Veeco

1998 Annual Report

The Future Is About to Surface

(In thousands except per share amounts)	**1998**	1997	1996	1995	1994
	Year ended December 31,				
Statement of income data:					
Net sales	**$206,838**	$216,728	$165,059	$123,976	$ 84,959
Operating income (excluding non-recurring charges)	**26,533[1]**	40,094[2]	33,493	23,509	11,248[3]
Income before income taxes	**18,145**	33,637	33,838	23,330	6,296[4]
Net income	**12,701**	26,027	26,897	20,833	6,201
Diluted earnings per share	**$ 0.85**	$ 1.75	$ 1.86	$ 1.48	$ 0.56
Pro forma diluted earnings per share excluding non-recurring charges[5]	**$ 1.08**	$ 1.66	$ 1.44	$ 1.03	$ 0.41
	As of December 31,				
	1998	1997	1996	1995	1994
Balance sheet data:					
Working capital	**$ 85,526**	$ 68,778	$ 61,994	$ 49,324	$ 25,543
Long-term debt (including current installments)	**17,147**	17,356	10,669	10,766	2,839
Shareholders' equity	**113,224**	93,758	71,569	58,448	40,910

(1) Excludes non-recurring merger and reorganization expenses of $7.5 million.

(2) Excludes non-recurring merger expenses of $2.3 million and an in-process R&D write-off of approximately $4.2 million.

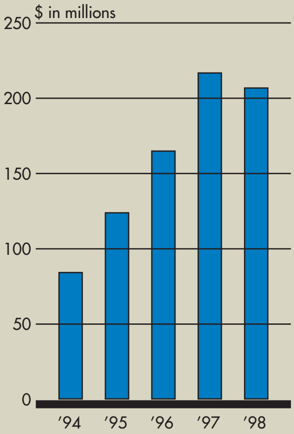
(3) Excludes non-recurring legal fees and claims related to litigation of $2.1 million.

(4) Excludes $.7 million extraordinary loss, net of $.4 million tax benefit.

(5) Computed using a fully taxed statutory rate and excludes the effects of the non-recurring charges.

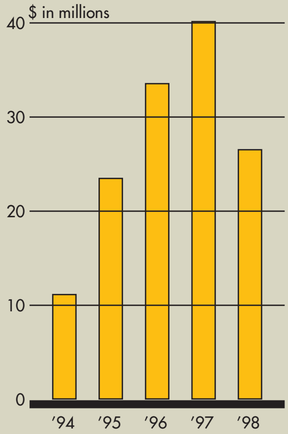
4 Year CAGR +25%

Sales



4 Year CAGR +24%

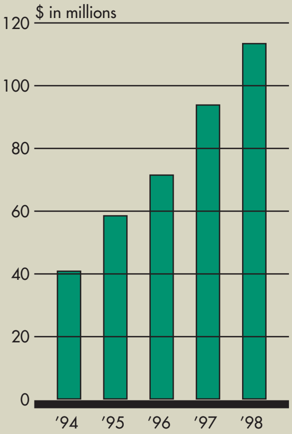
Operating Income*



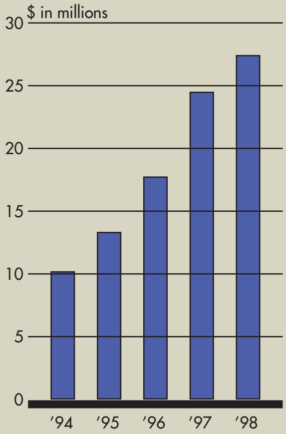
*Excludes all non-recurring charges

4 Year CAGR +29%

Stockholders' Equity



R&D



CAGR: Compounded annual growth rate.

Veeco designs, manufactures, markets and services a broad line of equipment primarily used by manufacturers in the data storage and semiconductor industries. These industries help create a wide range of information age technology products, such as personal computers and network servers, as well as "products of the future"—television set-top boxes, personal digital assistants and other consumer products.

Our Metrology equipment is used to provide critical surface measurements on thin film magnetic heads and disks used in hard disk drives, as well as on semiconductor devices. This equipment allows customers to monitor their products throughout the manufacturing process in order to improve yields, reduce costs and improve product quality.

Our Process Equipment products precisely deposit or remove (etch) various materials in the manufacturing of advanced thin film magnetic heads for the data storage industry. Veeco's leading edge technology allows customers to improve time to market of next generation high density thin film magnetic heads.

During 1998, we expanded our "one-stop shopping" strategy—to provide our customers with total solutions for improved manufacturing yields and faster time to market for their next generation products. We supply worldwide industry leaders, such as IBM, Seagate, Read-Rite, TDK, StorageTek, Sony and Siemens, through an expanded global sales and service organization located throughout the United States, Europe, Japan and Asia Pacific. We have manufacturing, research and development and engineering facilities located in Plainview and Ronkonkoma, New York; San Jose and Santa Barbara, California; and Tucson, Arizona.

The Future Is About to Surface

Total Integrated Solutions

About the Cover: Enlarged microscopic image of the data read element of a thin film magnetic head imaged by a Wyko® HD3300 Optical Interferometer, one of Veeco's metrology products.

To Our Shareholders

Commitment to Growth

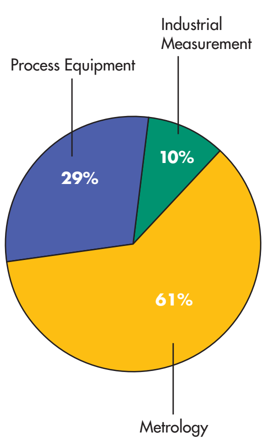
1998 was a challenging year for Veeco, our industry, and our data storage and semiconductor customers. Yet, we enter 1999 with renewed confidence and heightened optimism concerning the future growth opportunities for our company.

Our optimism is based upon the demand for our key technologies for next generation data storage and semiconductor products, our broadened portfolio of products, our strategic partnerships with key customers, an expanded worldwide service and support network, and strong financial position. In addition, Veeco's order rate of $62 million in the fourth quarter of 1998 is support for our optimism in 1999.

Veeco Sales by Product

Chart 1

Year ended 12/31/98



High growth Metrology and Process Equipment products represented 90% of sales.

1998 Review

For the year ended December 31, 1998, sales decreased 5% to $206.8 million from $216.7 million in 1997. While we are disappointed by this decrease, Veeco outperformed many of our semiconductor and data storage industry peers who were more dramatically affected by overcapacity and customers' reduced operating results. Our performance during the year was enhanced by our diversity of products and markets, which served to counteract what was an industry-wide cyclical downturn. As shown in Chart 1, sales by product were 61% Metrology, 29% Process Equipment, and 10% Industrial Measurement. Veeco's 1998 operating income, exclusive of non-recurring charges, decreased to $26.5 million from $40.1 million in 1997, primarily as a result of lower gross margins related to reduced sales volume in Process Equipment and new product introductions, as well as continued investment in new product research and development. Veeco's 1998 bookings were $221.4 million, a slight increase from the $218.6 million booked in 1997. Our book-to-bill ratio for the year was 1.07.

Net income for 1998 decreased to $12.7 million or $0.85 per share, from $26.0 million, or $1.75 per share, in 1997. On a pro-forma, fully taxed basis, Veeco's 1998 earnings per share was $1.08 compared to $1.66 in 1997, excluding one-time charges of $7.5 million in 1998 and $6.5 million in 1997.

Transition Year in Process Equipment

Sales of Veeco's Process Equipment group were down 28% in 1998 compared with 1997, primarily as a result of a sharp downturn in our core etch business. Veeco's etch business suffered significantly during 1998 as a result of manufacturing overcapacity among our customers. This decline in etch sales had a dramatic effect on Veeco's sales and profits during the year.

However, Veeco experienced rapid growth in our newer deposition product line, which grew to be nearly half of the group's sales. This deposition growth was the direct result of strategic initiatives undertaken in 1997 and 1998, including Veeco's internal development of ion beam deposition technology (IBD) as well as our acquisition of a physical vapor deposition (PVD) product line. Veeco has developed the industry's broadest line of Process Equipment tools to address the next generation requirements of thin film magnetic head manufacturers, including a unique combination of etch and deposition modules that provide critical process steps using a single cluster tool. We are excited about the compelling growth opportunities ahead for our deposition products, now well positioned to capitalize on the industry's ongoing transition from magnetoresistive (MR) to giant

Note that all financial results have been restated to reflect the pooling-of-interests with Digital Instruments, completed in May 1998.

magnetoresistive (GMR) technology. In addition, Veeco's etch sales started to recover during the fourth quarter of 1998, due to the need for advanced generation etch equipment for GMR development and production.

Double-Digit Sales Increase in Metrology

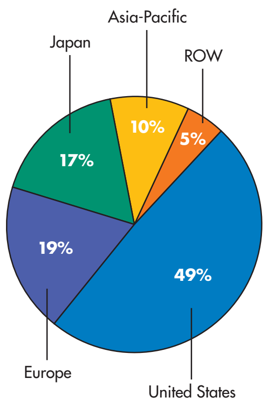
Sales of our Metrology group grew 12% in 1998 despite the industry downturn, driven by the move to 100% in-line metrology for critical steps at data storage customers. We are particularly pleased with the success of our Wyko product line during 1998. We identified and capitalized on key growth areas, introduced high-end automated production tools which responded to and anticipated specific customer needs, and leveraged Veeco's worldwide sales and service organization to penetrate key data storage and semiconductor customers—resulting in a 166% increase in Wyko's sales from 1996 to 1998.

During 1998 we also completed our merger with Digital Instruments, a $54.0 million atomic force microscopy company with a leading market share, strong intellectual property position and an installed base of over 2,500 units. As we begin 1999, we have a clear vision and strategy in place to propel Digital Instruments' future growth—centered on the company's ability to be the next-generation high-resolution solution for sub-micron measurements in semiconductor and data storage applications.

Veeco Sales by Geographic Region

Chart 2

Year ended 12/31/98



Half of the Company's sales were outside of the U.S.

Worldwide Penetration

Veeco continues to successfully penetrate international markets (see Chart 2). Late in 1998 we began to benefit from our move to direct sales and service support in Japan, which we initiated in 1997. As a result, in the fourth quarter, Veeco received approximately $9 million of orders from three Japanese data storage customers for combined etch and deposition Process Equipment tools for advanced MR/GMR applications. Veeco's total Japanese orders in the fourth quarter were a record $16.4 million.

