

# VEECO INSTRUMENTS INC

## FORM 10-Q (Quarterly Report)

Filed 08/04/06 for the Period Ending 06/30/06

|             |   |
|-------------|---|
| Address     | TERMINAL DRIVE<br>PLAINVIEW, NY 11803                       |
| Telephone   | 516 677-0200  |
| CIK         | 0000103145  |
| Symbol      | VECO  |
| SIC Code    | 3559 - Special Industry Machinery, Not Elsewhere Classified |
| Industry    | Semiconductors  |
| Sector      | Technology  |
| Fiscal Year | 12/31   |

# VEECO INSTRUMENTS INC

## FORM 10-Q (Quarterly Report)

Filed 8/4/2006 For Period Ending 6/30/2006

|             |  |
|-------------|--|
| Address     | TERMINAL DR<br>PLAINVIEW, New York 11803 |
| Telephone   | 516-349-8300                             |
| CIK         | 0000103145                               |
| Industry    | Semiconductors                           |
| Sector      | Technology                               |
| Fiscal Year | 12/31                                    |

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

- ☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2006  
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

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**VEECO INSTRUMENTS INC.**  
(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

**100 Sunnyside Boulevard, Suite B**  
**Woodbury, New York**  
(Address of Principal Executive Offices)

**11797-2902**  
(Zip Code)

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

Website: **www.veeco.com**

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

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

30,728,321 shares of common stock, \$0.01 par value per share, were outstanding as of the close of business on July 26, 2006.

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## SAFE HARBOR STATEMENT

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

- The cyclical nature of the microelectronics industries we serve directly affects our business.
- We operate in an industry characterized by rapid technological change.
- We face significant competition.
- We depend on a limited number of customers that operate in highly concentrated industries.
- Our quarterly operating results fluctuate significantly.
- We face securities class action and shareholder derivative lawsuits which could result in substantial costs, diversion of management’s attention and resources and negative publicity.
- Our acquisition strategy subjects us to risks associated with evaluating and pursuing these opportunities and integrating these businesses.
- Any difficulty or inability to attract, retain and motivate key employees could have a material adverse effect on our business.
- We are exposed to the risks of operating a global business and the requirement to comply with laws and regulations of various jurisdictions such as import/export controls, which may not apply to our non-U.S. competitors.
- We are subject to foreign currency exchange risks.
- Our success depends on protection of our intellectual property rights.
- We may be subject to claims of intellectual property infringement by others.
- We rely on a limited number of suppliers.
- Our outsourcing strategy could adversely affect our results of operations.
- Changes in accounting standards for stock-based compensation may adversely affect our stock price and our ability to attract, motivate and retain key employees.
- The implementation of a new information technology system may disrupt our operations.
- We may not obtain sufficient affordable funds to finance our future needs.
- We are subject to risks of non-compliance with environmental and safety regulations.
- We have adopted certain measures that may have anti-takeover effects which may make an acquisition of our company by another company more difficult.
- The other matters discussed under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in this Report and in the Annual Report on Form 10-K for the year ended December 31, 2005 of Veeco Instruments Inc. (“Veeco” or the “Company”).

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 Information — 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 site, as soon as reasonably practicable after we electronically file such material with the SEC.

**VEECO INSTRUMENTS INC.**

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements (Unaudited)

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

|   | <b>Three Months Ended June 30,</b> |             |
|---|------------------------------------|-------------|
|   | <b>2006</b>                        | <b>2005</b> |
| Net sales                                   | \$ 111,635                         | \$ 103,415  |
| Cost of sales                               | 61,923                             | 59,989      |
| Gross profit                                | 49,712                             | 43,426      |
| Costs and expenses:                         |                                    |             |
| Selling, general and administrative expense | 24,996                             | 21,435      |
| Research and development expense            | 15,252                             | 15,863      |
| Amortization expense                        | 3,989                              | 4,026       |
| Other (income) expense, net                 | (132)                              | 70          |
| Total operating expenses                    | 44,105                             | 41,394      |
| Operating income                            | 5,607                              | 2,032       |
| Interest expense, net                       | 1,149                              | 1,959       |
| Income before income taxes                  | 4,458                              | 73          |
| Income tax provision                        | 1,433                              | 522         |
| Net income (loss)                           | \$ 3,025                           | \$ (449)    |
| Net income (loss) per common share          | \$ 0.10                            | \$ (0.02)   |
| Diluted net income (loss) per common share  | \$ 0.10                            | \$ (0.02)   |
| Weighted average shares outstanding         | 30,322                             | 29,863      |
| Diluted weighted average shares outstanding | 31,254                             | 29,863      |

*See accompanying notes.*

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

|   | <b>Six Months Ended June 30,</b> |                   |
|---|----------------------------------|-------------------|
|   | <b>2006</b>                      | <b>2005</b>       |
| Net sales                                   | \$ 205,553                       | \$ 197,265        |
| Cost of sales                               | 114,072                          | 116,307           |
| Gross profit                                | 91,481                           | 80,958            |
| Costs and expenses:                         |                                  |                   |
| Selling, general and administrative expense | 46,326                           | 41,606            |
| Research and development expense            | 29,838                           | 30,687            |
| Amortization expense                        | 8,004                            | 8,516             |
| Other expense (income), net                 | 67                               | (28)              |
| Total operating expenses                    | 84,235                           | 80,781            |
| Operating income                            | 7,246                            | 177               |
| Interest expense, net                       | 2,527                            | 4,105             |
| Gain on extinguishment of debt              | (330)                            | —                 |
| Income (loss) before income taxes           | 5,049                            | (3,928)           |
| Income tax provision                        | 2,266                            | 1,223             |
| Net income (loss)                           | <u>\$ 2,783</u>                  | <u>\$ (5,151)</u> |
| Net income (loss) per common share          | <u>\$ 0.09</u>                   | <u>\$ (0.17)</u>  |
| Diluted net income (loss) per common share  | <u>\$ 0.09</u>                   | <u>\$ (0.17)</u>  |
| Weighted average shares outstanding         | 30,208                           | 29,859            |
| Diluted weighted average shares outstanding | 30,946                           | 29,859            |

*See accompanying notes.*



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

|   | June 30,<br>2006<br>(Unaudited) | December 31,<br>2005 |
|---|---------------------------------|----------------------|
| <b>Assets</b>   |                                 |                      |
| Current assets:   |                                 |                      |
| Cash and cash equivalents   | \$ 116,029                      | \$ 124,499           |
| Accounts receivable, less allowance for doubtful accounts of \$2,306 in 2006 and \$1,860 in 2005              | 88,673                          | 89,230               |
| Inventories   | 96,144                          | 88,904               |
| Prepaid expenses and other current assets   | 12,002                          | 9,640                |
| Deferred income taxes   | 3,309                           | 2,870                |
| Total current assets  | 316,157                         | 315,143              |
| Property, plant and equipment at cost, less accumulated depreciation of \$83,984 in 2006 and \$77,954 in 2005 | 72,317                          | 69,806               |
| Goodwill  | 99,622                          | 99,622               |
| Purchased technology, less accumulated amortization of \$58,341 in 2006 and \$51,992 in 2005                  | 49,235                          | 55,776               |
| Other intangible assets, less accumulated amortization of \$24,199 in 2006 and \$22,274 in 2005               | 20,670                          | 22,413               |
| Other assets  | 6,054                           | 5,100                |
| Total assets  | <u>\$ 564,055</u>               | <u>\$ 567,860</u>    |
| <b>Liabilities and shareholders' equity</b>   |                                 |                      |
| Current liabilities:  |                                 |                      |
| Accounts payable  | \$ 38,129                       | \$ 31,289            |
| Accrued expenses  | 46,848                          | 51,169               |
| Deferred profit   | 685                             | 537                  |
| Income taxes payable  | 2,145                           | 2,123                |
| Current portion of long-term debt   | 387                             | 375                  |
| Total current liabilities   | 88,194                          | 85,493               |
| Deferred income taxes   | 1,671                           | 1,048                |
| Long-term debt  | 209,008                         | 229,205              |
| Other non-current liabilities   | 3,374                           | 3,527                |
| Shareholders' equity  | 261,808                         | 248,587              |
| Total liabilities and shareholders' equity  | <u>\$ 564,055</u>               | <u>\$ 567,860</u>    |

*See accompanying notes.*

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

|  | <u>Six Months Ended June 30,</u> |                   |
|--|----------------------------------|-------------------|
|  | <u>2006</u>                      | <u>2005</u>       |
| <b>Operating activities</b>  |                                  |                   |
| Net income (loss)  | \$ 2,783                         | \$ (5,151)        |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                  |                   |
| Depreciation and amortization  | 14,594                           | 15,080            |
| Deferred income taxes  | 303                              | (101)             |
| Gain on extinguishment of debt   | (330)                            | —                 |
| Compensation expense for share-based payments  | 721                              | —                 |
| (Gain) loss on sale of property plant and equipment                                      | (16)                             | 83                |
| Other  | 21                               | —                 |
| Changes in operating assets and liabilities:   |                                  |                   |
| Accounts receivable  | 2,659                            | 6,281             |
| Inventories  | (6,354)                          | 8,975             |
| Accounts payable   | 6,765                            | 2,953             |
| Accrued expenses, deferred profit and other current liabilities                          | (1,576)                          | (2,428)           |
| Other, net   | (2,827)                          | (1,598)           |
| Net cash provided by operating activities  | <u>16,743</u>                    | <u>24,094</u>     |
| <b>Investing activities</b>  |                                  |                   |
| Capital expenditures   | (9,570)                          | (4,550)           |
| Payments for net assets of businesses acquired   | (3,161)                          | (15,038)          |
| Proceeds from sale of property, plant and equipment and assets held for sale             | 35                               | 2,178             |
| Net maturities of investments  | (80)                             | (41)              |
| Other  | (500)                            | —                 |
| Net cash used in investing activities  | <u>(13,276)</u>                  | <u>(17,451)</u>   |
| <b>Financing activities</b>  |                                  |                   |
| Proceeds from stock issuance   | 7,983                            | 1,041             |
| Repayments of long-term debt   | (19,585)                         | (176)             |
| Net cash (used in) provided by financing activities                                      | <u>(11,602)</u>                  | <u>865</u>        |
| Effect of exchange rates on cash and cash equivalents                                    | (335)                            | 1,572             |
| Net change in cash and cash equivalents  | <u>(8,470)</u>                   | <u>9,080</u>      |
| Cash and cash equivalents at beginning of period   | 124,499                          | 100,276           |
| Cash and cash equivalents at end of period   | <u>\$ 116,029</u>                | <u>\$ 109,356</u> |

*See accompanying notes.*

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

**Note 1—Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included. Operating results for the three and six months ended June 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information, refer to the financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

*Earnings (Loss) Per Share*

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

|  | <u>Three months ended June 30,</u> |               | <u>Six months ended June 30,</u> |               |
|--|------------------------------------|---------------|----------------------------------|---------------|
|  | <u>2006</u>                        | <u>2005</u>   | <u>2006</u>                      | <u>2005</u>   |
|  | (In thousands)                     |               |                                  |               |
| Weighted average shares outstanding                          | 30,322                             | 29,863        | 30,208                           | 29,859        |
| Dilutive effect of stock options and restricted stock awards | 932                                | —             | 738                              | —             |
| Dilutive weighted average shares outstanding                 | <u>31,254</u>                      | <u>29,863</u> | <u>30,946</u>                    | <u>29,859</u> |

Net income and diluted net income per common share are computed using the weighted average number of common and common equivalent shares outstanding during the period. The effect of approximately 140,000 and 158,000 common equivalent shares for the three and six months ended June 30, 2005, respectively, were anti-dilutive, and therefore are not included in the weighted average shares outstanding.

In addition, the effect of the assumed conversion of subordinated convertible notes into approximately 5.2 million and 5.3 million common equivalent shares is antidilutive, and therefore is not included in the weighted shares outstanding for the three and six months ended June 30, 2006, respectively. The effect of the assumed conversion of subordinated convertible notes into approximately 5.7 million common equivalent shares is antidilutive, and therefore is not included in the weighted average shares outstanding for the comparable prior year periods.

*Share-Based Compensation*

As of June 30, 2006, the Company has stock option and restricted stock plans, which are described more fully in Note 2. In addition, the Company assumed certain stock option plans and agreements in connection with various acquisitions, as also discussed in Note 2. Prior to 2006, the Company accounted for these stock option plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations and generally, no compensation expense was 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. Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, supersedes APB No. 25 and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees and non-employee directors, including grants of stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS No. 123(R) was adopted using the modified prospective method of application, which requires

Veeco to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in the pro forma disclosures in prior periods. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under previous accounting literature, which has the effect of reducing consolidated cash flows from operations and increasing cash flows from financing activities in periods after adoption. For the three and six months ended June 30, 2006, the Company did not recognize any amount of consolidated financing cash flows for such excess tax deductions.

Total share-based compensation expense is attributable to the remaining requisite service periods of stock options and restricted common stock awards. For the three and six months ended June 30, 2006, the Company granted 146,200 stock options and 198,250 restricted common stock awards to its directors, officers and employees. As a result of adopting SFAS No. 123(R), the Company's net income for the three and six months ended June 30, 2006 was \$0.2 million and \$0.3 million lower, respectively, than if it had continued to account for share-based compensation under APB No. 25. Net income per common share and diluted net income per common share for the three and six months ended June 30, 2006, are less than \$0.01 and \$0.01 lower, respectively, than if the Company had continued to account for share-based compensation under APB No. 25. As of June 30, 2006, the total unrecognized compensation cost related to nonvested stock awards and option awards is \$5.1 million and \$1.8 million, respectively, and the related weighted average period over which it is expected that such unrecognized compensation costs will be recognized is approximately 2.5 years for the nonvested stock awards and 2.4 years for option awards. Future share-based compensation expense will depend on levels of share-based awards granted in the future and, therefore, cannot be predicted at this time.

Prior to the Company's adoption of SFAS No. 123(R), SFAS No. 123 required that the Company provide pro forma information regarding net loss and loss per share as if compensation cost for the Company's stock-based awards had been determined in accordance with the fair value method prescribed therein. In accordance with SFAS No. 123, the following table illustrates the effect on net loss and net loss per share if the Company had applied the fair value recognition provisions, under which compensation expense would be recognized as incurred, to stock-based employee compensation.

|   | Three months ended<br>June 30, 2005      | Six months ended<br>June 30, 2005 |
|---|--|-----------------------------------|
|   | (In thousands, except per share amounts) |                                   |
| Net loss, as reported   | \$ (449)                                 | \$ (5,151)                        |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (21,192)                                 | (25,216)                          |
| Pro forma net loss  | <u>\$ (21,641)</u>                       | <u>\$ (30,367)</u>                |
| Net loss per common share:  |  |                                   |
| Net loss and diluted net loss per common share, as reported   | \$ (0.02)                                | \$ (0.17)                         |
| Net loss and diluted net loss per common share, pro forma   | \$ (0.72)                                | \$ (1.02)                         |

#### *Recent Accounting Pronouncements*

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. ("FIN") 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes*. FIN 48 clarifies the accounting and disclosure for income taxes by defining the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. It also provides guidance on derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact of FIN 48 on its consolidated financial position and results of operations.

## Note 2—Share-Based Payments

### *Stock Option and Restricted Stock Plans*

The Company has several stock option and restricted stock plans. The Veeco Instruments Inc. 2000 Stock Incentive Plan, as amended, (the “2000 Plan”), was approved by the Board of Directors and shareholders in May 2000. The 2000 Plan provides for the grant to officers and key employees of up to 8,530,000 options (1,776,524 options are available for future grants as of June 30, 2006) to purchase shares of common stock of the Company. Stock options granted pursuant to the 2000 Plan expire after seven years and generally become exercisable over a three-year period following the grant date. However, grants made under the 2000 Plan between June 17, 2005 and December 23, 2005 became exercisable on or before December 31, 2005, and are subject to a resale restriction which provides that the shares issuable upon exercise of the option may not be transferred prior to the second anniversary of the option grant date. In addition, the 2000 Plan provides for automatic annual grants of 5,000 shares of restricted stock to each member of the Board of Directors of the Company who is not an employee of the Company. Up to 1,700,000 of the awards authorized under the 2000 Plan may be issued in the form of restricted stock (1,456,750 shares are available for future grants as of June 30, 2006). In June 2006, the Company granted 158,250 shares of restricted common stock to key employees, which vest over three years, and in May 2006, granted 40,000 shares of restricted common stock to the non-employee members of the Board of Directors, which vest over a period of one year.

A summary of the Company’s restricted stock awards as of June 30, 2006, is presented below:

|                                | Shares<br>(000's) | Weighted-<br>Average<br>Grant-Date<br>Fair Value |
|--------------------------------|-------------------|--|
| Nonvested at beginning of year | 45                | \$ 15.60   |
| Granted                        | 198               | 24.32  |
| Vested                         | —                 | —  |
| Forfeited                      | —                 | —  |
| Nonvested at June 30, 2006     | 243               | \$ 22.71   |

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 provided for the grant of stock options to non-officer employees 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”) provided for the grant to officers and key employees of stock options to purchase shares of common stock of the Company. Stock options granted pursuant to the 1992 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”), provided 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.

The Non-Officer Plan, the 1992 Plan and the Directors’ Option Plan have been frozen; and, thus, there are no options available for future grant as of June 30, 2006 under these plans.

In addition to the plans described above, the Company assumed certain stock option plans and agreements relating to the merger in September 2001 with Applied Epi, Inc. (“Applied Epi”). These stock option plans do not have options available for future grants and expire after ten years from the date of grant. Options granted under two of the plans vested over three years and options granted under one of the plans vested immediately. As of June 30, 2006, there are 200,477 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 expired in February 2006.

In May 2000, the Company assumed certain stock option plans and agreements related to CVC, Inc. and Commonwealth Scientific Corporation, a subsidiary of CVC, Inc., which were in effect prior to the merger with Veeco.

These plans do not have options available for future grants, the options granted thereunder generally vested over a three to five year period and expire five to ten years from the date of grant. As of June 30, 2006, there are 7,251 options outstanding under the various CVC, Inc. and Commonwealth Scientific Corporation plans.

