendment dated as of March 20, 2002 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Annual Report on Form 10-K for the Year Ended December 31, 2001, Exhibit 10.5
10.6	Fifth Amendment dated as of February 5, 2003 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, JPMorgan Chase Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	*
10.7	Security Agreement dated as of March 20, 2002 among Veeco Instruments Inc., the subsidiaries of Veeco named therein and Fleet National Bank, as administrative agent.	Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2002, Exhibit 10.3
10.8	Loan Agreement dated as of December 15, 1999 between Applied Epi, Inc. and Jackson National Life Insurance Company.	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 10.2

Number	Exhibit	Incorporated by Reference to the Following Documents
10.9	Amendment to Loan Documents effective as of September 17, 2001 between Applied Epi, Inc. and Jackson National Life Insurance Company (executed in June 2002).	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2002, Exhibit 10.2
10.10	Promissory Note dated as of December 15, 1999 issued by Applied Epi, Inc. to Jackson National Life Insurance Company.	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 10.3
10.11	Collateral Pledge and Security Agreement among Veeco, State Street Bank and Trust Company, N.A., as trustee and as collateral agent, and State Street Bank and Trust Company, as securities intermediary, dated as of December 21, 2001.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.1
10.12	Supplement No. 1 to Collateral Pledge and Security Agreement among Veeco and State Street Bank and Trust Company, N.A., as trustee and as collateral agent, and State Street Bank and Trust Company, as securities intermediary, dated as of January 3, 2002.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.3
10.13	Registration Rights Agreement among Veeco and Merrill Lynch, Pierce, Fenner and Smith Incorporated, Salomon Smith Barney Inc. and Thomas Weisel Partners LLC, as the initial purchasers of Veeco's 4 <sup>1</sup> / <sub>8</sub> % Convertible Subordinated Notes due 2008, dated as of December 21, 2001.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.2
10.14	Registration Rights Agreement among Veeco and the Former Applied Epi Stockholders named therein, dated as of September 17, 2001.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.4
10.15	Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-1 (File No. 33-93958), Exhibit 10.20
10.16	Amendment dated May 15, 1997 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-35009) filed September 5, 1997, Exhibit 10.1
10.17	Amendment dated July 25, 1997 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-35009) filed September 5, 1997, Exhibit 10.2
10.18	Amendment dated May 29, 1998 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-79469) filed May 27, 1999, Exhibit 10.1
10.19	Amendment dated May 14, 1999 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-79469) filed May 27, 1999, Exhibit 10.2
10.20	Veeco Instruments Inc. 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-1 (File No. 33-85184), Exhibit 10.17
10.21	Amendment dated May 15, 1996 to Veeco Instruments Inc. Amended and Restated 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-8 (File No. 333-08981) filed July 26, 1996, Exhibit 10.2

Number	Exhibit	Incorporated by Reference to the Following Documents
10.22	Amendment dated May 15, 1997 to Veeco Instruments Inc. Amended and Restated 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-8 (File No. 333-35009) filed September 5, 1997, Exhibit 10.3
10.23	Amendment dated May 21, 1999 to Veeco Instruments Inc. Amended and Restated 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-8 (File No. 333-79469) filed May 27, 1999, Exhibit 10.3
10.24	Veeco Instruments Inc. First Amended and Restated Employees Stock Purchase Plan, dated October 26, 2000.	Annual Report on Form 10-K for the Year Ended December 31, 2000, Exhibit 10.18
10.25	Veeco Instruments Inc. 2000 Stock Option Plan.	Current Report on Form 8-K filed May 9, 2000, Exhibit 10.1
10.26	Amendment No. 1 to the Veeco Instruments Inc. 2000 Stock Option Plan, effective May 11, 2001.	Registration Statement on Form S-8 (File Number 333-66574) filed August 2, 2001, Exhibit 4.1
10.27	Amendment No. 2 to the Veeco Instruments Inc. 2000 Stock Option Plan, effective May 10, 2002.	Registration Statement on Form S-8 (File Number 333-88946) filed May 23, 2002, Exhibit 4.1
10.28	Veeco Instruments Inc. 2000 Stock Option Plan for Non-Officer Employees.	Registration Statement on Form S-8 (File Number 333-49476) filed November 7, 2000, Exhibit 4.4
10.29	Amendment No. 1 to the Veeco Instruments Inc. 2000 Stock Option Plan for Non-Officer Employees, effective dated July 26, 2001.	Registration Statement on Form S-8 (File Number 333-66574) filed August 2, 2001, Exhibit 4.2
10.30	CVC, Inc. 1999 Non-employee Directors' Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.1
10.31	CVC, Inc. Amended and Restated 1997 Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.2
10.32	Amended and Restated (1996) Stock Option Plan of CVC, Inc. (formerly, CVC Holdings, Inc.).	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.3
10.33	Form of Commonwealth Scientific Corporation Non-Qualified Stock Option Agreement.	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.4
10.34	Applied Epi, Inc. 1993 Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-69554) filed on September 18, 2001, Exhibit 4.1
10.35	Applied Epi, Inc. 2000 Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-69554) filed on September 18, 2001, Exhibit 4.2
10.36	Form of Applied Epi, Inc. Non-Qualified Restricted Stock Option Agreement.	Registration Statement on Form S-8 (File Number 333-69554) filed on September 18, 2001, Exhibit 4.3
10.37	Form of Warrant to Purchase Shares of Common Stock of Applied Epi, Inc. (assumed in connection with the Applied Epi merger and now exercisable for shares of common stock of Veeco Instruments Inc.)	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 4.6

Number	Exhibit	Incorporated by Reference to the Following Documents
10.38	Employment Agreement dated as of April 3, 2000 between Edward H. Braun and Veeco Instruments Inc.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000, Exhibit 10.2
10.39	Employment Agreement dated as of April 3, 2000 between John F. Rein, Jr. and Veeco Instruments Inc.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000, Exhibit 10.4
10.40	Letter Agreement, dated December 2, 1997 between Veeco Instruments Inc. and Dr. Don R. Kania.	Annual Report on Form 10-K for the Year Ended December 31, 1997, Exhibit 10.33
10.41	Letter Agreement dated January 16, 1995 between the Company and John P. Kiernan.	Annual Report on Form 10-K for the Year Ended December 31, 1994, Exhibit 10.20
21.1	Subsidiaries of the Registrant.	*
23.1	Consent of Ernst & Young LLP.	*
99.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	*
99.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	*

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\* Filed herewith



## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 27, 2003.

VEECO INSTRUMENTS INC.

By: /s/ Edward H. Braun  
Edward H. Braun  
*Chairman and Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated, on March 27, 2003.

<u>Signatures</u>	<u>Title</u>
<u>/s/ Edward H. Braun</u> Edward H. Braun	Director, Chairman and Chief Executive Officer (principal executive officer)
<u>/s/ Richard A. D'Amore</u> Richard A. D'Amore	Director
<u>/s/ Joel A. Elftmann</u> Joel A. Elftmann	Director
<u>/s/ Heinz K. Fridrich</u> Heinz K. Fridrich	Director
<u>/s/ Douglas A. Kingsley</u> Douglas A. Kingsley	Director
<u>/s/ Dr. Paul R. Low</u> Dr. Paul R. Low	Director
<u>/s/ Roger D. McDaniel</u> Roger D. McDaniel	Director

Signatures	Title
<div>/s/ Irwin H. Pfister</div> <div>Irwin H. Pfister</div>	Director
<div>/s/ Walter J. Scherr</div> <div>Walter J. Scherr</div>	Director
<div>/s/ John F. Rein, Jr.</div> <div>John F. Rein, Jr.</div>	Executive Vice President, Chief Financial Officer and Secretary (principal financial officer)
<div>/s/ John P. Kiernan</div> <div>John P. Kiernan</div>	Vice President, Finance and Corporate Controller (principal accounting officer)

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Edward H. Braun, Chairman and Chief Executive Officer of Veeco Instruments Inc. (the "Company"), certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2002 (the "Report");
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - (c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Edward H. Braun  
Edward H. Braun  
Chairman and Chief Executive Officer  
Veeco Instruments Inc.  
March 27, 2003

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, John F. Rein, Jr., Executive Vice President, Chief Financial Officer and Secretary of Veeco Instruments Inc. (the "Company"),  
certify that:

1. I have reviewed this annual report on Form 10-K for the year ended December 31, 2002 (the "Report");
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - (a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - (c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ John F. Rein, Jr.

John F. Rein, Jr.  
Executive Vice President, Chief Financial  
Officer and Secretary  
Veeco Instruments Inc.  
March 27, 2003

**Veeco Instruments Inc. and Subsidiaries**  
**Index to Consolidated Financial Statements**  
**and Financial Statement Schedule**

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## **Report of Independent Auditors**

To the Shareholders and the Board of Directors  
Veeco Instruments Inc.

We have audited the accompanying consolidated balance sheets of Veeco Instruments Inc. and Subsidiaries (the "Company") as of December 31, 2002 and 2001, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2002. Our audits also included the financial statement schedule in the accompanying Index. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Veeco Instruments Inc. and Subsidiaries at December 31, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1, in 2001, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, and in 2000, the Company changed its method of revenue recognition for certain products in accordance with the provisions of Staff Accounting Bulletin No. 101.

/s/ Ernst & Young LLP

Melville, New York  
February 7, 2003

**Veeco Instruments Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
**(Dollars in thousands)**

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents.....	<b>\$214,295</b>	\$203,154
Accounts receivable, less allowance for doubtful accounts of \$2,815 in 2002 and \$3,350 in 2001.....	<b>68,777</b>	88,449
Inventories .....	<b>86,250</b>	102,103
Prepaid expenses and other current assets .....	<b>18,392</b>	21,952
Deferred income taxes.....	<b>31,549</b>	46,832
Total current assets.....	<b>419,263</b>	462,490
Property, plant and equipment at cost, net .....	<b>55,872</b>	78,547
Goodwill.....	<b>30,658</b>	125,585
Purchased technology, less accumulated amortization of \$15,287 in 2002 and \$5,655 in 2001.....	<b>39,331</b>	48,445
Other intangible assets, less accumulated amortization of \$11,215 in 2002 and \$7,524 in 2001.....	<b>14,425</b>	15,943
Long-term investments .....	<b>17,483</b>	23,519
Deferred income taxes .....	<b>28,888</b>	—
Other assets .....	<b>898</b>	990
Total assets .....	<b><u>\$606,818</u></b>	<b><u>\$755,519</u></b>
<b>Liabilities and shareholders' equity</b>		
Current liabilities:		
Accounts payable .....	<b>\$13,078</b>	\$19,657
Accrued expenses .....	<b>44,993</b>	58,070
Deferred profit.....	<b>5,966</b>	14,566
Income taxes payable .....	<b>3,808</b>	8,630
Current portion of long-term debt.....	<b>312</b>	3,544
Total current liabilities.....	<b>68,157</b>	104,467
Deferred income taxes .....	—	10,157
Long-term debt.....	<b>230,273</b>	215,519
Other liabilities.....	<b>815</b>	1,405
Shareholders' equity:		
Preferred stock, 500,000 shares authorized; no shares issued and outstanding .....	—	—
Common stock, 60,000,000 shares authorized; 29,221,374 and 29,006,706 shares issued and outstanding in 2002 and 2001, respectively.....	<b>292</b>	290
Additional paid-in capital .....	<b>361,941</b>	359,007
Accumulated (deficit) earnings.....	<b>(55,246)</b>	68,484
Accumulated comprehensive income (loss).....	<b>586</b>	(3,810)
Total shareholders' equity .....	<b><u>307,573</u></b>	<b><u>423,971</u></b>
Total liabilities and shareholders' equity .....	<b><u>\$606,818</u></b>	<b><u>\$755,519</u></b>

See accompanying notes.

