VEECO INSTRUMENTS INC
Form 10-Q
May 07, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

OR

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

Commission file number 0-16244

VEECO INSTRUMENTS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**11-2989601**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
Terminal Drive	
Plainview, New York	**11803**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s telephone number, including area code:

(516) 677-0200

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

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

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

Large accelerated filer x		Accelerated filer o
Non-accelerated filer o	(Do not check if a smaller reporting company)	Smaller reporting company o
		Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

Title of Class	**Shares Outstanding**

Common Stock	as of April 30, 2018
par value $0.01 per share	48,691,999

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Safe Harbor Statement

This quarterly report on Form 10-Q (the Report) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Discussions containing such forward-looking statements may be found in Part I - Items 1, 2, and 3 hereof, as well as within this Report generally. In addition, when used in this Report, the words believes, anticipates, expects, estimates, targets, plans, intends, will, and similar expressions related to the future are intended 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.

In addition, the preparation of financial statements in conformity with U.S. Generally Accepted Accounting Principles (U.S. GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Although these estimates and assumptions are based on knowledge of current events and planned actions to be undertaken in the future, they may ultimately differ from actual results. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. All estimates and assumptions are subject to a number of risks and uncertainties that could cause actual results to differ materially from these estimates and assumptions.

The risks and uncertainties of Veeco Instruments Inc. (together with its consolidated subsidiaries, Veeco, the Company, we, us, and our, unl the context indicates otherwise) include, without limitation, the following:

- Unfavorable market conditions may adversely affect our operating results;
- We are exposed to the risks of operating a global business;
- We may be unable to effectively enforce and protect our intellectual property rights;
- We may be subject to claims of intellectual property infringement by others;
- We may be unable to successfully integrate the Ultratech business and may not realize the anticipated benefits of the acquisition;
- The price of our common shares is volatile and could further decline;

- We face significant competition;

- We operate in industries characterized by rapid technological change;

- Our sales to manufacturers are highly dependent on sales of consumer electronics applications, which can experience significant volatility due to seasonal and other factors;

- We have a concentrated customer base, located primarily in a limited number of regions, which operate in highly concentrated industries;

- A further reduction or elimination of foreign government subsidies and economic incentives may adversely affect the future order rate for our MOCVD equipment;

- The cyclicality of the industries we serve directly affects our business;

- The timing of our orders, shipments, and revenue recognition may cause our quarterly operating results to fluctuate significantly;

- Our sales cycle is long and unpredictable;

- Our backlog is subject to customer cancellation or modification which could result in decreased sales, increased inventory obsolescence, and liabilities to our suppliers for products no longer needed;

- Our failure to estimate customer demand accurately could result in inventory obsolescence, liabilities to our suppliers for products no longer needed, and manufacturing interruptions or delays which could affect our ability to meet customer demand;

- Our failure to successfully manage our outsourcing activities or failure of our outsourcing partners to perform as anticipated could adversely affect our results of operations;

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- We rely on a limited number of suppliers, some of whom are our sole source for particular components;

- Our inability to attract, retain, and motivate employees could have a material adverse effect on our business;

- We are exposed to risks associated with business combinations, acquisitions, and strategic investments;

- We may be unable to obtain required export licenses for the sale of our products;

- Our operating results may be adversely affected by tightening credit markets;

- We may be exposed to liabilities under the Foreign Corrupt Practices Act and other similar laws;

- We are subject to internal control evaluations and attestation requirements of Section 404 of the Sarbanes-Oxley Act and any delays or difficulties in satisfying these requirements or negative reports concerning our internal controls could adversely affect our future results of operations and our stock price;

- Changes in accounting pronouncements or taxation rules or practices may adversely affect our financial results;

- Our income taxes may change;

- We may be required to take additional impairment charges on assets;

- We have indebtedness in the form of convertible senior notes which could adversely affect our financial position, prevent us from implementing our strategy, and dilute the ownership interest of our existing shareholders;

- The accounting method for convertible debt securities that may be settled in cash, such as the Convertible Senior Notes, could have a material effect on our reported financial results;

- We are subject to foreign currency exchange risks;

- Our previously announced share repurchase program could affect the price of our common stock and increase volatility and may be suspended or terminated at any time, which may result in a decrease in the trading price of our common stock;

- If we are subject to cyber-attacks we could incur substantial costs and, if such attacks are successful, we could incur significant liabilities, reputational harm, and disruption to our operations;

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

- We are subject to risks of non-compliance with environmental, health, and safety regulations;

- Regulations related to conflict minerals will force us to incur additional expenses, may make our supply chain more complex, and may harm our relationships with customers; and

- We have significant operations in locations which could be materially and adversely impacted in the event of a natural disaster, an act of terrorism, or other significant disruption.