With the adoption of SFAS No. 123(R) on January 1, 2006, the Company is required to record the fair value of stock-based compensation awards as an expense. In order to determine the fair value of stock options on the date of grant, the Company applies the Black-Scholes option-pricing model. Inherent in the model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a level of judgment which make them critical accounting estimates.

Beginning in the fourth quarter of 2005, the Company used an expected stock-price volatility assumption that is a combination of both historical and implied volatilities of the underlying stock, which are obtained from public data sources. Prior to that time, the Company based this assumption solely on historical volatility.

With regard to the weighted-average option life assumption, the Company considers the exercise behavior of past grants and models the pattern of aggregate exercises.

The fair value of each option granted during the three and six months ended June 30, 2006, was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

|  |         |
|--|---------|
| Weighted-average expected stock-price volatility | 40%     |
| Weighted-average expected option life            | 3 years |
| Average risk-free interest rate                  | 4.99%   |
| Average dividend yield                           | 0%      |

The fair value of each option grant that was unvested as of January 1, 2006, was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

|  |         |
|--|---------|
| Weighted-average expected stock-price volatility | 60%     |
| Weighted-average expected option life            | 4 years |
| Average risk-free interest rate                  | 3.64%   |
| Average dividend yield                           | 0%      |

A summary of the Company's stock option plans as of and for the six months ended June 30, 2006, is presented below:

|   | Shares<br>(000's) | Weighted-<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value (000s) | Weighted-<br>Average<br>Remaining<br>Contractual Life<br>(in years) |
|---|-------------------|---|--|---|
| Outstanding at beginning of year        | 7,834             | \$ 24.81                                  |  |   |
| Granted                                 | 146               | 23.61                                     |  |   |
| Exercised                               | (454)             | 17.38                                     |  |   |
| Forfeited (including cancelled options) | (292)             | 23.49                                     |  |   |
| Outstanding at June 30, 2006            | <u>7,234</u>      | <u>\$ 25.30</u>                           | \$ 21,035                              | 3.5   |
| Options exercisable at June 30, 2006    | 6,982             | \$ 25.45                                  | \$ 20,350                              | 3.4   |

The weighted-average grant date fair value of stock options granted for the three and six months ended June 30, 2006 was \$7.61. The weighted-average grant date fair value of stock options granted for the three and six months ended June 30, 2005 was \$8.05 and \$7.99, respectively. The total intrinsic value of stock options exercised during the three and six months ended June 30, 2006 was \$2.8 million and \$3.2 million, respectively. The total intrinsic value of stock options exercised during the three and six months ended June 30, 2005 was less than \$0.1 million and \$0.1 million, respectively.

The following table summarizes information about stock options outstanding at June 30, 2006:

| Range of Exercise Prices | Options Outstanding                         |  |                                 | Options Exercisable                         |                                 |
|--------------------------|---|--|---------------------------------|---|---------------------------------|
|                          | Number Outstanding at June 30, 2006 (000's) | Weighted-Average Remaining Contractual Life (in years) | Weighted-Average Exercise Price | Number Outstanding at June 30, 2006 (000's) | Weighted-Average Exercise Price |
| \$0.27                   | 97  | 4.5  | \$ 0.27                         | 97  | \$ 0.27                         |
| 10.25-15.35              | 223   | 4.8  | 14.62                           | 180   | 14.62                           |
| 15.45-23.11              | 3,823                                       | 4.3  | 19.48                           | 3,760                                       | 19.48                           |
| 23.61-35.00              | 2,197                                       | 2.8  | 29.59                           | 2,051                                       | 30.02                           |
| 35.75-50.60              | 834   | 1.3  | 44.19                           | 834   | 44.19                           |
| 54.35-72.00              | 60  | 2.9  | 55.91                           | 60  | 55.91                           |
|                          | <u>7,234</u>                                | <u>3.5</u>   | <u>\$ 25.30</u>                 | <u>6,982</u>                                | <u>\$ 25.45</u>                 |

On April 12, 2005, the Compensation Committee (the "Committee") of the Company's Board of Directors approved the acceleration of vesting for unvested, out-of-the-money stock options granted under the Company's stock option plans prior to September 1, 2004. An option was considered out-of-the-money if the option exercise price was greater than the closing price of the Company's common stock on the NASDAQ National Market on April 11, 2005 (\$15.26), the last trading day before the Committee approved the acceleration. As a result of this action, options to purchase approximately 2,522,000 shares of the Company's common stock became immediately exercisable, including options held by the Company's executive officers to purchase approximately 852,000 shares of common stock. The weighted average exercise price of the options for which vesting was accelerated was \$21.24.

The purpose of the accelerated vesting was to avoid future compensation expense of approximately \$7.9 million in 2006 and \$3.6 million in 2007 associated with these options that the Company would otherwise recognize in its Consolidated Statements of Operations upon the adoption of SFAS No. 123(R) (see Note 1). In addition, many of these options had exercise prices significantly in excess of current market values and were not providing an effective means of employee retention and incentive compensation.

#### *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 2,000,000 shares of common stock to its full-time U.S. employees, nearly all of whom are eligible to participate. Under the terms of the ESP Plan, employees can choose to have up to 10% of their annual base earnings withheld to purchase the Company's common stock. The purchase price of the stock as of June 30, 2006 was 95% of the end-of-offering period market price and qualifies as a noncompensatory employee stock purchase plan under Section 423 of the Internal Revenue Code.

#### *Shares Reserved for Future Issuance*

As of June 30, 2006, the Company has reserved the following shares for future issuance related to:

|  |                   |
|--|-------------------|
| Issuance upon exercise of stock options and issuance of restricted stock | 9,010,505         |
| Issuance upon conversion of subordinated debt                            | 5,193,456         |
| Issuance of shares pursuant to the ESP Plan                              | 1,453,582         |
| Total shares reserved  | <u>15,657,543</u> |

#### *Preferred Stock*

The Board of Directors of the Company 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.



### Note 3—Balance Sheet Information

#### *Inventories*

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

|                  | <u>June 30, 2006</u> | <u>December 31, 2005</u> |
|------------------|----------------------|--------------------------|
|                  | (In thousands)       |                          |
| Raw materials    | \$ 51,932            | \$ 45,357                |
| Work in progress | 32,469               | 33,307                   |
| Finished goods   | 11,743               | 10,240                   |
|                  | <u>\$ 96,144</u>     | <u>\$ 88,904</u>         |

#### *Accrued Warranty*

The Company estimates the costs that may be incurred under the warranty it provides and recognizes a liability in the amount of such costs at the time the related revenue is recognized. Factors that affect the Company's warranty liability include product failure rates, material usage and labor costs incurred in correcting product failures during the warranty period. The Company periodically assesses the adequacy of its recognized warranty liability and adjusts the amount as necessary. Changes in the Company's warranty liability during the period are as follows:

|                                     | <u>Six Months Ended June 30,</u> |                 |
|-------------------------------------|----------------------------------|-----------------|
|                                     | <u>2006</u>                      | <u>2005</u>     |
|                                     | (In thousands)                   |                 |
| Balance as of January 1             | \$ 6,671                         | \$ 6,771        |
| Warranties issued during the period | 3,353                            | 2,833           |
| Settlements made during the period  | (3,264)                          | (3,160)         |
| Balance as of June 30               | <u>\$ 6,760</u>                  | <u>\$ 6,444</u> |

### Note 4—Segment Information

As of January 1, 2006, the Company changed its management structure in a manner that caused the composition of its reportable segments to change. The Company currently manages the business, reviews operating results and assesses performance, as well as allocates resources, based upon two separate reporting segments. The Company merged the former Ion Beam and Mechanical Process Equipment segment and the Epitaxial Process Equipment segment into one reporting segment. The new Process Equipment segment combines the etch, deposition, dicing and slicing products sold mostly to data storage customers and the molecular beam epitaxy and metal organic chemical vapor deposition products primarily sold to high brightness light emitting diode and wireless telecommunications customers. This segment includes production facilities in Plainview, New York, Ft. Collins, Colorado, Camarillo, California, St. Paul, Minnesota and Somerset, New Jersey. The Metrology segment remains unchanged and represents equipment that is used to provide critical surface measurements on products such as semiconductor devices and thin film magnetic heads and includes Veeco's broad line of atomic force microscopes, optical interferometers and stylus profilers sold to semiconductor customers, data storage customers and thousands of research facilities and scientific centers. This segment includes production facilities in Santa Barbara, California and Tucson, Arizona. Accordingly, the Company has restated segment information for the prior periods presented.

The Company evaluates the performance of its reportable segments 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. Items excluded from segment profit primarily consist of interest, amortization, income taxes, corporate expenses, 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 following tables present certain data pertaining to the reportable product segments of the Company and a reconciliation of EBITA to income (loss) before income taxes for the three and six months ended June 30, 2006 and 2005, and goodwill and total assets as of June 30, 2006 and December 31, 2005 (in thousands):

|  | <u>Process<br/>Equipment</u> | <u>Metrology</u> | <u>Unallocated<br/>Corporate<br/>Amount</u> | <u>Total</u> |
|--|------------------------------|------------------|---|--------------|
| <b>Three Months Ended June 30, 2006</b>                                      |                              |                  |   |              |
| Net sales  | \$ 67,361                    | \$ 44,274        | \$ —  | \$ 111,635   |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | 7,801                        | 6,316            | (4,521)                                     | 9,596        |
| Interest expense, net  | —                            | —                | 1,149                                       | 1,149        |
| Amortization expense   | 3,288                        | 441              | 260   | 3,989        |
| Income (loss) before income taxes  | 4,513                        | 5,875            | (5,930)                                     | 4,458        |
| <b>Three Months Ended June 30, 2005</b>                                      |                              |                  |   |              |
| Net sales  | \$ 61,157                    | \$ 42,258        | \$ —  | \$ 103,415   |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | 2,269                        | 6,517            | (2,728)                                     | 6,058        |
| Interest expense, net  | —                            | —                | 1,959                                       | 1,959        |
| Amortization expense   | 3,294                        | 457              | 275   | 4,026        |
| (Loss) income before income taxes  | (1,025)                      | 6,060            | (4,962)                                     | 73           |
| <b>Six Months Ended June 30, 2006</b>  |                              |                  |   |              |
| Net sales  | \$ 120,552                   | \$ 85,001        | \$ —  | \$ 205,553   |
| Income (loss) before interest, taxes, amortization and certain items (EBITA) | 9,677                        | 11,928           | (6,355)                                     | 15,250       |
| Interest expense, net  | —                            | —                | 2,527                                       | 2,527        |
| Amortization expense   | 6,576                        | 895              | 533   | 8,004        |
| Other items  | —                            | —                | (330)                                       | (330)        |
| Income (loss) before income taxes  | 3,101                        | 11,033           | (9,085)                                     | 5,049        |
| <b>Six Months Ended June 30, 2005</b>  |                              |                  |   |              |
| Net sales  | \$ 111,519                   | \$ 85,746        | \$ —  | \$ 197,265   |
| (Loss) income before interest, taxes, amortization and certain items (EBITA) | (433)                        | 14,279           | (5,153)                                     | 8,693        |
| Interest expense, net  | —                            | —                | 4,105                                       | 4,105        |
| Amortization expense   | 6,888                        | 1,038            | 590   | 8,516        |
| (Loss) income before income taxes  | (7,321)                      | 13,241           | (9,848)                                     | (3,928)      |

|                                | Process<br>Equipment | Metrology | Unallocated<br>Corporate<br>Amount | Total     |
|--------------------------------|----------------------|-----------|------------------------------------|-----------|
| <b>As of June 30, 2006</b>     |                      |           |                                    |           |
| Goodwill                       | \$ 70,254            | \$ 29,368 | \$ —                               | \$ 99,622 |
| Total assets                   | 297,035              | 136,903   | 130,117                            | 564,055   |
| <b>As of December 31, 2005</b> |                      |           |                                    |           |
| Goodwill                       | \$ 70,254            | \$ 29,368 | \$ —                               | \$ 99,622 |
| Total assets                   | 300,617              | 132,928   | 134,315                            | 567,860   |

Corporate total assets are comprised principally of cash at June 30, 2006 and December 31, 2005.

#### Note 5—Comprehensive Income (Loss)

Total comprehensive income (loss) was \$4.0 million and \$4.5 million for the three and six months ended June 30, 2006, and (\$2.4) million and (\$8.7) million for the three and six months ended 2005, respectively. The Company's comprehensive income (loss) is comprised of net income (loss) and foreign currency translation adjustments.

#### Note 6—Other Matters

As of June 30, 2006, the Company has outstanding \$200.0 million of 4.125% convertible subordinated notes. During the first quarter of 2006, the Company repurchased \$20.0 million of its notes, reducing the amount outstanding from \$220.0 million to \$200.0 million. The repurchase amount was \$19.5 million in cash, of which \$19.4 million related to principal and \$0.1 million related to accrued interest. As a result of the repurchase, the Company recorded a gain from the early extinguishment of debt in the amount of \$0.6 million, offset by a \$0.3 million proportionate reduction in the related deferred financing costs for a net gain of \$0.3 million.

In conjunction with a cost reduction plan announced by the Company in October 2005, the Company recognized a restructuring charge of approximately \$1.2 million in the fourth quarter of 2005. The \$1.2 million charge consisted of personnel severance costs for approximately 37 employees which included management, administration and manufacturing employees located at the Company's Plainview, New York, Camarillo, California and Somerset, New Jersey Process Equipment operations and the Santa Barbara, California Metrology operations. As of June 30, 2006, approximately \$1.0 million has been paid and approximately \$0.2 million remains in accrued expenses. The Company expects to pay the remainder by the fourth quarter of 2006.

A reconciliation of the liability for the 2005 restructuring charge for severance costs is as follows (in millions):

|   | Process<br>Equipment | Metrology     | Total         |
|---|----------------------|---------------|---------------|
| Charged to accrual                                      | \$ 0.8               | \$ 0.4        | \$ 1.2        |
| Cash payments during 2005                               | 0.2                  | 0.1           | 0.3           |
| Balance as of December 31, 2005                         | 0.6                  | 0.3           | 0.9           |
| Cash payments during the six months ended June 30, 2006 | 0.5                  | 0.2           | 0.7           |
| Balance as of June 30, 2006                             | <u>\$ 0.1</u>        | <u>\$ 0.1</u> | <u>\$ 0.2</u> |

#### Note 7—Business Acquisition and Related Party Transaction

In May 2006, Veeco invested \$0.5 million to purchase 19.9% of the common stock of Fluens Corporation ("Fluens"). Approximately 31% of Fluens is owned by a Vice President of Veeco. Veeco and Fluens plan to jointly develop a next-generation process for high-rate deposition of aluminum oxide for data storage applications. If this development is successful and upon the satisfaction of certain additional conditions by May 2009, Veeco will be obligated to purchase the balance of the outstanding stock of Fluens for \$3.0 million and pay an earn-out. In April 2006, Veeco issued a \$0.8 million purchase order to Fluens for a reactive sputtering deposition system. Veeco had advanced approximately \$0.4 million against this purchase order as of June 30, 2006.

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

### **Executive Summary:**

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

The Company currently manages the business, reviews operating results and assesses performance, as well as allocates resources, based upon two separate reporting segments. As of January 1, 2006, the Company merged the former Ion Beam and Mechanical Process Equipment segment and the Epitaxial Process Equipment segment into one reporting segment. The new Process Equipment segment combines the etch, deposition, dicing and slicing products sold mostly to data storage customers and the molecular beam epitaxy ("MBE") and metal organic chemical vapor deposition ("MOCVD") products primarily sold to HB-LED and wireless telecommunications customers. The Metrology segment remains unchanged and represents equipment that is used to provide critical surface measurements on products such as semiconductor devices and thin film magnetic heads and includes Veeco's broad line of atomic force microscopes ("AFMs"), optical interferometers and stylus profilers sold to semiconductor customers, data storage customers and thousands of research facilities and scientific centers. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality. The Company's metrology solutions are also key research instruments used by many universities, scientific laboratories and industrial applications.

Veeco currently maintains manufacturing facilities in Arizona, California, Colorado, Minnesota, New Jersey and New York, with sales and service locations around the world. Each of Veeco's products is currently manufactured in only one location, as management believes that the technological know-how and precision needed to make each of the Company's products requires specialized expertise.

### **Highlights of the Second Quarter of 2006:**

- Revenue was \$111.6 million, an 8% increase over the second quarter of 2005.
- Orders were \$143.2 million, up 21% from the second quarter of 2005.
- Gross margin was 44.5%, up from 42.0% for the second quarter of 2005.
- Net income was \$3.0 million, or \$0.10 per share, compared to a loss of (\$0.4) million, or (\$0.02) per share, in the second quarter of 2005.

### **Highlights of the First Half of 2006:**

- Revenue was \$205.6 million, a 4% increase over the first half of 2005.
- Orders were \$269.9 million, up 24% from the comparable 2005 period.
- Gross margin was 44.5%, up from 41.0% for the first half of 2005.
- Net income was \$2.8 million, or \$0.9 per share, compared to a loss of (\$5.2) million, or (\$0.17) per share in the comparable prior year period.

## **Current Business Conditions/Outlook:**

In the first half of 2006, Veeco's revenues were \$205.6 million, up \$8.3 million from \$197.3 million in the first six months of 2005. Operating income for the first half of 2006 was \$7.2 million, compared to \$0.2 million in the prior year period. Net income for the first six months of 2006 was \$2.8 million, or diluted net income of \$0.09 per share, compared to a net loss of (\$5.2) million, or diluted net loss of (\$0.17) per share, for the first six months of 2005.

Veeco's orders for the first half of 2006 were \$269.9 million, reflecting double digit market growth in data storage and in HB-LED/wireless. Within the strong order rate, Veeco's data storage orders increased 34% from the prior year period to \$141.8 million. Another area of strength was in HB-LED/wireless, which reported orders of \$51.7 million, up 90% from the prior year period. The strong order rate for the first half of 2006 reflects market growth in embedded storage for consumer electronic applications, the hard drive industry's investment in capacity requirements as well as technology changes such as perpendicular recording, and the beginning of HB-LED backlighting for emerging applications such as personal computers and flat panel televisions.