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

	<u>Year ended December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Net sales .....	<b>\$298,885</b>	\$449,251	\$376,113
Cost of sales .....	<b>183,042</b>	260,148	219,578
Gross profit .....	<b>115,843</b>	189,103	156,535
Costs and expenses:			
Selling, general and administrative expense .....	<b>75,899</b>	82,426	75,642
Research and development expense .....	<b>53,889</b>	59,722	51,239
Amortization expense .....	<b>13,323</b>	9,469	3,736
Merger and restructuring expenses .....	<b>11,248</b>	3,046	14,206
Asset impairment charges .....	<b>99,663</b>	3,418	3,722
Write-off of purchased in-process technology .....	<b>—</b>	8,200	—
Other (income) expense, net .....	<b>(284)</b>	2,497	852
	<b>253,738</b>	168,778	149,397
Operating (loss) income .....	<b>(137,895)</b>	20,325	7,138
Interest expense .....	<b>10,535</b>	2,427	2,374
Interest income .....	<b>(4,533)</b>	(3,004)	(3,681)
(Loss) income from continuing operations before income taxes .....	<b>(143,897)</b>	20,902	8,445
Income tax (benefit) provision .....	<b>(20,513)</b>	6,020	5,780
(Loss) income from continuing operations .....	<b>(123,384)</b>	14,882	2,665
Discontinued operations:			
Loss from operations, net of taxes .....	<b>—</b>	(2,450)	(2,163)
Loss on disposal, net of taxes .....	<b>(346)</b>	(2,123)	—
Loss from discontinued operations, net of taxes .....	<b>(346)</b>	(4,573)	(2,163)
Cumulative effect of change in accounting principle, net of taxes .....	<b>—</b>	—	(18,382)
Net (loss) income .....	<b><u>\$(123,730)</u></b>	<b><u>\$10,309</u></b>	<b><u>\$(17,880)</u></b>
(Loss) income per common share:			
(Loss) income per common share from continuing operations .....	<b>\$(4.24)</b>	\$0.57	\$0.11
Loss from discontinued operations .....	<b>(0.01)</b>	(0.17)	(0.09)
Cumulative effect of change in accounting principle, net of taxes .....	<b>—</b>	—	(0.77)
Net (loss) income per common share .....	<b><u>\$(4.25)</u></b>	<b><u>\$0.40</u></b>	<b><u>\$(0.75)</u></b>
Diluted (loss) income per common share from continuing operations .....	<b>\$(4.24)</b>	\$0.56	\$0.11
Loss from discontinued operations .....	<b>(0.01)</b>	(0.17)	(0.09)
Cumulative effect of change in accounting principle, net of taxes .....	<b>—</b>	—	(0.73)
Diluted net (loss) income per common share .....	<b><u>\$(4.25)</u></b>	<b><u>\$0.39</u></b>	<b><u>\$(0.71)</u></b>
Pro forma amounts assuming retroactive effect of change in accounting principle:			
Net income .....	<b>—</b>	—	\$502
Net income per common share .....	<b>—</b>	—	\$0.02
Diluted net income per common share .....	<b>—</b>	—	\$0.02
Weighted average shares outstanding .....	<b>29,096</b>	25,937	23,805
Diluted weighted average shares outstanding .....	<b>29,096</b>	26,355	25,128

See accompanying notes.



**Veeco Instruments Inc. and Subsidiaries**  
**Consolidated Statements of Shareholders' Equity**  
**(Dollars in thousands)**

	<u>Common Stock</u>			Retained	Unamortized	Accumulated		Comprehensive
	Shares	Amount	Additional Paid-In Capital	Earnings (Accumulated Deficit)	Deferred Compensation	Comprehensive (Loss) Income	Total	(Loss) Income
Balance at December 31, 1999 .....	21,279,565	\$213	\$149,446	\$75,276	\$(135)	\$(856)	\$223,944	\$20,796
Exercise of stock options and stock issuances under stock purchase plan.....	1,762,654	18	31,256	—	—	—	31,274	—
Stock option income tax benefit .....	—	—	28,988	—	—	—	28,988	—
Stock issued in connection with the Monarch merger.....	282,224	3	—	234	—	—	237	—
Adjustment to reflect change in year- end for CVC .....	1,338,208	13	16,938	545	—	—	17,496	—
Translation adjustment .....	—	—	—	—	—	(1,279)	(1,279)	(1,279)
Unrealized gain on available -for -sale securities.....	—	—	—	—	—	16	16	16
Deferred compensation .....	—	—	—	—	112	—	112	—
Net loss .....	—	—	—	(17,880)	—	—	(17,880)	(17,880)
Balance at December 31, 2000 .....	24,662,651	247	226,628	58,175	(23)	(2,119)	282,908	<u>\$(19,143)</u>
Exercise of stock options and stock issuances under stock purchase plan.....	460,595	4	5,960	—	—	—	5,964	—
Stock option income tax benefit .....	—	—	6,195	—	—	—	6,195	—
Stock issued in connection with the Applied Epi acquisition .....	3,883,460	39	120,224	—	—	—	120,263	—
Translation adjustment .....	—	—	—	—	—	(1,621)	(1,621)	(1,621)
Unrealized loss on available -for -sale securities.....	—	—	—	—	—	(2)	(2)	(2)
Minimum pension liability, net of tax effect	—	—	—	—	—	(68)	(68)	(68)
Deferred compensation .....	—	—	—	—	23	—	23	—
Net income .....	—	—	—	10,309	—	—	10,309	10,309
Balance at December 31, 2001 .....	29,006,706	290	359,007	68,484	—	(3,810)	423,971	<u>8,618</u>
Exercise of stock options and stock issuances under stock purchase plan.....	<b>214,668</b>	<b>2</b>	<b>1,761</b>	—	—	—	<b>1,763</b>	—
Stock option income tax benefit .....	—	—	<b>1,173</b>	—	—	—	<b>1,173</b>	—
Translation adjustment .....	—	—	—	—	—	<b>4,493</b>	<b>4,493</b>	<b>4,493</b>
Minimum pension liability, net of tax effect	—	—	—	—	—	<b>(97)</b>	<b>(97)</b>	<b>(97)</b>
Net loss .....	—	—	—	<b>(123,730)</b>	—	—	<b>(123,730)</b>	<b>(123,730)</b>
Balance at December 31, 2002 .....	<u><b>29,221,374</b></u>	<u><b>\$292</b></u>	<u><b>\$361,941</b></u>	<u><b>\$(55,246)</b></u>	<u><b>\$—</b></u>	<u><b>\$586</b></u>	<u><b>\$307,573</b></u>	<u><b>\$(119,334)</b></u>

See accompanying notes.

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

	Year ended December 31,		
	2002	2001	2000
<b>Operating activities</b>			
Net (loss) income .....	<b>\$(123,730)</b>	\$10,309	\$(17,880)
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:			
Non-cash merger and restructuring expenses .....	<b>114,664</b>	16,965	19,044
Depreciation and amortization .....	<b>27,929</b>	22,654	15,473
Deferred income taxes .....	<b>(22,643)</b>	(13,406)	(22,036)
Stock option income tax benefit .....	<b>1,173</b>	6,195	28,988
Loss on disposal of discontinued operations .....	<b>346</b>	2,123	—
Write-off of purchased in-process technology .....	—	8,200	—
Cumulative effect of change in accounting principle .....	—	—	18,382
Other .....	<b>613</b>	481	(47)
Changes in operating assets and liabilities, net of effect of acquisitions:			
Accounts receivable .....	<b>24,990</b>	18,748	(26,219)
Inventories .....	<b>3,553</b>	(9,083)	(24,952)
Accounts payable .....	<b>(6,960)</b>	(14,972)	7,439
Accrued expenses, deferred profit and other current liabilities .....	<b>(28,081)</b>	(21,224)	9,785
Recoverable income taxes .....	—	629	(4,100)
Other, net .....	<b>5,989</b>	(5,876)	5,790
Operating activities three months ended 12/31/99—CVC .....	—	—	638
Net cash (used in) provided by operating activities .....	<b>(2,157)</b>	21,743	10,305
<b>Investing activities</b>			
Capital expenditures .....	<b>(8,644)</b>	(19,180)	(17,803)
Proceeds from sale of property, plant and equipment .....	<b>1,790</b>	—	497
Proceeds from sale of businesses .....	<b>3,750</b>	—	3,000
Payments for net assets of businesses acquired .....	—	(59,557)	(13,835)
Purchases of available-for-sale securities .....	—	(284,685)	(436,013)
Sale of available-for-sale securities .....	—	67,946	110,453
Maturities of available-for-sale securities .....	—	243,634	349,578
Purchase of long-term investments .....	<b>(2,585)</b>	(23,519)	—
Maturities of long-term investments .....	<b>8,621</b>	—	—
Investing activities three months ended 12/31/99—CVC .....	—	—	(528)
Net cash provided by (used in) investing activities .....	<b>2,932</b>	(75,361)	(4,651)
<b>Financing activities</b>			
Proceeds from stock issuances .....	<b>1,763</b>	5,964	31,274
Net proceeds from borrowings under lines of credit .....	—	25,000	—
Proceeds from long-term debt .....	<b>20,000</b>	200,000	—
Repayments of long-term debt and borrowings under lines of credit .....	<b>(8,478)</b>	(33,662)	(9,318)
Payments for debt issuance costs .....	<b>(1,279)</b>	(6,000)	—
Other .....	—	(68)	—
Financing activities three months ended 12/31/99—CVC .....	—	—	3,627
Net cash provided by financing activities .....	<b>12,006</b>	191,234	25,583
Effect of exchange rate changes on cash and cash equivalents .....	<b>(1,640)</b>	2,119	2,331
Net increase in cash and cash equivalents .....	<b>11,141</b>	139,735	33,568
Cash and cash equivalents at beginning of year .....	<b>203,154</b>	63,419	29,851
Cash and cash equivalents at end of year .....	<b>\$214,295</b>	\$203,154	\$63,419

See accompanying notes.

**Veeco Instruments Inc.**  
**Notes to Consolidated Financial Statements**

**December 31, 2002**

**1. Description of Business and Significant Accounting Policies**

*Business*

Veeco Instruments Inc. (together with its consolidated subsidiaries, "Veeco", the "Company" or "we") designs, manufactures, markets and services a broad line of equipment primarily used by manufacturers in the data storage, semiconductor and telecommunications/wireless industries. These industries help create a wide range of information age products such as computer integrated circuits, personal computers, hard disk drives, network servers, fiber optic networks, digital cameras, wireless phones, TV set-top boxes and personal digital assistants. Veeco's products are also enabling advancements in the growing field of nanoscience and other areas of scientific and industrial research.

Veeco's process equipment products precisely deposit or remove (etch) various materials in the manufacturing of advanced thin film magnetic heads (TFMHs) for the data storage industry, semiconductor deposition of mask reticles, and telecommunications/wireless devices. Veeco's metrology equipment is used to provide critical surface measurements on semiconductor devices and TFMHs. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality. Veeco's metrology solutions are also used by many universities, scientific laboratories and industrial applications.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

*Principles of Consolidation*

The accompanying consolidated financial statements include the accounts of Veeco and its subsidiaries. Intercompany items and transactions have been eliminated in consolidation.

*Revenue Recognition*

Effective January 1, 2000 the Company changed its method of accounting for revenue recognition in accordance with Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*. The Company recognizes revenue when persuasive evidence of an arrangement exists, the seller's price is fixed or determinable and collectibility is reasonably assured.

For products produced according to the Company's published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment.

For products produced according to a particular customer's specifications, revenue is recognized when the product has been tested and it has been demonstrated that it meets the customer's specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount of any customer retention (generally 10% to 20%), which is not payable by the customer until installation is completed and final customer acceptance is achieved. The amount of customer retention

is recorded in accounts receivable with a corresponding liability recorded in deferred profit. At December 31, 2002 and 2001, \$1.4 million and \$3.3 million, respectively, are recorded in accounts receivable and deferred profit pertaining to customer retentions. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% to 2% of the sales value of the related equipment.

For new products, new applications of existing products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 80% to 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the entire contract amount. The profit on these transactions is deferred and recorded as deferred profit in the accompanying balance sheets. At December 31, 2002 and 2001, \$4.6 million and \$11.2 million, respectively, are recorded in deferred profit pertaining to shipments where revenue recognition has been fully deferred.

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

The Company estimates the costs that may be incurred under its warranty and records a liability in the amount of such costs at the time the related revenue is recognized. Factors that affect the Company's warranty liability include historical and anticipated rates of warranty claims and costs per claim. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary.

Prior to the adoption of SAB 101, the Company recognized revenue when title passed, generally upon shipment. The cumulative effect of the change from the prior year resulted in a charge to income of \$18.4 million (net of income taxes of \$12.6 million), which is included in the Consolidated Statement of Operations for the year ended December 31, 2000. The effect of the change on the year ended December 31, 2000 was to increase income before the cumulative effect of the accounting change by \$1.3 million (\$.05 per share). The pro forma amounts presented in the Consolidated Statements of Operations were calculated assuming the accounting change was made retroactively to prior periods. For the year ended December 31, 2000, the Company recognized approximately \$67.0 million in revenue that was included in the cumulative effect adjustment as of January 1, 2000. The effect of that revenue was to increase income by \$18.4 million (after reduction for income taxes of \$12.6 million) during the year ended December 31, 2000.

#### *Cash Flows*

The Company considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents. Interest paid during 2002, 2001 and 2000 was approximately \$11.5 million, \$2.1 million and \$2.3 million, respectively. Income taxes paid in 2002, 2001 and 2000 were approximately \$7.1 million, \$4.9 million and \$6.7 million, respectively.

In connection with the acquisition of Applied Epi, Inc. ("Applied Epi") in 2001, the Company issued shares of Common Stock with a fair market value of \$101.0 million and assumed stock options and warrants with a fair market value of \$19.2 million, each of which are non-cash items and are excluded from the accompanying Consolidated Statement of Cash Flows for the year ended December 31, 2001.