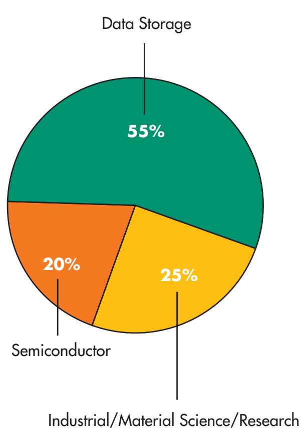
Continued Investment in Future Technologies

During 1998 Veeco continued to invest in research and development—with spending reaching $27.4 million, a 12% increase over 1997 levels. This research and development effort resulted in several significant new products during 1998, including the HD3300 Optical Interferometer for 100% in-line testing of pole tip recession during the manufacture of thin film magnetic heads, and further advancements in both our IBD and PVD line of Process Equipment deposition tools for GMR head production.

Veeco Sales by Market

Chart 3

Year ended 12/31/98



Data storage sales were 69% in the fourth quarter.

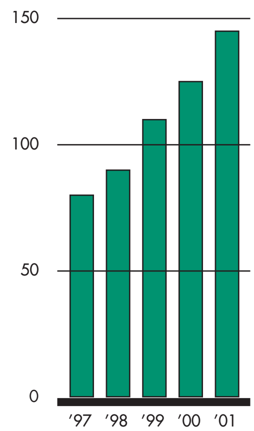
Strengthened Financial Position

At year-end, Veeco's balance sheet remained strong, with $85.5 million in working capital and $113.2 million in shareholders' equity. In February 1999, Veeco completed a public offering of 3.575 million shares of common stock at a price of $52.00 per share. Of the 3.575 million shares sold, 1.0 million were sold by the Company and 2.575 million by certain selling stockholders. The net proceeds to the Company from the offering were approximately $49 million of cash, providing additional capital for future growth.

Worldwide PC Shipments

Chart 4

in millions of units



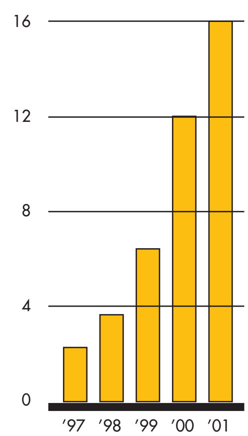
PC unit growth is forecasted to be 10-15% per year through 2001.

Source: Dataquest

Average Disk Drive Capacity per Desktop PC

Chart 5

in gigabytes



Hard disk drive capacity is expected to grow at over 60% per year through 2001.

Source: TrendFOCUS

Capitalizing on Technological Change

As we enter 1999 and prepare for the new millennium, we are enthusiastic about the compelling technology changes occurring in the markets we address. Equally important, the strategic initiatives which we have taken over the past few years position us well to take maximum advantage of these trends.

Emerging Applications

The industries Veeco serves produce data storage devices and semiconductors used in a wide range of information age products, including personal computers and network servers, as well as in emerging product areas such as television set-top boxes, digital cameras, personal digital assistants and other consumer products. These products continually require smaller, faster and less expensive microelectronic components, including thin film magnetic heads and semiconductor devices. Long-term opportunities continue to look favorable for the Company based upon industry forecasts of annual unit growth through 2001 of 10–15% for PCs (Chart 4), 12–17% for hard disk drives, and 30% for magnetoresistive (MR) and giant magnetoresistive (GMR) thin film magnetic heads (Chart 6). As shown in Chart 5, hard disk drive capacity is expected to grow at over 60% per year through 2001.

Greater Investment in Equipment

Devices with smaller feature sizes and higher levels of performance require more precise manufacturing steps, which, in turn, require increased use of etch, deposition and metrology equipment in the manufacturing process. As a result, manufacturers of thin film magnetic heads and semiconductor devices are required to increase their investments in advanced manufacturing equipment capable of producing these components as quickly and cost effectively as possible. We work closely with our customers to understand their next generation technology roadmaps in order to help them develop and refine critical manufacturing processes and achieve their new product time-to-market objectives.

Two of Veeco's primary markets, data storage and semiconductor, are undergoing rapid technological change:

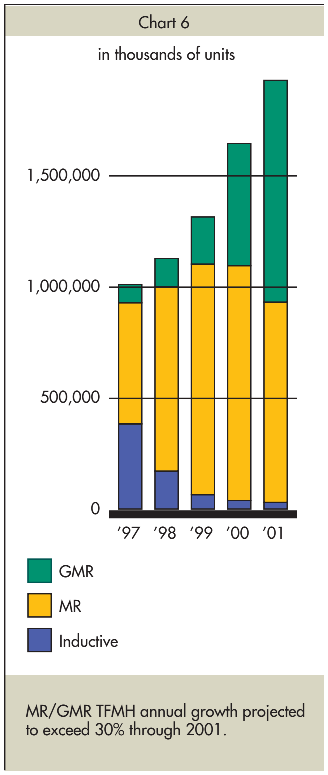
The GMR Transition

In data storage, the industry is undergoing a transition to GMR heads, which enable the storage of more data. These newer, more sensitive heads, with their finer geometries and thinner films, are more complicated to manufacture, thereby favoring increased use of ion beam etch and deposition equipment. In addition, these tighter tolerances are spurring the growth of 100% in-line metrology testing in order to improve yields. Current critical investment is being made in GMR process technology required for the data storage industry to produce an estimated 100 million heads in 1999, 370 million heads in 2000 and 775 million heads in 2001. While the disk drive industry suffered from overcapacity in 1998, this rapid change in processing technology is driving investment in new capital equipment. Leading the way in this technology ramp up are several of Veeco's key U.S. customers, including IBM, Read-Rite and Seagate, as well as leading European, Japanese and Asia-Pacific customers.

Growth in Semiconductor Niche Markets

In the semiconductor industry, manufacturers use metrology tools in their wafer fabrication facilities to detect any process deviations as early in the manufacturing process as possible; these tools are critical for yield enhancement and cost reduction. The fabrication of complex, high performance devices with smaller feature sizes (less than 0.25 microns) on larger substrate sizes (300mm wafers) will drive future investment in surface metrology equipment, such as Veeco's atomic force microscopes. Finer geometries, advanced interconnect and chem-mechanical

Thin Film Magnetic Head Growth



Source: Peripheral Research Inc.

polishing are examples of the newer semiconductor-oriented technologies which Veeco has targeted for future growth opportunities.

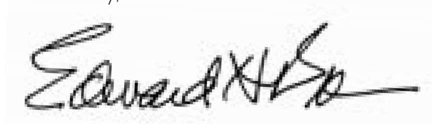
The Future

Veeco will continue to pursue our corporate strategy, which is focused on expanding our product lines to be the leading full service metrology and process equipment "one-stop" supplier to data storage manufacturers, and developing emerging applications for our metrology equipment in the semiconductor industry. Key elements of this strategy include:

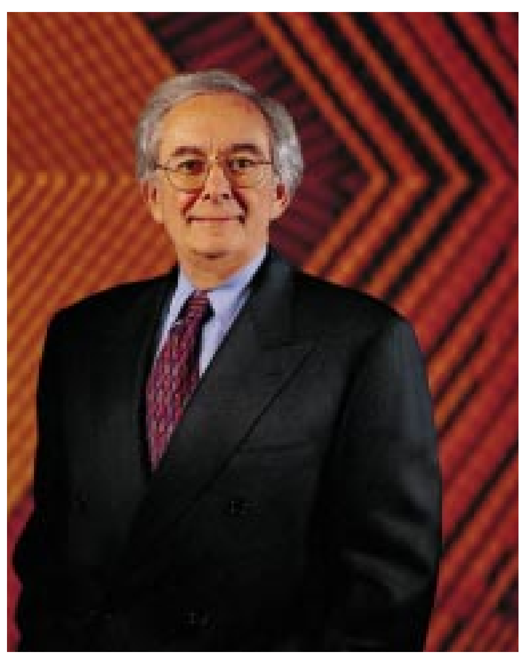
- Providing our data storage and semiconductor customers with technical expertise and equipment to improve the quality of their products and reduce the time it takes to bring their new products to market.
- Capitalizing on our technology expertise and working closely with our customers to develop next generation products.
- Pursuing strategic mergers and acquisitions to provide our customers with a broad range of complementary products and technologies.
- Identifying important trends in technology in order to capitalize on areas of high growth.
- Utilizing our global sales and service network to provide world class support to our customers for existing and future products.

I would like to personally thank our customers, employees, shareholders and suppliers for their support during 1998. We begin 1999 with a clear vision of Veeco's future growth, and we look forward to sharing in that growth together.

Sincerely,



Edward H. Braun
Chairman, Chief Executive Officer and President



Edward H. Braun, *Chairman, Chief Executive Officer and President*

Products

Markets

Metrology | **Process Equipment** | **Industrial Measurement** | *Sales by Market*

Data Storage

Metrology

Veeco is the leader in 3D surface metrology tools sold to leading data storage manufacturers for 100% in-line testing of critical production steps in the manufacture of thin film magnetic heads (TFMHs). These products include:

- Atomic Force/Magnetic Force Microscopes
- Optical Profilers
- Stylus Profilers

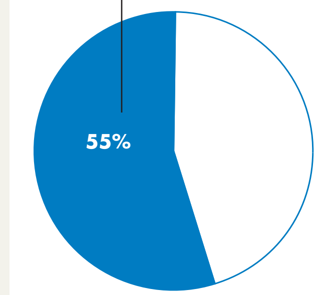
Process Equipment

Veeco is the leading manufacturer of etch and deposition systems used in the production of TFMHs. These products include:

- Ion Beam Deposition Systems
- Ion Beam Etch Systems
- Physical Vapor Deposition Systems
- Diamond-Like Carbon Coating Systems

Industrial Measurement

Veeco's X-Ray fluorescence (XRF) products measure thickness and composition of deposited films on hard disks and TFMHs. Veeco's leak detectors are used for vacuum maintenance of process chambers.



Semiconductor

Metrology

Veeco's metrology tools are used by semiconductor manufacturers to detect process deviations—critical for yield optimization and process development. Veeco sells the following metrology products to semiconductor companies:

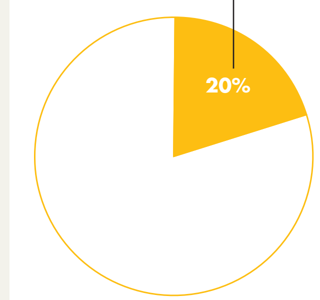
- Atomic Force/Scanning Probe Microscopes
- Optical Profilers
- Stylus Profilers

Process Equipment

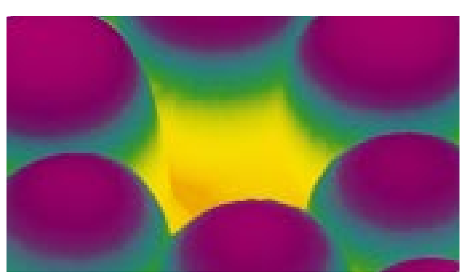
Veeco's Process Equipment (etch and deposition) is used in specialized semiconductor applications such as sub-micron etching of different materials in developmental activities.