Veeco is continuing its strategy for growth as well as its focus on improving profitability and gross margin performance. For the remainder of 2006, the Company has planned significant new product introductions in both the Process Equipment and Metrology business units, which are expected to provide an opportunity for revenue growth. Veeco has forecasted that 2006 revenues will grow by approximately 11-13% over 2005 to \$455-\$465 million. In addition, consumer spending on many types of electronics has increased and various worldwide regions, such as the Asia-Pacific region, are experiencing growth. The Company reviews a number of indicators to predict the strength of its markets going forward, including plant utilization trends, capacity requirements and capital spending trends. Many of these trends have remained positive through the current year. However, Veeco currently anticipates its orders in the third quarter will decrease from the strong second quarter rate due to the seasonal buying patterns that the Company has experienced in recent years. The Company believes that orders will recover again in the fourth quarter.

Technology changes are continuing in all of Veeco's markets: the continued increase of 80 GB hard drives and investment in 120 GB hard drives in data storage; the increased use of "mini" drives in consumer electronic applications; the increased use of Veeco's automated AFMs for 65 nanometer and below semiconductor applications; the opportunity for Veeco's MOCVD and MBE products to further penetrate the emerging wireless and HB-LED markets. Veeco believes that these changes, together with the continued funding of nanoscience research, will prompt customers to seek the Company's next-generation solutions to address their manufacturing and technology challenges.

The Company's goal is to continue to increase gross margins in 2006, with improvements in both Process Equipment and Metrology. Veeco has forecasted that gross margins will increase from 42.4% in 2005 to approximately 45% in 2006 and has already realized gross margins of 44.5% for the first half of the year. Veeco anticipates that progress in this area will continue to come from increased sales volume, the introduction of new products with higher gross margins, and better supply chain management, including outsourcing of new products and development of common hardware and software platforms.

## Results of Operations:

### Three Months Ended June 30, 2006 and 2005

The following tables show selected items of Veeco's Consolidated Statements of Operations, percentages of sales and comparisons between the three months ended June 30, 2006 and 2005 and the analysis of sales and orders for the same periods by segment, industry and regions (in thousands):

|   | Three Months ended<br>June 30, |             |                 |               | Dollar<br>Change |
|---|--------------------------------|-------------|-----------------|---------------|------------------|
|   | 2006                           |             | 2005            |               |                  |
| Net sales                                   | \$ 111,635                     | 100.0%      | \$ 103,415      | 100.0%        | \$ 8,220         |
| Cost of sales                               | 61,923                         | 55.5        | 59,989          | 58.0          | 1,934            |
| Gross profit                                | 49,712                         | 44.5        | 43,426          | 42.0          | 6,286            |
| Operating expenses:                         |                                |             |                 |               |                  |
| Selling, general and administrative expense | 24,996                         | 22.4        | 21,435          | 20.7          | 3,561            |
| Research and development expense            | 15,252                         | 13.7        | 15,863          | 15.3          | (611)            |
| Amortization expense                        | 3,989                          | 3.5         | 4,026           | 3.9           | (37)             |
| Other (income) expense, net                 | (132)                          | (0.1)       | 70              | 0.1           | (202)            |
| Total operating expenses                    | 44,105                         | 39.5        | 41,394          | 40.0          | 2,711            |
| Operating income                            | 5,607                          | 5.0         | 2,032           | 2.0           | 3,575            |
| Interest expense, net                       | 1,149                          | 1.0         | 1,959           | 1.9           | (810)            |
| Income before income taxes                  | 4,458                          | 4.0         | 73              | 0.1           | 4,385            |
| Income tax provision                        | 1,433                          | 1.3         | 522             | 0.5           | 911              |
| Net income (loss)                           | <u>\$ 3,025</u>                | <u>2.7%</u> | <u>\$ (449)</u> | <u>(0.4)%</u> | <u>\$ 3,474</u>  |

|                         | Sales                          |                   |  |                                | Orders            |  |                  |               | Book to Bill<br>Ratio |             |
|-------------------------|--------------------------------|-------------------|--|--------------------------------|-------------------|--|------------------|---------------|-----------------------|-------------|
|                         | Three Months ended<br>June 30, |                   | Dollar and<br>Percentage<br>Change<br><br>Year to Year | Three Months ended<br>June 30, |                   | Dollar and<br>Percentage<br>Change<br><br>Year to Year |                  |               |                       |             |
|                         | 2006                           | 2005              |  | 2006                           | 2005              |  |                  |               |                       |             |
|                         | 2006                           | 2005              |  | 2006                           | 2005              |  |                  |               |                       |             |
| Segment Analysis        |                                |                   |  |                                |                   |  |                  |               |                       |             |
| Process Equipment       | \$ 67,361                      | \$ 61,157         | \$ 6,204   | 10.1 %                         | \$ 94,309         | \$ 68,387  | \$ 25,922        | 37.9 %        | 1.40                  | 1.12        |
| Metrology               | 44,274                         | 42,258            | 2,016  | 4.8                            | 48,899            | 50,166   | (1,267)          | (2.5)         | 1.10                  | 1.19        |
| Total                   | <u>\$ 111,635</u>              | <u>\$ 103,415</u> | <u>\$ 8,220</u>  | <u>7.9 %</u>                   | <u>\$ 143,208</u> | <u>\$ 118,553</u>                                      | <u>\$ 24,655</u> | <u>20.8 %</u> | <u>1.28</u>           | <u>1.15</u> |
| Industry Analysis       |                                |                   |  |                                |                   |  |                  |               |                       |             |
| Data Storage            | \$ 53,105                      | \$ 47,370         | \$ 5,735   | 12.1 %                         | \$ 71,446         | \$ 60,391  | \$ 11,055        | 18.3 %        | 1.35                  | 1.27        |
| HB-LED/wireless         | 18,424                         | 13,905            | 4,519  | 32.5                           | 27,405            | 13,278   | 14,127           | 106.4         | 1.49                  | 0.95        |
| Semiconductor           | 12,448                         | 16,896            | (4,448)  | (26.3)                         | 19,997            | 18,966   | 1,031            | 5.4           | 1.61                  | 1.12        |
| Research and Industrial | 27,658                         | 25,244            | 2,414  | 9.6                            | 24,360            | 25,918   | (1,558)          | (6.0)         | 0.88                  | 1.03        |
| Total                   | <u>\$ 111,635</u>              | <u>\$ 103,415</u> | <u>\$ 8,220</u>  | <u>7.9 %</u>                   | <u>\$ 143,208</u> | <u>\$ 118,553</u>                                      | <u>\$ 24,655</u> | <u>20.8 %</u> | <u>1.28</u>           | <u>1.15</u> |
| Regional Analysis       |                                |                   |  |                                |                   |  |                  |               |                       |             |
| US                      | \$ 32,244                      | \$ 29,842         | \$ 2,402   | 8.0 %                          | \$ 51,812         | \$ 31,360  | \$ 20,452        | 65.2 %        | 1.61                  | 1.05        |
| Europe                  | 16,095                         | 23,006            | (6,911)  | (30.0)                         | 9,648             | 22,728   | (13,080)         | (57.6)        | 0.60                  | 0.99        |
| Japan                   | 11,297                         | 20,769            | (9,472)  | (45.6)                         | 19,596            | 19,060   | 536              | 2.8           | 1.73                  | 0.92        |
| Asia-Pacific            | 51,999                         | 29,798            | 22,201   | 74.5                           | 62,152            | 45,405   | 16,747           | 36.9          | 1.20                  | 1.52        |
| Total                   | <u>\$ 111,635</u>              | <u>\$ 103,415</u> | <u>\$ 8,220</u>  | <u>7.9 %</u>                   | <u>\$ 143,208</u> | <u>\$ 118,553</u>                                      | <u>\$ 24,655</u> | <u>20.8 %</u> | <u>1.28</u>           | <u>1.15</u> |

Net sales of \$111.6 million for the second quarter of 2006 were up \$8.2 million compared to the second quarter of 2005. By segment, process equipment sales were up \$6.2 million or 10.1%. The increase in process equipment sales is primarily due to an increase in sales to data storage customers driven by an increase in the production of data storage devices. Metrology sales increased \$2.0 million primarily due to increased AFM sales to the research and industrial markets. By region, net sales increased by 74.5% and 8.0% in Asia-Pacific and the U.S., respectively, while sales in Japan and Europe declined by 45.6% and 30.0%, respectively. The Company believes that there will continue to be quarter-to-quarter variations in the geographic distribution of sales.

Orders of \$143.2 million for the second quarter of 2006 increased by \$24.7 million, or 20.8%, from the comparable 2005 period. By segment, the 37.9% increase in process equipment orders was primarily driven by continued market growth in the data storage and HB-LED/wireless sectors reflecting growth in embedded storage in consumer electronics, continued investment in perpendicular recording technology, and HB-LED backlighting of small area flat panel displays. The 2.5% decrease in metrology orders was due to a \$4.5 million decrease in orders for optical metrology products, partially offset by a \$3.2 million increase in orders for AFM products.

The Company's book-to-bill ratio for the second quarter of 2006, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period was 1.28. The Company's backlog as of June 30, 2006 is \$159.1 million, compared to \$114.1 million as of December 31, 2005. During the quarter ended June 30, 2006, the Company experienced backlog adjustments and order cancellations of \$10.5 million, primarily in the HB-LED/wireless industry for MOCVD products. The Company also experienced rescheduling of order delivery dates by customers. Due to changing business conditions and customer requirements, the Company may continue to experience cancellations and/or rescheduling of orders.

Gross profit for the quarter ended June 30, 2006, was 44.5%, as compared to 42.0% in the second quarter of 2005. Process equipment gross margins increased from 36.7% to 40.3%, primarily due to an increase in sales volume of \$6.2 million, favorable product mix, cost reductions and improved supply chain management, which included outsourcing in this segment. Metrology gross margins increased to 51.0% from 49.7%, principally due to higher sales volume and favorable product mix of optical metrology products.

Selling, general and administrative expenses were \$25.0 million, or 22.4% of sales in the second quarter of 2006, compared with \$21.4 million, or 20.7%, in the comparable prior year period. The \$3.6 million increase is primarily attributable to annual incentive compensation related expenses, including stock options, restricted shares, severance and cash incentives as well as annual salary increases. In addition, selling, general and administrative expenses increased due to litigation related expenses for the securities class action and consolidated derivative action lawsuits as well as expansion of field sales and marketing personnel to support the Company's new product introductions and the Company's Asia-Pacific operations.

Research and development expense totaled \$15.3 million in the second quarter of 2006, a decrease of \$0.6 million from the second quarter of 2005, primarily due to the timing of new product development efforts in AFM and MOCVD. As a percentage of sales, research and development decreased in the second quarter of 2006 to 13.7% from 15.3% for the comparable prior year period.

Amortization expense remained flat at \$4.0 million in the second quarter of 2006 compared with the second quarter of 2005.

Net interest expense in the second quarter of 2006 was \$1.1 million compared to \$2.0 million in the second quarter of 2005. This reduction was due to an increase in interest rates and higher cash balances invested during the second quarter of 2006 compared to the comparable prior year period, as well as the reduction in interest expense related to the early extinguishment of debt.

Income tax provision for the quarter ended June 30, 2006 was \$1.4 million compared to \$0.5 million in the second quarter of 2005. The 2006 provision for income taxes included \$1.1 million relating to Veeco's foreign operations which continue to be profitable and \$0.3 million relating to the Company's domestic operations. Due to significant domestic net operating losses, which are fully reserved by a valuation allowance, Veeco's domestic operations are not expected to incur significant income taxes for the foreseeable future. The 2005 provision for income taxes of \$0.5 million related to Veeco's foreign operations, which were profitable.

## Six Months Ended June 30, 2006 and 2005

The following tables show selected items of Veeco's Consolidated Statements of Operations, percentages of sales and comparisons between the six months ended June 30, 2006 and 2005, and the analysis of sales and orders for the same periods by segment, industry and regions (in thousands):

|   | Six Months ended<br>June 30, |             |                   |               | Dollar<br>Change |
|---|------------------------------|-------------|-------------------|---------------|------------------|
|   | 2006                         |             | 2005              |               |                  |
| Net sales                                   | \$ 205,553                   | 100.0%      | \$ 197,265        | 100.0%        | \$ 8,288         |
| Cost of sales                               | 114,072                      | 55.5        | 116,307           | 59.0          | (2,235)          |
| Gross profit                                | 91,481                       | 44.5        | 80,958            | 41.0          | 10,523           |
| Operating expenses:                         |                              |             |                   |               |                  |
| Selling, general and administrative expense | 46,326                       | 22.6        | 41,606            | 21.1          | 4,720            |
| Research and development expense            | 29,838                       | 14.5        | 30,687            | 15.5          | (849)            |
| Amortization expense                        | 8,004                        | 3.9         | 8,516             | 4.3           | (512)            |
| Other expense (income), net                 | 67                           | —           | (28)              | —             | 95               |
| Total operating expenses                    | 84,235                       | 41.0        | 80,781            | 40.9          | 3,454            |
| Operating income                            | 7,246                        | 3.5         | 177               | 0.1           | 7,069            |
| Interest expense, net                       | 2,527                        | 1.2         | 4,105             | 2.1           | (1,578)          |
| Gain on extinguishment of debt              | (330)                        | (0.2)       | —                 | —             | (330)            |
| Income (loss) before income taxes           | 5,049                        | 2.5         | (3,928)           | (2.0)         | 8,977            |
| Income tax provision                        | 2,266                        | 1.1         | 1,223             | 0.6           | 1,043            |
| Net income (loss)                           | <u>\$ 2,783</u>              | <u>1.4%</u> | <u>\$ (5,151)</u> | <u>(2.6)%</u> | <u>\$ 7,934</u>  |

|                         | Sales                        |                   |                                    |              | Orders                       |                   |                                    |               | Book to Bill<br>Ratio |             |
|-------------------------|------------------------------|-------------------|------------------------------------|--------------|------------------------------|-------------------|------------------------------------|---------------|-----------------------|-------------|
|                         | Six Months ended<br>June 30, |                   | Dollar and<br>Percentage<br>Change |              | Six Months ended<br>June 30, |                   | Dollar and<br>Percentage<br>Change |               |                       |             |
|                         | 2006                         | 2005              | Year to Year                       |              | 2006                         | 2005              | Year to Year                       |               | 2006                  | 2005        |
|                         | 2006                         | 2005              | 0000                               | 0000         | 2006                         | 2005              | 0000                               | 0000          | 2006                  | 2005        |
| Segment Analysis        |                              |                   |                                    |              |                              |                   |                                    |               |                       |             |
| Process Equipment       | \$ 120,552                   | \$ 111,519        | \$ 9,033                           | 8.1 %        | \$ 177,802                   | \$ 123,812        | \$ 53,990                          | 43.6 %        | 1.47                  | 1.11        |
| Metrology               | 85,001                       | 85,746            | (745)                              | (0.9)        | 92,100                       | 93,678            | (1,578)                            | (1.7)         | 1.08                  | 1.09        |
| Total                   | <u>\$ 205,553</u>            | <u>\$ 197,265</u> | <u>\$ 8,288</u>                    | <u>4.2 %</u> | <u>\$ 269,902</u>            | <u>\$ 217,490</u> | <u>\$ 52,412</u>                   | <u>24.1 %</u> | <u>1.31</u>           | <u>1.10</u> |
| Industry Analysis       |                              |                   |                                    |              |                              |                   |                                    |               |                       |             |
| Data Storage            | \$ 93,188                    | \$ 72,985         | \$ 20,203                          | 27.7 %       | \$ 141,832                   | \$ 105,694        | \$ 36,138                          | 34.2 %        | 1.52                  | 1.45        |
| HB-LED/wireless         | 33,520                       | 36,209            | (2,689)                            | (7.4)        | 51,732                       | 27,245            | 24,487                             | 89.9          | 1.54                  | 0.75        |
| Semiconductor           | 23,757                       | 34,250            | (10,493)                           | (30.6)       | 30,095                       | 33,394            | (3,299)                            | (9.9)         | 1.27                  | 0.98        |
| Research and Industrial | 55,088                       | 53,821            | 1,267                              | 2.4          | 46,243                       | 51,157            | (4,914)                            | (9.6)         | 0.84                  | 0.95        |
| Total                   | <u>\$ 205,553</u>            | <u>\$ 197,265</u> | <u>\$ 8,288</u>                    | <u>4.2 %</u> | <u>\$ 269,902</u>            | <u>\$ 217,490</u> | <u>\$ 52,412</u>                   | <u>24.1 %</u> | <u>1.31</u>           | <u>1.10</u> |
| Regional Analysis       |                              |                   |                                    |              |                              |                   |                                    |               |                       |             |
| US                      | \$ 64,445                    | \$ 62,602         | \$ 1,843                           | 2.9 %        | \$ 88,388                    | \$ 68,624         | \$ 19,764                          | 28.8 %        | 1.37                  | 1.10        |
| Europe                  | 34,450                       | 44,200            | (9,750)                            | (22.1)       | 26,816                       | 32,702            | (5,886)                            | (18.0)        | 0.78                  | 0.74        |
| Japan                   | 26,298                       | 34,984            | (8,686)                            | (24.8)       | 31,174                       | 36,411            | (5,237)                            | (14.4)        | 1.19                  | 1.04        |
| Asia-Pacific            | 80,360                       | 55,479            | 24,881                             | 44.8         | 123,524                      | 79,753            | 43,771                             | 54.9          | 1.54                  | 1.44        |
| Total                   | <u>\$ 205,553</u>            | <u>\$ 197,265</u> | <u>\$ 8,288</u>                    | <u>4.2 %</u> | <u>\$ 269,902</u>            | <u>\$ 217,490</u> | <u>\$ 52,412</u>                   | <u>24.1 %</u> | <u>1.31</u>           | <u>1.10</u> |

Net sales of \$205.6 million for the six months ended June 30, 2006 were up \$8.3 million compared to the six months ended June 30, 2005. By segment, process equipment sales were up \$9.0 million or 8.1%. The increase in process equipment sales is primarily due to sales to data storage customers driven by an increase in the production of data storage devices. Metrology sales decreased \$0.7 million, primarily due to decreased optical metrology sales. By region, sales in Asia-Pacific increased by 44.8%, while sales in Japan and Europe declined by 24.8% and 22.1%, respectively. The Company believes that there will continue to be period-to-period variations in the geographic distribution of sales.