#### *Inventories*

Inventories are stated at the lower of cost (principally first-in, first-out method) or market.

#### *Depreciable Assets*

Depreciation and amortization are generally computed by the straight-line method and are charged against income over the estimated useful lives of depreciable assets.

#### *Long-Lived Assets*

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of*, and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations for a Disposal of a Segment of a Business*. See Note 7, *Restructuring Charges* for discussion of the impact of the current year charge recorded under SFAS No. 144.

Intangible assets consist of customer related intangible assets, purchased technology, patents, trademarks, covenants not-to-compete, software licenses and deferred finance costs. Intangible assets are amortized over periods ranging from 1 year to 17 years using the straight-line method. The estimated aggregate amortization expense for intangible assets with definite lives for each of the five succeeding fiscal years is as follows (in thousands):

2003 .....	\$12,653
2004 .....	10,857
2005 .....	10,573
2006 .....	9,722
2007 .....	6,520

The carrying values of intangible and other long-lived assets are periodically reviewed to determine if any impairment indicators are present. If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization and depreciation period, their carrying values are reduced to estimated fair value. Impairment indicators include, among other conditions, cash flow deficits, an historic or anticipated decline in revenue or operating profit, adverse legal or regulatory developments, accumulation of costs significantly in excess of amounts originally expected to acquire the asset and a material decrease in the fair value of some or all of the assets. Assets are grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows generated by

other asset groups. During 2002, 2001 and 2000, approximately \$5.3 million, \$3.4 million and \$3.7 million, respectively, of impairment charges relating to property, plant and equipment and other long-lived assets were recorded (see Notes 2 and 7).

#### *Derivative Financial Instruments*

During 2001, the Company began using derivative financial instruments to minimize the impact of foreign exchange rate changes on earnings and cash flows. In the normal course of business, the Company's operations are exposed to fluctuations in foreign exchange rates. In order to reduce the effect of fluctuating foreign currencies on short-term foreign currency-denominated intercompany transactions and other known foreign currency exposures, the Company enters into monthly forward contracts. The Company does not use derivative financial instruments for trading or speculative purposes. The Company's forward contracts do not subject it to material risks due to exchange rate movements because gains and losses on these contracts are intended to offset exchange gains and losses on the underlying assets and liabilities; both the forward contracts and the underlying assets and liabilities are marked-to-market through earnings. The aggregate foreign currency exchange gain (loss) included in determining consolidated results of operations was approximately \$0.1 million, (\$1.9) million and (\$0.8) million in 2002, 2001, and 2000, respectively. In 2002 and 2001, the foreign currency exchange gain (loss) is net of approximately (\$1.0) million and \$0.4 million of realized hedging (losses) gains, respectively, which were recorded and included in other (income) expense, net. As of December 31, 2002, approximately \$0.3 million of losses related to forward contracts are included in accrued expenses and have been subsequently paid in January 2003. As of December 31, 2002 and 2001, there were no open forward contracts.

#### *Goodwill*

The Company first implemented SFAS No. 142, *Goodwill and Other Intangible Assets* in 2001, with the acquisitions of TM and Applied Epi (see Note 2) and fully implemented SFAS No. 142 on January 1, 2002. The intangible assets that are classified as goodwill and those with indefinite lives are no longer amortized under the provisions of this standard. Intangible assets with definite lives will continue to be amortized over their estimated useful life. The standard also requires that an impairment test be performed to support the carrying value of goodwill and indefinite lived intangible assets at least annually. The Company's policy is to perform this annual impairment test in the fourth quarter of each fiscal year.

The Company completed the first of the required impairment tests of goodwill and indefinite lived intangible assets in the first quarter of 2002. The Company has reviewed its business and determined that four reporting units should be reviewed for impairment in accordance with the standard. The four reporting units are New York Equipment and Telecommunications Equipment, which comprise the process equipment operating segment, and Atomic Force Microscope ("AFM") and Optical, which comprise the metrology operating segment. Based upon the judgment of management, it was determined that there was no impairment to goodwill or intangibles assets with indefinite lives as of January 1, 2002.

During the fourth quarter of 2002, in accordance with SFAS No. 142, management evaluated whether any events and circumstances exist that would require goodwill of a reporting unit to be

reviewed for impairment. Management determined that due to the continued weakness in the telecommunications industry and the uncertainty of the timing and speed of recovery, impairment indicators were present. In accordance with SFAS No. 142, if impairment indicators are present, the fair value of the reporting unit must be determined. Based upon the judgment of management, goodwill arising from the Applied Epi acquisition, which took place in September 2001 and is part of the process equipment operating segment, was deemed significantly impaired. As a result, the Company recorded an impairment charge of \$94.4 million and has written down goodwill related to the telecommunications equipment reporting unit to approximately \$7.5 million as of December 31, 2002. The impairment to goodwill is included in asset impairment charges in the accompanying Consolidated Statement of Operations for the year ended December 31, 2002. The fair value of the telecommunications equipment reporting unit was determined by using the income approach, which involves estimating discounted after tax cashflows.

Net income (loss) for the year ended December 31, 2001 and December 31, 2000, includes approximately \$1.5 million and \$0.7 million, respectively, of goodwill amortization expense. Excluding this amount would have resulted in both net income per common share and diluted net income per common share of \$0.45 for the year ended December 31, 2001 and net loss per common share of \$(0.72) and diluted net loss per common share of \$(0.69) for the year ended December 31, 2000.

#### *Environmental Compliance and Remediation*

Environmental compliance costs include ongoing maintenance, monitoring and similar costs. Such costs are expensed as incurred. Environmental remediation costs are accrued when environmental assessments and/or remedial efforts are probable and the cost can be reasonably estimated.

#### *Foreign Operations*

Foreign currency denominated assets and liabilities are translated into U.S. dollars at the exchange rates existing at the balance sheet date. Resulting translation adjustments due to fluctuations in the exchange rates are recorded as a separate component of shareholders' equity. Income and expense items are translated at the average exchange rates during the respective periods.

#### *Research and Development Costs*

Research and development costs are charged to expense as incurred and include expenses for development of new technology and the transition of the technology into new products or services.

#### *Advertising Expense*

The cost of advertising is expensed as of the first showing. The Company incurred \$3.7 million, \$5.6 million and \$4.9 million in advertising costs during 2002, 2001 and 2000, respectively.

#### *Stock Based Compensation*

At December 31, 2002, the Company has four fixed stock option plans, which are described more fully in Note 5. In addition, the Company assumed certain stock option plans and agreements in connection with various acquisitions, as discussed in Note 5. The Company accounts for these stock

option plans under the recognition and measurement principles of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. No compensation expense is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net (loss) income and (loss) income per share if the Company had applied the fair value recognition provisions, under which compensation expense would be recognized as incurred, of SFAS No. 123, *Accounting for Stock-Based Compensation*, to stock-based employee compensation.

	<b>December 31.</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
	<b>(In thousands, except per share amounts)</b>		
Net (loss) income, as reported .....	\$(123,730)	\$10,309	\$(17,880)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects .....	27,845	18,692	12,666
Pro forma net loss .....	<u>\$(151,575)</u>	<u>\$(8,383)</u>	<u>\$(30,546)</u>
 (Loss) income per share:			
Net (loss) income per common share, as reported .....	\$(4.25)	\$0.40	\$(0.75)
Net loss per common share, pro forma.....	\$(5.21)	\$(0.32)	\$(1.28)
Diluted net (loss) income per common share, as reported .....	\$(4.25)	\$0.39	\$(0.71)
Diluted net loss per common share, pro forma .....	\$(5.21)	\$(0.32)	\$(1.28)

During December 2002, the Company adopted SFAS No. 148, *Accounting for Stock-Based Compensation—Transition and Disclosure*. The adoption of this standard did not impact the Company's consolidated financial position or results of operations.

#### *Fair Value of Financial Instruments*

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses, approximate fair value due to their short maturities. The carrying amount of the Company's long-term investments approximate fair value at December 31, 2002.

The fair values of the Company's debt, including current maturities, are estimated using discounted cash flow analyses, based on the estimated current incremental borrowing rates for similar types of securities. The carrying amount of the Company's debt at December 31, 2002 and 2001 approximates its fair value.

#### *Income (Loss) Per Share*

Income (loss) per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed using the weighted average number of common shares and common equivalent shares outstanding during the period. The effect of



approximately 254,000 common equivalent shares for the year ended December 31, 2002 was antidilutive, therefore diluted earnings per share is not presented for such period.

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

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Weighted average shares outstanding .....	29,096	25,937	23,805
Dilutive effect of stock options and warrants.....	<u>—</u>	<u>418</u>	<u>1,323</u>
Diluted weighted average shares outstanding .....	<u>29,096</u>	<u>26,355</u>	<u>25,128</u>

The assumed conversion of subordinated convertible debentures into approximately 5.7 million common equivalent shares is antidilutive for 2002 and 2001 and therefore not included in the above diluted weighted average shares outstanding.

#### *Other Recent Accounting Pronouncements*

In April 2002, the Financial Accounting Standards Board ("FASB") issued Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB No. 13 and Technical Corrections*. SFAS No. 145 rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, an amendment of APB Opinion No. 30. The provisions of Statement 145 related to the rescission of Statement 4 are effective for financial statements issued for fiscal years beginning after May 15, 2002. Certain provisions of SFAS No. 145 related to Statement 13 are effective for transactions occurring after May 15, 2002. All other provisions of this Statement will be effective for financial statements issued on or after May 15, 2002. Early application of all the provisions of this Statement is encouraged. As such, the Company adopted SFAS No. 145 in December 2002. The adoption of this Statement did not have a significant impact on the Company's consolidated financial position or results of operations.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 addresses the accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force EITF) No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." It also substantially nullifies EITF Issue No. 88-10, "Costs Associated with Lease Modification or Termination." Statement 146 is effective for exit or disposal activities initiated after December 31, 2002, with early application encouraged. The Company has not yet determined what the effect of the adoption of SFAS No. 146 will be on the consolidated financial position or results of operations of the Company.

#### *Reclassifications*

Certain amounts in the 2001 consolidated financial statements have been reclassified to conform to the 2002 presentation.

## 2. Business Combinations and Basis of Presentation

### *Applied Epi, Inc.*

On September 17, 2001, a wholly owned subsidiary of the Company merged with and into Applied Epi, of St. Paul, Minnesota. As a result of the merger, Applied Epi became a subsidiary of the Company. Applied Epi provides molecular beam epitaxy ("MBE") equipment used in manufacturing high-speed compound semiconductor devices for telecommunications, optoelectronic and wireless markets and is now part of the Company's process equipment segment. Applied Epi, founded in 1986, was a privately held company. Under the merger agreement, the stockholders of Applied Epi received an aggregate of 3,883,460 shares of Veeco common stock and \$29.8 million in cash. In addition, the Company incurred acquisition costs and exchanged options and warrants of Applied Epi for options and warrants to purchase 1,021,248 shares of the Company's common stock. The exchanged options and warrants were recorded at fair market value using the Black- Scholes option-pricing model. The merger consideration is computed as follows (in thousands):

Fair market value of shares issued.....	\$101,040
Cash payment.....	29,800
Fair market of stock options/warrants assumed .....	19,223
Transaction costs.....	<u>2,905</u>
Total purchase price .....	<u>\$152,968</u>

The merger was accounted for using the purchase method of accounting. The results of operations for Applied Epi since the date of acquisition are included in the accompanying Consolidated Statements of Operations. The purchase price was allocated to the net assets acquired, based upon their estimated fair values, as follows (in thousands):

Accounts receivable.....	\$12,389
Inventories.....	11,966
Other current assets.....	4,079
Property, plant and equipment.....	12,812
Goodwill.....	101,891
Amortizable intangible assets .....	48,500
In-process technology .....	7,000
Other non-current assets .....	<u>675</u>
Total assets .....	<u>199,312</u>
Accounts payable.....	2,139
Other current liabilities .....	10,582
Deferred income taxes .....	22,663
Long-term debt.....	<u>10,960</u>
Total liabilities.....	<u>46,344</u>
Total purchase price .....	<u>\$152,968</u>

The purchase price was allocated to intangible assets as follows: approximately \$101.9 million to goodwill, which is non-amortizable under SFAS No. 142 and is not deductible for income tax purposes; \$41.0 million to core technology, amortizable over approximately six years; \$1.0 million to non-compete

agreements, amortizable over three years; \$4.5 million to customer related intangibles, amortizable over six months to five years and \$2.0 million to trademarks and trade names, amortizable over ten years. During the fourth quarter of 2002, the Company recorded an impairment charge of \$94.4 million and has written down goodwill related to its telecommunications equipment reporting unit, which comprises Applied Epi, to approximately \$7.5 million as of December 31, 2002, in accordance with SFAS No. 142. The purchased in-process technology, which totaled \$7.0 million, included the value of products in the development stage, which had not reached technological feasibility and for which there were no alternative future uses. Accordingly, this amount was expensed at the acquisition date. Applied Epi's in-process technology value was comprised of programs related to research systems, production systems, performance products and metal organic chemical vapor deposition (MOCVD) systems that were approximately 40%, 40%, 50% and 25% complete, respectively, at the date of acquisition. The value assigned to purchased in-process technology was determined by using the income approach, which involves estimating the discounted after-tax cash flows attributable to projects, based on the projects' stage of completion. The rate used to discount net cash flows to their present value was 25%. As of December 31, 2002, programs related to both research and performance products are 100% complete. As of December 31, 2002, programs related to production systems are 59% complete; one program has been cancelled and one program has been postponed due to current market and business conditions. Due to the current market and business conditions and as a result of the Company's reorganization in the process equipment segment (see Note 7), MOCVD system programs have been abandoned by the Company.