Industrial Measurement

Veeco manufactures micro-beam XRF measurement systems to determine thickness and composition of multilayers on semiconductor wafers and devices such as flip chips. Veeco leak detectors identify leaks in process chambers used to manufacture semiconductors as well as in final testing of devices.



Industrial/Material Science/Research



Metrology

Veeco metrology tools are used in a broad range of scientific and industrial applications such as research, development, manufacturing, quality control and defect analysis. Examples include characterizing advanced materials, optics, biological samples and imaging various surfaces.

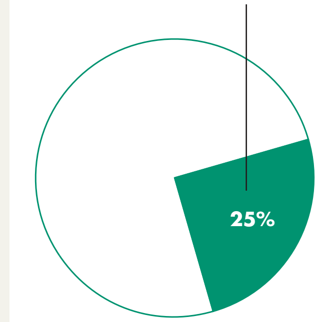
- Atomic Force/Scanning Probe Microscopes
- Optical Measurement Systems
- Stylus Profilers

Process Equipment

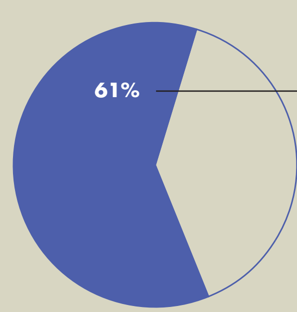
Veeco ion beam etch systems are used in industrial applications such as micro-machining of sensors, optoelectronics, and process development. Our deposition systems are also used in research and development applications for next generation Extreme Ultra Violet Lithography (EUVL).

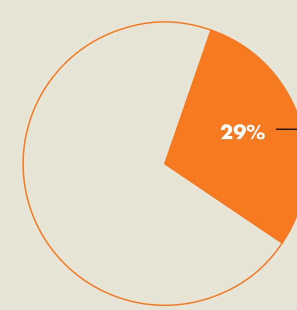
Industrial Measurement

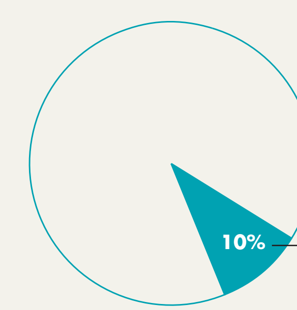
Veeco leak detection products are the industry standard for detecting leaks in hermetically sealed packages for a wide range of industrial applications. Veeco's XRF Systems are used to measure the thickness and composition of materials used in a broad range of industrial applications including metal finishing and electronics.



Sales by Product







Metrology

Leader in 3D Surface Metrology

Veeco's mergers with Wyko Corporation in 1997 and Digital Instruments in 1998, along with our existing products, yielded a powerful combination of measurement technologies, including stylus profilers, optical profilers, atomic force microscopes and X-Ray fluorescence systems.

These tools are used to measure properties such as critical dimensions, film thickness, microroughness, step height, contour and depth in data storage devices, semiconductors and industrial/material science/research applications.

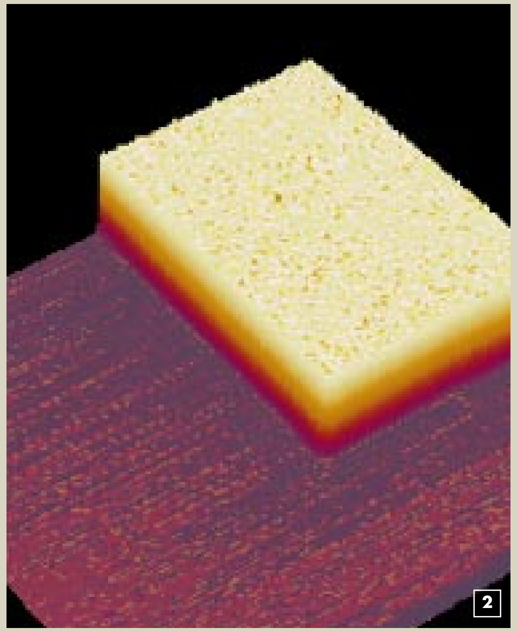
As a result of the increased miniaturization of microelectronic components, the data storage industry is in the early stages of adopting in-line metrology products for yield improvement. Veeco's product line positions us as leaders in the production of in-line metrology products for next generation magnetoresistive (MR) and giant magnetoresistive (GMR) thin film magnetic heads (TFMHs). Since the new heads are more sensitive and complicated to manufacture, there is a greater value to be derived from 100% testing of critical process steps in order to ramp up production and improve yields of these next-generation devices.

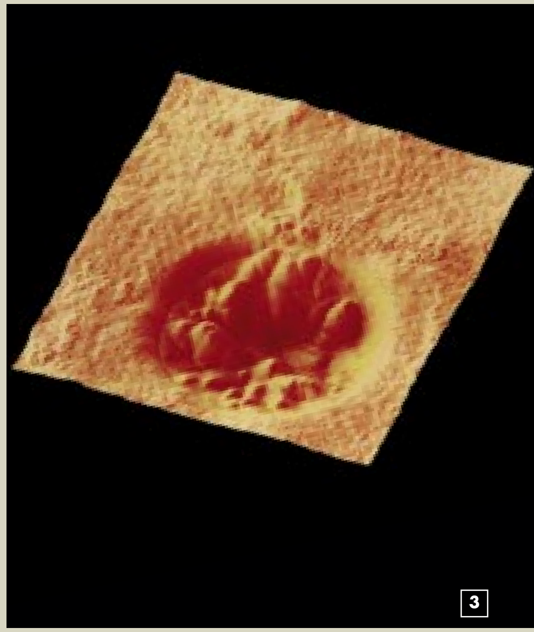
For example, Veeco shipped over 250 Wyko Optical Profilers to leading data storage industry customers during 1998 for 100% in-line testing of pole tip recession (PTR) and air bearing surface dimensions. This new tool received rapid acceptance due to its fast payback and ability to increase yields of MR/GMR TFMHs.

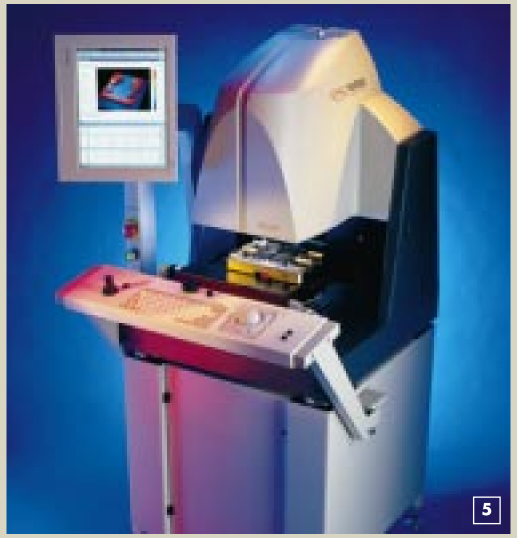
By merging with Digital Instruments®, Veeco complemented its existing family of metrology products by adding next generation atomic force microscopy (AFM) technology capable of measuring and imaging nanometer-level dimensional variations and surface properties. Over time, the feature sizes in integrated circuits and magnetoresistive elements of data storage devices have decreased—and are expected to continue to do so. Digital Instruments' patented AFM technology positions us well for this transition. For example, in 1998 Veeco shipped over ten fab-ready Digital Instruments Dimension® 9000s, which provide a next-generation solution for sub-micron in-line measurements required by both our data storage and semiconductor industry customers.

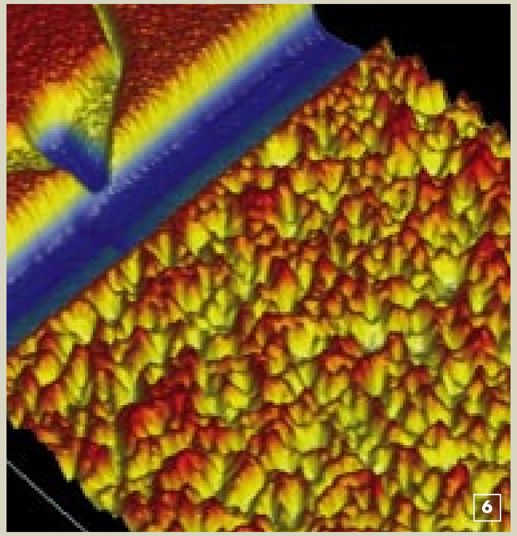
Another rapid growth area for Veeco Metrology during 1998 was our bump inspection system, where we capitalized on an emerging opportunity in flip chip high density interconnect for semiconductor packaging. We shipped approximately 25 Wyko SP3000 Series to key semiconductor customers during the year, including Motorola, Lucent and Texas Instruments, as well as several packaging suppliers.

Veeco's Metrology revenues have grown at an average rate greater than 25% per year from 1994 through 1998. This growth is the result of our strong technology and intellectual property position in surface metrology and our diversified markets of data storage, semiconductor and industrial/material science/research. We are quite pleased that Veeco received major orders in 1998 from leading data storage and semiconductor customers despite an industry-wide downturn. In the future, Veeco will strive to continue to identify specific growth opportunities in metrology, broaden our product line, and leverage our strong research-oriented heritage to yield next-generation production technologies.









1: Digital Instruments' Dimension 9000 AFM provides next generation solutions for in-line sub-micron measurements. 2 and 3: Veeco Metrology images of Chem-Mechanical Planarization Process on Semiconductor Wafers.

4: Image shows enlargement of solder bumps on semiconductor wafer and magnified image of those bumps using Wyko SP3000 tool.

5: Wyko HD3300 Optical Interferometer used for 100% in-line testing of pole tip recession of TFMHs.

6: Enlarged microscopic image of the data read element of a thin film magnetic head imaged by a Wyko HD3300 Optical Interferometer.

Process Equipment

"One-Stop Shopping"

Veeco is a leading manufacturer of etch and deposition Process Equipment used in the production of thin film magnetic heads for the data storage industry.

Ion beam systems are used to either deposit or remove (etch) materials with accuracy and uniformity demanded by next generation TFMH manufacturers. Veeco's Process Equipment product line includes ion beam etch, ion beam deposition, physical vapor deposition and diamond-like carbon coating (DLC) systems.

In order to satisfy market demand for devices with greater storage capacity, the data storage industry has responded with new head designs to achieve higher areal densities required to store more data. In fact, areal densities have been increasing since 1990 at an annual rate of 60%, and are expected to continue to do so until at least 2005. These new designs utilize MR and GMR heads—and the industry is in the early stages of transitioning to GMR technology.