Orders of \$269.9 million for the six months ended June 30, 2006 increased by \$52.4 million, or 24.1%, from the comparable 2005 period. By segment, the 43.6% increase in process equipment orders was primarily driven by the continued strong data storage industry conditions resulting from the expanded use of hard drives in consumer electronics as well as improved conditions in the HB-LED/wireless market. The 1.7% decrease in metrology orders was due to a \$1.5 million decrease in optical metrology products and a \$0.1 million decrease in AFM products.

The Company's book-to-bill ratio for the six months ended June 30, 2006, which is calculated by dividing orders received in a given time period by revenue recognized in the same time period was 1.31. The Company's backlog as of June 30, 2006 is \$159.1 million, compared to \$114.1 million as of December 31, 2005. During the six months ended June 30, 2006, the Company experienced backlog adjustments and order cancellations of \$19.3 million, primarily in the HB-LED/wireless industry for MOCVD products. The Company also experienced rescheduling of order delivery dates by customers. Due to changing business conditions and customer requirements, the Company may continue to experience cancellations and/or rescheduling of orders.

Gross profit for the six months ended June 30, 2006, was 44.5%, as compared to 41.0% in the comparable prior year period. Process equipment gross margins increased to 39.3% from 33.6%, primarily due to an increase in sales volume of \$9.0 million, favorable product mix, cost reductions and improved supply chain management, which included outsourcing in this segment. Metrology gross margins increased to 51.9% from 50.7%, principally due to better product mix.

Selling, general and administrative expenses were \$46.3 million, or 22.6% of sales in the six months ended June 30, 2006, compared with \$41.6 million, or 21.1% of sales in the six months ended June 30, 2005. The \$4.7 million increase is primarily attributable to annual incentive related compensation expenses, including stock options, restricted shares, severance and cash incentives as well as annual salary increases. In addition, selling, general and administrative expenses increased due to litigation related expenses for the securities class action and consolidated derivative action lawsuits as well as expansion of field sales and marketing personnel to support the Company's new product introductions and the Company's Asia-Pacific operations.

Research and development expense totaled \$29.8 million in the six months ended June 30, 2006, a decrease of \$0.8 million from the comparable period of 2005, primarily due to the timing of new product development efforts. As a percentage of sales, research and development decreased during the 2006 period to 14.5% from 15.5% for the comparable 2005 period.

Amortization expense totaled \$8.0 million in the six months ended June 30, 2006, compared with \$8.5 million in the prior year period, due to certain intangible assets becoming fully amortized.

During the six months ended June 30, 2006, the Company repurchased \$20.0 million aggregate principal amount of its 4.125% convertible subordinated notes. As a result of this repurchase, the amount of convertible subordinated notes outstanding was reduced to \$200.0 million, and the Company recorded a gain from the early extinguishment of debt in the amount of \$0.6 million, offset by a \$0.3 million proportionate reduction in the related deferred financing costs, for a net gain of \$0.3 million.

Net interest expense in the six months ended June 30, 2006 was \$2.5 million compared to \$4.1 million in the prior year period. This reduction was due to an increase in interest rates and higher cash balances invested during the six months ended June 30, 2006, compared to the six months ended June 30, 2005, as well as the reduction in interest expense related to the early extinguishment of debt.

Income tax provision for the six months ended June 30, 2006 was \$2.3 million compared to \$1.2 million in the prior year period. The 2006 provision for income taxes included \$1.7 million relating to Veeco's foreign operations, which continue to be profitable, and \$0.6 million relating to the Company's domestic operations. Due to significant domestic net operating losses, which are fully reserved by a valuation allowance, Veeco's domestic operations are not expected to incur significant income taxes for the foreseeable future. The 2005 provision for income taxes of \$1.2 million primarily related to Veeco's foreign operations, which were profitable.



## Liquidity and Capital Resources

Historically, Veeco's principal capital requirements have included the funding of acquisitions and capital expenditures. The Company generates cash from operations, revolving credit facilities and debt and stock issuances. Veeco's ability to generate sufficient cash flows from operations is primarily dependent on the continued demand for the Company's products and services.

The Company had a net decrease in cash of \$8.5 million for the six months ended June 30, 2006 from December 31, 2005. Cash provided by operations was \$16.7 million for this period, as compared to cash provided by operations of \$24.1 million for the comparable 2005 period. Net income (loss) adjusted for non-cash items provided operating cash flows of \$18.1 million for the six months ended June 30, 2006, compared to \$9.9 million for the comparable 2005 period. Included in the net cash provided by operations for the six months ended June 30, 2006, was an increase in net operating assets and liabilities of \$1.3 million. Accounts receivable decreased \$2.7 million during the six months ended June 30, 2006, primarily due to an improvement in days sales outstanding. Inventories increased by approximately \$6.4 million during the same period, principally due to the ramp up for the expected increases in production for the third quarter. Accounts payable increased by \$6.8 million, as the Company managed its payables to increase days payable outstanding, as well as the increase in inventory purchases to support the production ramp. Accrued expenses and other current liabilities decreased \$1.6 million during the six months ended June 30, 2006, due to a reduction in incentive compensation under the Company's annual bonus plans, reflecting the timing of the payments which occurred during the first quarter of the year.

Cash used in investing activities of \$13.3 million for the six months ended June 30, 2006, resulted primarily from capital expenditures of \$9.6 million and earn-out payments totaling \$3.2 million to the former owners of TurboDisc and Nanodevices Inc. The Company expects to invest approximately \$21.0 million in total during 2006 in capital projects primarily related to engineering equipment and lab tools used in producing Veeco's products, enhanced manufacturing facilities and the continuing implementation of SAP and related computer systems.

Cash used in financing activities for the six months ended June 30, 2006 totaled \$11.6 million, primarily consisting of cash used in the repurchase of a portion of the Company's outstanding 4.125% convertible notes, as discussed below, partially offset by \$8.0 million of common stock issuances resulting from the exercise of employee stock options.

As of June 30, 2006, the Company has outstanding \$200.0 million of 4.125% convertible subordinated notes. During the first quarter of 2006, the Company repurchased \$20.0 million of its notes, reducing the amount outstanding from \$220.0 million to \$200.0 million. The repurchase amount was \$19.5 million in cash, of which \$19.4 million related to principal and \$0.1 million related to accrued interest. As a result of the repurchase, the Company recorded a gain from the early extinguishment of debt in the amount of \$0.6 million, offset by a \$0.3 million proportionate reduction in the related deferred financing costs, for a net gain of \$0.3 million. The Company may engage in similar transactions in the future depending on market conditions, its cash position and other factors.

The Company believes that existing cash balances together with cash generated from operations and amounts available under the Company's revolving credit facility will be sufficient to meet the Company's projected working capital and other cash flow requirements for the next twelve months, as well as the Company's contractual obligations, over the next three years. The Company believes it will be able to meet its obligation to repay the outstanding \$200.0 million convertible subordinated notes that mature on December 21, 2008, through a combination of conversion of the notes outstanding, refinancing, cash generated from operations and/or other means.

The Company is potentially liable for earn-out payments to the former owners of certain acquired businesses based on revenue targets achieved by the acquired businesses. During the first quarter of 2006, the Company paid an earn-out payment of \$2.0 million to the former owner of TurboDisc. During the second quarter of 2006, the Company paid approximately \$1.2 million to the former shareholders of Nanodevices Inc. Both amounts were accrued at December 31, 2005. No additional payments will be required in the future to either set of former owners. The Company is potentially liable for an earn-out payment to the former shareholders of Advanced Imaging, Inc. based on achieving revenue in excess of certain targets for 2006, which currently do not appear achievable.

In May 2006, Veeco invested \$0.5 million to purchase 19.9% of the common stock of Fluens Corporation (“Fluens”). Approximately 31% of Fluens is owned by a related party who is a Vice President of Veeco. Veeco and Fluens plan to jointly develop a next-generation process for high-rate deposition of aluminum oxide for data storage applications. If this development is successful and upon the satisfaction of certain additional conditions by May 2009, Veeco will be obligated to purchase the balance of the outstanding stock of Fluens for \$3.0 million and pay an earn-out. The Company will accrue liabilities that may arise from this transaction when management believes the outcomes of the relevant contingencies are determinable beyond a reasonable doubt. In April 2006, Veeco issued a \$0.8 million purchase order to Fluens for a reactive sputtering deposition system. Veeco had advanced approximately \$0.4 million against this purchase order as of June 30, 2006.

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

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

*Revenue Recognition:* The Company recognizes revenue in accordance with the SEC Staff Accounting Bulletin (“SAB”) No. 104, *Revenue Recognition*. Certain of Veeco’s product sales are accounted for as multiple-element arrangements in accordance with Emerging Issues Task Force (“EITF”) 00-21, *Revenue Arrangements with Multiple Deliverables*. A multiple-element arrangement is a transaction which may involve the delivery or performance of multiple products, services, or rights to use assets, and performance may occur at different points in time or over different periods of time. The Company recognizes revenue when persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collectibility is reasonably assured. For products 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, it has been demonstrated that it meets the customer’s specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount of any customer retention (generally 10% to 20%), which is not payable by the customer until installation is completed and final customer acceptance is achieved. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or require the building of complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% to 2% of the sales value of the related equipment. For new products, new applications of existing products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 80% to 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the amount billed at the time of shipment. The profit on the amount billed for these transactions is deferred and recorded as deferred profit in the accompanying consolidated balance sheets. At June 30, 2006 and December 31, 2005, \$0.7 million and \$0.5 million, respectively, are recorded in deferred profit. Service and maintenance contract revenues are recorded as deferred revenue, which is included in other accrued expenses, and recognized as revenue on a straight-line basis over the service period of the related contract.

*Inventory Valuation:* Inventories are stated at the lower of cost (principally first-in, first-out method) or market. Management evaluates the need to record adjustments for impairment of inventory on a quarterly basis. The Company's policy is to assess the valuation of all inventories, including raw materials, work-in-process, finished goods and spare parts. Obsolete inventory or inventory in excess of management's estimated usage for the next 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, and a material decrease in the fair value of some or all of the assets. Assets are grouped at the lowest levels for which there are identifiable cash flows that are largely independent of the cash flows generated by other asset groups. Changes in strategy and/or market conditions could significantly impact these assumptions, and thus Veeco may be required to record impairment charges for those assets not previously recorded.

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

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

*Deferred Tax Valuation Allowance:* As part of the process of preparing Veeco's Consolidated Financial Statements, the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves estimating the actual current tax expense, together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within its Consolidated Balance Sheets. The carrying value of deferred tax assets is adjusted by a valuation allowance to recognize the extent to which the future tax benefits will be recognized on a more likely than not basis. Veeco's net deferred tax assets consist primarily of net operating loss and tax credit carryforwards, and timing differences between the book and tax treatment of inventory and other asset valuations. Realization of these net deferred tax assets is dependent upon the Company's ability to generate future taxable income.

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

At June 30, 2006, the Company had a valuation allowance of \$71.5 million against substantially all of its domestic net deferred tax assets, which consist of net operating loss and tax credit carryforwards, as well as temporary deductible differences. The valuation allowance was calculated in accordance with the provisions of SFAS No. 109, which places primary importance on the Company's historical results of operations. Although the Company's results in prior years were significantly affected by restructuring and other charges, the Company's historical loss and the losses incurred in 2005 and 2004 represent negative evidence sufficient to require a full valuation allowance under the provisions of SFAS No. 109. If the Company is able to realize part or all of the deferred tax assets in future periods, it will reduce its provision for income taxes with a release of the valuation allowance in an amount that corresponds with the income tax liability generated.

*Share-Based Compensation:* Prior to 2006, the Company accounted for its stock option plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations and generally, no compensation expense was 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. Effective January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*, supersedes APB No. 25 and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. SFAS No. 123(R) was adopted using the modified prospective method of application, which requires Veeco to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in the pro forma disclosures in prior periods. SFAS No. 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under previous accounting literature, which has the effect of reducing consolidated net operating cash flows and increasing consolidated net financing cash flows in periods after adoption. For the three and six months ended June 30, 2006, the Company did not recognize any amount of consolidated financing cash flows for such excess tax deductions.

Total share-based compensation expense is attributable to the remaining requisite service periods of stock options and restricted common stock awards. For the three and six months ended June 30, 2006, the Company granted 146,200 stock options and 198,250 restricted common stock awards to its directors, officers and employees. As a result of adopting SFAS No. 123(R), the Company's net income for the three and six months ended June 30, 2006 was \$0.2 million and \$0.3 million lower, respectively, than if it had continued to account for share-based compensation under APB No. 25. Net income per common share and diluted net income per common share for the three and six months ended June 30, 2006 are less than \$0.01 and \$0.01 lower, respectively, than if the Company had continued to account for share-based compensation under APB No. 25. As of June 30, 2006, the total unrecognized compensation cost related to nonvested stock awards and option awards is \$5.1 million and \$1.8 million, respectively, and the related weighted average period over which it is expected that such unrecognized compensation costs will be recognized is approximately 2.5 years for the nonvested stock awards and 2.4 years for option awards. Future share-based compensation expense will depend on levels of share-based awards granted in the future and, therefore, cannot be predicted at this time.

With the adoption of SFAS No. 123(R) on January 1, 2006, the Company is required to record the fair value of stock-based compensation awards as an expense. In order to determine the fair value of stock options on the date of grant, the Company applies the Black-Scholes option-pricing model. Inherent in the model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a level of judgment which make them critical accounting estimates. Beginning in the fourth quarter of 2005, the Company used an expected stock-price

volatility assumption that is a combination of both historical and implied volatilities of the underlying stock, which are obtained from public data sources. Prior to that time, the Company based this assumption solely on historical volatility. With regard to the weighted-average option life assumption, the Company considers the exercise behavior of past grants and models the pattern of aggregate exercises.

*Other Recent Accounting Pronouncements:* In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. (“FIN”) 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes*. FIN 48 clarifies the accounting and disclosure for income taxes by defining the threshold for recognizing the benefits of tax return positions in the financial statements as “more-likely-than-not” to be sustained by the taxing authority. It also provides guidance on derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently assessing the impact of FIN 48 on its consolidated financial position and results of operations.

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

Veeco's net sales to foreign customers represented approximately 71.1% and 68.6% of Veeco's total net sales for the three and six months ended June 30, 2006, respectively, and 71.1% and 68.3% for the comparable 2005 periods, respectively. The Company expects that net sales to foreign customers will continue to represent a large percentage of Veeco's total net sales. Veeco's net sales denominated in foreign currencies represented approximately 16.4% and 16.5% of Veeco's total net sales for the three and six months ended June 30, 2006, respectively, and 17.1% and 19.2% for the comparable 2005 periods, respectively. The aggregate foreign currency exchange losses included in determining the consolidated results of operations was approximately \$0.1 million and \$0.4 million for the three and six months ended June 30, 2006, respectively, and \$0.1 million and \$0.1 million for the comparable 2005 periods, respectively. Included in the aggregate foreign currency exchange losses, were losses of approximately \$0.1 million and gains of approximately \$0.1 million for the three and six months ended June 30, 2006, respectively, and gains of less than \$0.1 million for each of the comparable 2005 periods. Veeco is exposed to financial market risks, including changes in foreign currency exchange rates. The changes in currency exchange rates that have the largest impact on translating Veeco's international operating profit are the Japanese Yen and the Euro. Veeco uses derivative financial instruments to mitigate these risks. Veeco does not use derivative financial instruments for speculative or trading purposes. The Company 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 \$4.1 million and \$3.9 million for the three and six months ended June 30, 2006, respectively. As of June 30, 2006, the Company had entered into forward contracts for the month of July for the notional amount of approximately \$23.9 million, which approximates the fair market value on June 30, 2006.

### **Item 4. Controls and Procedures.**

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

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

The Company is presently in the process of implementing new company-wide integrated applications software and, to date, has completed the conversion to this new platform in approximately 70% of Veeco's businesses with the remainder expected to be completed in the first half of 2007. As a result, certain changes have been made to the Company's internal controls, which management believes will strengthen the Company's internal control structure. There have been no other significant changes in our internal controls or other factors during the fiscal quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## Part II. OTHER INFORMATION

### Item 1. Legal Proceedings.

#### *In re Veeco Instruments Inc. Securities Litigation and Shareholder Derivative Litigation*

Veeco and certain of its officers have been named as defendants in a consolidated securities class action lawsuit pending in federal court in the Southern District of New York (the “Court”). The lawsuit arises out of the restatement in March 2005 of Veeco’s financial statements for the quarterly periods and nine months ended September 30, 2004 as a result of the Company’s discovery of certain improper accounting transactions at its TurboDisc business unit. The plaintiffs in the lawsuit seek unspecified damages and assert claims against all defendants for violations of Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and claims against the individual defendants for violations of Section 20(b) of the Exchange Act. The Court has certified a plaintiff class for the lawsuit consisting of all persons who acquired the Company’s securities during the period from April 26, 2004 through February 10, 2005. The parties are currently involved in the discovery process. Although the Company believes this lawsuit is without merit and intends to defend vigorously against the claims, the lawsuit could result in substantial costs, divert management’s attention and resources from our operations and negatively affect our public image and reputation.

In addition, three shareholder derivative lawsuits have been consolidated and are also pending before the Court. The plaintiffs in the consolidated derivative action assert that the Company’s directors and certain of its officers breached fiduciary duties in connection with the improper accounting transactions at the TurboDisc business unit. The plaintiffs in the consolidated derivative action seek unspecified damages allegedly sustained by the Company and the return of all bonuses, restricted stock, stock options and other incentive compensation. The parties are currently involved in the discovery process on this action. An unfavorable outcome or prolonged litigation in these matters could materially harm the Company’s business.

### Item 1A. Risk Factors.

Information regarding risk factors appears in the “Safe Harbor Statement” at the beginning of this Quarterly Report on Form 10-Q and in Part I — Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K.