The following table represents the unaudited pro forma results of Veeco and Applied Epi, as if the combination had been consummated as of January 1, 2000:

	<u>Year Ended December 31,</u>	
	<u>2001</u>	<u>2000</u>
	(In thousands, except per share amounts)	
Revenue.....	\$482,451	\$393,657
Income (loss) from continuing operations.....	24,447	(26,089)
Net income (loss) .....	19,874	(46,634)
Income (loss) per common share from continuing operations.....	\$0.82	\$(0.91)
Net income (loss) per common share .....	\$0.67	\$(1.62)
Diluted income (loss) per common share from continuing operations.....	\$0.80	\$(0.91)
Diluted net income (loss) per common share.....	\$0.65	\$(1.62)

The pro forma results of operations for Applied Epi for the years ended December 31, 2001 and 2000 include charges of \$1.1 million and \$20.9 million, respectively, related to stock based compensation expense. The pro forma results of operations for the year ended December 31, 2000 include a \$7.0 million charge related to the write-off of purchased in-process technology.

#### *ThermoMicroscopes Corp.*

On July 16, 2001, the Company acquired ThermoMicroscopes Corp. ("TM"), formerly a subsidiary of Thermo Electron Corporation, based in Sunnyvale, California, for cash. TM is a manufacturer of atomic force microscopes, scanning probe microscopes, near field optical microscopes and probes. The

acquisition was accounted for using the purchase method of accounting. The results of operations for TM for the period from July 16, 2001 through December 31, 2001 are included in the accompanying Consolidated Statement of Operations for the year ended December 31, 2001. Results of operations prior to the acquisition are not material to the Consolidated Statements of Operations for years ended December 31, 2001 and 2000 and therefore no pro forma financial information has been provided.

In connection with the TM acquisition, approximately \$1.2 million of the purchase price was allocated to in-process technology projects for projects that had not reached technological feasibility and had no alternative future uses and thus, this amount was expensed as of the date of acquisition. On the date of acquisition, the majority of TM's in-process technology value was comprised of the Fanou project (which included the Aurora III product), which was approximately 90% complete, with the remainder completed in the first quarter of 2002. The value assigned to purchased in-process technology was determined by using the income approach and the rate used to discount net cash flows to their present value was 28%. The actual results of the Fanou project did not differ materially from the underlying assumptions used by the Company.

#### *CVC, Inc.*

On May 5, 2000, a wholly-owned subsidiary of the Company merged with CVC, Inc. ("CVC"), of Rochester, New York. As a result, CVC became a wholly-owned subsidiary of the Company. Under the terms of the agreement, CVC shareholders received 0.43 shares of Veeco Common Stock (5,386,238 shares in total) for each share of CVC common stock outstanding. The merger was accounted for as a pooling of interests and, as a result, historical consolidated financial data has been restated to include CVC data. CVC provides cluster tool equipment used in the production of disk drive head fabrication, optical active and passive components and specialty semiconductor applications.

During June 2000, the Company implemented a reorganization plan in an effort to integrate CVC into the Company, consolidate duplicate manufacturing facilities and reduce other operating costs. In connection therewith, Veeco recorded a \$33.0 million charge to earnings during the year ended December 31, 2000, which affected the process equipment segment of Veeco. Similar to Veeco, CVC provided manufacturing equipment used in the production of evolving tape and disk drive recording head fabrication, optical active components, MRAM, and specialty semiconductor applications. The benefits of the merger and of the actions taken which resulted in restructuring charges were to reduce operating costs of Veeco and CVC after the consummation of the merger. The benefits of these actions were realized immediately, as Veeco experienced cost savings in the process equipment segment of the Company's operations. Of these charges, \$15.3 million related to a non-cash write-off of inventory (included in cost of sales), \$14.0 million represented merger and reorganization costs (of which \$9.2 million related to investment banking, legal and other transaction costs and \$4.8 million pertained to duplicate facility and personnel costs) and \$3.7 million was for the write-down of long-lived assets. The \$4.8 million charge for duplicate facility and personnel costs principally related to the closing of CVC's Virginia facilities and an approximate 200-person work force reduction, which included both management and manufacturing employees principally located in Alexandria, Virginia, and Rochester and Plainview, New York. Veeco determined that, following the merger, the operations previously conducted by CVC in the Virginia facilities could be conducted more efficiently in existing Veeco facilities. This determination led to the closing of the Virginia facilities and the rationalization of personnel. The accrual of \$14.0 million for merger and reorganization costs was expended as of December 31, 2000, which represented \$9.4 million for transaction costs, \$3.5 million for termination

benefits paid and \$1.1 million for duplicate facility costs. The write-down of long-lived assets to estimated fair value related primarily to leasehold improvements, machinery and equipment and intangible assets for CVC's Virginia facilities. As a result of closing CVC's Virginia facilities and disposing of the duplicate ion beam etch and deposition product lines, goodwill and other intangibles were impaired, as well as machinery, equipment, furniture and fixtures and leasehold improvements which were deemed to have no future use. In addition, the \$15.3 million non-cash write-off of inventory principally related to CVC's Virginia facilities' product line of ion beam etch and deposition equipment. The Company has integrated this product line into Veeco's existing ion beam etch and deposition products and has determined that a portion of this product line's inventory is not useable.

Prior to the merger, CVC's fiscal year end was September 30. CVC's operating results for the three months ended December 31, 1999 is not reflected in Veeco's 1999 or 2000 operating results. The following describes the adjustment to retained earnings in 2000 from changing the fiscal year end of CVC effective January 1, 2000 (in thousands):

Revenues from October 1, 1999 to December 31, 1999 .....	\$25,216
Expenses from October 1, 1999 to December 31, 1999 .....	<u>24,671</u>
Net income adjustment to Veeco retained earnings at January 1, 2000 .....	<u>\$545</u>

#### *Atomic Force Microscope Assets*

On March 23, 2000, the Company purchased certain atomic force microscope assets from International Business Machines Corporation. The acquisition was accounted for using the purchase method of accounting. The results of operations are included in the accompanying Consolidated Statements of Operations from the date of acquisition. Results of operations prior to the acquisition are not material to the Consolidated Statement of Operations for the year ended December 31, 2000.

#### *Slider Level Crown Product Line*

On February 11, 2000, Veeco entered into a strategic alliance with Seagate Technology, Inc. ("Seagate") under which Veeco assumed production responsibility for Seagate's internal Slider Level Crown ("SLC") product line and acquired rights to commercialize such products for sale to third parties. The acquisition was accounted for using the purchase method of accounting. Results of operations are included in the accompanying Consolidated Statements of Operations from the date of acquisition. Results of operations prior to the acquisition are not material to the Consolidated Statement of Operations for the year ended December 31, 2000.

In connection with the restructuring in 2001 (see Note 7), the Company decided to phase out the SLC product line and, thus, approximately \$2.5 million of intangible assets, principally relating to goodwill that was previously allocated to this line of business, were written-off. This product line generated revenues of approximately \$4.6 million and \$18.2 million in the years ended December 31, 2001 and 2000, respectively.

#### *Monarch Labs, Inc.*

On January 31, 2000, Monarch Labs, Inc. ("Monarch"), a developer and manufacturer of automated quasi-static test systems for the data storage industry, merged with a subsidiary of Veeco.

Monarch was a privately-held company located in Longmont, Colorado. Under the terms of the merger, Monarch shareholders received 282,224 shares of Veeco Common Stock. The merger was accounted for as a pooling of interests transaction. However, since Monarch's historical results of operations and financial position are not material in relation to those of Veeco, financial information prior to the merger is not restated and \$3,000 and \$234,000 have been included as an adjustment to common stock and additional paid-in capital, respectively, during the year ended December 31, 2000.

### 3. Balance Sheet Information (in thousands):

	<u>December 31,</u>		
	<u>2002</u>	<u>2001</u>	
Inventories:			
Raw materials.....	\$50,312	\$59,065	
Work in process .....	23,363	26,068	
Finished goods .....	12,575	16,970	
	<u>\$86,250</u>	<u>\$102,103</u>	
	<u>December 31,</u>		<u>Estimated</u>
	<u>2002</u>	<u>2001</u>	<u>Useful Lives</u>
Property, plant and equipment:			
Land.....	\$8,274	\$9,196	
Buildings and improvements .....	34,080	43,012	10-40 years
Machinery and equipment .....	67,219	76,717	3-10 years
Leasehold improvements .....	3,177	4,448	3-7 years
	112,750	133,373	
Less accumulated depreciation and amortization.....	56,878	54,826	
	<u>\$55,872</u>	<u>\$78,547</u>	
	<u>December 31,</u>		
	<u>2002</u>	<u>2001</u>	
Accrued expenses:			
Payroll and related benefits.....	\$11,965	\$14,845	
Sales, use and other taxes .....	10,024	13,837	
Customer deposits and advanced billings .....	5,063	8,807	
Installation and warranty .....	4,481	8,337	
Other.....	13,460	12,244	
	<u>\$44,993</u>	<u>\$58,070</u>	

## *Investments*

Management determines the appropriate classification of securities at the time of purchase and reevaluates such designation as of each balance sheet date. During the year ended December 31, 2001, available-for-sale securities with fair values at the date of sale of approximately \$67.9 million were sold.

In connection with the subordinated notes offering in December 2001 and the exercise of the over allotment option in January 2002 (see Note 4), the Company purchased approximately \$25.9 million of U.S. government securities, which have been pledged to the trustee under the indenture, as security for the exclusive benefit of the holders of the notes. These securities represent restricted investments and will be sufficient to provide for the payment in full of the first six scheduled interest payments due on the notes, of which two payments of \$4.5 million were made on June 21, 2002 and December 21, 2002. These investments are classified as held to maturity and have a balance of \$17.5 million as of December 31, 2002. The amounts of these long-term investments are carried at amortized cost at December 31, 2002.

## **4. Debt**

### *Credit Facilities*

On April 19, 2001, the Company entered into a \$100.0 million revolving credit facility (the "Facility"). The Facility's interest rate is a floating rate based on the prime rate of the lending banks and is adjustable to a maximum rate of  $\frac{1}{4}\%$  above the prime rate in the event the Company's ratio of debt to cash flows exceeds a defined amount. A LIBOR based interest rate option is also provided. The Facility has a term of four years and borrowings under the Facility may be used for general corporate purposes, including working capital and acquisitions. The Facility contains certain restrictive covenants, which among other things, impose limitations with respect to the incurrence of indebtedness, the payment of dividends, long-term leases, investments, mergers, acquisitions, consolidations and sales of assets.

The Company is also required to satisfy certain financial tests and the accounts receivable of the Company and material domestic subsidiaries are pledged to secure the Company's obligations under the Facility. In connection with a recent amendment of this facility, certain financial covenants were amended to allow for the fourth quarter 2002 restructuring charges as well as certain definitions were amended. As of December 31, 2002, and for all prior periods, the Company was in compliance with the covenants set forth in the Facility.

As of December 31, 2002 and 2001, no borrowings were outstanding under the Facility and as of December 31, 2002 and 2001, the Company was contingently liable for letters of credit of approximately \$3.3 million and \$4.0 million, respectively, issued under the Facility.

### *Long-term Debt*

Long-term debt is summarized as follows (in thousands):

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
Subordinated debt .....	\$220,000	\$200,000
Mortgage notes payable .....	10,447	14,513
Term loan payable .....	—	4,390
Other .....	138	160
	<u>230,585</u>	<u>219,063</u>
Less current portion .....	312	3,544
	<u>\$230,273</u>	<u>\$215,519</u>

### *Subordinated Debt*

In December 2001, the Company issued \$200.0 million of 4.125% convertible subordinated notes. On January 3, 2002, the Company issued an additional \$20.0 million of subordinated notes pursuant to the exercise of an over-allotment option. The notes are convertible, at the option of the holder, at any time on or prior to maturity into shares of common stock at a conversion price of \$38.51 per share. The Company pays interest on these notes on June 21 and December 21 of each year. Interest payments commenced on June 21, 2002 (see Note 3). The notes will mature on December 21, 2008. After the third anniversary of the issuance, the notes may be redeemed at the option of the Company, at the redemption prices set forth in the indenture.