Veeco provides our data storage customers with the broadest line of etch and deposition equipment in the industry and thereby offers a "total solution" for the manufacture of these MR/GMR TFMHs. Our combined etch and deposition cluster tools are critical for completing 23-plus GMR etch and deposition steps. In January 1999, Read-Rite completed a $20 million order for Veeco's Process Equipment tools in order to ramp up to production of GMR heads later this year. We believe that this order is indicative of the magnitude of opportunity afforded Veeco by our broad product line, "one-stop shopping" strategy, cluster configuration and key customer partnerships—in fact, we have already achieved initial penetration of many of the leading worldwide data storage customers.

Veeco's Microetch® brand is the industry leader in ion beam etch technology. This market is again expanding in 1999 with the increased need to etch smaller GMR dimensions. Based upon award winning technology developed in collaboration with Lawrence Livermore National Labs, Veeco's ion beam deposition system incorporates next generation deposition technology for the production of very thin multi-layer films that are highly uniform and virtually pinhole and defect-free. Veeco's current series of deposition tools are ideal for the demanding process steps of MR/GMR TFMH development. Veeco's DLC coatings improve the head's reliability, enabling higher areal density with protection against electrostatic damage. At the end of 1998, we introduced and received orders for a new Physical Vapor Deposition (PVD) tool, the Cymetra 6-target. Veeco's ability to now provide complete solutions in a single cluster tool that incorporates ion beam etch, ion beam deposition and PVD allows customers flexibility in experimenting with various processes before arriving at their specific production configuration.

We intend to leverage our leadership position in ion beam etch, critical deposition technology and strong key account relationships in order to fully penetrate the MR/GMR opportunity. As we begin 1999, data storage customers are just beginning their ramp up to GMR head production—and we are well positioned to meet their equipment requirements.

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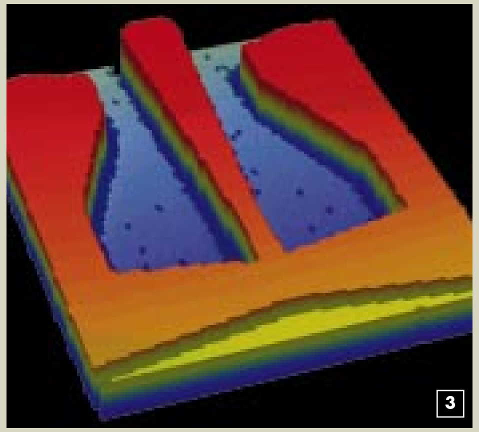

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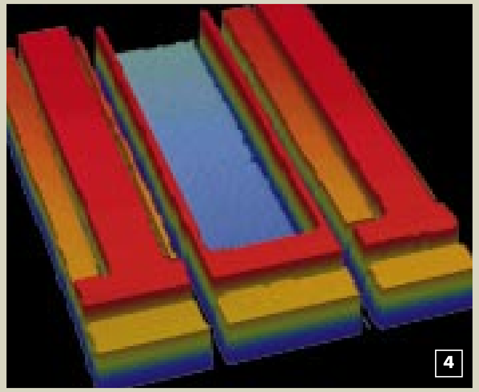
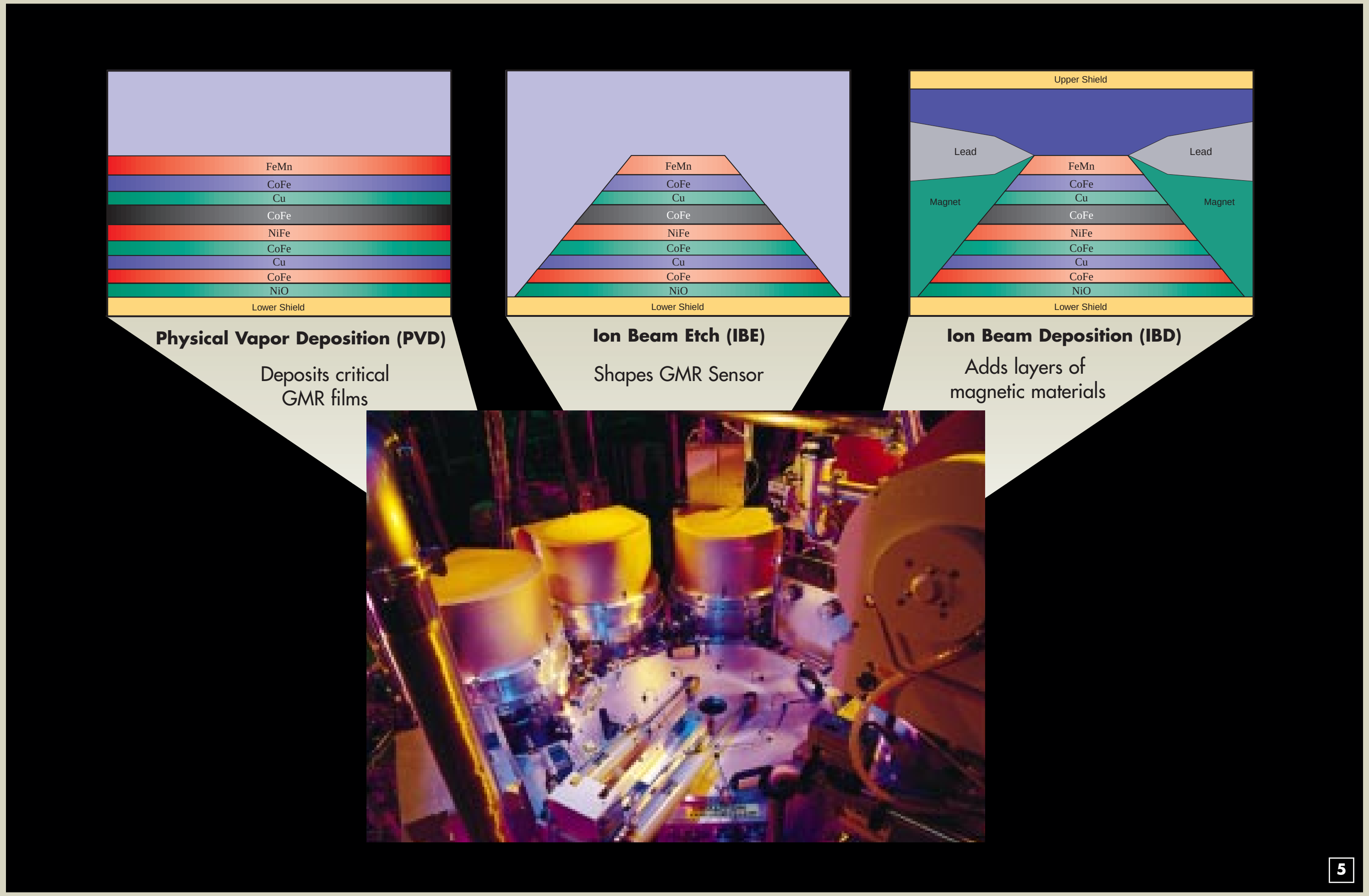


4



5

1: Veeco Ion Beam Source.

2: Veeco's IBE/IBD/PVD Cluster Tool.

3/4: Air Bearing Cavity etched by Veeco IBE tool to achieve critical fly height; imaged by Wyko Optical Profiler.

5: Veeco's next generation etch and deposition technologies provide total MR/GMR solutions in a single cluster tool to the data storage industry.

Worldwide Customer Support

Integrated Total Solutions

Veeco's worldwide customer support is a key strategic resource in providing integrated total solutions to our customers—by creating strong customer partnerships and establishing significant competitive barriers. The result of several years of expansion, Veeco's support network now spans 19 offices in the U.S., Japan, Asia Pacific and Europe—offering seven day per week, 24 hour per day worldwide support to our customers. Veeco's 130-plus field engineers and technical support staff is one of the largest teams servicing key data storage customers.

During 1998, we continued to upgrade and enhance this critical aspect of our company through the following initiatives:

- Created an integrated service network to mirror our Metrology and Process Equipment sales focus;
- Added a service and support facility in Penang, Malaysia and strengthened our network throughout the Asia-Pacific region;
- Expanded service and support operations in Japan and Europe through the addition of key personnel;
- Created a fully-equipped training and technical support facility in San Jose, CA for customer use.

Our customer support objective is to:

- Enhance our product offerings by continuing to provide quality and timely customer service;
- Deliver the right product, at the right time, which meets our customers' specific requirements;
- Provide "single point of contact" service for Veeco customers;
- Be viewed by our customers as a "best in class" service provider;
- Achieve maximum account penetration of each customer.

Veeco's service and support programs are designed to ensure peak performance and top process efficiency for our customers. In order to meet their heightened demands, Veeco must provide our worldwide customers with extensive global process support in addition to broadened process technologies. New service and support capabilities are focused on maximizing production availability for our products in the field, and include a broad range of service options, such as:

- Extended warranty program;
- Preventive maintenance;
- On-site, dedicated service teams assigned to customer locations;
- Strategically located replacement parts in 14 locations worldwide to ensure rapid response;
- Customized customer training programs.

Due to the critical role our equipment plays in their manufacturing processes, our customers have the right to expect a great deal from Veeco. It is our objective to exceed their expectations. Our service programs are designed to ensure peak performance and top process efficiency to our customers—thus maximizing their investment, minimizing their cost of ownership and shortening their time to market for new products. Strategic partnering and customer focus teams also compress product development cycles, improve manufacturing ramps and provide timely new product introductions.

Customer satisfaction is more than just superior product performance and reliability—it's the total measure of how Veeco's products perform in our customers' production and research environments.

"In September, Read-Rite announced new GMR technology that catapulted us to the lead in the race for higher areal densities. Veeco was critical to this effort, and we value not only their leading-edge technology, but their worldwide service and support network as well. We consider Veeco an important contributor to our success."

Alan S. Lowe
President and Chief Operating Officer,
Read-Rite Corp.

"Veeco has been an important supplier to Seagate for some time. This relationship was strengthened during 1998 as Veeco continued to broaden their product offerings, expand international sales and service to meet our needs, and truly became an integral partner in our technology developments. Our relationship with Veeco has helped to improve Seagate's time-to-market position."