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

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Veeco Instruments Inc. and Subsidiaries
Consolidated Balance Sheets

(in thousands, except share amounts)
(unaudited)

	March 31, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 245,525	$ 279,736
Restricted cash	841	847
Short-term investments	65,130	47,780
Accounts receivable, net	108,219	98,866
Contract assets	1,984	160
Inventories	130,964	120,266
Deferred cost of sales	1,080	15,994
Prepaid expenses and other current assets	29,615	33,437
Total current assets	583,358	597,086
Property, plant, and equipment, net	83,100	85,058
Intangible assets, net	356,311	369,843
Goodwill	307,131	307,131
Deferred income taxes	3,281	3,047
Other assets	28,847	25,310
Total assets	$ 1,362,028	$ 1,387,475
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 58,273	$ 50,318
Accrued expenses and other current liabilities	54,297	58,068
Customer deposits and deferred revenue	94,473	112,032
Income taxes payable	1,581	3,846
Total current liabilities	208,624	224,264
Deferred income taxes	36,794	36,845
Long-term debt	278,489	275,630
Other liabilities	10,164	10,643
Total liabilities	534,071	547,382
Stockholders equity:		
Preferred stock, $0.01 par value; 500,000 shares authorized; no shares issued and outstanding.		
Common stock, $0.01 par value; 120,000,000 shares authorized; 48,691,371 and 48,229,251 shares issued at March 31, 2018 and December 31, 2017, respectively; 48,691,371 and 48,144,416 shares outstanding at March 31, 2018 and December 31, 2017, respectively.	487	482
Additional paid-in capital	1,054,331	1,051,953
Accumulated deficit	(228,697)	(212,870)

Accumulated other comprehensive income		1,836		1,812
Treasury stock, at cost, 84,835 shares at December 31, 2017.				(1,284)
Total stockholders equity		827,957		840,093
Total liabilities and stockholders equity	$	1,362,028	$	1,387,475

See accompanying Notes to the Consolidated Financial Statements.

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Veeco Instruments Inc. and Subsidiaries
Consolidated Statements of Operations

(in thousands, except per share amounts)
(unaudited)

	Three months ended March 31, 2018	2017
Net sales	$ 158,574	$ 94,499
Cost of sales	101,894	59,999
Gross profit	56,680	34,500
Operating expenses, net:		
Research and development	24,320	14,989
Selling, general, and administrative	26,383	19,105
Amortization of intangible assets	13,532	2,867
Restructuring	2,695	1,338
Acquisition costs	1,342	1,361
Asset impairment		463
Other, net	(157)	(78)
Total operating expenses, net	68,115	40,045
Operating income (loss)	(11,435)	(5,545)
Interest income	624	793
Interest expense	(5,246)	(4,135)
Income (loss) before income taxes	(16,057)	(8,887)
Income tax expense (benefit)	(230)	(10,527)
Net income (loss)	$ (15,827)	$ 1,640
Income (loss) per common share:		
Basic	$ (0.34)	$ 0.04
Diluted	$ (0.34)	$ 0.04
Weighted average number of shares:		
Basic	46,963	39,619
Diluted	46,963	40,140

See accompanying Notes to the Consolidated Financial Statements.

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Veeco Instruments Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income (Loss)

(in thousands)
(unaudited)

	Three months ended March 31, 2018	2017
Net income (loss)	$ (15,827)	$ 1,640
Other comprehensive income (loss), net of tax:		
Unrealized gain (loss) on available-for-sale securities	(8)	(114)
Foreign currency translation	32	15
Total other comprehensive income (loss), net of tax	24	(99)
Total comprehensive income (loss)	$ (15,803)	$ 1,541

See accompanying Notes to the Consolidated Financial Statements.