### *Mortgage Notes Payable*

Long-term debt at December 31, 2002 also consists of two mortgage notes payable, secured by certain land and buildings with carrying amounts aggregating approximately \$23.3 million at December 31, 2002. One mortgage note payable (\$6.3 million at December 31, 2002) bears interest at a rate of 7.75% through December 2002, at which time the interest rate will change each year based on an average treasury yield plus 1.75%. This note is being amortized over a period of 25 years with the final payment due on December 1, 2007. The second mortgage note payable (\$4.2 million at December 31, 2002) bears interest at a rate of 7.91%, with the final payment due on January 1, 2020. A third mortgage was paid off on December 30, 2002, in connection with the reorganization of the process equipment segment of the business (see Note 7). A fourth mortgage was paid off on October 14, 2002.

### *Term Loan Payable*

In April 1998, CVC borrowed \$8.0 million from a commercial bank. The seven-year term loan required monthly payments of principal and interest at 8.39% until April 2005. The obligation was secured by substantially all of the assets of CVC. As of December 31, 2001, \$4.4 million was outstanding under this loan. On December 30, 2002, the term loan was paid off in connection with the



reorganization of the process equipment segment of the business and, thus, a prepayment penalty of \$0.3 million was required to be paid by the Company (see Note 7).

Long-term debt matures as follows (in thousands):

2003 .....	\$312
2004 .....	337
2005 .....	354
2006 .....	376
2007 .....	5,599
Thereafter .....	<u>223,607</u>
	230,585
Less current portion .....	<u>312</u>
	<u><u>\$230,273</u></u>

## 5. Stock Compensation Plans and Shareholders' Equity

### *Fixed Option Plans*

The Company has four fixed option plans. The Veeco Instruments Inc. 2000 Stock Option Plan (the "2000 Plan") was approved by the Board of Directors and shareholders in May 2000. The 2000 Plan, as amended, provides for the grant to officers and key employees of up to 4,400,000 options (909,435 options available for future grants as of December 31, 2002) to purchase shares of Common Stock of the Company. Stock options granted pursuant to the 2000 Plan become exercisable over a three-year period following the grant date and expire after seven years. In addition, the 2000 Plan provides for automatic annual grants of stock options to each member of the Board of Directors of the Company who is not an employee of the Company. The Veeco Instruments Inc. 2000 Stock Option Plan for Non-Officer Employees (the "Non-Officer Plan") was approved by the Board of Directors in October 2000. The Non-Officer Plan provides for the grant to non-officer employees of up to 670,000 options (139,686 options available for future grants as of December 31, 2002) to purchase shares of Common Stock of the Company. Stock options granted pursuant to the Non-Officer Plan become exercisable over a three-year period following the grant date and expire after seven years. The Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan (the "1992 Plan") provides for the grant to officers and key employees of options to purchase shares of Common Stock of the Company. Stock options granted pursuant to the Stock Option Plan become exercisable over a three-year period following the grant date and expire after ten years. The Veeco Instruments Inc. 1994 Stock Option Plan for Outside Directors, (as amended, the "Directors' Option Plan"), provides for automatic annual grants of stock options to each member of the Board of Directors of the Company who is not an employee of the Company. Such options are exercisable immediately and expire after ten years. Both the 1992 Plan and the Directors' Option Plan have been replaced by the 2000 Plan and thus there are no options available for future grant as of December 31, 2002 under either plan.

In addition to the four fixed plans, the Company assumed certain stock option plans and agreements, in connection with the merger with Applied Epi. The stock option plans do not have options available for future grants, expire after ten years from the date of grant and two of the plans

vest over three years and one of the plans calls for immediate vesting. As of December 31, 2002, there are 387,514 options outstanding under the various Applied Epi plans. In addition, Veeco assumed certain warrants related to Applied Epi, which were in effect prior to the merger with Veeco. These warrants are fully vested, have no expiration date and have an exercise price of \$29.35 per share. At December 31, 2002, there are 211,603 warrants outstanding. In May 2000, the Company assumed certain stock option plans and agreements related to CVC and Commonwealth Scientific Corporation, a subsidiary of CVC, which plans and agreements were in effect prior to the merger with Veeco. These plans do not have options available for future grants, generally vest over a three-to-five year period and expire after five to ten years from the date of grant. As of December 31, 2002, there are 82,867 options outstanding under the various CVC and Commonwealth Scientific Corporation plans.

The fair values of the options issued under the plans at the date of grant were estimated with the following weighted-average assumptions for 2002, 2001 and 2000: risk-free interest rate of 3.7%, 4.2%, and 6.4%, respectively, no dividend yield, volatility factor of the expected market price of the Company's Common Stock of 78%, 80% and 80%, respectively, and a weighted-average expected life of the options of four years.

A summary of the Company's stock option plans as of and for the years ended December 31, 2000, 2001, and 2002, is presented below:

	2000		2001		2002	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
	(000)		(000)		(000)	
Outstanding at beginning of year .....	3,065	\$21.87	3,063	\$36.18	4,867	\$33.85
Granted .....	1,642	46.66	1,702	34.67	1,658	22.03
Assumed in acquisition .....	—	—	810	16.17	—	—
Exercised .....	(1,397)	18.62	(404)	10.52	(137)	7.21
Forfeited .....	(247)	32.10	(304)	45.84	(575)	36.64
Outstanding at end of year .....	3,063	\$36.18	4,867	\$33.85	5,813	\$30.83
Options exercisable at year-end .....	809	\$27.09	2,021	\$29.33	2,952	\$32.85
Weighted-average fair value of options granted during the year .....		\$29.36		\$17.59		\$13.14

The following table summarizes information about fixed stock options outstanding at December 31, 2002:

Range Of Exercise price	Options Outstanding			Options Exercisable	
	Number Outstanding at December 31, 2002 (000's)	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Outstanding at December 31, 2002 (000's)	Weighted-Average Exercise Price
\$0.27 .....	186	8.0	\$0.27	186	\$0.27
4.50- 6.07 .....	67	7.0	5.98	57	5.96
8.59-12.69 .....	47	5.3	10.40	21	9.70
12.89-18.05 .....	101	5.5	14.10	43	14.16
21.00-31.00 .....	2,652	6.1	24.36	1,097	27.57
31.74-47.29 .....	2,361	5.1	38.19	1,249	39.41
48.13-72.00 .....	385	6.3	54.53	290	53.77
74.06-97.88 .....	14	7.6	78.08	9	78.08
	<u>5,813</u>	<u>5.8</u>	<u>\$30.83</u>	<u>2,952</u>	<u>\$32.85</u>

### *Employee Stock Purchase Plan*

Under the Veeco Instruments Inc. Amended and Restated Employee Stock Purchase Plan (the "ESP Plan"), the Company is authorized to issue up to 250,000 shares of Common Stock to its full-time domestic employees, nearly all of whom are eligible to participate. Under the terms of the ESP Plan, employees can choose each year to have up to 10% of their annual base earnings withheld to purchase the Company's Common Stock. The purchase price of the stock is 85% of the lower of its beginning-of-year or end-of-year market price. Under the ESP Plan, the Company issued 78,017 shares, 57,001 shares and 25,793 shares to employees in 2002, 2001 and 2000, respectively. The fair value of the employees' purchase rights was estimated using the following assumptions for 2002, 2001 and 2000, respectively: no dividend yield for all years; an expected life of one year for all years; expected volatility of 74%, 80% and 80%; and risk-free interest rates of 2.2%, 5.0%, and 6.0%.

The weighted-average fair value of those purchase rights granted in 2002, 2001 and 2000 was \$15.09, \$16.81 and \$21.30, respectively.

### *Shares Reserved for Future Issuance*

As of December 31, 2002, the Company has reserved the following shares for future issuance related to:

Issuance upon exercise of stock options.....	6,861,779
Issuance upon conversion of subordinated debt.....	5,712,802
Issuance upon exercise of warrants.....	211,603
Issuance of shares pursuant to the ESP Plan.....	<u>138</u>
Total shares reserved.....	<u>12,786,322</u>

### *Preferred Stock*

The Board of Directors has authority under the Company's Certificate of Incorporation to issue shares of preferred stock with voting and economic rights to be determined by the Board or Directors.

## **6. Income Taxes**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax

purposes. Significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	<b>December 31,</b>	
	<b>2002</b>	<b>2001</b>
Deferred tax assets:		
Inventory valuation.....	<b>\$9,346</b>	\$9,370
Domestic net operating loss carryforwards.....	<b>33,404</b>	17,486
Tax credit carryforwards .....	<b>15,266</b>	10,605
Foreign net operating loss carryforwards .....	<b>693</b>	168
Warranty and installation .....	<b>1,662</b>	2,899
Other accruals .....	<b>16,325</b>	12,059
Deferred profit.....	<b>2,304</b>	5,751
Other .....	<b>3,776</b>	4,961
Total deferred tax assets.....	<b>82,776</b>	63,299
Valuation allowance.....	<b>(3,104)</b>	(2,419)
Net deferred tax assets .....	<b>79,672</b>	60,880
Deferred tax liabilities:		
Tax over book depreciation.....	<b>975</b>	1,843
Purchased intangible assets .....	<b>16,504</b>	20,419
DISC termination.....	<b>1,747</b>	1,934
Other .....	<b>9</b>	9
Total deferred tax liabilities.....	<b>19,235</b>	24,205
Net deferred taxes .....	<b>\$60,437</b>	<b>\$36,675</b>

For financial reporting purposes, (loss) income from continuing operations before income taxes consists of (in thousands):

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
Domestic .....	<b>\$(155,766)</b>	\$5,158	\$1,482
Foreign .....	<b>11,869</b>	15,744	6,963
	<b>\$(143,897)</b>	<b>\$20,902</b>	<b>\$8,445</b>

Significant components of the (benefit) provision for income taxes from continuing operations are presented below (in thousands):

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
Current:			
Federal .....	<b>\$(1,283)</b>	\$4,337	\$7,190
Foreign .....	<b>2,543</b>	7,535	2,590
State .....	<b>67</b>	1,463	2,681
	<b>1,327</b>	13,335	12,461
Deferred:			
Federal .....	<b>(21,046)</b>	(5,091)	(6,092)
Foreign .....	<b>2,551</b>	(1,964)	268
State .....	<b>(3,345)</b>	(260)	(857)
	<b>(21,840)</b>	(7,315)	(6,681)
	<b><u>\$(20,513)</u></b>	<b><u>\$6,020</u></b>	<b><u>\$5,780</u></b>

The following is a reconciliation of the income tax (benefit) expense from continuing operations computed using the Federal statutory rate to the Company's actual income tax expense from continuing operations (in thousands):

	<b>Year ended December 31,</b>		
	<b>2002</b>	<b>2001</b>	<b>2000</b>
(Benefit) tax at U.S. statutory rates .....	<b>\$(50,363)</b>	\$7,316	\$2,956
State income (benefit) taxes (net of federal benefit) .....	<b>(3,301)</b>	1,003	890
Goodwill impairment .....	<b>33,038</b>	—	—
Goodwill amortization .....	—	414	144
Nondeductible merger expenses .....	—	—	3,623
Other nondeductible expenses .....	<b>210</b>	153	243
In-process purchased technology .....	—	2,870	—
Research and development tax credit .....	<b>(1,211)</b>	(2,602)	(1,437)
Benefit of extra territorial income exclusion .....	<b>(473)</b>	—	—
Benefit of foreign sales corporation .....	—	(3,342)	(845)
Net change in valuation allowance .....	<b>685</b>	1,917	—
Foreign tax rate differential .....	<b>2,039</b>	(1,709)	291
Other .....	<b>(1,137)</b>	—	(85)
	<b><u>\$(20,513)</u></b>	<b><u>\$6,020</u></b>	<b><u>\$5,780</u></b>

The Company has domestic net operating loss carryforwards of approximately \$81.4 million, which expire in the years 2020 and 2022.

The Company also has credit carryforwards of approximately \$15.3 million, consisting primarily of research and development credits, which expire at various times between 2017 and 2022, and foreign tax credits that expire by 2007. A valuation allowance of approximately \$0.7 million and \$1.9 million has been provided in 2002 and 2001, respectively, in connection with the foreign tax credit carryforward.

## 7. Commitments and Contingencies and Other Matters

In response to the significant decline in the business environment and current market conditions, the Company has restructured its business and operations. The actions giving rise to the restructuring charges below were implemented in order for Veeco to remain competitive and such actions are expected to benefit Veeco by reducing future operating costs.