G. Patrick Bonnie
Senior Vice President and General Manager of
Recording Head Operations, Seagate Technology Inc.

(In thousands, except per share data)	**1998**	Years ended December 31, 1997	1996	1995	1994
Statement of income data:					
Net sales	**$206,838**	$ 216,728	$165,059	$123,976	$84,959
Cost of sales	**111,778**	110,680	83,521	61,693	45,359
Gross profit	**95,060**	106,048	81,538	62,283	39,600
Costs and expenses	**68,527**	65,954	48,045	38,774	28,352
Merger and reorganization expenses	**7,500**[(1)]	2,250[(2)]	—	—	—
Write-off of purchased in-process technology	**—**	4,200	—	—	—
Legal fees and claims related to litigation	**—**	—	—	—	2,051
Operating income	**19,033**	33,644	33,493	23,509	9,197
Interest expense (income), net	**888**	7	(345)	179	2,901
Income before income taxes and extraordinary item	**18,145**	33,637	33,838	23,330	6,296
Income tax provision (benefit)	**5,444**	7,610	6,941	2,497	(584)
Income before extraordinary item	**12,701**	26,027	26,897	20,833	6,880
Extraordinary (loss), net of $355 tax benefit	**—**	—	—	—	(679)
Net income	**$ 12,701**	$ 26,027	$ 26,897	$ 20,833	$ 6,201
Earnings per share:					
Income before extraordinary item per common share	**$ .87**	$ 1.81	$ 1.89	$ 1.52	$ .65
Extraordinary (loss) per common share	**—**	—	—	—	(.06)
Net income per common share	**$ .87**	$ 1.81	$ 1.89	$ 1.52	$ .59
Diluted income before extraordinary item per common share	**$ .85**	$ 1.75	$ 1.86	$ 1.48	$ .62
Diluted extraordinary (loss) per common share	**—**	—	—	—	(.06)
Diluted net income per common share	**$ .85**	$ 1.75	$ 1.86	$ 1.48	$ .56
Pro Forma Presentation:[(3)]					
Income before income taxes and extraordinary item	**$ 18,145**	$ 33,637	$ 33,838	$ 23,330	$ 6,296
Pro forma income tax provision	**6,898**	12,817	12,963	7,054	1,926
Pro forma income before extraordinary item	**11,247**	20,820	20,875	16,276	4,370
Extraordinary (loss), net of $355 tax benefit	**—**	—	—	—	(679)
Pro forma net income	**$ 11,247**	$ 20,820	$ 20,875	$ 16,276	$ 3,691
Pro forma net income per common share	**$ .77**	$ 1.45	$ 1.46	$ 1.18	$ .35
Pro forma diluted net income per common share	**$ .76**	$ 1.40	$ 1.44	$ 1.16	$ .33
Weighted average shares outstanding	**14,627**	14,392	14,251	13,750	10,579
Diluted weighted average shares outstanding	**14,887**	14,908	14,490	14,068	11,056

	1998	As of December 31, 1997	1996	1995	1994
Balance Sheet Data:					
Cash and cash equivalents	**$ 23,492**	$ 20,444	$ 26,322	$ 20,862	$ 5,610
Working capital	**85,526**	68,778	61,994	49,324	25,543
Excess of cost over net assets acquired, net	**4,187**	4,318	4,448	4,579	4,710
Total assets	**172,837**	159,631	113,339	93,248	62,643
Long-term debt (including current installments)	**17,147**	17,356	10,669	10,766	2,839
Shareholders' equity	**113,224**	93,758	71,569	58,448	40,910

(1) Merger expenses related to the Digital merger were comprised of transaction fees and expenses of $3.3 million and a $1.6 million non-cash compensation charge related to stock issued in accordance with a pre-existing agreement with a key Digital employee. Reorganization expenses consisted of $.5 million for termination benefit costs, $.7 million for an estimated loss on a future sublease of an abandoned office and manufacturing facility, $.9 million for write-down of long-lived assets held for sale or disposal, and $.5 million for other costs. See Note 2 to the Consolidated Financial Statements.

(2) During 1997, the Company recorded a $2.3 million charge for merger related fees consisting of investment banking, legal and other transaction costs in connection with the merger with Wyko.

(3) Pro forma net income and pro forma earnings per share present income taxes as if Digital, which was merged with the Company in May 1998 in a transaction accounted for as a pooling of interests, had been a "C" corporation for all periods presented and, therefore, subject to federal income taxes at the corporation level. Prior to the merger, Digital had elected "S" corporation status for income tax purposes and, therefore, was not subject to federal income taxes.

(In thousands, except per share data)	**1998**	1997	1996	1995	1994
		Years ended December 31,			
Statement of income data:					
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	1998	1997	1996	1995	1994
		As of December 31,			
Balance Sheet Data:					
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Quarterly Results of Operations

The following table presents selected financial data for each quarter of fiscal 1998 and 1997. This information is unaudited, has been prepared on a basis consistent with the Company's audited financial statements and, in the opinion of the Company's management, reflects all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of this information in accordance with generally accepted accounting principles. Such quarterly results are not necessarily indicative of future results of operations and should be read in conjunction with the audited financial statements of the Company and the notes thereto.

Quarterly Statements of Income

	Fiscal 1998					Fiscal 1997				
(In thousands, except for per share data):	**Q1***	**Q2**	**Q3**	**Q4**	**Year**	Q1*	Q2	Q3	Q4	Year
Net sales	**$53,659**	**$51,147**	**$50,539**	**$51,493**	**$206,838**	$49,210	$54,547	$55,195	$57,776	$216,728
Cost of sales	**29,518**	**27,048**	**27,317**	**27,895**	**111,778**	25,216	27,379	28,234	29,851	110,680
Gross profit	**24,141**	**24,099**	**23,222**	**23,598**	**95,060**	23,994	27,168	26,961	27,925	106,048
Cost and expenses	**16,502**	**18,165**	**16,882**	**16,978**	**68,527**	14,081	15,865	16,028	19,980	65,954
Merger and reorganization expenses	**—**	**7,500**	**—**	**—**	**7,500**	—	—	2,250	—	2,250
Write-off of purchased in-process technology	**—**	**—**	**—**	**—**	**—**	—	4,200	—	—	4,200
Operating income (loss)	**7,639**	**(1,566)**	**6,340**	**6,620**	**19,033**	9,913	7,103	8,683	7,945	33,644
Interest expense (income)	**198**	**267**	**283**	**140**	**888**	55	75	(209)	86	7
Income (loss) before income taxes	**7,441**	**(1,833)**	**6,057**	**6,480**	**18,145**	9,858	7,028	8,892	7,859	33,637
Income tax provision (benefit)	**1,733**	**(51)**	**1,817**	**1,945**	**5,444**	2,557	1,363	2,007	1,683	7,610
Net income (loss)	**$ 5,708**	**$ (1,782)**	**$ 4,240**	**$ 4,535**	**$ 12,701**	$ 7,301	$ 5,665	$ 6,885	$ 6,176	$ 26,027
Net income (loss) per common share	**$ .39**	**$ (0.12)**	**$ .29**	**$ .31**	**$ .87**	$ .51	$ .39	$ .48	$ .43	$ 1.81
Diluted net income (loss) per common share	**$ .39**	**$ (0.12)**	**$ .29**	**$ .30**	**$ .85**	$ .50	$ .38	$ .46	$ .41	$ 1.75
Pro Forma Presentation:										
Income (loss) before income taxes	**$ 7,441**	**$ (1,833)**	**$ 6,057**	**$ 6,480**	**$ 18,145**	$ 9,858	$ 7,028	$ 8,892	$ 7,859	$ 33,637
Pro forma income tax provision (benefit)	**2,836**	**(678)**	**2,241**	**2,499**	**6,898**	3,792	2,709	3,350	2,966	12,817
Pro forma net income (loss)	**$ 4,605**	**$ (1,155)**	**$ 3,816**	**$ 3,981**	**$ 11,247**	$ 6,066	$ 4,319	$ 5,542	$ 4,893	$ 20,820
Pro forma net income (loss) per common share	**$ .32**	**$ (.08)**	**$ .26**	**$ .27**	**$ .77**	$ .42	$ .30	$ .38	$ .34	$ 1.45
Pro forma diluted net income (loss) per common share	**$ .31**	**$ (.08)**	**$ .26**	**$ .26**	**$ .76**	$ .41	$ .29	$ .37	$ .33	$ 1.40
Weighted average shares outstanding	**14,510**	**14,566**	**14,654**	**14,774**	**14,627**	14,308	14,352	14,432	14,458	14,392
Diluted weighted average shares outstanding	**14,733**	**14,827**	**14,860**	**15,125**	**14,887**	14,734	14,848	15,049	14,981	14,908

**Restated from previously filed Form 10-Q for the quarter ended March 31, 1998 due to the Digital merger.*

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

Overview

Veeco is a leader in the design, manufacture, marketing and servicing of a broad line of precision metrology and process equipment used to measure, test and manufacture microelectronic products for the data storage and semiconductor industries. Precision metrology equipment is primarily used to measure critical dimensions on thin film magnetic heads (TFMHs) and semiconductor devices. Process equipment is primarily used to etch and deposit materials in the manufacture of TFMHs.

During the last several years, Veeco has increasingly emphasized its metrology product line, which accounted for $126.2 million or 61.0% of its net sales for the year ended December 31, 1998. This emphasis was demonstrated by the mergers with Wyko in July 1997 and Digital in May 1998. These mergers resulted in a broadening of the metrology product line by adding the optical interferometry products manufactured by Wyko and atomic force/scanning probe microscopes manufactured by Digital to the stylus profiler products manufactured by Veeco. Veeco's net sales for 1998 included $102.5 million attributable to sales of Wyko and Digital products. Veeco's consolidated financial condition and results of operations have been retroactively restated to reflect Veeco's mergers with Wyko and Digital, which have been accounted for as poolings of interests.

Results of Operations

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

	Years ended December 31, **1998**	1997	1996
Net sales	**100.0%**	100.0%	100.0%
Cost of sales	**54.0**	51.1	50.6
Gross profit	**46.0**	48.9	49.4
Operating expenses:			
Research and development	**13.2**	11.3	10.7
Selling, general and administrative	**20.3**	19.2	18.0
Other—net	**(.3)**	—	0.4
Merger and reorganization expenses	**3.6**	1.0	—
Write-off of purchased in-process technology	**—**	1.9	—
Total operating expenses	**36.8**	33.4	29.1
Operating income	**9.2**	15.5	20.3
Interest expense (income), net	**0.4**	0.0	(0.2)
Income before income taxes	**8.8**	15.5	20.5
Income tax provision	**2.7**	3.5	4.2
Net income	**6.1%**	12.0%	16.3%

Years Ended December 31, 1998 and 1997

Net sales were $206.8 million for the year ended December 31, 1998, representing a decrease of $9.9 million or 4.6%, when compared to the year ended December 31, 1997. The decrease in sales reflects a 27.9% decrease in process equipment sales partially offset by an 11.9% increase in metrology sales. Sales in the U.S., Europe, Japan and Asia Pacific, respectively, accounted for 48.8%, 19.0%, 16.8% and 10.4%, respectively, of the Company's net sales for the year ended December 31, 1998. Sales in the U.S. decreased approximately 18.2%, while international sales included a 79.3% increase in Europe, a 16.8% increase in Japan and a 43.8% decrease in Asia Pacific from the comparable 1997 period. The decrease in U.S. sales principally reflects reduced process equipment sales to data storage customers. The increase in sales in Europe and in Japan principally reflects increased process equipment sales to data storage customers along with increased metrology sales for data storage and semiconductor applications. The decrease in sales in Asia Pacific principally reflects a decrease in sales of all product lines resulting from the economic downturn in that region. The Company believes that there will continue to be quarter to quarter variations in the geographic concentration of sales.