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Veeco Instruments Inc. and Subsidiaries
Consolidated Statements of Cash Flows

(in thousands)
(unaudited)

	Three months ended March 31, 2018	2017
Cash Flows from Operating Activities		
Net income (loss)	$ (15,827)	$ 1,640
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	17,726	5,799
Non-cash interest expense	2,859	2,185
Deferred income taxes	(269)	(6,246)
Share-based compensation expense	4,537	4,186
Asset impairment		463
Provision for bad debts		92
Changes in operating assets and liabilities:		
Accounts receivable and contract assets	(11,177)	5,871
Inventories and deferred cost of sales	4,555	13,603
Prepaid expenses and other current assets	3,824	(3,743)
Accounts payable and accrued expenses	2,009	613
Customer deposits and deferred revenue	(17,559)	(13,727)
Income taxes receivable and payable, net	(2,283)	130
Long-term income tax liability		(4,877)
Other, net	(202)	343
Net cash provided by (used in) operating activities	(11,807)	6,332
Cash Flows from Investing Activities		
Capital expenditures	(2,259)	(4,187)
Proceeds from the sale of investments	34,000	27,411
Payments for purchases of investments	(54,300)	(219,141)
Net cash provided by (used in) investing activities	(22,559)	(195,917)
Cash Flows from Financing Activities		
Cash withholdings for employee stock purchase plans	1,136	585
Restricted stock tax withholdings	(427)	(461)
Purchases of common stock	(592)	
Proceeds from long-term debt borrowings		335,752
Principal payments on long-term debt		(89)
Net cash provided by (used in) financing activities	117	335,787
Effect of exchange rate changes on cash and cash equivalents	32	15
Net increase (decrease) in cash, cash equivalents, and restricted cash	(34,217)	146,217
Cash, cash equivalents, and restricted cash - beginning of period	280,583	277,444
Cash, cash equivalents, and restricted cash - end of period	$ 246,366	$ 423,661
Supplemental Disclosure of Cash Flow Information		
Interest paid	$ 4,674	$ 31
Income taxes paid	2,373	672
Non-cash operating and financing activities		
Net transfer of property, plant, and equipment to (from) inventory	339	(81)

See accompanying Notes to the Consolidated Financial Statements.

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Veeco Instruments Inc. and Subsidiaries

Notes to the Consolidated Financial Statements - continued

(unaudited)

Note 1 - Basis of Presentation

The accompanying unaudited Consolidated Financial Statements of Veeco have been prepared in accordance with U.S. GAAP as defined in Financial Accounting Standards Board (FASB) Accounting Standards Codification 270 for interim financial information and with the instructions to Rule 10-01 of Securities and Exchange Commission Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements as the interim information is an update of the information that was presented in Veeco s most recent annual financial statements. For further information, refer to Veeco s Consolidated Financial Statements and Notes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Form 10-K). In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal, recurring nature.

Veeco reports interim quarters on a 13-week basis ending on the last Sunday of each quarter. The fourth quarter always ends on the last day of the calendar year, December 31. The 2018 interim quarters end on April 1, July 1, and September 30, and the 2017 interim quarters ended on April 2, July 2, and October 1. These interim quarters are reported as March 31, June 30, and September 30 in Veeco s interim consolidated financial statements.

Change in Accounting Policy

The Company adopted ASC Topic 606, *Revenue from Contracts with Customers* (ASC 606), as of January 1, 2018, using the full retrospective method. All amounts and disclosures set forth in this Form 10-Q reflect these changes. The most significant financial statement impacts of adopting ASC 606 are the elimination of the constraint on revenue associated with the billing retention related to the receipt of customer final acceptance and the identification of installation services as a performance obligation. The elimination of the constraint on revenue related to customer final acceptance, which is usually about 10 percent of a system sale, is now generally recognized at the time the Company transfers control of the system to the customer, which is earlier than under the Company s previous revenue recognition model for certain contracts that were subject to the billing constraint. The new performance obligation related to installation services is now recognized as the installation services are performed, which is later than the Company s previous revenue recognition model.