### *2002 Merger and Restructuring Charges*

In conjunction with the plan announced by the Company in October 2002 to reduce operating costs by \$24.0 million in 2003, as a result of the continued weakness in the Company's served markets and the uncertainty of their recovery, the Company recorded merger and restructuring charges of approximately \$124.0 million during the fourth quarter of 2002. The \$124.0 million charge consisted of a \$15.0 million inventory write-down (included in cost of sales) in the process equipment segment, due to rationalization and discontinuance of certain product lines, \$2.6 million of personnel costs and business relocation, \$6.4 million of merger-related expenses, \$0.3 million for a prepayment penalty on early extinguishment of debt and \$99.7 million in asset impairment charges, primarily in the process equipment segment. The \$99.7 million in asset impairment charges included a \$94.4 million write-down of goodwill, a \$3.5 million impairment of two buildings and a \$1.8 million impairment of other fixed assets (see Note 1).

In light of current economic conditions, as well as the significant decline in process equipment sales, the Company implemented a plan to rationalize certain product lines, which required discontinuance or modification of several products. As a result of the significant reduction in sales volume and the rationalization of product lines, excess plant capacity existed. Part of the plan to reduce future operating costs consisted of consolidation or elimination of certain facilities resulting in the reduction of excess capacity. The plan includes closing process equipment manufacturing facilities, in Fort Collins, Colorado and in Rochester, New York. The manufacturing activities of the Rochester facility ceased as of December 31, 2002, and the manufacturing activities of the Fort Collins facility are in the process of being phased out. The manufacturing at both of these sites will be transferred to the Company's Plainview, New York facility. As a result of this reorganization the Company recorded an inventory write-down of approximately \$15.0 million. In connection with these actions, certain products sold to the data storage industry were discontinued. These products include certain physical vapor deposition equipment. A portion of this product line's inventory is not useable and thus has been written-off by the Company. The \$15.0 million charge also included the discontinuance or modification of certain telecommunications product lines, due to the continued decline in the telecommunications industry. This industry has seen a significant deterioration due to excess fiber optic capacity created by telephonic carriers as well as current economic conditions, which have resulted in a significant decrease in capital spending.

The \$2.6 million charge for personnel costs and business relocation includes severance costs of approximately \$1.6 million and business relocation costs of approximately \$1.0 million. The severance charges relate to a workforce reduction of approximately 180 employees, located in all operations of the Company. The majority of the job classifications affected were in production, purchasing, engineering, service, sales and marketing and were concentrated in the process equipment segment. Business relocation costs of \$1.0 million include costs related to rental payments and/or lease termination fees on lease agreements relating to locations vacated by the Company. In addition, the business relocation costs include operating costs of the Rochester facility that has ceased manufacturing operations. These operating costs will be incurred while the building is being marketed for sale. As of

December 31, 2002, approximately \$1.0 million in termination benefits has been paid and approximately \$0.6 million remains accrued, which will be paid by the third quarter of 2003. As of December 31, 2002, approximately \$0.1 million of business relocation costs has been paid and approximately \$0.9 million remains accrued. Of the \$0.9 million remaining, approximately \$0.2 million is expected to be paid in the first quarter of 2003, \$0.5 million is expected to be paid by the end of 2003 and approximately \$0.2 million in the aggregate is anticipated to be paid monthly through the third quarter of 2005.

On July 11, 2002, the Company entered into a merger agreement with FEI, headquartered in Hillsboro, Oregon. On January 8, 2003, the agreement was terminated. Veeco incurred approximately \$6.4 million in expenses related to the proposed merger with FEI. Merger-related costs were initially accounted for as an asset, and the Company intended to allocate these direct costs to the purchase price of the acquisition. However, due to the termination of the merger agreement, these costs were written off. These costs include legal, accounting, tax, investment banking and regulatory fees and printing costs. As of December 31, 2002, \$3.7 million of these costs have been paid and approximately \$2.7 million remains accrued, which will be paid in the first quarter of 2003.

In conjunction with the restructuring in the process equipment segment and the closure of two manufacturing facilities, the Company has classified the two facilities as held for sale as of December 31, 2002. In accordance with SFAS No. 144, these facilities are measured at the lower of their carrying amount or fair value less cost to sell. Accordingly, an impairment charge of \$3.5 million was recorded by the Company. Fair value was determined by the Company based upon recent market data. Land, buildings and other fixed assets held for sale of approximately \$10.2 million are included in prepaid expenses and other current assets in the accompanying Consolidated Balance Sheet at December 31, 2002. The sale of these two facilities is expected to occur by the end of 2003. Certain machinery and equipment and furniture and fixtures with a net book value of \$1.8 million, the majority of which is a result of the closing of the Rochester facility, were deemed to have no future value and, thus, the Company has written off those assets and has included this charge in asset impairment charges in the accompanying Consolidated Statement of Operations for the year ended December 31, 2002.

As a result of the Rochester facility being available for sale, the Company paid off a term loan and mortgage related to the building. Due to the prepayment of the term loan, the Company was required to pay a penalty of approximately \$0.3 million in December 2002, which is included in the merger and restructuring charges in the accompanying Consolidated Statement of Operations for the year ended December 31, 2002.

During the three months ended September 30, 2002, the Company incurred a restructuring charge of approximately \$0.9 million related to cost reduction efforts in response to continuing poor industry conditions and the decreased level of new orders. The \$0.9 million charge includes severance related costs for approximately 40 management and manufacturing employees principally located in the process equipment segment. As of December 31, 2002, approximately \$0.4 million has been expended and approximately \$0.5 million remains accrued, which is anticipated to be paid in the first quarter of 2003. This charge is offset in part by approximately \$0.8 million of income related to the settlement of a post-retirement benefit plan of the process equipment segment.

During the three months ended June 30, 2002, the Company incurred a restructuring charge of approximately \$1.1 million related to the reductions in work force announced in the fourth quarter of

2001 and the first quarter of 2002. The \$1.1 million charge includes severance related costs for approximately 30 employees, which included both management and manufacturing employees principally located in the process equipment segment. As of December 31, 2002, approximately \$0.6 million has been expended and approximately \$0.5 million remains accrued, which is expected to be paid in the first quarter of 2003.

During the three months ended March 31, 2002, the Company incurred a restructuring charge of \$0.8 million related to the reduction in work force announced in the fourth quarter of 2001. This charge includes severance related costs for approximately 60 employees, which included both management and manufacturing employees located at the Company's Minnesota metrology and New York process equipment operations. As of December 31, 2002, this accrual was fully expended.

A reconciliation of the fourth quarter 2002 liability for personnel, business relocation and merger related costs is as follows (in millions):

	<b>Accrued Severance Costs</b>	<b>Accrued Business Relocation Costs</b>	<b>Accrued Merger Costs</b>
Charged to accrual .....	\$1.6	\$1.0	\$6.4
Cash payments through December 31, 2002.....	<u>1.0</u>	<u>0.1</u>	<u>3.7</u>
Balance as of December 31, 2002 .....	<u><u>\$0.6</u></u>	<u><u>\$0.9</u></u>	<u><u>\$2.7</u></u>

A reconciliation of the liabilities for the restructuring charges during the first nine months of 2002 for severance related costs is as follows (in millions):

	<b>Third Quarter 2002 Charge</b>	<b>Second Quarter 2002 Charge</b>	<b>First Quarter 2002 Charge</b>
Charged to accrual .....	\$0.9	\$1.1	\$0.8
Cash payments through December 31, 2002.....	<u>0.4</u>	<u>0.6</u>	<u>0.8</u>
Balance as of December 31, 2002 .....	<u><u>\$0.5</u></u>	<u><u>\$0.5</u></u>	<u><u>\$0.0</u></u>

### *2001 Restructuring Charges*

During the year ended December 31, 2001, the Company recorded restructuring charges of approximately \$20.0 million in response to the significant downturn in the telecommunications industry and the overall weak business environment. This downturn has affected Veeco's customers' ability to purchase capital equipment and was evidenced by a significant decline in the order rate for the Company's products. The \$20.0 million charge consisted of a \$13.6 million write-off of inventory (included in cost of sales) related to order cancellations and the rationalization of certain product lines, \$3.0 million related to personnel costs and business relocation and \$3.4 million was for the write-down of long-lived assets. Of the \$13.6 million write-off of inventory, approximately \$9.6 million was associated with the Company's process equipment segment, which sells primarily to the telecommunications and data storage industries and approximately \$4.0 million related to Veeco's metrology segment, which sells mainly to the semiconductor, research and data storage industries. During 2001, Veeco experienced a significant amount of order cancellations for products for which many of the raw materials had been purchased prior to the cancellation date due to the amount of



lead-time necessary to build many of these tools. The \$3.0 million charge for personnel and business relocation costs principally related to plant consolidations and a workforce reduction of approximately 230 employees, located in all operations of the Company. The majority of the job classifications that were eliminated included manufacturing, sales and marketing, due to the downturn in the economy. As of December 31, 2002, approximately \$2.5 million of personnel and business relocation costs have been paid and approximately \$0.5 million remains accrued. Of this \$0.5 million liability, approximately \$0.3 million relates to rental payments on a lease agreement for space the Company has vacated and will be paid over the next three years and \$0.2 million relates to termination costs that will be paid in the first quarter of 2003. The write-down of long-lived assets to estimated fair value related primarily to the write-off of goodwill and intangible assets acquired in connection with the SLC product line of approximately \$2.5 million, as well as the write-down of certain machinery and equipment of approximately \$0.9 million, which was deemed to have no future value.

A reconciliation of the 2001 liability for personnel and business relocation costs is as follows (in millions):

	<u>Accrued Severance Costs</u>	<u>Accrued Lease Costs</u>
Charged to accrual .....	\$2.6	\$0.4
Cash payments through December 31, 2001 .....	1.2	—
Cash payments through December 31, 2002 .....	1.2	0.1
Balance as of December 31, 2002 .....	<u>\$0.2</u>	<u>\$0.3</u>

#### *Minimum Lease Commitments*

Minimum lease commitments as of December 31, 2002 for property and equipment under operating lease agreements (exclusive of renewal options) are payable as follows (in thousands):

2003 .....	\$3,134
2004 .....	2,303
2005 .....	1,844
2006 .....	1,717
2007 .....	1,683
Thereafter .....	<u>4,236</u>
	<u>\$14,917</u>

Rent charged to operations amounted to \$3.9 million, \$3.8 million and \$3.9 million in 2002, 2001 and 2000, respectively. In addition, the Company is obligated under the leases for certain other expenses, including real estate taxes and insurance.

#### *Royalties*

The Company has arrangements with a number of third parties to use patents in accordance with license agreements. Royalties and license fees expensed under these agreements approximated \$2.2 million, \$1.6 million and \$0.5 million in 2002, 2001 and 2000, respectively.

### *Related Party Transaction*

The Company makes purchases of inventory from a company, which is owned partially by an individual who was also employed by the Company. This individual resigned from the Company effective February 10, 2003. Payments to this related company in 2002, 2001 and 2000 were approximately \$4.6 million, \$5.0 million and \$4.1 million, respectively.

### *Environmental Remediation*

The Company may, under certain circumstances, be obligated to pay up to \$250,000 in connection with the implementation of a comprehensive plan of environmental remediation at its Plainview, New York facility. The Company has been indemnified for any liabilities it may incur in excess of \$250,000 with respect to any such remediation. No comprehensive plan has been required to date. Even without consideration of such indemnification, the Company does not believe that any material loss or expense is probable in connection with any remediation plan that may be proposed.

The Company is aware that petroleum hydrocarbon contamination has been detected in the soil at the site of a facility leased by the Company in Santa Barbara, California. The Company has been indemnified for any liabilities it may incur which arise from environmental contamination at the site. Even without consideration of such indemnification, the Company does not believe that any material loss or expense is probable in connection with any such liabilities. The former owner of the land and building in which the Company's Santa Barbara, California metrology operations are located has disclosed that there are hazardous substances present in the ground under the building. Management believes that the comprehensive indemnification clause that is part of the purchase contract provides adequate protection against any environmental issues that may arise.

### *Litigation*

On August 15, 2001, a lawsuit was commenced in the Superior Court of California, County of Santa Clara, by Toyo Corporation ("Toyo") against ThermoMicroscopes Corp. ("TM"), the Company, Thermo Spectra Corporation and Thermo Electron Corporation. The lawsuit related to a Distribution Agreement between Toyo and TM under which Toyo had been appointed the exclusive distributor for the sale of TM products in Japan. In the lawsuit, Toyo claimed, among other things, that TM breached the Distribution Agreement and that the Company, Thermo Spectra and Thermo Electron intentionally interfered with Toyo's contractual relationship with TM, in each case, by virtue of the sale of the outstanding shares of TM to the Company, which Toyo alleges constituted an assignment of the Distribution Agreement without Toyo's consent. In February 2003, the parties agreed in principle to settle the lawsuit, with the Company and Thermo Electron each making an equal payment to Toyo. The Company adequately provided for this liability in purchase accounting for the TM acquisition and thus the settlement of this lawsuit will not have an impact on the consolidated results of operations, nor will it have a material impact on the Company's consolidated balance sheet or its cash position.