Metrology sales of $126.2 million for the year ended December 31, 1998 increased by $13.4 million or 11.9% over the comparable 1997 period principally reflecting increased purchases of metrology products for in-line inspection of critical steps in data storage applications. Process equipment sales of $60.9 million for the year ended December 31, 1998, decreased by $23.6 million or 27.9% from the comparable 1997 period, as sales of ion beam etch products declined, partially offset by increased sales of new deposition products associated with the transition to magnetoresistive (MR) and giant magnetoresistive (GMR) thin film magnetic heads (TFMHs). Ion beam etch sales continue to be negatively affected by excess capacity in the data storage industry. Industrial measurement sales for the year ended December 31, 1998, of $19.7 million increased 1.5% over the comparable 1997 period.

Veeco received $221.4 million of orders for the year ended December 31, 1998, representing a 1.3% increase from $218.6 million of orders in the comparable 1997 period. Metrology orders increased 12.4% to $131.4 million reflecting increased purchases of in-line metrology products for production applications such as PTR (pole tip recession) measurements for new MR and GMR TFMHs. Process equipment orders decreased 7.3% to $71.7 million as a result of a reduction in orders of ion beam etch products, reflecting weak data storage market conditions, including industry-wide overcapacity. Industrial measurement orders decreased 25.1% to $18.3 million as a result of a reduction in orders of industrial leak detection equipment. The book-to-bill ratio for the year ended December 31, 1998 was 1.07 to 1.

Gross profit for the year ended December 31, 1998 of $95.1 million represents a decrease of $11.0 million from the comparable 1997 period. Gross profit as a percentage of net sales decreased to 46.0% for 1998 from 48.9% for 1997, principally due to a decrease in gross margin for the process equipment product line. This decline resulted from lower sales volume, increased field support, warranty, facility and information system costs and the increase in sales of new deposition products with lower initial gross margins than established ion beam etch products. The metrology product line experienced higher field service and warranty costs as it expanded sales of production related inspection tools to data storage customers at a variety of international locations.

Research and development expense for the year ended December 31, 1998 of $27.4 million increased by $2.9 million or 11.9% over the comparable period of 1997, as the Company continues to invest in new product development in each of its product lines with particular emphasis on in-line inspection tools in the metrology product line and deposition tools for its process equipment line.

Selling, general and administrative expenses of $42.0 million for the year ended December 31, 1998 remained relatively flat when compared to 1997.

As described in Note 2 to the Company's Consolidated Financial Statements, for the year ended December 31, 1998, the Company recorded a $7.5 million pre-tax charge for merger and reorganization expenses principally related to the merger with Digital during such period. During the year ended December 31, 1997, the Company recorded a $4.2 million write-off for the fair values of acquired in-process engineering and development projects that had not reached technological feasibility and have no future alternative uses and a $2.3 million charge related to the merger with Wyko.

Income taxes for the year ended December 31, 1998 amounted to $5.4 million or 30% of income before income taxes as compared to $7.6 million or 23% of income before income taxes for the same period of 1997. These effective tax rates reflect Digital's "S" Corporation status for five months in 1998 (through the merger date) compared to a full year in 1997. As an "S" Corporation, Digital was not subject to federal income taxes at the corporation level.

Years Ended December 31, 1997 and 1996

Net sales were $216.7 million for the year ended December 31, 1997 representing an increase of approximately $51.7 million or 31.3%, when compared to the year ended December 31, 1996. The increase reflects growth in Veeco's process equipment and metrology product lines. Sales in the U.S. increased approximately 54.2%, while international sales included a 27.3% increase in Asia Pacific, a 5.2% increase in Europe and a 4.5% decrease in Japan.

Sales of metrology products increased by 22.5% to approximately $112.8 million in 1997 compared to 1996 principally as a result of increased sales of Wyko optical interferometers, Dektak stylus profilers and scatterometers, atomic force microscopes and Digital SPM systems. Sales of Wyko optical interferometers increased by 81%, reflecting increased acceptance by the semiconductor industry of non-contact optical measurement for advanced packaging. Sales of Dektak stylus profilers and scatterometers increased by 21% reflecting acceptance of new product introductions in the data storage and semiconductor industries. Atomic force microscope sales increased 15% reflecting increased demand for advanced semiconductor applications. NanoScope® Dimension SPM systems sales increased by approximately 16%, partially offset by a decrease in sales of Digital's other product groups. Sales of process equipment increased by 59% to approximately $84.5 million in 1997 compared to 1996, driven principally by increased demand from the data storage industry for equipment used in the production of MR and GMR heads for high density hard drives. Of this increase, approximately 39% was due to growth in volume, with the balance of the increase due to a shift in customer demand to multi-process modules with increased automation which resulted in an approximately 47% higher average selling price of a system. Sales of industrial measurement products were approximately $19.4 million in 1997, which remained relatively flat when compared to 1996.

Veeco received approximately $218.6 million of orders in 1997 compared to approximately $186.1 million in 1996, reflecting both the increased demand for high density hard drives and the continued industry transition to the next generation MR thin film magnetic heads as well as increased semiconductor industry investment in advanced products. The book-to-bill ratio was 1.01 to 1 for the year ended December 31, 1997.

Gross profit increased to approximately $106.0 million, or 48.9% of net sales for 1997, compared to $81.5 million or 49.4% of net sales for 1996. This decrease in gross margin is principally attributable to a decrease in gross margin in Digital's scanning probe/atomic force microscopes from 57.4% in 1996 to 56.2% in 1997.

Research and development expense increased by approximately $6.8 million to approximately $24.5 million, or 11.3% of net sales in 1997 compared to approximately $17.7 million or 10.7% of sales in 1996, due to increased R&D investment in process equipment and metrology. Increased R&D investment was made in process equipment in physical vapor deposition (PVD) and in ion beam deposition. In metrology, increased investments were made in Wyko optical interferometer products for both data storage and semiconductor market products along with investments in Dektak stylus profilers for the semiconductor, data storage and flat panel display markets and investments in Digital products for integrated circuit and data storage applications.

Selling, general and administrative expenses increased by approximately $11.9 million to 19.2% of net sales in 1997 from 18.0% for 1996. Selling expense increased $9.0 million, principally due to higher sales commissions resulting from higher sales volume, increased compensation and travel expense as a result of additional sales and service personnel required to support Veeco's growth and an increase in advertising and marketing to support new products.

Operating expenses in 1997 include merger costs incurred in connection with the merger with Wyko Corporation of approximately $2.3 million, consisting of investment banking, legal and other transaction costs. Operating expenses in 1997 also include the effect of a $4.2 million charge representing the write-off of the fair values of in-process engineering and development projects that had not reached technological feasibility and have no future alternative uses.

Income taxes amounted to $7.6 million or 22.6% of income before income taxes for 1997 as compared to $6.9 million or 20.5% of income before income taxes for 1996. The principal reason for the low effective tax rate when compared to the statutory income tax rate is due to Digital's "S" Corporation status. As an "S" Corporation, Digital was not subject to federal income taxes at the corporation level.

Liquidity and Capital Resources

Net cash provided by operations totaled $10.8 million in 1998 compared to $18.1 million in 1997 and $23.4 million in 1996. Cash provided by operations in 1998 resulted from (i) net income plus non-cash charges for depreciation and amortization, and certain merger and reorganization charges of $20.9 million plus (ii) increases of accrued expenses and other current liabilities, and other net operating assets and liabilities of $1.8 million and $1.1 million, respectively, and a decrease in accounts receivable of $2.7 million. These items were partially offset by an increase in inventories and a provision for deferred income taxes of $8.8 million and $1.1 million, respectively, as well as a decrease in accounts payable of $5.8 million. The increase in inventories is attributable to an increase in inventory at the Company's domestic manufacturing and international sales locations to support new product introductions. Cash from operations in 1997 resulted from (i) net income plus non-cash charges for depreciation and amortization and the write-off of purchased in-process technology of $32.4 million plus (ii) increases of accounts payable, accrued expenses and other current liabilities, and other net operating assets and liabilities of $8.7 million, $4.5 million and $.6 million, respectively. These items were partially offset by increases in accounts receivable, inventories and a provision for deferred income taxes of $12.8 million, $13.6 million and $1.7 million, respectively. The increases in accounts receivable, inventories, accounts payable and accrued expenses are attributable to the increased 1997 sales volume. Cash from operations in 1996 resulted from (i) net income plus non-cash charges for depreciation and amortization of $28.9 million plus (ii) increases of accounts payable, accrued expenses and other current liabilities, and other net operating assets and liabilities of $2.9 million, $4.1 million and $1.2 million, respectively. These items were partially offset by increases in accounts receivable, inventories and deferred income taxes of $4.2 million, $8.7 million and $0.9 million, respectively. The increases in accounts receivable, inventories, accounts payable and accrued expenses are attributable to the increased 1996 sales volume.

Net cash used in investing activities in 1998 totaled $8.1 million compared to $25.4 million in 1997 and $4.1 million in 1996. Veeco made capital expenditures of $8.1 million in 1998, compared to $21.0 million in the comparable 1997 period. Capital expenditures in 1998 were principally for engineering and application lab equipment. Cash used for investing activities in 1997 primarily related to the PVD acquisition ($4.4 million) and capital expenditures ($21.0 million). Capital expenditures in 1997 included the purchase of a 100,000 square foot building in California for $9.7 million for the Company's metrology business, as well as for manufacturing facilities, laboratory and test equipment and business system upgrades. Cash used in investing activities in 1996 was for capital expenditures.