The Company applied ASC 606 retrospectively and elected to use the disclosure exemption in the transition guidance under which the Company does not disclose prior period information regarding the amount of the transaction price allocated to remaining performance obligations. The cumulative effect of the adoption was recognized as a decrease to Accumulated deficit of $6.9 million on January 1, 2016. The following tables summarize the impact of adoption on the Company s previously reported financial position and results:

	December 31, 2017		
	As reported	Adjustments	As adjusted

		(in thousands)	
Balance Sheet			
Contract assets	$	$ 160	$ 160
Deferred cost of sales	16,060	(66)	15,994
Deferred taxes	2,953	94	3,047
Accrued expenses and other current liabilities	60,339	(2,271)	58,068
Customer deposits and deferred revenue	108,953	3,079	112,032
Additional paid-in capital	1,053,079	(1,126)	1,051,953
Accumulated deficit	(213,376)	506	(212,870)

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Veeco Instruments Inc. and Subsidiaries

Notes to the Consolidated Financial Statements - continued

(unaudited)

	Three months ended March 31, 2017		
	As reported	Adjustments	As adjusted
	(in thousands, except per share amounts)		
Statement of Operations			
Net sales	$ 94,386	$ 113	$ 94,499
Cost of sales	60,186	(187)	59,999
Income tax expense (benefit)	(10,282)	(245)	(10,527)
Net income (loss)	1,095	545	1,640
Diluted earnings (loss) per share	0.03	0.01	0.04

The Company s adoption of the standard had no impact to cash provided by or used in operating, investing, or financing activities on the Consolidated Statements of Cash Flows.

Revenue Recognition

Revenue is recognized upon the transfer of control of the promised product or service to the customer in an amount that reflects the consideration the Company expects to receive in exchange for such product or service. The Company s contracts with customers generally do not contain variable consideration. In the rare instances where variable consideration is included, the Company estimates the amount of variable consideration and determines what portion of that, if any, has a high probability of significant subsequent revenue reversal, and if so, that amount is excluded from the transaction price. The Company s contracts with customers frequently contain multiple deliverables, such as systems, upgrades, components, spare parts, installation, maintenance, and service plans. Judgment is required to properly identify the performance obligations within a contract and to determine how the revenue should be allocated among the performance obligations. The Company also evaluates whether multiple transactions with the same customer or related parties should be considered part of a single contract based on an assessment of whether the contracts or agreements are negotiated or executed within a short time frame of each other or if there are indicators that the contracts are negotiated in contemplation of one another.

When there are separate units of accounting, the Company allocates revenue to each performance obligation on a relative stand-alone selling price basis. The stand-alone selling prices are determined based on the prices at which the Company separately sells the systems, upgrades, components, spare parts, installation, maintenance, and service plans. For items that are not sold separately, the Company estimates stand-alone selling prices generally using an expected cost plus margin approach. The maximum revenue recognized at a given point on a contract is limited to the amount for which it is probable that a significant reversal will not occur in the future.

Most of the Company s revenue is recognized at a point in time when the performance obligation is satisfied. The Company considers many facts when evaluating each of its sales arrangements to determine the timing of revenue recognition, including its contractual obligations and the nature of the customer s post-delivery acceptance provisions. The Company s system sales arrangements, including certain upgrades, generally include field acceptance provisions that may include functional or mechanical test procedures. For many of these arrangements, a customer source inspection of the system is performed in the Company s facility or test data is sent to the customer documenting that the system is functioning to the agreed upon specifications prior to delivery. Historically, such source inspection or test data replicates the field acceptance provisions that are performed at the customer s site prior to final acceptance of the system. When the Company objectively demonstrates that the criteria specified in the contractual acceptance provisions are achieved prior to delivery, transfer of control of the product to the customer is considered to have occurred and revenue is recognized upon system delivery since there is no substantive contingency remaining related to the acceptance provisions at that date. For new products, new applications of existing products, or for products with substantive customer acceptance provisions where the Company cannot objectively demonstrate that the criteria specified in the contractual acceptance provisions have been achieved prior to delivery, and the Company does not have a history of meeting the criteria, revenue and the associated costs are deferred and fully recognized upon obtaining objective evidence that the acceptance provisions have been achieved and thus transferring control of the product to the customer, assuming all other revenue recognition criteria have been met.

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Veeco Instruments Inc. and Subsidiaries

Notes to the Consolidated Financial Statements - continued

(unaudited)

In certain cases the Company s contracts with customers contain a billing retention, typically 10% of the sales price, which is billed by the Company and payable by the customer when field acceptance provisions are completed. Revenue recognized in advance of the amount that has been billed is recorded as a contract asset on the Consolidated Balance Sheets.

The Company recognizes revenue related to maintenance and service contracts over time based upon the respective contract term. Installation revenue is recognized over time as the installation services are performed. The Company recognizes revenue from the sales of components, spare parts, and specified service engagements at a point in time, which is typically consistent with the time of delivery in accordance with the terms of the applicable sales arrangement.