The Company is involved in various other legal proceedings arising in the normal course of its business. Based upon the advice of counsel, the Company does not believe that the ultimate resolution of these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

### *Concentrations of Credit Risk*

The Company's business depends in large part upon the capital expenditures of data storage, telecommunications/wireless and semiconductor manufacturers, as well as research and industrial customers, which accounted for the following percentages of the Company's net sales:

	<u>December 31,</u>		
	<u>2002</u>	<u>2001</u>	<u>2000</u>
Data storage.....	<b>32%</b>	31%	44%
Telecommunications/Wireless.....	<b>15%</b>	30%	23%
Semiconductor .....	<b>13%</b>	17%	14%
Research and Industrial.....	<b>40%</b>	22%	19%

Sales to Seagate accounted for approximately 13%, 7% and 18% of the Company's net sales during the years ended December 31, 2002, 2001 and 2000, respectively. Each of the Company's segments sell to this major customer. At December 31, 2002, accounts receivable due from Seagate represented approximately 12% of aggregate accounts receivable. At December 31, 2001, accounts receivable due from IBM represented approximately 11% of aggregate accounts receivable.

The Company manufactures and sells its products to companies in different geographic locations. In certain instances, the Company requires advanced deposits for a portion of the sales price in advance of shipment, however, the majority of the system sales do not require such advance payments. The Company does, however, perform periodic credit evaluations of its customers' financial condition and, where appropriate, requires that letters of credit be provided on foreign sales. Receivables generally are due within 30-60 days, other than customers in Japan where payment terms range from 90-150 days. The Company's net accounts receivable are concentrated in the following geographic locations (in thousands):

	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
United States .....	<b>\$24,691</b>	\$40,222
Europe .....	<b>12,573</b>	25,829
Japan.....	<b>20,424</b>	14,982
Asia Pacific .....	<b>11,049</b>	6,818
Other.....	<b>40</b>	598
	<b><u>\$68,777</u></b>	<u>\$88,449</u>

### *Discontinued Operations*

In December 2001, the Company signed a letter of intent to sell the remainder of the industrial measurement business. In January 2000, the Company sold its leak detection business, which was part of this segment. Accordingly, the Company classified the industrial measurement business as a discontinued operation at December 31, 2001. In May 2002, the Company sold the remainder of its industrial measurement business. During the year ended December 31, 2002, the Company recorded an additional loss on the disposal of the discontinued operations of \$0.3 million, net of taxes of approximately \$0.2 million. During the year ended 2001, the Company recorded a loss on disposal of

discontinued operations of \$2.1 million, which is net of income taxes of \$1.5 million and includes the write-off of approximately \$1.0 million of goodwill that was previously allocated to this segment. Sales for the industrial measurement business totaled \$6.0 million and \$10.6 million for the years ended December 31, 2001 and 2000, respectively. Loss from discontinued operations for the years ended December 31, 2001 and 2000 was \$2.5 million and \$2.2 million, respectively, which is net of income taxes of \$1.7 million and \$1.5 million, respectively. The assets sold included accounts receivable, inventories, prepaid expenses and other current assets and fixed assets, as well as certain liabilities assumed by the purchaser. The net assets held for sale of approximately \$4.6 million were included in prepaid expenses and other current assets in the accompanying Consolidated Balance Sheet at December 31, 2001.

## 8. Foreign Operations, Geographic Area and Product Segment Information

Revenue and long-lived assets related to operations in the United States and other foreign countries as of and for the years ended December 31, 2002, 2001 and 2000 are as follows (in thousands):

	Net Sales to Unaffiliated Customers			Long-Lived Assets		
	2002	2001	2000	2002	2001	2000
United States .....	\$262,207	\$407,407	\$347,970	\$54,171	\$76,766	\$58,236
Foreign Countries.....	143,085	176,341	95,884	1,701	1,781	1,688
Eliminations .....	(106,407)	(134,497)	(67,741)	—	—	—
	<u>\$298,885</u>	<u>\$449,251</u>	<u>\$376,113</u>	<u>\$55,872</u>	<u>\$78,547</u>	<u>\$59,924</u>

Revenue related to the Company's operations in Japan and Asia Pacific for the years ended December 31, 2002, 2001 and 2000 are \$46.8 million and \$49.3 million, \$80.0 million and \$33.5 million, and \$27.4 million and \$15.9 million, respectively.

The Company has two reportable segments: process equipment and metrology. The Company's process equipment product line includes etch and deposition systems, primarily for data storage and optical telecommunications applications. The Company's metrology product line includes AFMs, stylus profilers and optical interferometers sold primarily to customers in the data storage and semiconductor industries, as well as research and development centers and universities.

The Company evaluates performance based on income or loss from operations before interest, income taxes and amortization (EBITA). The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. Costs excluded from segment profit primarily consist of corporate expenses, including income taxes, as well as other unusual charges for purchased in-process technology, restructuring and asset impairment charges and merger-related costs. Corporate expenses are comprised primarily of general and administrative expenses.

The Company's reportable segments are business units that offer different products. The reportable segments are each managed separately because they manufacture and distribute distinct

products with different production processes. The following represents the reportable product segments of the Company (in thousands):

	(Loss) income before interest, income taxes								
	Net Sales			and amortization			Total Assets		
	2002	2001	2000	2002	2001	2000	2002	2001	2000
Process equipment .....	\$146,691	\$277,249	\$216,283	<b>\$(17,603)</b>	\$37,781	\$20,742	\$183,497	\$337,294	\$149,847
Metrology .....	152,194	172,002	159,830	<b>25,902</b>	27,427	31,096	133,757	128,063	112,029
Unallocated corporate amount .....	—	—	—	<b>(6,960)</b>	(7,203)	(7,714)	289,564	290,162	160,649
Merger and restructuring expenses .....	—	—	—	<b>(11,248)</b>	(3,046)	(14,206)	—	—	—
Inventory write-off .....	—	—	—	<b>(15,000)</b>	(13,547)	(15,322)	—	—	—
Asset impairment charges .....	—	—	—	<b>(99,663)</b>	(3,418)	(3,722)	—	—	—
Write-off of purchased in-process technology .....	—	—	—	—	(8,200)	—	—	—	—
Total .....	<u>\$298,885</u>	<u>\$449,251</u>	<u>\$376,113</u>	<u><b>\$(124,572)</b></u>	<u>\$29,794</u>	<u>\$10,874</u>	<u>\$606,818</u>	<u>\$755,519</u>	<u>\$422,525</u>

The following table outlines the components of goodwill by business segment at December 31, 2002 and 2001 (in thousands):

	December 31,	
	2002	2001
Process Equipment .....	<b>\$8,413</b>	\$102,808
Metrology .....	<b>22,245</b>	22,777
Total .....	<u><b>\$30,658</b></u>	<u>\$125,585</u>

*Other Significant Items (in thousands):*

	Year ended December 31,		
	2002	2001	2000
Depreciation and amortization expense:			
Process equipment .....	<b>\$17,878</b>	\$13,618	\$8,559
Metrology .....	<b>6,761</b>	5,323	4,477
Unallocated corporate .....	<b>3,290</b>	3,713	2,437
Consolidated depreciation and amortization expense .....	<u><b>\$27,929</b></u>	<u>\$22,654</u>	<u>\$15,473</u>
Expenditures for long-lived assets:			
Process equipment .....	<b>\$5,165</b>	\$11,908	\$11,653
Metrology .....	<b>1,956</b>	2,418	4,241
Unallocated corporate .....	<b>1,523</b>	4,854	1,909
Consolidated expenditures for long-lived assets .....	<u><b>\$8,644</b></u>	<u>\$19,180</u>	<u>\$17,803</u>

## 9. Defined Contribution Benefit Plan

The Company maintains a defined contribution plan under Section 401(k) of the Internal Revenue Code. Principally all of the Company's domestic full-time employees are eligible to participate in the plan. Under the plan, employees may contribute up to a maximum of 60% of their annual wages. Employees are immediately vested in their contributions. Company contributions to the plan were \$0.5 million, \$2.2 million and \$1.3 million in 2002, 2001 and 2000, respectively. Generally, the plan calls for vesting of Company contributions over a five-year period.

## Schedule II—Valuation and Qualifying Accounts

COL. A	COL. B	COL. C		COL. D	COL. E
Description	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
Deducted from asset accounts:					
Year ended December 31, 2002:					
Allowance for doubtful accounts.....	\$3,350,000	\$1,020,000	\$—	\$1,555,000	\$2,815,000
Valuation allowance on net deferred tax assets .....	2,419,000	—	685,000	—	3,104,000
	<u>\$5,769,000</u>	<u>\$1,020,000</u>	<u>\$685,000</u>	<u>\$1,555,000</u>	<u>\$5,919,000</u>
Deducted from asset accounts:					
Year ended December 31, 2001:					
Allowance for doubtful accounts.....	\$2,067,000	\$589,000	\$1,000,000	\$306,000	\$3,350,000
Valuation allowance on net deferred tax assets .....	502,000	—	1,998,000	81,000	2,419,000
	<u>\$2,569,000</u>	<u>\$589,000</u>	<u>\$2,998,000</u>	<u>\$387,000</u>	<u>\$5,769,000</u>
Deducted from asset accounts:					
Year ended December 31, 2000:					
Allowance for doubtful accounts.....	\$2,354,000	\$683,000	\$—	\$970,000	\$2,067,000
Valuation allowance on net deferred tax assets .....	655,000	—	—	153,000	502,000
	<u>\$3,009,000</u>	<u>\$683,000</u>	<u>\$—</u>	<u>\$1,123,000</u>	<u>\$2,569,000</u>

## INDEX TO EXHIBITS

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

Number	Exhibit	Incorporated by Reference to the Following Documents
2.1	Agreement and Plan of Merger, dated as of September 6, 2001, among Veeco Instruments Inc., Veeco Acquisition Corp., Applied Epi, Inc., the shareholders of Applied Epi, Inc. listed on the signature pages thereto and Paul E. Colombo, as Stockholders' Representative.	Current Report on Form 8-K, filed September 14, 2001, Exhibit 99.1
3.1	Amended and Restated Certificate of Incorporation of the Company dated December 1, 1994, as amended June 2, 1997 and July 25, 1997.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 1997, Exhibit 3.1
3.2	Amendment to Certificate of Incorporation of Veeco dated May 29, 1998.	Annual Report on Form 10-K for the year ended December 31, 2000, Exhibit 3.2
3.3	Amendment to Certificate of Incorporation of Veeco dated May 5, 2000.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000, Exhibit 3.1
3.4	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of Veeco.	Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2001, Exhibit 3.1
3.5	Third Amended and Restated Bylaws of the Company, effective October 26, 2000.	Registration Statement on Form S-8 (File No. 333-49476), filed November 7, 2000, Exhibit 4.3
4.1	Rights Agreement, dated as of March 13, 2001, between Veeco Instruments Inc. and American Stock Transfer and Trust Company, as Rights Agent, including the form of the Certificate of Designation, Preferences and Rights setting forth the terms of the Series A Junior Participating Preferred Stock, par value \$0.01 per share, as Exhibit A, the form of Rights Certificates as Exhibit B and the Summary of Rights to Purchase Preferred Stock as Exhibit C.	Registration Statement on Form 8-A dated March 15, 2001, Exhibit 1
4.2	Amendment to Rights Agreement, dated as of September 6, 2001, between Veeco Instruments Inc. and American Stock Transfer and Trust Company, as rights agent.	Current Report on Form 8-K, filed September 21, 2001, Exhibit 4.1
4.3	Amendment No 2 to Rights Agreement, dated as of July 11, 2002, between Veeco Instruments Inc. and American Stock Transfer and Trust Company, as rights agent.	Current Report on Form 8-K, filed July 12, 2002, Exhibit 4.1
4.4	Indenture between Veeco and State Street Bank and Trust Company, N.A., as trustee, dated December 21, 2001, relating to the 4 <sup>1</sup> / <sub>8</sub> % convertible subordinated notes due 2008.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 4.1
10.1	Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2001, Exhibit 10.1