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

The annual meeting of stockholders of the Company was held on May 5, 2006. The matters voted on at the meeting were: (a) the election of three directors: (i) Edward H. Braun, (ii) Richard A. D’Amore and (iii) Douglas A. Kingsley; and (b) ratification of the Board’s appointment of Ernst & Young LLP as the Company’s independent registered public accounting firm for the year ending December 31, 2006. The terms of each of the following directors continued after the meeting: Heinz K. Fridrich, Roger D. McDaniel, Irwin H. Pfister, Joel A. Elftmann, Paul R. Low and Peter J. Simone. As of the record date for the meeting, there were 30,152,702 shares of common stock outstanding, each of which was entitled to one vote with respect to each of the matters voted on at the meeting. Each of the directors up for reelection was reelected and the appointment of Ernst & Young LLP as the Company’s independent registered public accounting firm was ratified by the required number of votes on each such matter. The results of the voting were as follows:

| <u>Matter</u> | <u>For</u> | <u>Withheld</u> |
|---------------|------------|-----------------|
| (a)(i)        | 27,615,725 | 507,202         |
| (a)(ii)       | 27,615,566 | 507,361         |
| (a)(iii)      | 27,836,198 | 286,429         |

| <u>Matter</u> | <u>For</u> | <u>Against</u> | <u>Abstained</u> | <u>Broker<br/>Non-Votes</u> |
|---------------|------------|----------------|------------------|-----------------------------|
| (b)           | 27,119,197 | 968,777        | 34,952           | —                           |

**Item 6. Exhibits.**

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

| <b>Number</b> | <b>Description</b>   | <b>Incorporated by Reference to the Following Document:</b> |
|---------------|--|---|
| 10.1          | Veeco Instruments Inc. 2006 Long-Term Cash Incentive Plan  | *   |
| 10.2          | Form of Amendment to Employment Agreement of Edward H. Braun and John F. Rein, Jr.   | *   |
| 10.3          | Form of Amendment to Letter Agreement of John K. Bulman, John P. Kiernan, Robert P. Oates and Jeannine M. Sargent                                  | *   |
| 10.4          | Veeco Instruments Inc. Amended and Restated 2000 Stock Incentive Plan, effective July 20, 2006   | *   |
| 31.1          | Certification of Chief Executive Officer pursuant to Rule 13a — 14(a) or Rule 15d — 14(a) of the Securities Exchange Act of 1934.                  | *   |
| 31.2          | Certification of Chief Financial Officer pursuant to Rule 13a — 14(a) or Rule 15d — 14(a) of the Securities Exchange Act of 1934.                  | *   |
| 32.1          | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | *   |
| 32.2          | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | *   |

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\* Filed herewith



## SIGNATURES

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

Date: August 4, 2006

Veeco Instruments Inc.

By: /s/ EDWARD H. BRAUN

Edward H. Braun

*Chairman and Chief Executive Officer*

By: /s/ JOHN F. REIN, JR.

John F. Rein, Jr.

*Executive Vice President, Chief Financial Officer and Secretary*

## INDEX TO EXHIBITS

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\* Filed herewith

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**Veeco Instruments Inc.**  
**2006 Long-Term Cash Incentive Plan**

## **1. Plan Objective**

The Veeco Instruments Inc. 2006 Long-Term Cash Incentive Plan (the “Plan”) is designed to encourage results-oriented actions on the part of key executives of Veeco Instruments Inc. and its subsidiaries (collectively, the “Company”) that will drive the achievement of specific business objectives.

## **2. Definitions**

“*Administrator*” means the Committee or such individual or committee to which authority has been delegated in writing; provided that determinations made under Section 5(d) and Section 6 shall be made by the Committee. The Chief Executive Officer of the Company may exercise the powers of the Administrator to designate Participants for the Plan (other than Section 16 Executives) and to determine target awards and performance goals for such Participants.

“*Board*” means the Board of Directors of Veeco Instruments Inc.

“*Code*” means the Internal Revenue Code of 1986, as amended from time to time.

“*Committee*” means the Compensation Committee of the Board, which is comprised wholly of independent, outside directors.

“*Designated Beneficiary*” means the beneficiary designated by a Participant, in a manner determined by the Company, to receive amounts due the Participant in the event of the Participant’s death. In the absence of an effective designation by the Participant, Designated Beneficiary shall mean the Participant’s estate.

“*Disability*” means permanent and total disability within the meaning of Section 105(d)(4) of the Code.

“*Eligible Employee*” means a full-time, regular employee of the Company.

“*Employer*” means the Company and any affiliate whose employees participate in the Plan. The term shall also mean any successor to the Company.

“*Fiscal Year*” means the fiscal year of the Company.

“*Participant*” means an Eligible Employee designated by the Administrator to receive an award under the Plan.

“*Performance Goals*” means the objective(s) established by the Committee for a Performance Period. Performance Goals shall be objective and measurable criteria, deemed by the Committee to be closely linked to long-term shareholder value, such as Earnings Before Interest, Taxes and Amortization (“EBITA”), Revenue or other performance measures.

“*Performance Period*” means the period of years selected by the Committee during which Performance Goals are measured for purposes of determining the extent to which a Participant has earned his or her Target Bonus or any portion or multiple of it. A Performance Period must be at least two years in length.

“*Period to Date Performance*” means the Company’s performance for each of the Performance Goals as measured from the beginning of the Performance Period to the end of the most recently completed fiscal quarter.

“*Section 16 Executive*” means an employee who is subject to the reporting requirements of Section 16 of the Securities Exchange Act of 1934, as amended.

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*“Target Bonus”* means the dollar amount specified for each Participant for each Performance Period.

*“Termination of Employment”* means the date on which a Participant shall cease to serve as an Eligible Employee for any reason.

### **3. Administration**

(a) The Administrator shall have full power and authority to establish the rules and regulations relating to the Plan, to interpret the Plan and those rules and regulations, to designate Performance Periods and Participants for the Plan, to determine each Participant’s target award, performance goals and final award, to make all factual and other determinations in connection with the Plan, and to take all other actions necessary or appropriate for the proper administration of the Plan, including the delegation of such authority or power, where appropriate.

(b) All powers of the Administrator shall be executed in its sole discretion, in the best interest of the Company, not as a fiduciary, and in keeping with the objectives of the Plan and need not be uniform as to similarly situated individuals. The Administrator’s administration of the Plan, including all such rules and regulations, interpretations, selections, determinations, approvals, decisions, delegations, amendments, terminations and other actions, shall be final and binding on the Company and all employees of the Company, including the Participants and their respective beneficiaries.

### **4. Target Awards and Performance Goals**

(a) The Administrator shall establish the Performance Period and the performance goals for each Performance Period and shall establish for each Participant a target award that will be payable if and to the extent that the Company attains such performance goals for the specified Performance Period.

(b) The Administrator may establish appropriate terms and conditions to accommodate newly eligible employees (e.g., newly hired or promoted employees). Unless otherwise determined by the Administrator, the target award for a newly eligible employee shall be prorated based on a fraction, the numerator of which is the number of months such Participant will participate in the Plan during the Performance Period (rounded to the nearest whole month) and the denominator of which is equal to the total number of months in such Performance Period.

(c) Target awards under the Plan shall be expressed as a percent of the Participant’s base salary in effect on January 1<sup>st</sup> of the first fiscal year of the Performance Period, except for Participants who become eligible during the Performance Period (as a result of their hire or promotion date), in which case the base salary in effect at the time of commencement of participation shall be used.

### **5. Calculation of Incentive Awards**

(a) At the end of the Performance Period, the Administrator shall determine whether and to what extent the performance goals have been met based on the Company’s cumulative performance for the Performance Period. The Administrator shall then determine the percentage of the target award that is earned for the Performance Period based on such cumulative performance.

(b) Participants must be employed on the last day of the applicable Performance Period in order to be eligible to receive an incentive award under the Plan with respect to that Performance Period, except as otherwise provided in this Plan, by written agreement between the Company and a Participant or as the Administrator may determine.

(c) If a Participant terminates employment as a result of death, Disability, or retirement, he or she (or his or her Designated Beneficiary, in the event of death) shall receive a pro-rated award at the end of the Performance Period based on the Company’s cumulative performance for the Performance Period and pro-rated based on the length of service during the Performance Period as compared to the entire Performance Period, rounded to the

nearest whole month. For the purpose of this Plan, retirement shall mean any voluntary termination of employment on or after age 60, provided the Participant has completed at least one full year of service during the Performance Period.

(d) If a "Change in Control" of the Company (as that term is defined in the Veeco Instruments Inc. 2000 Stock Incentive Plan, as it may be amended from time to time) occurs during the Performance Period, the following provisions shall apply:

1. If the Committee determines that it would be impracticable to continue the Plan following the Change in Control, then each Participant will receive a pro-rated award, calculated by the Committee based on the Company's Period-to-Date Performance as of the date of the Change in Control, pro-rated based on the length of service of such Participant during the Performance Period as compared to the entire Performance Period, rounded to the nearest whole month. This award will be paid as soon as practicable thereafter.
2. A Participant whose employment is terminated by the Company without cause within twelve (12) months following the Change in Control will receive a pro-rated award, calculated by the Committee based on the Company's Period-to-Date Performance as of the later of the Participant's termination or the date of the Change in Control, pro-rated based on the length of service during the Performance Period as compared to the entire Performance Period, rounded to the nearest whole month. This award will be paid as soon as practicable thereafter.
3. In all other cases, the Plan shall continue following the Change of Control, except to the extent adjusted or amended under Section 6 or 7 below.

(e) Amounts earned under the terms of the Plan shall be paid to Participants in cash in a single lump sum amount, on or before March 15<sup>th</sup> of the year following the end of the Performance Period.

## **6. Changes to Performance Goals and Target Awards**

At any time prior to the final determination of awards, the Committee may adjust the performance goals and target awards to reflect a change in corporate capitalization (such as a stock split or stock dividend), or a corporate transaction (such as a change in control, merger, consolidation, separation, reorganization or partial or complete liquidation), or to reflect equitably the occurrence of any extraordinary event, any change in applicable accounting rules or principles, any change in the Company's method of accounting, any change in applicable law, any change due to any merger, consolidation, acquisition, reorganization, stock split, stock dividend, combination of shares or other changes in the Company's corporate structure or shares, or any other change of a similar nature.

## **7. Amendments and Termination**

The Company may at any time amend or terminate the Plan by action of the Committee; provided that no such action shall adversely affect any outstanding awards to Participants. The Committee shall have the right to modify the terms of the Plan as may be necessary or desirable to comply with the laws or local customs of countries in which the Company operates or has employees.

## **8. Miscellaneous Provisions**

(a) This Plan is not a contract between the Company and the Participants. Neither the establishment of this Plan, nor any action taken hereunder, shall be construed as giving any Participant any right to be retained in the employ of the Company or any of its subsidiaries. Nothing in the Plan, and no action taken pursuant to the Plan, shall affect the right of the Company or a subsidiary to terminate a Participant's employment at any time and for any or no reason. Except as provided in Section 7, the Company is under no obligation to continue the Plan.

(b) A Participant's right and interest under the Plan may not be assigned or transferred, except upon death as provided in Section 5(c) above, and any attempted assignment or transfer shall be null and void and shall

extinguish, in the Company's sole discretion, the Company's obligation under the Plan to pay awards with respect to the Participant. The Company's obligations under the Plan may be assigned to any corporation which acquires all or substantially all of the assets of the Company or, with respect to a particular Participant, of the business unit that employed the Participant, or any corporation into which the Company may be merged or consolidated.

(c) The Plan shall be unfunded. The Company shall not be required to establish any special or separate fund, or to make any other segregation of assets, to assure payment of awards. The Company's obligations hereunder shall constitute a general, unsecured obligation, awards shall be paid solely out of the Company's general assets, and no Participant shall have any right to any specific assets of the Company.

(d) The Company shall have the right to deduct from awards or any other payments of wages any and all federal, state and local taxes or other amounts required by law to be withheld.

(e) The Company's obligation to pay compensation as herein provided is subject to any applicable orders, rules or regulations of any government agency or office having authority to regulate the payment of wages, salaries, and other forms of compensation.

(f) Upon a violation by the Participant of any of the restrictive covenants contained in any agreement between the Participant and the Company, the Participant shall forfeit his or her entitlement to any award granted pursuant to this Plan. The Administrator may, in its sole discretion, waive in whole or in part the Company's right to enforce forfeiture under this section, but no such waiver shall be effective unless expressly made in writing for that purpose.

(g) The Company may, to the extent permitted by law, deduct from and set off against its obligations to a Participant hereunder (including, without limitation, amounts payable in connection with an award hereunder as wages or benefits or other form of compensation), any amounts the Participant owes to the Company for any reason whatsoever and such Participant shall remain liable for any portion of the Participant's obligation not satisfied by such setoff. By accepting an award under this Plan, each Participant agrees to the deduction or setoff provided for in this section.

(h) If the Committee, in its sole discretion, determines that any provision of the Plan could cause any payment to be made or benefit to be provided to a Participant to be deferred compensation that does not comply with Section 409A(a)(1) of the Code, such provision shall be null and void, and, if permitted by Section 409A, the Committee shall amend the Plan to maintain to the maximum extent practicable the original intent of the provision without violating the requirements of Section 409A of the Code.

(i) The validity, construction, interpretation and effect of the Plan shall exclusively be governed by and determined in accordance with the laws of the State of Delaware.

\* \* \* \* \*

**FORM OF  
AMENDMENT TO EMPLOYMENT AGREEMENT**

Date: June 9, 2006

Prior Agreement: Employment Agreement effective April 1, 2003, by and between Veeco Instruments Inc. (the "Company"), and \_\_\_\_\_ ("Executive")

Defined Terms: Capitalized terms used but not defined herein shall have the meanings assigned to such terms in the Prior Agreement.

The undersigned hereby amend and supplement the Prior Agreement by adding the following provisions:

If Executive's employment with the Company terminates for any reason (including death or Disability), other than pursuant to a termination of Executive's employment for Cause or a resignation by the Executive without Good Reason, and contingent upon Executive's compliance with the provisions of the Prior Agreement and satisfaction of any conditions precedent to severance and similar payments under the Prior Agreement (such as execution and non-revocation of a general release of claims), the following would apply:

*Restricted Stock, Restricted Stock Units:*

The Eligible Shares (as defined below) shall become vested and the restrictions with regard thereto shall lapse upon such termination. As used herein, "Eligible Shares" shall mean all shares of restricted stock or restricted stock units which (a) were awarded to Executive on or after the date of this Amendment, (b) are held by Executive as of the date of termination and (c) continue to be subject to restrictions as of such date.

*Long-term Cash Incentive Awards:*

Change in Control Situation: If such termination occurs within 12 months following a "Change of Control," then Executive will be entitled to receive a pro-rated portion of any outstanding long-term cash incentive awards, which portion will be calculated by the Compensation Committee of the Company's Board of Directors as of the later of the date of Executive's termination or the date of the Change of Control and based on the Company's performance measured from the beginning of the applicable performance period to the end of the most recently completed fiscal quarter, and will be pro-rated based on the length of service during the applicable performance period as compared to the entire performance period, rounded to the nearest whole month. This award will be paid as soon as practicable following the Change in Control (or, if later, the date of such termination).

Non-Change in Control Situation: If such termination occurs other than as a result of or within 12 months following a "Change of Control," then Executive will be entitled to receive a pro-rated portion of any outstanding long-term cash incentive awards at the end of the applicable performance period based on the Company's cumulative performance for the performance period and pro-rated based on the length of service during the applicable performance period as compared to the entire performance period, rounded to the nearest whole month. This award will be paid at the same time as awards are payable to participants generally with respect to such performance period.

Except as amended and supplemented hereby, the Prior Agreement shall remain in full force and effect.

VEECO INSTRUMENTS INC.

EXECUTIVE:

By: \_\_\_\_\_  
Name:  
Title

\_\_\_\_\_

**FORM OF  
AMENDMENT TO LETTER AGREEMENT**

Date: June 9, 2006

Prior Agreement: Letter Agreement effective [April 1, 2003], by and between Veeco Instruments Inc. (the "Company"), and  
\_\_\_\_\_ ("Executive")

Defined Terms: Capitalized terms used but not defined herein shall have the meanings assigned to such terms in the Prior Agreement.

The undersigned hereby amend and supplement the Prior Agreement by adding the following provisions:

In the event Executive's employment with the Company is terminated without "Cause" or Executive resigns for "Good Reason," and contingent upon Executive's compliance with the provisions of the Prior Agreement and satisfaction of any conditions precedent to severance and similar payments under the Prior Agreement (such as execution and non-revocation of a general release of claims), the following would apply:

*Restricted Stock, Restricted Stock Units:*

The Eligible Shares (as defined below) shall become vested and the restrictions with regard thereto shall lapse upon such termination. As used herein, "Eligible Shares" shall mean all shares of restricted stock or restricted stock units which (a) were awarded to Executive on or after the date of this Amendment, (b) are held by Executive as of the date of termination and (c) continue to be subject to restrictions as of such date.

*Long-term Cash Incentive Awards:*

Change in Control Situation: If such termination occurs within 12 months following a "Change of Control," then Executive will be entitled to receive a pro-rated portion of any outstanding long-term cash incentive awards, which portion will be calculated by the Compensation Committee of the Company's Board of Directors as of the later of the date of Executive's termination or the date of the Change of Control and based on the Company's performance measured from the beginning of the applicable performance period to the end of the most recently completed fiscal quarter, and will be pro-rated based on the length of service during the applicable performance period as compared to the entire performance period, rounded to the nearest whole month. This award will be paid as soon as practicable following the Change in Control (or, if later, the date of such termination).

Non-Change in Control Situation: If such termination occurs other than as a result of or within 12 months following a "Change of Control," then Executive will be entitled to receive a pro-rated portion of any outstanding long-term cash incentive awards at the end of the applicable performance period based on the Company's cumulative performance for the performance period and pro-rated based on the length of service during the applicable performance period as compared to the entire performance period, rounded to the nearest whole month. This award will be paid at the same time as awards are payable to participants generally with respect to such performance period.

Except as amended and supplemented hereby, the Prior Agreement shall remain in full force and effect.

VEECO INSTRUMENTS INC.