The Company may receive customer deposits on system transactions. The timing of the transfer of goods or services related to the deposits is either at the discretion of the customer or expected to be within one year from the deposit receipt. As such, the Company does not adjust transaction prices for the time value of money. Incremental direct costs incurred related to the acquisition of a customer contract, such as sales commissions, are expensed as incurred since the expected amortization period is one year or less.

The Company has elected to treat shipping and handling costs as a fulfillment activity and therefore such costs are included in cost of services upon shipment of products. Taxes assessed by governmental authorities that are collected by the Company from a customer are excluded from revenue.

Income Taxes

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (2017 Tax Act), which makes broad and complex changes to the U.S. tax code. Certain income tax effects of the 2017 Tax Act are reflected in the Company s financial results in accordance with Staff Accounting Bulletin No. 118 (SAB 118), which provides SEC staff guidance regarding the application of ASC Topic 740, *Income Taxes* (ASC 740). Refer to Note 10, Income Taxes, for further information on the financial statement impact of the 2017 Tax Act.

Because of the complexity of the new global intangible low-taxed income (GILTI) rule, the Company is continuing to evaluate this provision of the 2017 Tax Act and the application of ASC 740. Under U.S. GAAP, the Company is allowed to make an accounting policy choice of either (1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (period cost method) or (2) factoring such amounts into a company s measurement of its deferred taxes (deferred method). The Company s selection of an accounting policy with respect to the new GILTI tax rules will depend, in part, on analyzing its global income to determine whether it expects to have future U.S. inclusions in taxable income related to GILTI, and if so, what the impact will be. This assessment depends not only on the Company s current structure and estimated future results of global operations, but also on its intent and ability to modify its structure and/or business. The Company is not yet able to reasonably estimate the effect of this provision of the 2017 Tax Act; therefore, the Company has not made any deferred tax adjustments related to potential GILTI tax in its consolidated financial statements and has not made a policy election decision regarding whether to record deferred taxes on GILTI.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02: *Leases*, which generally requires operating lessee rights and obligations to be recognized as assets and liabilities on the Balance Sheet. In addition, interest on lease liabilities is to be recognized separately from the amortization of right-of-use assets in the Statement of Operations. Further, payments of the principal portion of lease liabilities are to be classified as financing activities while payments of interest on lease liabilities and variable lease payments are to be classified as operating activities in the Statement of Cash Flows. When the standard is adopted, the Company will be required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, with early application permitted. The Company is evaluating the impact of adopting the ASU on the

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Veeco Instruments Inc. and Subsidiaries

Notes to the Consolidated Financial Statements - continued

(unaudited)

consolidated financial statements.

The Company is also evaluating other pronouncements recently issued but not yet adopted. The adoption of these pronouncements is not expected to have a material impact on the Company s consolidated financial statements.

Recently Adopted Accounting Pronouncements

The Company adopted ASU 2016-01, *Financial Instruments Overall*, as of January 1, 2018. This ASU requires certain equity investments to be measured at fair value, with changes in fair value recognized in net income. For equity investments without readily observable market prices, the Company measures these investments at cost adjusted for changes in observable prices minus impairment. Changes in measurement are included in Other, net in the Consolidated Statements of Operations. This ASU has not had a material impact on the consolidated financial statements upon adoption, and the Company will monitor its cost method investments each reporting period for changes in observable market prices, if any, which may be material in future periods.

The Company adopted ASU 2016-16, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory*, as of January 1, 2018. This ASU requires the Company to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. This ASU has not had a material impact on the consolidated financial statements.

The Company adopted ASU 2016-18, *Statement of Cash Flows: Restricted Cash,* as of January 1, 2018. This ASU requires the Company to include Restricted cash with Cash and cash equivalents when reconciling the beginning and end of period total amounts shown on the Statement of Cash Flows. This ASU has not had a material impact on the consolidated financial statements.

Note 2 - Income (Loss) Per Common Share

The Company considers unvested share-based awards that have non-forfeitable rights to dividends prior to vesting to be participating shares, which are treated as a separate class of security from the Company s common shares for calculating per share data. Therefore, the Company applies the two-class method when calculating income (loss) per share. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. However, since the holders of the participating shares are not obligated to fund losses, participating shares are excluded from the calculation of loss per share.