Net cash provided by financing activities totaled $1.4 million in 1998 compared to $1.6 million in 1997 and a use of cash of $14.0 million in 1996. The generation of cash in 1998 resulted from proceeds from stock issuances partially offset by distributions to former Digital shareholders of $2.0 million. The generation of cash in 1997 resulted from proceeds from the sale of Common Stock and proceeds from long-term debt offset by distributions to former Digital shareholders of $10.0 million. Cash used in 1996 principally resulted from distributions of $14.0 million to former Digital shareholders.

On February 2, 1999, the Company completed a public offering, pursuant to which 1,000,000 shares of Common Stock, par value $.01 per share, were issued and sold for $52.00 per share, less underwriting discounts and commissions of $2.34 per share. The Company expects to use the net proceeds of the offering (approximately $49.0 million) for capital expenditures including clean manufacturing areas and expanded customer application laboratories and for working capital and general corporate purposes, including potential acquisitions.

The Company has an unsecured $40.0 million Credit Facility (the "Credit Facility") which may be used for working capital, acquisitions and general corporate purposes. The Credit Facility bears interest at the prime rate of the lending banks, but is adjustable to a maximum rate of ¼% above the prime rate in the event the Company's ratio of debt to cash flow exceeds a defined ratio. A LIBOR-based interest rate option is also provided. As of December 31, 1998 there were no amounts outstanding under the Credit Facility.

The Company will be required to repay promissory notes owed to former stockholders of Digital in the aggregate principal amount of $8,000,000 when they become due in March 2000. The notes bear interest at an annual rate of 7.21%.

The Company believes that existing cash balances together with cash generated from operations and amounts available under the Credit Facility will be sufficient to meet the Company's projected working capital and other cash flow requirements through 1999.

Year 2000

The Year 2000 Issue is the result of computer programs using two digits rather than four to define the applicable year. Any of the Company's computer programs or hardware or other equipment that have date-sensitive software or embedded chips may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

Based on recent assessments, the Company has determined that it needs to modify or replace portions of its business systems' software and certain hardware so that those systems will properly utilize dates beyond December 31, 1999. The Company presently believes that with modifications or replacements of its business systems, existing software and certain hardware, the Company's computer programs should be able to continue to operate effectively after December 31, 1999. However, if such modifications and replacements are not made, or are not completed in a timely manner, the Year 2000 Issue could have a material impact on the operations of the Company. Furthermore, in addition to its own systems, the Company relies directly and indirectly on external systems of its customers, suppliers, creditors, financial organizations, utilities providers and governmental agencies (collectively, "Third Parties").

The Company is utilizing both internal and external resources to resolve the Year 2000 Issue following a phased approach which is comprised of inventory and assessment, planning and renovation, testing and implementation. The following describes the Company's efforts to identify and address its and applicable Third Party Year 2000 Issues with respect to a) the Company's information technology (IT) and non-IT systems, including facilities and infrastructure, b) the Company's products and c) the Company's suppliers:

a) The Company's IT and non-IT systems including facilities and infrastructure:

In 1997, the Company completed the installation of a new business system for its process equipment and industrial product lines which has been certified by the vendor as Year 2000 compliant. The Company recently completed its assessment and testing of its business systems for its metrology business lines. Based upon such assessment and testing, along with installing vendor upgrades and relying upon compliance statements received from its software and hardware vendors, the Company believes its metrology business systems will properly utilize dates beyond December 31, 1999. Furthermore, the Company is in the process of installing a new business system for its sales and service offices in Europe that the vendor has certified is Year 2000 compliant.

The Company recently completed its inventory and assessment of its desktop systems and laptops. The Company currently uses standard "off the shelf" vendor-supplied software on its desktop systems and laptops. Based upon this assessment, the Company is not aware of any business critical remediation that is required and believes that its business critical desktop systems and laptops will properly utilize dates beyond December 31, 1999.

The Company is in the process of assessing its Year 2000 risk with respect to telephone and communications systems, utility systems and building security systems. Formal inquiries were sent to Third Parties in December 1998 inquiring as to such Third Parties' Year 2000 readiness. The Company anticipates completing its assessment before June 30,1999.

b) The Company's products:

The Company has recently completed its inventory and assessment of its products' Year 2000 readiness utilizing testing guidelines prepared by Sematech, a consortium of suppliers to worldwide semiconductor manufacturers. The Company plans to comply with Sematech's guidelines for Year 2000 compliance for its metrology and process equipment lines. The Company's new products are designed to be Year 2000 ready; however, some of the Company's older products will require upgrades for Year 2000 readiness. The Company intends to provide upgrades for certain of such products, some of which will be provided to customers without charge. Notwithstanding such efforts, any failure of the Company's products to perform, including system malfunctions due to the onset of Year 2000, could result in claims against the Company which could have a material adverse effect on the Company's business, results of operations or financial condition. In such event, the Company's customers could choose to convert to other Year 2000 ready products in order to avoid such malfunctions, which could have a material adverse effect on the Company's business, financial condition or results of operations.

c) The Company's suppliers:

The Company is in the process of assessing its significant suppliers and subcontractors regarding the status of their Year 2000 readiness. To date, the Company is not aware of any Year 2000 issue that would materially impact the Company's business, financial condition or results of operations. However, the Company has no means of ensuring that suppliers or subcontractors will be Year 2000 ready. The inability of suppliers or subcontractors to complete their Year 2000 resolution process in a timely fashion could materially impact the Company. The Company is unable to determine the effect of non-compliance by suppliers or subcontractors.

The Company will utilize both internal and external resources to reprogram or replace, test, and implement the software and operating equipment for Year 2000 modifications. The total cost of the Year 2000 project is estimated at $400,000 to $750,000 and is being funded through operating cash flows. To date, the Company has incurred approximately $250,000 of which $100,000 has been expensed and $150,000 has been capitalized, related to all phases of the Year 2000 project. Of the total remaining project costs, approximately $250,000 to $400,000 is attributable to the purchase of new software and operating equipment which will be capitalized. The remaining $50,000 to $250,000 relates to repair of hardware and software and external consultant costs and will be expensed as incurred.

Management of the Company believes it has an effective program in place to resolve the Year 2000 Issue in a timely manner. As noted above, the Company has not yet completed all necessary phases of the Year 2000 program. In the event the Company does not successfully complete any additional phases, the Company's ability to do business with its suppliers and customers may be disrupted. In addition, there can be no assurance that the systems of Third Parties with which the Company interacts will not suffer from Year 2000 problems, or that such problems would not have a material adverse effect on the Company's business, financial condition or results of operations. In particular, Year 2000 problems that have been or may in the future be identified with respect to the IT and Non-IT systems of Third Parties having widespread national and international interactions with persons and entities generally (for example, certain IT and Non-IT systems of governmental agencies, utilities and information and financial networks) could have a material adverse impact on the Company's financial condition or results of operations.

The Company does not currently have any contingency plans and has not yet determined its most reasonably likely worst case scenario with respect to the Year 2000 Issue. The Company currently is in the process of reviewing its Year 2000 compliance plans to determine what contingency plans, if any, are appropriate. There can be no assurance that such measures will prevent the occurrence of Year 2000 problems, which could have a material adverse effect upon the Company's business, results of operations or financial condition.

Risk Factors That May Impact Future Results

Certain information provided by the Company, statements made by its employees or information included in its filings with the Securities and Exchange Commission may contain statements which are "forward-looking statements" which involve risks and uncertainties. The following risk factors should be considered by shareholders of and by potential investors in the Company.

Dependence on Microelectronics Industry; Cyclicality of Data Storage and Semiconductor Industries. Veeco's business depends in large part upon the capital expenditures of data storage and semiconductor manufacturers which accounted for the following percentages of the Company's net sales for the periods indicated:

	Year ended December 31,		
	1998	1997	1996
Data Storage	**54.9%**	53.2%	45.5%
Semiconductor	**19.5%**	19.8%	23.0%

The data storage and semiconductor industries have been characterized by cyclicality. These industries have experienced significant economic downturns at various times in the last decade, characterized by diminished product demand, accelerated erosion of average selling prices and production overcapacity. Recently, the data storage and semiconductor industries have experienced inventory oversupply and poor operating results and, as a result, Veeco's sales to data storage and semiconductor customers were weaker in 1998 than in 1997.

Fluctuations in Quarterly Operating Results. Veeco's quarterly results have fluctuated significantly in the past and we expect this trend to continue. Factors which affect quarterly results include:

- specific economic conditions in the data storage and semiconductor industries
- the timing of significant orders
- shipment delays
- specific feature requests by customers
- the introduction of new products by Veeco and its competitors
- production and quality problems
- changes in the cost of materials
- disruption in sources of supply
- seasonal patterns of capital spending by customers
- a downturn in the market for personal computers or other products incorporating data storage technology and semiconductors
- market acceptance of Veeco's systems and Veeco's customers' products

Many of these factors are beyond Veeco's control. If Veeco's net sales levels in a particular quarter do not meet expectations, Veeco's operating results will be adversely affected, which may have an adverse impact on the Company's Common Stock price.

Rapid Technological Change; Importance of Timely Product Introduction. The data storage and semiconductor manufacturing industries are subject to rapid technological change and new product introductions and enhancements. Veeco's ability to remain competitive will depend in part upon the Company's ability to develop in a timely and cost effective manner new and enhanced systems at competitive prices and to accurately predict technology transitions. In addition, new product introductions or enhancements by Veeco's competitors could cause a decline in sales or loss of market acceptance of Veeco's existing products. Increased competitive pressure could also lead to intensified price competition resulting in lower margins, which could materially and adversely affect the Company's business, financial condition and results of operations. The Company's success in developing, introducing and selling new and enhanced systems depends upon a variety of factors, including:

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

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

Limited Sales Backlog. Veeco's backlog at the beginning of a quarter typically does not include all sales required to achieve Veeco's sales objective for that quarter. Moreover, all customer purchase orders are subject to cancellation or rescheduling by the customer, generally with limited or no penalties. Therefore, backlog at any particular date is not necessarily representative of actual sales for any succeeding period. The Company's net sales and operating results for a quarter may depend upon orders obtained for systems to be shipped in the same quarter that the order is received. In addition, Veeco derives a substantial portion of its net sales in any fiscal period from the sale of a relatively small number of high-priced systems. As a result, the timing of recognition of revenue for a single transaction could have a material adverse effect on Veeco's sales and operating results. Veeco's business and financial results for a particular period could be materially and adversely affected if an anticipated order for even one system is not received in time to permit shipping during the period.