Number	Exhibit	Incorporated by Reference to the Following Documents
10.2	Amendment and Waiver dated as of September 17, 2001 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 10.1
10.3	Consent and Second Amendment dated as of December 21, 2001 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Annual Report on Form 10-K for the Year Ended December 31, 2001, Exhibit 10.3
10.4	Third Amendment dated as of February 7, 2002 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Annual Report on Form 10-K for the Year Ended December 31, 2001, Exhibit 10.4
10.5	Fourth Amendment dated as of March 20, 2002 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, The Chase Manhattan Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	Annual Report on Form 10-K for the Year Ended December 31, 2001, Exhibit 10.5
10.6	Fifth Amendment dated as of February 5, 2003 to the Credit Agreement, dated April 19, 2001 among Veeco Instruments Inc., Fleet National Bank, as administrative agent, JPMorgan Chase Bank, as syndication agent, HSBC Bank USA, as documentation agent and the lenders named therein.	*
10.7	Security Agreement dated as of March 20, 2002 among Veeco Instruments Inc., the subsidiaries of Veeco named therein and Fleet National Bank, as administrative agent.	Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2002, Exhibit 10.3
10.8	Loan Agreement dated as of December 15, 1999 between Applied Epi, Inc. and Jackson National Life Insurance Company.	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 10.2
10.9	Amendment to Loan Documents effective as of September 17, 2001 between Applied Epi, Inc. and Jackson National Life Insurance Company (executed in June 2002).	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2002, Exhibit 10.2
10.10	Promissory Note dated as of December 15, 1999 issued by Applied Epi, Inc. to Jackson National Life Insurance Company.	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 10.3
10.11	Collateral Pledge and Security Agreement among Veeco, State Street Bank and Trust Company, N.A., as trustee and as collateral agent, and State Street Bank and Trust Company, as securities intermediary, dated as of December 21, 2001.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.1



Number	Exhibit	Incorporated by Reference to the Following Documents
10.12	Supplement No. 1 to Collateral Pledge and Security Agreement among Veeco and State Street Bank and Trust Company, N.A., as trustee and as collateral agent, and State Street Bank and Trust Company, as securities intermediary, dated as of January 3, 2002.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.3
10.13	Registration Rights Agreement among Veeco and Merrill Lynch, Pierce, Fenner and Smith Incorporated, Salomon Smith Barney Inc. and Thomas Weisel Partners LLC, as the initial purchasers of Veeco's 4 <sup>1</sup> / <sub>8</sub> % Convertible Subordinated Notes due 2008, dated as of December 21, 2001.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.2
10.14	Registration Rights Agreement among Veeco and the Former Applied Epi Stockholders named therein, dated as of September 17, 2001.	Registration Statement on Form S-3 (File No. 333-84252), filed March 13, 2002, Exhibit 10.4
10.15	Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-1 (File No. 33-93958), Exhibit 10.20
10.16	Amendment dated May 15, 1997 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-35009) filed September 5, 1997, Exhibit 10.1
10.17	Amendment dated July 25, 1997 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-35009) filed September 5, 1997, Exhibit 10.2
10.18	Amendment dated May 29, 1998 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-79469) filed May 27, 1999, Exhibit 10.1
10.19	Amendment dated May 14, 1999 to Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan.	Registration Statement on Form S-8 (File No. 333-79469) filed May 27, 1999, Exhibit 10.2
10.20	Veeco Instruments Inc. 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-1 (File No. 33-85184), Exhibit 10.17
10.21	Amendment dated May 15, 1996 to Veeco Instruments Inc. Amended and Restated 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-8 (File No. 333-08981) filed July 26, 1996, Exhibit 10.2
10.22	Amendment dated May 15, 1997 to Veeco Instruments Inc. Amended and Restated 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-8 (File No. 333-35009) filed September 5, 1997, Exhibit 10.3
10.23	Amendment dated May 21, 1999 to Veeco Instruments Inc. Amended and Restated 1994 Stock Option Plan for Outside Directors.	Registration Statement on Form S-8 (File No. 333-79469) filed May 27, 1999, Exhibit 10.3
10.24	Veeco Instruments Inc. First Amended and Restated Employees Stock Purchase Plan, dated October 26, 2000.	Annual Report on Form 10-K for the Year Ended December 31, 2000, Exhibit 10.18
10.25	Veeco Instruments Inc. 2000 Stock Option Plan.	Current Report on Form 8-K filed May 9, 2000, Exhibit 10.1
10.26	Amendment No. 1 to the Veeco Instruments Inc. 2000 Stock Option Plan, effective May 11, 2001.	Registration Statement on Form S-8 (File Number 333-66574) filed August 2, 2001, Exhibit 4.1
10.27	Amendment No. 2 to the Veeco Instruments Inc. 2000 Stock Option Plan, effective May 10, 2002.	Registration Statement on Form S-8 (File Number 333-88946) filed May 23, 2002, Exhibit 4.1

Number	Exhibit	Incorporated by Reference to the Following Documents
10.28	Veeco Instruments Inc. 2000 Stock Option Plan for Non-Officer Employees.	Registration Statement on Form S-8 (File Number 333-49476) filed November 7, 2000, Exhibit 4.4
10.29	Amendment No. 1 to the Veeco Instruments Inc. 2000 Stock Option Plan for Non-Officer Employees, effective dated July 26, 2001.	Registration Statement on Form S-8 (File Number 333-66574) filed August 2, 2001, Exhibit 4.2
10.30	CVC, Inc. 1999 Non-employee Directors' Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.1
10.31	CVC, Inc. Amended and Restated 1997 Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.2
10.32	Amended and Restated (1996) Stock Option Plan of CVC, Inc. (formerly, CVC Holdings, Inc.).	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.3
10.33	Form of Commonwealth Scientific Corporation Non-Qualified Stock Option Agreement.	Registration Statement on Form S-8 (File Number 333-36348) filed May 5, 2000, Exhibit 4.4
10.34	Applied Epi, Inc. 1993 Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-69554) filed on September 18, 2001, Exhibit 4.1
10.35	Applied Epi, Inc. 2000 Stock Option Plan.	Registration Statement on Form S-8 (File Number 333-69554) filed on September 18, 2001, Exhibit 4.2
10.36	Form of Applied Epi, Inc. Non-Qualified Restricted Stock Option Agreement.	Registration Statement on Form S-8 (File Number 333-69554) filed on September 18, 2001, Exhibit 4.3
10.37	Form of Warrant to Purchase Shares of Common Stock of Applied Epi, Inc. (assumed in connection with the Applied Epi merger and now exercisable for shares of common stock of Veeco Instruments Inc.)	Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2001, Exhibit 4.6
10.38	Employment Agreement dated as of April 3, 2000 between Edward H. Braun and Veeco Instruments Inc.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000, Exhibit 10.2
10.39	Employment Agreement dated as of April 3, 2000 between John F. Rein, Jr. and Veeco Instruments Inc.	Quarterly Report on Form 10-Q for the Quarter Ended June 30, 2000, Exhibit 10.4
10.40	Letter Agreement, dated December 2, 1997 between Veeco Instruments Inc. and Dr. Don R. Kania.	Annual Report on Form 10-K for the Year Ended December 31, 1997, Exhibit 10.33
10.41	Letter Agreement dated January 16, 1995 between the Company and John P. Kiernan.	Annual Report on Form 10-K for the Year Ended December 31, 1994, Exhibit 10.20
21.1	Subsidiaries of the Registrant.	*
23.1	Consent of Ernst & Young LLP.	*
99.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	*
99.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	*

\* Filed herewith

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Veeco Instruments Inc. (the "Company") on Form 10-K for the year ended December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Edward H. Braun, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Edward H. Braun

Edward H. Braun  
Chairman and Chief Executive Officer  
Veeco Instruments Inc.  
March 27, 2003

A signed original of this written statement required by Section 906 has been provided to Veeco Instruments Inc. and will be retained by Veeco Instruments Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Veeco Instruments Inc. (the "Company") on Form 10-K for the year ended December 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John F. Rein, Jr., Executive Vice President, Chief Financial Officer and Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ John F. Rein, Jr.

John F. Rein, Jr.  
Executive Vice President, Chief Financial  
Officer and Secretary  
Veeco Instruments Inc.  
March 27, 2003

A signed original of this written statement required by Section 906 has been provided to Veeco Instruments Inc. and will be retained by Veeco Instruments Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

# CORPORATE INFORMATION

VEECO INSTRUMENTS INC. >>>

## Board of Directors

Edward H. Braun  
Chairman and CEO,  
Veeco Instruments Inc.

Richard A. D'Amore  
General Partner,  
North Bridge Venture Partners

Joel A. Elftmann  
President and Chairman,  
Custom Fab Solutions LLC;  
Former Chairman,  
FSI International (Nasdaq®: FSII)

Heinz K. Fridrich  
Industry Professor Emeritus,  
University of Florida

Douglas A. Kingsley  
Managing Director,  
Advent International

Dr. Paul R. Low  
President and CEO, PRL Associates

Roger D. McDaniel  
Retired CEO, MEMC Electronics  
Materials, Inc. and IPEC, Inc.

Irwin H. Pfister  
Executive Vice President,  
Schlumberger, Ltd. (NYSE: SLB)

Walter J. Scherr  
Consultant and former  
Executive Vice President,  
Veeco Instruments Inc.

## Corporate Management

Edward H. Braun  
Chairman and CEO

Don R. Kania, Ph.D.  
President

John F. Rein, Jr.  
Executive Vice President,  
Chief Financial Officer  
and Secretary

John K. Bulman  
Executive Vice President,  
Worldwide Sales and  
Foreign Operations

Susan C. Aulenbacher  
Vice President, Human Resources

John P. Kiernan  
Vice President, Finance and  
Corporate Controller

Christopher J. Mann  
Vice President,  
Worldwide Service

Carmine D. Morello  
Vice President,  
Chief Information Officer

Robert P. Oates  
Vice President, Treasurer

David Reamer  
Vice President, Strategic Marketing  
and Business Development

Gregory A. Robbins  
Vice President, General Counsel

Robert J. Valentine  
Vice President, Operations

Debra A. Wasser  
Vice President, Investor Relations  
and Corporate Communications

## Operating Management

Emmanuel N. Lakios  
President, General Manager,  
IBD/PVD/IBE Products

Matthew Abbene  
Vice President, General Manager,  
Ion Sources

Kenneth L. Babcock, Ph.D.  
Vice President, General Manager,  
Research AFM Products

Marlin A. Braun  
Vice President, General Manager,  
MBE Products

Lloyd J. LaComb, Jr., Ph.D.  
Senior Vice President,  
General Manager,  
Automated AFM Products

Anthony L. Martinez  
Vice President, General Manager,  
Optical/Industrial Products

Henry Shii  
Vice President, General Manager,  
Japan

Francis Steenbeke  
Vice President, General Manager,  
Europe

Michael Weiss  
Vice President, General Manager,  
Asia-Pacific

## Veeco Worldwide Offices

USA  
Woodbury, NY  
(corporate headquarters)  
Plainview, NY\*  
Rochester, NY  
Chadds Ford, PA  
St. Paul, MN\*  
Edina, MN  
Ft. Collins, CO  
Tucson, AZ\*  
San Diego, CA  
Santa Barbara, CA\*  
Fremont, CA  
Sunnyvale, CA\*  
\*manufacturing facility

International  
Dourdon, France  
Cambridge, UK  
Greater Manchester, UK  
Munich, Germany  
Mannheim, Germany  
Dresden, Germany  
Tokyo, Japan  
Singapore  
Hsinchu, Taiwan  
Penang, Malaysia  
Shanghai, China  
Beijing, China

Outside Counsel  
Kaye Scholer LLP  
425 Park Avenue  
New York, NY 10022

Independent Auditors  
Ernst & Young LLP  
395 North Service Road  
Melville, NY 11747

Transfer Agent & Registrar  
American Stock Transfer &  
Trust Co.  
59 Maiden Lane  
New York, NY 10038  
1-800-937-5449

Stock Listing  
The Company's Common  
Stock is listed on the Nasdaq  
National Market® under the  
symbol VECO. Options on  
Veeco's Common Stock are  
traded on the Chicago Board  
Options Exchange and the  
American Stock Exchange.

## Investor Relations

Veeco welcomes inquiries  
from its stockholders and  
other interested investors.  
For further information on  
the Company's activities,  
additional copies of this  
report, the Annual Report on  
Form 10-K or other financial  
materials, please contact:

Investor Relations  
Veeco Instruments Inc.  
100 Sunnyside Blvd.  
Woodbury, NY 11797  
(516) 677-0200  
or visit our website at  
[www.veeco.com](http://www.veeco.com)

## Annual Meeting

The 2002 annual meeting of  
stockholders will be held at  
9:30 a.m. on Friday, May 9,  
2003 at the Corporate  
Center, 395 North Service  
Road, Melville, New York.

Veeco, Dimension,  
Digital Instruments,  
NanoScope, NanoMan,  
PicoForce, NEXUS and  
GEN2000 are trademarks  
of Veeco Instruments Inc.

To the extent that this annual  
report discusses expectations about  
market conditions or about market  
acceptance and future sales of the  
Company's products, or otherwise  
makes statements about the future,  
such statements are forward-looking  
and are subject to a number of risks  
and uncertainties that could cause  
actual results to differ materially from  
the statements made. These factors  
include the cyclical nature of the data  
storage, telecommunication/wireless  
and semiconductor industries, risks  
associated with the acceptance of  
new products by individual customers  
and by the marketplace, and other  
factors discussed under the Manage-  
ment's Discussion and Analysis  
section of the Company's Annual  
Report on Form 10-K.



Veeco Instruments Inc.  
100 Sunnyside Blvd.  
Woodbury, New York 11797  
516.677.0200  
[www.veeco.com](http://www.veeco.com)