The dilutive effect of the Convertible Senior Notes on income (loss) per share is calculated using the treasury stock method since the Company has both the current intent and ability to settle the principal amount of the Convertible Senior Notes in cash. See Note 5, Liabilities, for additional information on the Convertible Senior Notes.

Basic income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares outstanding during the period under the two-class method. Diluted income per share is calculated by dividing net income by the weighted average number of shares used to calculate basic income (loss) per share plus the weighted average number of common share equivalents outstanding during the period. The dilutive effect of outstanding options to purchase common stock and non-participating share-based awards is considered in diluted income per share by application of the treasury stock method. The dilutive effect of performance share units is included in diluted income per common share in the periods the performance targets have been achieved. The computations of basic and diluted income (loss) per share for the three months ended March 31, 2018 and 2017 are as follows:

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Veeco Instruments Inc. and Subsidiaries

Notes to the Consolidated Financial Statements - continued

(unaudited)

	Three months ended March 31, 2018	2017
	(in thousands, except per share amounts)	
Net income (loss)	$ (15,827)	$ 1,640
Net income (loss) per common share:		
Basic	$ (0.34)	$ 0.04
Diluted	$ (0.34)	$ 0.04
Basic weighted average shares outstanding	46,963	39,619
Effect of potentially dilutive share-based awards		521
Diluted weighted average shares outstanding	46,963	40,140
Unvested participating shares excluded from basic weighted average shares outstanding since the securityholders are not obligated to fund losses	59	N/A
Common share equivalents excluded from the diluted weighted average shares outstanding since Veeco incurred a net loss and their effect would be antidilutive	169	N/A
Potentially dilutive non-participating shares excluded from the diluted calculation as their effect would be antidilutive	2,092	1,499
Maximum potential shares to be issued for settlement of Convertible Senior Notes excluded from the diluted calculation as their effect would be antidilutive	8,618	8,618

Note 3 Business Combinations

Ultratech

On May 26, 2017, the Company completed its acquisition of Ultratech, Inc. (Ultratech). Ultratech develops, manufactures, sells, and supports lithography, laser annealing, and inspection equipment for manufacturers of semiconductor devices, including front-end semiconductor manufacturing and advanced packaging. Ultratech also develops, manufactures, sells, and supports ALD equipment for scientific and industrial applications. Ultratech s customers are primarily located throughout the United States, Europe, China, Japan, Taiwan, Singapore, and Korea. The results of Ultratech s operations have been included in the consolidated financial statements since the date of acquisition.

Ultratech shareholders received (i) $21.75 per share in cash and (ii) 0.2675 of a share of Veeco common stock for each Ultratech common share outstanding on the acquisition date. Approximately $2.7 million of the cash merger consideration is included in Accrued expenses and other current liabilities on the Consolidated Balance Sheets as of March 31, 2018 and December 31, 2017, related to shareholder appraisal proceedings.

The following table presents unaudited pro forma financial information as if the acquisition of Ultratech had occurred on January 1, 2016:

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Veeco Instruments Inc. and Subsidiaries

Notes to the Consolidated Financial Statements - continued

(unaudited)

		Three months ended March 31, 2017 (in thousands, except per share amounts)
Net sales	$	151,908
Loss before income taxes		(13,461)
Diluted earnings per share	$	(0.07)

The pro-forma results were calculated by combining the unaudited results of the Company with the stand-alone unaudited results of Ultratech for the pre-acquisition period, and adjusting for the following:

(i) Additional amortization expense related to identified intangible assets valued as part of the purchase price allocation that would have been incurred starting on January 1, 2016.

(ii) Additional depreciation expense for the property, plant, and equipment fair value adjustments that would have been incurred starting on January 1, 2016.

(iii) All acquisition related costs incurred by the Company as well as by Ultratech pre-acquisition have been removed from the year ended December 31, 2017 and included in the year ended December 31, 2016, as such expenses would have been incurred in the first quarter following the acquisition.

(iv) All amortization of inventory step-up has been removed from the year ended December 31, 2017 and recorded in the year ended December 31, 2016, as such costs would have been incurred as the corresponding inventory was sold.

(v) Additional interest expense related to the Convertible Senior Notes (see Note 5, Liabilities) as if they had been issued on January 1, 2016.

(vi) Income tax expense (benefit) was adjusted for the impact of the above adjustments for each period.

(vii) All shares issued in connection with the acquisition were considered outstanding as of January 1, 2016 for purposes of calculating diluted earnings per share.