EXECUTIVE:

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

\_\_\_\_\_



**VEECO INSTRUMENTS INC.**  
**AMENDED AND RESTATED 2000 STOCK INCENTIVE PLAN**  
**(formerly known as the 2000 STOCK OPTION PLAN)**

**Effective July 20, 2006**

**1. Purpose**

The purpose of the Plan is to provide a means through which the Company and its Affiliates may attract capable persons to enter and remain in the employ of the Company and Affiliates and to provide a means whereby employees, directors and consultants of the Company and its Affiliates can acquire and maintain Common Stock ownership, thereby strengthening their commitment to the welfare of the Company and Affiliates and promoting an identity of interest between stockholders and these employees.

The Plan provides for granting Incentive Stock Options, Nonqualified Stock Options, Restricted Stock and Restricted Stock Units.

**2. Definitions**

The following definitions shall be applicable throughout the Plan.

“Affiliate” means (i) any entity that directly or indirectly is controlled by, or is under common control with the Company, (ii) any entity in which the Company has a significant equity interest, and (iii) any Subsidiary; in each case as determined by the Committee.

“Annual Revenue” means the Company’s or a business unit’s net sales for the fiscal year, determined in accordance with generally accepted accounting principles; provided, however, that prior to the fiscal year, the Committee shall determine whether any significant item(s) shall be excluded or included from the calculation of Annual Revenue with respect to one or more Participants.

“Board” means the Board of Directors of the Company or, to the extent the Board of Directors of the Company has authorized a committee thereof to take action with respect to the Plan on its behalf, the committee so authorized.

“Cash Flow” means, as to any Fiscal Period, the operating cash flow of the Company for such Fiscal Period, provided that prior to the Fiscal Period, the Committee shall determine whether any significant item(s) shall be included or excluded from the calculation of Cash Flow with respect to one or more Participants.

“Cause” means the Company or an Affiliate having “cause” to terminate a Participant’s employment or service, as defined in any existing employment, consulting or any other agreement between the Participant and the Company or an Affiliate or, in the absence of such an employment, consulting or other agreement, upon (i) the determination by the Committee that the Participant has ceased to perform his duties to the Company or an Affiliate (other than as a result of his incapacity due to physical or mental illness or injury), which failure amounts to an intentional and extended neglect of his duties to such party, (ii) the Committee’s determination that the Participant has engaged or is about to engage in conduct materially injurious to the Company or an Affiliate, (iii) the Participant having been convicted of, or pleaded guilty or no contest to, a felony or a crime involving moral turpitude or (iv) the failure of the Participant to follow instruction of the Board or his direct superiors.

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“Change in Control, shall, unless in the case of a particular Plan Award, the applicable Plan Award Agreement states otherwise or contains a different definition of “Change in Control”, be deemed to occur upon:

(i) the acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) (each, a “Person”) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of 30% or more (on a fully diluted basis) of either (A) the then outstanding shares of Common Stock, taking into account as outstanding for this purpose such Common Stock issuable upon the exercise of options or warrants, the conversion of convertible stock or debt, and the exercise of any similar right to acquire such common stock (the “Outstanding Company Common Stock”) or (B) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the “Outstanding Company Voting Securities”); provided, however, that for purposes of the Plan, the following acquisitions shall not constitute a Change of Control: (I) any acquisition by the Company, (II) any acquisition by any employee benefit plan sponsored or maintained by the Company or any Affiliate, (III) any acquisition by any Person which complies with clauses (A), (B) and (C) of subsection (v) of this Section 2(f), or (IV) in respect of an Award held by a particular Participant, any acquisition by the Participant or any “affiliate” (within the meaning of 17 C.F.R. §230.405) of the Participant (persons described in clauses (I), (II), and (IV) being referred to hereafter as “Excluded Persons”);

(ii) Individuals who, on the date hereof, constitute the Board (the “Incumbent Directors”) cease for any reason to constitute at least a majority of the Board, provided that any person becoming a director subsequent to the date hereof, whose election or nomination for election was approved by a vote of at least two-thirds of the Incumbent Directors then on the Board (either by a specific vote or by approval of the proxy statement of the Corporation in which such person is named as a nominee for director, without written objection to such nomination) shall be deemed to be an Incumbent Director; provided, however, that no individual initially elected or nominated as a director of the Corporation as a result of an actual or threatened election contest with respect to directors or as a result of any other actual or threatened solicitation of proxies or consents by or on behalf of any person other than the Board shall be deemed to be an Incumbent Director;

(iii) the dissolution or liquidation of the Company;

(iv) the sale of all or substantially all of the business or assets of the Company; or

(v) the consummation of a merger, consolidation, statutory share exchange or similar form of corporate transaction involving the Company that requires the approval of the Company’s stockholders, whether for such transaction or the issuance of securities in the transaction (a “Business Combination”), unless immediately following such Business Combination: (A) more than 50% of the total voting power of (x) the corporation resulting from such Business Combination (the “Surviving Corporation”), or (y) if applicable, the ultimate parent corporation that directly or indirectly has beneficial ownership of sufficient voting securities eligible to elect a majority of the directors of the Surviving Corporation (the “Parent Corporation”), is represented by the Outstanding Company Voting Securities that were outstanding immediately prior to such Business Combination (or, if applicable, is represented by shares into which the Outstanding Company Voting Securities were converted pursuant to such Business Combination), (B) no Person (other than any Excluded Person), is or becomes the beneficial owner, directly or indirectly, of 30% or more of the total voting power of the outstanding voting securities eligible to elect directors of the Parent Corporation (or, if there is no Parent Corporation, the Surviving Corporation) and (C) at least a majority of the members of the board of directors of the Parent Corporation (or, if there is no Parent Corporation, the Surviving Corporation) following the consummation of the Business Combination were Incumbent Directors.

“Code” means the Internal Revenue Code of 1986, as amended. Reference in the Plan to any section of the Code shall be deemed to include any amendments or successor provisions to such section and any regulations under such section.

“Committee” means a committee of at least two people as the Board may appoint to administer the Plan or, if no such committee has been appointed by the Board, the Board. Unless the Board is acting as the Committee or the Board specifically determines otherwise, each member of the Committee shall, at the time he takes any action with respect to a Plan Award under the Plan, be an Eligible Director. However, the mere fact that a Committee member shall fail to qualify as an Eligible Director shall not invalidate any Plan Award granted by the Committee which Plan Award is otherwise validly made under the Plan.

“Common Stock” means the common stock, par value \$0.01 per share, of the Company.

“Company” means Veeco Instruments Inc. With respect to the definitions of the Performance Goals, the Committee may determine that “Company” means Veeco Instruments Inc. and one or more of its Affiliates.

“Date of Grant” means the date on which the granting of a Plan Award is authorized, or such other date as may be specified in such authorization or, if there is no such date, the date indicated on the applicable Plan Award Agreement.

“Disability” means, unless in the case of a particular Plan Award, the applicable Plan Award Agreement states otherwise, the entitlement of a Participant to receive benefits under the long-term disability plan of the Company or an Affiliate, as may be applicable to the Participant in question, or, in the absence of such a plan, the complete and permanent inability by reason of illness or accident to perform the duties of the occupation at which a Participant was employed or served when such disability commenced or, as determined by the Committee based upon medical evidence acceptable to it.

“Dividend Equivalent” means, on any dividend record date, consideration equivalent in value and kind to the dividend on one share of Stock as declared by the Board with respect to such record date; provided that “Dividend Equivalent” shall not include any dividend with respect to which adjustment under Section 10(a) has been made.

“Earnings Per Share” means as to any Fiscal Period, the Company’s Net Income divided by a weighted average number of shares of Stock outstanding and dilutive common equivalent shares of Stock deemed outstanding.

“EBITA” means Net Income before interest, taxes and amortization, each as determined under generally accepted accounting principles or as otherwise defined hereunder.

“Effective Date” means the date on which the Plan is approved by the Board, subject to the approval of the stockholders of the Company.

“Eligible Director” means a person who is (i) a “non-employee director” within the meaning of Rule 16b-3 under the Exchange Act, or a person meeting any similar requirement under any successor rule or regulation and (ii) an “outside director” within the meaning of Section 162(m) of the Code, and the Treasury Regulations promulgated thereunder; provided, however, that clause (ii) shall apply only with respect to grants of Plan Awards with respect to which the Company’s tax deduction could be limited by Section 162(m) of the Code if such clause did not apply.

“Eligible Person” means any (i) individual regularly employed by the Company or an Affiliate who satisfies all of the requirements of Section 6; provided, however, that no such employee covered by a collective bargaining agreement shall be an Eligible Person unless and to the extent that such eligibility is set forth in such collective bargaining agreement or in an agreement or instrument relating thereto; (ii) director of the Company or an Affiliate or (iii) consultant or advisor to the Company or an Affiliate who may be offered securities pursuant to Form S-8 (which, as of the Effective Date, includes only those who (A) are natural persons and (B) provide bona fide services to the Company or an Affiliate other than in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market for the Company’s securities).

“Exchange Act” means the Securities Exchange Act of 1934, as amended.

“Fair Market Value”, on a given date means (i) if the Stock is listed on a national securities exchange, the closing price on the primary exchange with which the Stock is listed and traded on the date prior to such date, or, if there is no such sale on that date, then on the last preceding date on which such a sale was reported; (ii) if the Stock is not listed on any national securities exchange but is quoted in the National Market System of the National Association of Securities Dealers Automated Quotation System (“NASDAQ”) on a last sale basis, the closing price reported on the date prior to such date, or, if there is no such sale on that date, then on the last preceding date on which a sale was reported; or (iii) if the Stock is not listed on a national securities exchange nor quoted in the NASDAQ on a last sale basis, the amount determined by the Committee to be the fair market value based upon a good faith attempt to value the Stock accurately and computed in accordance with applicable regulations of the Internal Revenue Service.

“Fiscal Period” means the fiscal year, quarter or other period of the Company.

“Incentive Stock Option” means an Option granted by the Committee to a Participant under the Plan which is designated by the Committee as an incentive stock option as described in Section 422 of the Code and which otherwise meets the requirements set forth herein.

“Mature Shares” means shares of Stock owned by a Participant which are not subject to any pledge or other security interest and have either been held by the Participant for six months, previously acquired by the Participant on the open market or meet such other requirements as the Committee may determine necessary in order to avoid an accounting earnings charge on account of the use of such shares to pay the Option Price or satisfy a withholding obligation in respect of a Plan Award.

“Net Income” means as to any Fiscal Period, the income after taxes of the Company for such Fiscal Period determined in accordance with generally accepted accounting principles, provided that prior to the Fiscal Period, the Committee shall determine whether any significant item(s) shall be included or excluded from the calculation of Net Income with respect to one or more Participants.

“New Orders” means as to any Fiscal Period, the firm orders for a system, product, part, or service that are recorded for such Fiscal Period.

“Non-Employee Director” means a member of the Board who is not an employee of the Company or any Affiliate.

“Nonqualified Stock Option” means an Option granted by the Committee to a Participant under the Plan which is not designated by the Committee as an Incentive Stock Option.

“Normal Termination” means termination of employment or service with the Company or an Affiliate:

- (i) on account of death or Disability;
- (ii) by the Company or such Affiliate without Cause; or
- (iii) in the case of Plan Awards granted to an Eligible Director, a resignation from or a failure to be re-elected to the Board.

“Option” means an award granted under Section 7.

“Option Period” means the period described in Section 7(d).

“Option Price” means the exercise price for an Option as described in Section 7(a).

“Original Effective Date” shall mean April 3, 2000, the date on which the Company’s 2000 Stock Option Plan was approved by the Board.

“Participant” means an Eligible Person who has been selected by the Committee to participate in the Plan and to receive a Plan Award pursuant to Section 6.

“Performance Goals” means the goal(s) (or combined goal(s)) determined by the Committee (in its discretion) to be applicable to a Participant with respect to an award of shares of Restricted Stock or Restricted Stock Units. As determined by the Committee, the Performance Goals applicable to an award of shares of Restricted Stock or Restricted Stock Units may provide for a targeted level or levels of achievement using one or more of the following measures: (a) Annual Revenue, (b) Cash Flow, (c) Earnings Per Share, (d) EBITA, (e) Net Income, (f) New Orders, (g) Personal Goals, (h) Return on Assets, and (i) Return on Sales. The Performance Goals may differ from Participant to Participant and from award to award. Any criteria used may be (i) measured in absolute terms, (ii) compared to another company or companies, (iii) measured against the performance of the Company as a whole or a segment of the Company and/or (iv) measured on a pre-tax or post-tax basis (if applicable).

“Personal Goals” means as to a Participant, the objective and measurable goals set by a “management by objectives” or other process and approved by the Committee (in its discretion).

“Plan” means this Veeco Instruments Inc. 2000 Stock Incentive Plan.

“Plan Award” means an award of Options, Restricted Stock or Restricted Stock Units, as the Committee determines.

“Plan Award Agreement” means any agreement between the Company and a Participant who has been granted a Plan Award that defines the rights and obligations of the parties thereto.

“Restricted Stock” means an award of Common Stock subject to restrictions as provided in Section 8 of this Plan.

“Restricted Stock Agreement” means a Plan Award Agreement relating to the grant of Restricted Stock.

“Restricted Stock Unit” means a contractual right described in Section 8A hereof, to receive an amount based on the Fair Market Value of a share of Stock.

“Restricted Stock Unit Agreement” means a Plan Award Agreement relating to the grant of Restricted Stock Units.

“Return on Assets” means as to any Fiscal Period, the Net Income of the Company divided by the average of beginning and ending assets.

“Return on Sales” means as to any Fiscal Period, the percentage equal to the Company’s Net Income or the business unit’s EBITA, divided by the Company’s or the business unit’s revenue for such Fiscal Period.

“Securities Act” means the Securities Act of 1933, as amended.

“Stock” means the Common Stock or such other authorized shares of stock of the Company as the Committee may from time to time authorize for use under the Plan.

“Subsidiary” means any subsidiary of the Company as defined in Section 424(f) of the Code.

### 3. **Effective Date and Duration**

The Plan is effective as of the Effective Date; provided that the effectiveness of the Plan and the validity of any and all Plan Awards granted pursuant to the Plan is contingent upon approval of the Plan by the shareholders of the Company in a manner intended to comply with the shareholder approval requirements of Sections 162(m) and 422(b)(i) of the Code.

The expiration date of the Plan, on and after which no Plan Awards may be granted hereunder, shall be the tenth anniversary of the Original Effective Date; provided, however, that the administration of the Plan shall continue in effect until all matters relating to Plan Awards previously granted have been settled.

### 4. **Administration**

The Committee shall administer the Plan. A majority of the members of the Committee shall constitute a quorum. The acts of a majority of the members present at any meeting at which a quorum is present or acts approved in writing by a majority of the Committee shall be deemed the acts of the Committee.

(a) Subject to the provisions of the Plan and applicable law, the Committee shall have the power, in addition to other express powers and authorizations conferred on the Committee by the Plan, to: (i) designate Participants; (ii) determine the type or types of Plan Awards to be granted to a Participant; (iii) determine the number of Shares to be covered by, or with respect to which payments, rights, or other matters are to be calculated in connection with, Plan Awards; (iv) determine the terms and conditions of any Plan Awards; (v) determine whether, to what extent, and under what circumstances Plan Awards may be settled or exercised in cash, Stock, other securities, other Plan Awards or other property, or canceled, forfeited or suspended and the method or methods by which Plan Awards may be canceled, forfeited, suspended or, if applicable, settled or exercised; (vi) determine whether, to what extent, and under what circumstances cash, Stock, other securities, other Plan Awards, other property and other amounts payable with respect to a Plan Award shall be deferred either automatically or at the election of the holder thereof or of the Committee; (vii) interpret, administer reconcile any inconsistency, correct any default and/or supply any omission in the Plan and any instrument or agreement relating to, or Plan Award granted under, the Plan; (viii) establish, amend, suspend, or waive such rules and regulations and appoint such agents as it shall deem appropriate for the proper administration of the Plan; and (ix) make any other determination and take any other action that the Committee deems necessary or desirable for the administration of the Plan.

(b) Unless otherwise expressly provided in the Plan, all designations, determinations, interpretations and other decisions under or with respect to the Plan or any Plan Award or any documents evidencing Plan Awards shall be within the sole discretion of the Committee, may be made at any time and shall be final, conclusive and binding upon all parties, including, without limitation, the Company, any Affiliate, any Participant, any holder or beneficiary of any Plan Award, and any shareholder.

(c) Notwithstanding any provision of the Plan to the contrary, in order to foster and promote achievement of the purposes of the Plan or to comply with provisions of law in other countries in which the Company or any of its Affiliates operates or has employees, the Committee, in its sole discretion, shall have the power and authority to (a) modify the terms and conditions of any Plan Awards made to Eligible Employees employed outside the United States, and (b) establish subplans, modified option exercise procedures, and other Award terms, conditions, and procedures to the extent such actions may be necessary or advisable to comply with provisions of the laws and regulations of countries outside the United States in order to assure the lawfulness, validity and effectiveness of Plan Awards granted hereunder.

(d) Notwithstanding the above, no Committee member may participate in any action of the Committee with respect to any claim or dispute regarding only that Committee member.

## **5. Grant of Awards; Shares Subject to the Plan**

The Committee may, from time to time, grant Plan Awards to one or more Eligible Persons; provided, however, that:

(a) Subject to Section 10, the aggregate number of shares of Stock in respect of which Plan Awards may be granted under the Plan shall not exceed 8,530,000; provided further that that aggregate number of Plan Awards issued in the form of Restricted Stock or Restricted Stock Units shall not exceed 1,700,000

(b) Shares of Stock authorized under the Plan shall be deemed to have been used in settlement of Plan Awards whether or not they are actually delivered. In the event any Plan Award shall be surrendered, terminate, expire, or be forfeited, the number of shares of Stock no longer subject thereto shall thereupon be released and shall thereafter be available for new grants under the Plan;

(c) Shares of Stock delivered by the Company in settlement of Plan Awards granted under the Plan may be authorized and unissued Stock or Stock held in the treasury of the Company or may be purchased on the open market or by private purchase;

(d) Subject to Section 10, (i) no person may be granted Options under the Plan during any calendar year with respect to more than 300,000 shares of Stock; (ii) no person may be granted Restricted Stock and Restricted Stock Units under the Plan during any calendar year with respect to more than 50,000 shares of Stock in the aggregate; and

(e) Without limiting the generality of the preceding provisions of this Section 5, the Committee may, but solely with the Participant's consent, agree to cancel any Plan Award under the Plan and issue a new Plan Award in substitution therefor upon such terms as the Committee may in its sole discretion determine, provided that the substituted Plan Award satisfies all applicable Plan requirements as of the date such new Award is made, provided further that, without shareholder approval, no such action may lower the exercise price of a previously granted Option.