Note 4 - Assets

Investments

Short-term investments are generally classified as available-for-sale and reported at fair value, with unrealized gains and losses, net of tax, presented as a separate component of stockholders equity under the caption Accumulated other comprehensive income in the Consolidated Balance Sheets. These securities may include U.S. treasuries, government agency securities, corporate debt, and commercial paper, all with maturities of greater than three months when purchased. All realized gains and losses and unrealized losses resulting from declines in fair value that are other than temporary are included in Other, net in the Consolidated Statements of Operations.

Fair value is the price that would be received for an asset or the amount paid to transfer a liability in an orderly transaction between market participants. Veeco classifies certain assets based on the following fair value hierarchy:

Level 1: Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly; and

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Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Veeco has evaluated the estimated fair value of financial instruments using available market information and valuations as provided by third-party sources. The use of different market assumptions or estimation methodologies could have a significant effect on the estimated fair value amounts.

The following table presents the portion of Veeco s assets that were measured at fair value on a recurring basis at March 31, 2018 and December 31, 2017:

	Level 1	Level 2	Level 3	Total
		(in thousands)		
March 31, 2018				
Cash equivalents				
U.S. treasuries	$ 6,496	$	$	$ 6,496
Total	$ 6,496	$	$	$ 6,496
Short-term investments				
U.S. treasuries	$ 42,228	$	$	$ 42,228
Corporate debt		10,522		10,522
Commercial paper		12,380		12,380
Total	$ 42,228	$ 22,902	$	$ 65,130
December 31, 2017				
Cash equivalents				
U.S. treasuries	$ 12,490	$	$	$ 12,490
Total	$ 12,490	$	$	$ 12,490
Short-term investments				
U.S. treasuries	$ 33,895	$	$	$ 33,895
Corporate debt		10,886		10,886
Commercial paper		2,999		2,999
Total	$ 33,895	$ 13,885	$	$ 47,780

There were no transfers between fair value measurement levels during the three months ended March 31, 2018.

At March 31, 2018 and December 31, 2017, the amortized cost and fair value of available-for-sale securities consist of:

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		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value
				(in thousands)				
March 31, 2018								
U.S. treasuries	$	42,245	$		$	(17)	$	42,228
Corporate debt		10,540				(18)		10,522
Commercial paper		12,379		1				12,380
Total	$	65,164	$	1	$	(35)	$	65,130
December 31, 2017								
U.S. treasuries	$	33,914	$		$	(19)	$	33,895
Corporate debt		10,894				(8)		10,886
Commercial paper		2,999						2,999
Total	$	47,807	$		$	(27)	$	47,780

Available-for-sale securities in a loss position at March 31, 2018 and December 31, 2017 consist of:

	March 31, 2018				December 31, 2017			
		Estimated Fair Value		Gross Unrealized Losses		Estimated Fair Value		Gross Unrealized Losses
				(in thousands)				
U.S. treasuries	$	37,275	$	(17)	$	33,895	$	(19)
Corporate debt		10,522		(18)		10,886		(8)
Total	$	47,797	$	(35)	$	44,781	$	(27)

At March 31, 2018 and December 31, 2017, there were no short-term investments that had been in a continuous loss position for more than 12 months.

The maturities of securities classified as available-for-sale at March 31, 2018 were all due in one year or less. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. There were no realized gains for the three months ended March 31, 2018 and 2017.

Accounts Receivable

Accounts receivable is presented net of an allowance for doubtful accounts of $0.3 million at both March 31, 2018 and December 31, 2017.

Inventories

Inventories are stated at the lower of cost or net realizable value, with cost determined on a first-in, first-out basis. Inventories at March 31, 2018 and December 31, 2017 consist of the following:

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	March 31, 2018	December 31, 2017
	(in thousands)	
Materials	$ 70,621	$ 59,919
Work-in-process	35,211	37,222
Finished goods	25,132	23,125
Total	$ 130,964	$ 120,266

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets primarily consist of supplier deposits, prepaid value-added tax, lease deposits, prepaid insurance, and prepaid licenses. Veeco had deposits with its suppliers of $11.5 million and $7.6 million at March 31, 2018 and December 31, 2017, respectively.

Property, Plant, and Equipment

Property, plant, and equipment at March 31, 2018 and December 31, 2017 consist of the following:

	March 31, 2018	December 31, 2017
	(in thousands)	
Land		