6. **Eligibility**

Participation shall be limited to Eligible Persons who have received written notification from the Committee, or from a person designated by the Committee, that they have been selected to participate in the Plan.

7. **Terms of Options**

(a) **Option Grants.**

(i) Eligible Persons. The Committee is authorized to grant one or more Incentive Stock Options or Nonqualified Stock Options to any Eligible Person; provided, however, that no Incentive Stock Options shall be granted to any Eligible Person who is not an employee of the Company or a Subsidiary. Each Option so granted shall be subject to the following conditions of this Section 7, or to such other conditions as may be reflected in the applicable Plan Award Agreement.

(ii) Eligible Directors. For periods prior to December 31, 2005, each Participant who is a Non-Employee Director of the Company shall receive upon initial election to office and thereafter annually on the date of the Company's annual meeting of stockholders ( provided that such date is at least 6 months following such Eligible Director's initial election to office) an Option to acquire 10,000 shares of Stock at a price equal to the Fair Market Value of the shares of Stock subject to such Option on the Date of Grant.

(b) **Option Price.** The exercise price ("Option Price") per share of Stock for each Option shall be set by the Committee at the time of grant but shall not be less than the Fair Market Value of a share of Stock on the Date of Grant subject, in the case of an Incentive Stock Option, to Section 7(g).

(c) **Manner of Exercise and Form of Payment.** No shares of Stock shall be delivered pursuant to any exercise of an Option until payment in full of the aggregate exercise price therefor is received by the Company. Options which have become exercisable may be exercised by delivery of written notice of exercise to the Committee accompanied by payment of the Option Price. The Option Price shall be payable in cash and/or, at the sole discretion of the Committee, shares of Stock valued at the Fair Market Value at the time the Option is exercised (including by means of attestation of ownership of a sufficient number of shares of Stock in lieu of actual delivery of such shares to the Company), provided that such shares of Stock are Mature Shares, or, in the discretion of the Committee, either (i) in other property having a fair market value on the date of exercise equal to the Option Price, (ii) by delivering to the Committee a copy of irrevocable instructions to a stockbroker to deliver promptly to the Company an amount of loan proceeds, or proceeds of the sale of the Stock subject to the Option, sufficient to pay the Option Price or (iii) by such other method as the Committee may allow.

(d) **Vesting.**

(i) In General. Unless otherwise provided in a Stock Option Agreement or other written agreement between the Company and a Participant, Options shall vest and become exercisable as follows:

(x) with respect to one-third of the shares of Stock covered by the Option, on the first anniversary of the Date of Grant;

(y) with respect to an additional one-third of the shares of Stock covered by the Option, on the second anniversary of the Date of Grant;



(z) with respect to the remaining one-third of the shares of Stock covered by the Option, on the third anniversary of the Date of Grant.

Notwithstanding the foregoing, the Committee may, in its sole discretion, accelerate the exercisability of any Option, which acceleration shall not affect the terms and conditions of any such Option other than with respect to exercisability. If an Option is exercisable in installments, such installments or portions thereof which become exercisable shall remain exercisable until the Option expires.

(ii) **Non-Employee Directors.** Notwithstanding Section 7(d)(i), Options granted to Eligible Directors shall be immediately vested and exercisable as of the Date of Grant.

(e) **Option Period and Termination.** An Option may be exercised by the holder thereof in accordance with Section 7(d) above; provided, however, that no Option shall be exercisable later than seven years from the Date of Grant (the "Option Period"). Notwithstanding the foregoing, unless the applicable Stock Option Agreement or other written agreement between the Company and a Participant provides otherwise, an Option shall expire earlier than the end of the Option Period in the following circumstances:

(i) If prior to the end of the Option Period, the Participant shall undergo a Normal Termination, the Option shall expire on the earlier of the last day of the Option Period and the date that is three months after the date of such Normal Termination; provided, however, that any Participant whose employment with the Company or any Affiliate is terminated and who is subsequently rehired by the Company or any Affiliate prior to the expiration of the Option shall not be considered to have undergone a termination. In the event of a Normal Termination, the Option shall remain exercisable by the Participant for the period described in the first sentence of this Section 7(e)(i), only to the extent the Option was exercisable at the time of such Normal Termination.

(ii) If the Participant dies prior to the end of the Option Period and while still in the employ or service of the Company or an Affiliate, or following a Normal Termination but prior to the expiration of an Option, the Option shall expire on the earlier of the last day of the Option Period and the date that is one year after the date of death of the Participant. In such event, the Option shall remain exercisable by the person or persons to whom the Participant's rights under the Option pass by will or the applicable laws of descent and distribution until its expiration, only to the extent the Option was exercisable by the Participant at the time of death.

(iii) If the Participant ceases employment or service with the Company and Affiliates for reasons other than Normal Termination or death, the Option shall expire immediately upon such cessation of employment or service.

(f) **Other Terms and Conditions.** Except as specifically provided otherwise in a Stock Option Agreement, each Option granted under the Plan shall be subject to the following terms and conditions:

(i) Each Option or portion thereof that is exercisable shall be exercisable for the full amount of such exercisable portion or for any part thereof.

(ii) Each Option shall cease to be exercisable, as to any share of Stock, when the Participant purchases the share or when the Option expires.

(iii) Subject to Section 9(h), Options shall not be transferable by the Participant except by will or the laws of descent and distribution and shall be exercisable during the Participant's lifetime only by the Participant.

(iv) Each Option shall vest and become exercisable by the Participant in accordance the provisions of Section 7(d).

(v) At the time of any exercise of an Option, the Committee may, in its sole discretion, require a Participant to deliver to the Committee a written representation that the shares of Stock to be acquired upon such exercise are to be acquired for investment and not for resale or with a view to the distribution thereof. Upon such a request by the Committee, delivery of such representation prior to the delivery of any shares of Stock issued upon exercise of an Option shall be a condition precedent to the right of the Participant or such other person to purchase any such shares. In the event certificates for Stock are delivered under the Plan with respect to which such investment representation has been obtained, the Committee may cause a legend or legends to be placed on such certificates to make appropriate reference to such representation and to restrict transfer in the absence of compliance with applicable federal or state securities laws.

(vi) Each Participant awarded an Incentive Stock Option under the Plan shall notify the Company in writing immediately after the date he or she makes a disqualifying disposition of any shares of Stock acquired pursuant to the exercise of such Incentive Stock Option. A disqualifying disposition is any disposition (including any sale) of such Stock before the later of (a) two years after the Date of Grant of the Incentive Stock Option and (b) one year after the date the Participant acquired the Stock by exercising the Incentive Stock Option.

(g) **Incentive Stock Option Grants to 10% Stockholders.** Notwithstanding anything to the contrary in this Section 7, if an Incentive Stock Option is granted to a Participant who owns stock representing more than ten percent of the voting power of all classes of stock of the Company or of a Subsidiary, the Option Period shall not exceed five years from the Date of Grant of such Option and the Option Price shall be at least 110 percent of the Fair Market Value (on the Date of Grant) of the Stock subject to the Option.

(h) **\$100,000 Per Year Limitation for Incentive Stock Options.** To the extent the aggregate Fair Market Value (determined as of the Date of Grant) of Stock for which Incentive Stock Options are exercisable for the first time by any Participant during any calendar year (under all plans of the Company) exceeds \$100,000, such excess Incentive Stock Options shall be treated as Nonqualified Stock Options.

(i) **Voluntary Surrender.** The Committee may permit the voluntary surrender of all or any portion of any Nonqualified Stock Option granted under the Plan to be conditioned upon the granting to the Participant of a new Option for the same or a different number of shares of Stock as the Option surrendered or require such voluntary surrender as a condition precedent to a grant of a new Option to such Participant. Such new Option shall be exercisable at an Option Price, during an Option Period, and in accordance with any other terms or conditions specified by the Committee at the time the new Option is granted, all determined in accordance with the provisions of the Plan without regard to the Option Price, Option Period, or any other terms and conditions of the Nonqualified Stock Option surrendered.

## 8. **Restricted Stock**

### (a) **Award of Restricted Stock.**

(i) The Committee is authorized to award shares of Restricted Stock to any Eligible Person. Each award of Restricted Stock shall be subject to the following conditions of this Section 8, or to such other conditions as may be reflected in the applicable Restricted Stock Agreement.

(ii) The Committee shall from time to time, in its sole and absolute discretion, (A) select which Eligible Persons shall be awarded Restricted Stock, (B) determine the purchase price, if any, and form of payment for Restricted Stock; and (C) determine any other terms and conditions applicable to such Restricted Stock, consistent with this Plan.

(iii) Upon the selection of a Participant to be awarded Restricted Stock, the Committee shall instruct the Secretary of the Company to issue a certificate representing such Restricted Stock and may impose such conditions on the issuance of such Restricted Stock as it deems appropriate.

(iv) Upon initial election to office, each Non-Employee Director shall receive 5,000 shares of Restricted Stock.

(v) On the day following the date of each annual meeting of the Company's stockholders, each Non-Employee Director with service greater than six months prior to such date shall receive 5,000 shares of Restricted Stock.

(vi) The Restricted Stock granted pursuant to clause (iv) or (v) above shall be granted pursuant to a Restricted Stock Agreement in a form, and having such terms as are, approved by the Committee including, without limitation, that (A) the purchase price for such shares shall consist solely of such Director's service as a Director and (B) the Restrictions with respect to such Restricted Stock shall lapse on the first anniversary of the Date of Grant, provided that the director remains continuously in active service as a director for at least nine months following the Date of Grant; provided further that the service requirement shall be deemed to be satisfied with respect to a particular Director in the event of a termination of such Director's service as described in clause (i) of the definition of "Normal Termination."

(b) **General Restrictions.**

(i) All shares of Restricted Stock issued under this Plan (including any shares received by holders thereof with respect to shares of Restricted Stock as a result of stock dividends, stock splits or any other form of recapitalization) shall, be subject to such restrictions as the Committee shall provide, which restrictions shall be set forth in the applicable Restricted Stock Agreement and may include, without limitation, restrictions concerning voting rights and transferability and restrictions based on duration of employment with the Company, Company performance and individual performance; provided, however, that the Committee, on such terms and conditions as it determines to be appropriate, may remove any or all of the restrictions imposed by the terms of the Restricted Stock Agreement including, without limitation, upon a Change in Control. Restricted Stock may not be transferred, sold or encumbered until all restrictions terminate or expire.

(ii) The Committee, in its sole discretion, may impose such other restrictions on Shares of Restricted Stock as it may deem advisable or appropriate, in accordance with this Section 8.

(iii) The Committee may set restrictions based upon the achievement of specific performance objectives (Company-wide, divisional, or individual), applicable federal or state securities laws, or any other basis determined by the Committee in its discretion.

(c) **Section 162(m) Performance Restrictions.** For purposes of qualifying grants of Restricted Stock as "performance-based compensation" under Section 162(m) of the Code, the Committee, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals shall be set by the Committee on or before the latest date permissible to enable the Restricted Stock to qualify as "performance-based compensation" under Section 162(m) of the Code. In granting Restricted Stock which is intended to qualify under Section 162(m) of the Code, the Committee shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure

qualification of the Restricted Stock under Section 162(m) of the Code (e.g., in determining the Performance Goals).

(d) **Legend on Certificates.** The Committee, in its discretion, may legend the certificates representing Restricted Stock to give appropriate notice of such restrictions. For example, the Committee may determine that some or all certificates representing Shares of Restricted Stock shall bear the following legend:

“The sale or other transfer of the shares of stock represented by this certificate, whether voluntary, involuntary, or by operation of law, is subject to certain restrictions on transfer as set forth in the Veeco Instruments Inc. 2000 Stock Incentive Plan and in a Restricted Stock Agreement. A copy of the Plan and such Restricted Stock Agreement may be obtained from the Secretary of Veeco Instruments Inc.”

(e) **Termination of Employment.** Except as otherwise expressly provided for herein or in the applicable Restricted Stock Agreement, any shares of Restricted Stock which are subject to restriction at the time of an Employee’s termination of employment with the Company for any reason, or when a director’s service as director of the Company ends or when a consulting arrangement terminates, as applicable, shall be forfeited upon such termination and the Participant shall have no further rights to or with respect to such shares.

(f) **Repurchase of Restricted Stock.** The Committee shall provide in the terms of each individual Restricted Stock Agreement that upon a termination of employment of a Participant or, if applicable, upon a termination of any consulting relationship between the restricted stockholder and the Company, the Company shall have the right but not the obligation, to purchase any Restricted Stock held by such Participant or consultant at a cash price per share equal to the price paid by the Participant or consultant for such Restricted Stock; provided, however, that provision may be made that no such right of repurchase shall exist in the event of a Normal Termination or termination of consultancy without Cause.

(g) **Restricted Stock Award Notice or Agreement.** Restricted Stock shall be issued only pursuant to a written Restricted Stock Award Notice or Agreement, which shall specify the terms of the award and contain such other terms and conditions as the Committee shall determine, consistent with this Plan.

(h) **Escrow; Rights as a Stockholder.** The Secretary of the Company or such other escrow holder as the Committee may appoint shall retain physical custody of each certificate representing Restricted Stock until all of the restrictions imposed under the Restricted Stock Agreement with respect to the shares evidenced by such certificate expire or shall have been removed. While such shares are held by the escrow holder, the Participant shall have, unless otherwise provided by the Committee and subject to the provisions of this Section 8, all the rights of a stockholder with respect to said shares, subject to any restrictions among other shareholders of Common Stock, including the right to receive all dividends and other distributions paid or made with respect to the shares represented by such certificate; provided, however, that in the discretion of the Committee, any extraordinary distributions with respect to the Common Stock shall be subject to the restrictions set forth in this Section 8.

(i) **Return of Restricted Stock to Company.** On the date set forth in the applicable Restricted Stock Agreement, the Restricted Stock for which restrictions have not lapsed shall revert to the Company and again shall become available for grant under the Plan.

8A. **Restricted Stock Units**

(a) **Award of Restricted Stock Units.**

(i) The Committee is authorized to award Restricted Stock Units to any Eligible Person. The Committee shall from time to time, in its sole and absolute discretion, (A) select which Eligible Persons shall be awarded Restricted Stock Units, and (B) determine any terms and conditions applicable to such Restricted Stock Units consistent with this Plan, and impose such conditions on the issuance of such Stock pursuant to such Restricted Stock Units as it deems appropriate.

(ii) The Committee may set restrictions on the vesting of Restricted Stock Units based upon the achievement of specific performance objectives (Company-wide, divisional, or individual), applicable federal or state securities laws, or any other basis determined by the Committee in its discretion.

(iii) Restricted Stock Units that become payable in accordance with their terms and conditions shall be settled in shares of Stock or, if so designated by the Committee, in cash or a combination of cash and shares of Stock, as determined by the Committee. Any person who holds Restricted Stock Units shall have no ownership interest in the shares of Stock to which such Restricted Stock Units relate unless and until payment with respect to such Restricted Stock Units is actually made in shares of Stock. Each award of Restricted Stock Units shall be subject to the terms and conditions of this Section 8A and/or to such other terms and conditions as may be reflected in the applicable Restricted Stock Unit Award Notice or Agreement.

(b) **Section 162(m) Performance Restrictions.** For purposes of qualifying grants of Restricted Stock Units as “performance-based compensation” under Section 162(m) of the Code, the Committee, in its discretion, may set restrictions based upon the achievement of Performance Goals. The Performance Goals shall be set by the Committee on or before the latest date permissible to enable the Restricted Stock Units to qualify as “performance-based compensation” under Section 162(m) of the Code. In granting Restricted Stock Units that are intended to qualify under Section 162(m) of the Code, the Committee shall follow any procedures determined by it from time to time to be necessary or appropriate to ensure qualification of the Restricted Stock Units under Section 162(m) of the Code (e.g., in determining the Performance Goals).

(c) **Termination of Employment.** Except as otherwise expressly provided for herein or in the applicable Restricted Stock Unit Agreement, any Restricted Stock Units that have not vested at the time of an Employee’s termination of employment with the Company for any reason (or, if applicable, when a director’s service as director of the Company ends or when a consulting arrangement terminates, as applicable) shall be forfeited upon such termination, and the Participant shall have no further rights to or with respect to such Restricted Stock Units.

(d) **Dividend Equivalents; Extraordinary Distributions.** A Participant who holds Restricted Stock Units shall be credited with Dividend Equivalents. Such Dividend Equivalents shall be credited to and paid to such Participant in the manner and at the time as dividends are otherwise payable to Participants who hold Restricted Stock. In the discretion of the Committee, any extraordinary distributions on the Common Stock with respect to which an adjustment is made to the Restricted Stock Units shall be subject to the terms and conditions, vesting and other restrictions described in this Section 8A.

(e) **Restricted Stock Unit Award Notice or Agreement.** Restricted Stock Units shall be issued only pursuant to a written Restricted Stock Unit Award Notice or Agreement, which shall specify the terms of the award and contain such other terms and conditions as the Committee shall determine, consistent with this Plan.

9. **General**

(a) **Additional Provisions of a Plan Award.** Subject to Section 409A of the Code, Plan Awards granted to a Participant under the Plan also may be subject to such other provisions (whether or not applicable to the benefit awarded to any other Participant) as the Committee determines appropriate including, without limitation, provisions to assist the Participant in financing the purchase of shares of Stock upon the exercise of options, provisions for the forfeiture of or restrictions on resale or other disposition of shares of Stock acquired under any Plan Award, provisions giving the Company the right to repurchase shares of Stock acquired under any Plan Award in the event the Participant elects to dispose of such shares, provisions allowing the Participant to elect to defer the receipt of shares of Stock with respect to Restricted Stock Units or upon the exercise of Options for a specified time or until a specified event, and provisions to comply with Federal and state securities laws and Federal and state tax withholding requirements. Any such provisions shall be reflected in the applicable Plan Award Agreement.

(b) **Compliance with Section 409A of the Code.** It is the Company's intention that all Plan Awards granted hereunder shall be designed and administered in such manner that they are either exempt from the application of, or comply with, the requirements of Section 409A of the Code. Notwithstanding anything herein to the contrary, any provision in the Plan that is inconsistent with Section 409A of the Code shall be deemed to be amended to comply with Section 409A of the Code, and to the extent such provision cannot be amended to comply therewith, it shall be null and void.

(c) **Privileges of Stock Ownership.** Except as otherwise specifically provided in the Plan, no person shall be entitled to the privileges of ownership in respect of shares of Stock which are subject to Plan Awards hereunder until such shares have been issued to that person.

(d) **Government and Other Regulations.** The obligation of the Company to make payment of Plan Awards in shares of Stock or otherwise shall be subject to all applicable laws, rules, and regulations, and to such approvals by governmental agencies as may be required. Notwithstanding any terms or conditions of any Plan Award to the contrary, the Company shall be under no obligation to issue, offer to sell or to sell and shall be prohibited from issuing, offering to sell or selling any shares of Stock pursuant to a Plan Award unless such shares have been properly registered for issuance or sale pursuant to the Securities Act with the Securities and Exchange Commission or unless the Company has received an opinion of counsel, satisfactory to the Company, that such shares may be issued, offered or sold without such registration pursuant to an available exemption therefrom and the terms and conditions of such exemption have been fully complied with. The Company shall be under no obligation to register for issuance or sale under the Securities Act any of the shares of Stock to be issued, offered or sold under the Plan. If the shares of Stock issued, offered for sale or sold under the Plan are issued, offered or sold pursuant to an exemption from registration under the Securities Act, the Company may restrict the transfer of such shares and may legend Stock certificates representing such shares of Stock in such manner as it deems advisable to ensure the availability of any such exemption.

(e) **Tax Withholding.**

(i) A Participant may be required to pay to the Company or any Affiliate and the Company or any Affiliate shall have the right and is hereby authorized to withhold from any shares of Stock or other property deliverable under any Plan Award or from any compensation or other amounts owing to a Participant the amount (in cash, Stock or other property) of any required tax withholding and payroll taxes in respect of the issuance, vesting or exercise of any Plan Award, or any payment or transfer under a Plan Award or under the Plan and to take such other action as may be necessary in the opinion of the Company to satisfy all obligations for the payment of such taxes.

(ii) Without limiting the generality of clause (i) above, the Committee may, in its sole discretion, permit a Participant to satisfy, in whole or in part, the foregoing withholding liability (but no more than the minimum required withholding liability) by (A) delivery of shares of Stock owned by the Participant (which shares must be Mature Shares) with a Fair Market Value equal to such withholding liability or (B) having the Company withhold from the number of shares of Stock otherwise issuable pursuant to the exercise of an Option or from any Restricted Stock Award a number of shares of Stock with a Fair Market Value equal to such withholding liability.

(f) **Claim to Plan Awards and Employment Rights.** No employee of the Company or any Affiliate, or other person, shall have any claim or right to be granted a Plan Award under the Plan or, having been selected for the grant of a Plan Award, to be selected for a grant of any other Award. Neither the Plan nor any action taken hereunder shall be construed as giving any Participant any right to be retained in the employ or service of the Company or any Affiliate.

(g) **No Liability of Committee Members.** No member of the Committee shall be personally liable by reason of any contract or other instrument executed by such member or on his behalf in his capacity as a member of the Committee nor for any mistake of judgment made in good faith, and the Company shall indemnify and hold harmless each member of the Committee and each other employee, officer or director of the Company to whom any duty or power relating to the administration or interpretation of the Plan may be allocated or delegated, against any cost or expense (including counsel fees) or liability (including any sum paid in settlement of a claim) arising out of any act or omission to act in connection with the Plan unless arising out of such person's own fraud or willful bad faith; provided, however, that approval of the Board shall be required for the payment of any amount in settlement of a claim against any such person. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled under the Company's Articles of Incorporation or By-Laws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

(h) **Governing Law.** The Plan shall be governed by and construed in accordance with the internal laws of the State of Delaware without regard to the principles of conflicts of law thereof, or principals of conflicts of law of any other jurisdiction which could cause the application of the laws of any jurisdiction other than the State of Delaware.

(i) **Nontransferability.**

(i) Each Option shall be exercisable only by the Participant during the Participant's lifetime, or, if permissible under applicable law, by the Participant's legal guardian or representative. No Plan Award may be assigned, alienated, pledged, attached, sold or otherwise transferred or encumbered by a Participant otherwise than by will or by the laws of descent and distribution and any such purported assignment, alienation, pledge, attachment, sale, transfer or encumbrance shall be void and unenforceable against the Company or any Affiliate; provided that the designation of a beneficiary shall not constitute an assignment, alienation, pledge, attachment, sale, transfer or encumbrance.

(ii) Notwithstanding the foregoing, the Committee or its delegate may, in its sole discretion, permit Nonqualified Stock Options or Restricted Stock to be transferred by a Participant, without consideration, subject to such rules as the Committee may adopt consistent with any applicable Plan Award Agreement to preserve the purposes of the Plan, to:

(A) any person who is a "family member" of the Participant, as such term is used in the instructions to Form S-8 (collectively, the "Immediate Family Members");

(B) a trust solely for the benefit of the Participant and his or her Immediate Family Members;

(C) a partnership or limited liability company whose only partners or shareholders are the Participant and his or her Immediate Family Members; or

(D) any other transferee as may be approved either (a) by the Board or the Committee in its sole discretion, or (b) as provided in the applicable Plan Award Agreement;

(each transferee described in clauses (A), (B), (C) and (D) above is hereinafter referred to as a “Permitted Transferee”); provided that the Participant gives the Committee advance written notice describing the terms and conditions of the proposed transfer and the Committee notifies the Participant in writing that such a transfer would comply with the requirements of the Plan. For purposes of this paragraph, “delegate” shall refer to the Chief Executive Officer of the Company, except with respect to the transfer of any of Chief Executive Officer’s own Plan Awards.

(iii) The terms of any Plan Award transferred in accordance with the preceding paragraph (ii) shall apply to the Permitted Transferee and any reference in the Plan, or in any applicable Plan Award Agreement, to a Participant shall be deemed to refer to the Permitted Transferee, except that (A) Permitted Transferees shall not be entitled to transfer any Plan Awards, other than by will or the laws of descent and distribution; (B) Permitted Transferees shall not be entitled to exercise any transferred Plan Awards unless there shall be in effect a registration statement on an appropriate form covering the shares of Stock to be acquired pursuant to the exercise of such Plan Award if the Committee determines, consistent with any applicable Plan Award Agreement, that such a registration statement is necessary or appropriate, (C) the Committee or the Company shall not be required to provide any notice to a Permitted Transferee, whether or not such notice is or would otherwise have been required to be given to the Participant under the Plan or otherwise, and (D) the consequences of termination of the Participant’s employment by, or services to, the Company or any Affiliate under the terms of the Plan and the applicable Plan Award Agreement shall continue to be applied with respect to the Participant, following which the Plan Awards shall be exercisable by the Permitted Transferee only to the extent, and for the periods, specified in the Plan and the applicable Plan Award Agreement.

(j) **Reliance on Reports.** Each member of the Committee and each member of the Board shall be fully justified in relying, acting or failing to act, and shall not be liable for having so relied, acted or failed to act in good faith, upon any report made by the independent public accountant of the Company and upon any other information furnished in connection with the Plan by any person or persons other than himself.

(k) **Relationship to Other Benefits.** No payment under the Plan shall be taken into account in determining any benefits under any pension, retirement, profit sharing, group insurance or other benefit plan of the Company or any Affiliate, except as otherwise specifically provided in such other plan.

(l) **Expenses.** The expenses of administering the Plan shall be borne by the Company.

(m) **Pronouns.** Masculine pronouns and other words of masculine gender shall refer to both men and women.



(n) **Titles and Headings.** The titles and headings of the sections in the Plan are for convenience of reference only, and in the event of any conflict, the text of the Plan, rather than such titles or headings shall control.

(o) **Termination of Employment.** For all purposes herein, a person who transfers from employment or service with the Company to employment or service with an Affiliate or vice versa, or from employment or service with one Affiliate to employment or service with another Affiliate, shall not be deemed to have terminated employment or service with the Company or any such Affiliate.

(p) **Severability .** If any provision of the Plan or any Plan Award Agreement is or becomes or is deemed to be invalid, illegal, or unenforceable in any jurisdiction or as to any person or Plan Award, or would disqualify the Plan or any Plan Award under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to the applicable laws, or if it cannot be construed or deemed amended without, in the determination of the Committee, materially altering the intent of the Plan or the Plan Award, such provision shall be stricken as to such jurisdiction, person or Plan Award and the remainder of the Plan and any such Plan Award shall remain in full force and effect.

## 10. **Changes in Capital Structure**

(a) **Adjustments .** Plan Awards granted under the Plan and any Plan Award Agreements, the maximum number of shares of Stock subject to all Plan Awards stated in Section 5(a) and the maximum number of shares of Stock with respect to which any one person may be granted Plan Awards during any period stated in Section 5(d) shall be subject to adjustment or substitution, as determined by the Committee in its sole discretion, as to the number, price or kind of a share of Stock or other consideration subject to such Plan Awards or as otherwise determined by the Committee to be equitable (i) in the event of changes in the outstanding Stock or in the capital structure of the Company by reason of stock or extraordinary cash dividends, stock splits, reverse stock splits, recapitalization, reorganizations, mergers, consolidations, combinations, exchanges, or other relevant changes in capitalization occurring after the Date of Grant of any such Plan Award or (ii) in the event of any change in applicable laws or any change in circumstances which results in or would result in any substantial dilution or enlargement of the rights granted to, or available for, Participants, or which otherwise warrants equitable adjustment because it interferes with the intended operation of the Plan. Any adjustment in Incentive Stock Options under this Section 10 shall be made only to the extent not constituting a “modification” within the meaning of Section 424(h)(3) of the Code, and any adjustments under this Section 10 shall be made in a manner which does not adversely affect the exemption provided pursuant to Rule 16b-3 under the Exchange Act. Further, with respect to Plan Awards intended to qualify as “performance-based compensation” under Section 162(m) of the Code, such adjustments or substitutions shall be made only to the extent that the Committee determines that such adjustments or substitutions may be made without causing the Company to be denied a tax deduction on account of Section 162(m) of the Code. The Company shall give each Participant notice of an adjustment hereunder and, upon notice, such adjustment shall be conclusive and binding for all purposes.

Notwithstanding the above, in the event of any of the following:

A. The Company is merged or consolidated with another corporation or entity and, in connection therewith, consideration is received by shareholders of the Company in a form other than stock or other equity interests of the surviving entity;

B. All or substantially all of the assets of the Company are acquired by another person;

C. The reorganization or liquidation of the Company; or

D. The Company shall enter into a written agreement to undergo an event described in clauses A, B or C above,

then the Committee may, in its discretion and upon at least 10 days advance notice to the affected persons, cancel any outstanding Plan Awards and pay to the holders thereof, in cash or Stock, or any combination thereof, the value of such Plan Awards based upon the price per share of Stock received or to be received by other shareholders of the Company in the event. The terms of this Section 10 may be varied by the Committee in any particular Plan Award Agreement.

(b) **Section 409A of the Code.** Notwithstanding Section 10(a) above, or anything herein to the contrary, (i) any adjustments made pursuant to Section 10(a) to Plan Awards that are considered “deferred compensation” within the meaning of Section 409A of the Code shall be made in compliance with the requirements of Section 409A of the Code, (ii) any adjustments made pursuant to Section 10(a) to Plan Awards that are not considered “deferred compensation” subject to Section 409A of the Code shall be made in such a manner as to ensure that, after such adjustment, the Plan Awards either (x) continue not to be subject to Section 409A of the Code or (y) comply with the requirements of Section 409A of the Code, and (c) in any event, neither the Committee nor the Board shall have the authority to make any adjustments pursuant to Section 10(a) to the extent the existence of such authority would cause a Plan Award that is not intended to be subject to Section 409A of the Code at the time such Plan Award is granted to be subject thereto.

#### 11. **Effect of Change in Control**

Except to the extent reflected in a particular Plan Award Agreement or other written agreement between the Company and a Participant:

(a) In the event of a Change in Control, all Plan Awards shall become immediately vested, all Options shall become exercisable, and any restrictions applicable to shares of Restricted Stock or Restricted Stock Units shall terminate with respect to 100 percent of the shares subject to such Plan Award; provided, however, that no such vesting or termination shall occur if provision has been made in writing in connection with such transaction for (a) the continuation of the Plan and/or assumption of such Plan Awards by a successor corporation (or a parent or subsidiary thereof) or (b) the substitution for such Plan Awards of new options or awards of Restricted Stock or Restricted Stock Units covering the stock of a successor corporation (or a parent or subsidiary thereof), with appropriate adjustments as to the number and kinds of shares and exercise prices. In the event of any such continuation, assumption or substitution, the Plan and/or such Plan Awards shall continue in the manner and under the terms so provided.

(b) In addition, in the event of a Change in Control, the Committee may in its discretion and upon at least 10 days’ advance notice to the affected persons, cancel any outstanding Plan Awards and pay to the holders thereof, in cash or stock, or any combination thereof, the value of such Plan Awards based upon the price per share of Stock received or to be received by other shareholders of the Company in the event.

(c) The obligations of the Company under the Plan shall be binding upon any successor corporation or organization resulting from the merger, consolidation or other reorganization of the Company, or upon any successor corporation or organization succeeding to substantially all of the assets and business of the Company. The Company agrees that it will make appropriate provisions for the preservation of Participants’ rights under the Plan in any agreement or plan which it may enter into or adopt to effect any such merger, consolidation, reorganization or transfer of assets.

12. **Nonexclusivity of the Plan**

Neither the adoption of this Plan by the Board nor the submission of this Plan to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board to adopt such other incentive arrangements as it may deem desirable, including, without limitation, the granting of stock options otherwise than under this Plan, and such arrangements may be either applicable generally or only in specific cases.

13. **Amendments and Termination**

(a) **Amendment and Termination of the Plan .** The Board may amend, alter, suspend, discontinue, or terminate the Plan or any portion thereof at any time; provided that no such amendment, alteration, suspension, discontinuation or termination shall be made without shareholder approval if such approval is necessary to comply with any tax or regulatory requirement applicable to the Plan (including as necessary to prevent the Company from being denied a tax deduction on account of Section 162(m) of the Code); and provided further that any such amendment, alteration, suspension, discontinuance or termination that would impair the rights of any Participant or any holder or beneficiary of any Plan Award theretofore granted shall not to that extent be effective without the consent of the affected Participant, holder or beneficiary.

(b) **Amendment of Plan Award Agreements .** The Committee may waive any conditions or rights under, amend any terms of, or alter, suspend, discontinue, cancel or terminate, any Plan Award theretofore granted or the associated Plan Award Agreement, prospectively or retroactively; provided that any such waiver, amendment, alteration, suspension, discontinuance, cancellation or termination that would impair the rights of any Participant in respect of any Plan Award theretofore granted shall not to that extent be effective without the consent of the affected Participant. Notwithstanding the foregoing or anything in the Plan to the contrary, if the Committee determines that any provision of any Plan Award would cause a Participant to incur any additional tax or interest under Section 409A of the Code or any Treasury regulations or guidance promulgated thereunder, the Committee shall have the right, in its sole discretion, to reform such provision to comply with Section 409A of the Code; provided that, the Committee shall maintain, to the maximum extent practicable, the original intent and economic benefit to such Participant of such provisions without violating Section 409A of the Code.

(c) **Repricing.** Notwithstanding any other provision of this Plan, no amendment or modification of the Plan or of any Stock Option Agreement may lower the exercise price of a previously granted award, nor may the Board, the Committee or the Company cancel and regrant an Option with the effect of repricing an Option, without in either case shareholder approval.

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**Revision History:**

| <b>Date</b>      | <b>Description</b>        | <b>Notes</b>  |
|------------------|---------------------------|---|
| May 12, 2000     | Original adoption of plan | Plan named “Veeco Instruments Inc. 2000 Stock Option Plan”      |
| May 11, 2001     | Amendment No. 1           |   |
| May 10, 2002     | Amendment No. 2           |   |
| May 11, 2003     | Amendment No. 3           |   |
| May 7, 2004      | Amendment and Restatement | Plan renamed “Veeco Instruments Inc. 2000 Stock Incentive Plan” |
| May 25, 2005     | Amendment No. 1           |   |
| October 20, 2005 | Amendment No. 2           | Amendment effective January 1, 2006                             |
| July 20, 2006    | Amendment and Restatement |   |

**CERTIFICATION PURSUANT TO  
RULE 13a—14(a) or RULE 15d—14(a)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

I, Edward H. Braun, Chairman and Chief Executive Officer of Veeco Instruments Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2006 of Veeco Instruments Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ EDWARD H. BRAUN

Edward H. Braun  
Chairman and Chief Executive Officer  
Veeco Instruments Inc.  
August 4, 2006

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**CERTIFICATION PURSUANT TO  
RULE 13a—14(a) or RULE 15d—14(a)  
OF THE SECURITIES EXCHANGE ACT OF 1934**

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

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2006 of Veeco Instruments Inc.;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, 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 report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ JOHN F. REIN, JR.

John F. Rein, Jr.

Executive Vice President, Chief Financial Officer and Secretary  
Veeco Instruments Inc.

August 4, 2006

**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 Quarterly Report of Veeco Instruments Inc. (the "Company") on Form 10-Q for the period ended June 30, 2006 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

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Edward H. Braun  
Chairman and Chief Executive Officer  
Veeco Instruments Inc.  
August 4, 2006

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.

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**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 Quarterly Report of Veeco Instruments Inc. (the "Company") on Form 10-Q for the period ended June 30, 2006 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.  
August 4, 2006

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.

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