Highly Competitive Industry. The data storage and semiconductor capital equipment industries are intensely competitive. Established companies, both domestic and foreign, compete with each of Veeco's product lines. Many of Veeco's competitors have greater financial, engineering, manufacturing and marketing resources than the Company. A substantial investment is required by customers to install and integrate capital equipment into a production line. As a result, once a manufacturer has selected a particular vendor's capital equipment, Veeco believes that the manufacturer generally relies upon that equipment for the specific production line application and frequently will attempt to consolidate its other capital equipment requirements with the same vendor. Accordingly, if a particular customer selects a competitor's capital equipment, the Company expects to experience difficulty in selling to that customer for a significant period of time. The Company believes that Veeco's ability to compete successfully depends on a number of factors both within and outside of Veeco's control, including:

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

Veeco cannot be certain that it will be able to compete successfully in the future.

Dependence on Principal Customers; Industry Concentration. Veeco relies on Veeco's principal customers for a significant portion of Veeco's sales. Veeco's principal customers include International Business Machines Corporation ("IBM"), Seagate Technology, Inc. ("Seagate") and Read-Rite Corp. ("Read-Rite"). The following table sets forth the percentage of Veeco's net sales to such principal customers for the periods indicated:

	Year Ended December 31,		
	1998	1997	1996
IBM	**17.4%**	5.9%	4.1%
Seagate	**10.6%**	13.9%	10.5%
Read-Rite	**7.1%**	11.0%	10.6%
Next five top customers	**10.9%**	11.8%	7.8%

If the Company lost a major customer, or a significant portion of Veeco's sales to any major customer, it could adversely affect Veeco's results of operations. Veeco's ability to increase sales in the future will depend in part upon Veeco's ability to obtain orders from new customers. The Company cannot be certain that it will be able to do so. In addition, a relatively small number of large manufacturers, many of whom are Veeco's customers, dominate the data storage industry and, to a lesser extent, the semiconductor industry. If any of these large manufacturers discontinues its relationship with Veeco or suffers economic setbacks, Veeco's results of operations could be materially and adversely affected.

Quantitative and Qualitative Disclosure about Market Risk

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

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

Interest Rates. Veeco centrally manages its debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. Veeco's investment portfolios consist of cash equivalents; accordingly, the carrying amounts approximate market value. It is the Company's practice to hold these investments to maturity. Assuming year-end 1998 variable debt and investment levels, a one-point change in interest rates would not have a material impact on net interest expense.

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

Veeco's net sales to foreign customers represented approximately 51.2% of Veeco's total net sales in 1998, 43.2% in 1997 and 51.7% in 1996. The Company expects 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 12.9% of Veeco's total net sales in 1998, 6.3% in 1997 and 7.3% in 1996. The Company generally has not engaged in foreign currency hedging transactions. The aggregate foreign exchange gains and (losses) included in determining consolidated results of operations were $774,000, $(34,000), and $(153,000) in 1998,1997, and 1996, respectively.

Changes in currency exchange rates that would have been the largest impact on translating Veeco's international operating profit include the German mark and Japanese yen. The Company estimates that a 10% change in foreign exchange rates would impact reported operating profit by less than $2.5 million. The Company believes that this quantitative measure has inherent limitations because, as discussed in the first paragraph of this section, it does not take into account any governmental actions or changes in either customer purchasing patterns or our financing and operating strategies.

Veeco Instruments Inc. and Subsidiaries

(Dollars in thousands)	December 31, 1998	1997
Assets		
Current assets:		
Cash and cash equivalents	**$ 23,492**	$ 20,444
Accounts receivable, less allowance for doubtful accounts of $1,725 in 1998 and $1,005 in 1997	**43,018**	44,927
Inventories	**53,324**	44,825
Prepaid expenses and other current assets	**1,388**	1,695
Deferred income taxes	**5,910**	4,602
Total current assets	**127,132**	116,493
Property, plant and equipment at cost, net	**37,204**	33,344
Excess of cost over net assets acquired, less accumulated amortization of $1,171 in 1998 and $1,040 in 1997	**4,187**	4,318
Other assets, net	**4,314**	5,476
Total assets	**$172,837**	$159,631
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	**$ 15,624**	$ 21,360
Accrued expenses	**24,549**	22,146
Income taxes payable	**1,226**	3,999
Current portion of long-term debt	**207**	210
Total current liabilities	**41,606**	47,715
Deferred income taxes	**925**	702
Long-term debt	**8,940**	9,146
Notes payable to former Digital shareholders	**8,000**	8,000
Other liabilities	**142**	310
Shareholders' equity:		
Preferred stock, 500,000 shares authorized; no shares issued and outstanding	**—**	—
Common stock, 25,000,000 shares authorized; 14,841,030 and 14,475,719 shares issued and outstanding in 1998 and 1997, respectively	**148**	145
Additional paid-in capital	**62,810**	54,474
Retained earnings	**49,806**	39,105
Cumulative translation adjustment	**460**	34
Total shareholders' equity	**113,224**	93,758
Total liabilities and shareholders' equity	**$172,837**	$159,631

See accompanying notes.

Consolidated Statements of Income

Veeco Instruments Inc. and Subsidiaries

(In thousands, except per share data)	**1998**	1997	1996
	Year ended December 31,		
Net sales	**$206,838**	$216,728	$165,059
Cost of sales	**111,778**	110,680	83,521
Gross profit	**95,060**	106,048	81,538
Costs and expenses:			
Research and development expense	**27,374**	24,470	17,702
Selling, general and administrative expense	**41,951**	41,591	29,712
Other—net	**(798)**	(107)	631
Merger and reorganization expenses	**7,500**	2,250	—
Write-off of purchased in-process technology	**—**	4,200	—
	76,027	72,404	48,045
Operating income	**19,033**	33,644	33,493
Interest expense (income), net	**888**	7	(345)
Income before income taxes	**18,145**	33,637	33,838
Income tax provision	**5,444**	7,610	6,941
Net income	**$ 12,701**	$ 26,027	$ 26,897
Earnings per share:			
Net income per common share	**$ .87**	$ 1.81	$ 1.89
Diluted net income per common share	**$ .85**	$ 1.75	$ 1.86
Pro forma income tax presentation:			
Income before income taxes	**$ 18,145**	$ 33,637	$ 33,838
Pro forma income tax provision	**6,898**	12,817	12,963
Pro forma net income	**$ 11,247**	$ 20,820	$ 20,875
Pro forma earnings per share:			
Pro forma net income per common share	**$ .77**	$ 1.45	$ 1.46
Pro forma diluted net income per common share	**$ .76**	$ 1.40	$ 1.44
Weighted average shares outstanding	**14,627**	14,392	14,251
Diluted weighted average shares outstanding	**14,887**	14,908	14,490

See accompanying notes.

Consolidated Statements of Shareholders' Equity

Veeco Instruments Inc. and Subsidiaries

(Dollars in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Cumulative Translation Adjustment	Total	Comprehensive Income
Balance at December 31, 1995	14,234,749	$ 143	$ 47,398	$ 10,181	$ 769	$ 58,491	
Exercise of stock options and stock issuances under stock purchase plan	48,807	—	285	—	—	285	
Translation adjustment	—	—	—	—	(104)	(104)	$ (104)
Net income	—	—	—	26,897	—	26,897	26,897
Distributions to former shareholders of Digital	—	—	—	(14,000)	—	(14,000)	
Balance at December 31, 1996	14,283,556	143	47,683	23,078	665	71,569	$ 26,793
Exercise of stock options and stock issuances under stock purchase plan	192,163	2	2,068	—	—	2,070	
Translation adjustment	—	—	—	—	(631)	(631)	$(631)
Stock option income tax benefit	—	—	1,790	—	—	1,790	
Sale of stock			2,933			2,933	
Net income	—	—	—	26,027	—	26,027	26,027
Distributions to former shareholders of Digital	—	—	—	(10,000)	—	(10,000)	
Balance at December 31, 1997	14,475,719	145	54,474	39,105	34	93,758	$ 25,396
Exercise of stock options and stock issuances under stock purchase plan	**365,311**	**3**	**3,562**	**—**	**—**	**3,565**	
Translation adjustment	**—**	**—**	**—**	**—**	**426**	**426**	**$426**
Stock option income tax benefit	**—**	**—**	**3,189**	**—**	**—**	**3,189**	
Non-cash compensation charge	**—**	**—**	**1,585**	**—**	**—**	**1,585**	
Net income	**—**	**—**	**—**	**12,701**	**—**	**12,701**	**12,701**
Distributions to former shareholders of Digital	**—**	**—**	**—**	**(2,000)**	**—**	**(2,000)**	
Balance at December 31, 1998	**14,841,030**	**$148**	**$62,810**	**$49,806**	**$ 460**	**$113,224**	**$13,127**

See accompanying notes.

Veeco Instruments Inc. and Subsidiaries

(Dollars in thousands)	Year ended December 31, 1998	1997	1996
Operating activities			
Net income	**$12,701**	$ 26,027	$ 26,897
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**4,703**	2,215	2,041
Deferred income taxes	**(1,085)**	(1,709)	(895)
Non-cash merger and reorganization expenses	**3,544**	—	—
Write-off of purchased in-process technology	**—**	4,200	—
Changes in operating assets and liabilities:			
Accounts receivable	**2,695**	(12,805)	(4,205)
Inventories	**(8,836)**	(13,633)	(8,684)
Accounts payable	**(5,823)**	8,694	2,901
Accrued expenses and other current liabilities	**1,847**	4,483	4,086
Other, net	**1,073**	638	1,229
Net cash provided by operating activities	**10,819**	18,110	23,370
Investing activities			
Capital expenditures	**(8,138)**	(21,047)	(4,067)
Net assets of business acquired	**—**	(4,375)	—
Net cash used in investing activities	**(8,138)**	(25,422)	(4,067)
Financing activities			
Proceeds from stock issuance	**3,565**	5,003	285
Proceeds from long-term debt	**—**	6,800	—
Distributions to former shareholders of Digital	**(2,000)**	(10,000)	(14,000)
Other	**(209)**	(160)	(289)
Net cash provided by (used in) financing activities	**1,356**	1,643	(14,004)
Effect of exchange rate changes on cash and cash equivalents	**(989)**	(209)	161
Net increase (decrease) in cash and cash equivalents	**3,048**	(5,878)	5,460
Cash and cash equivalents at beginning of year	**20,444**	26,322	20,862
Cash and cash equivalents at end of year	**$23,492**	$ 20,444	$ 26,322

See accompanying notes.

Veeco Instruments Inc. and Subsidiaries

1. Significant Accounting Policies

Business
Veeco Instruments Inc. ("Veeco" or the "Company") designs, manufactures, markets and services a broad line of precision metrology and process equipment used to measure, test and manufacture microelectronic products for the data storage and semiconductor industries. Veeco's precision metrology equipment is primarily used to measure critical dimensions on thin film magnetic heads and semiconductor devices. The Company's process equipment is primarily used to etch and deposit materials in the manufacture of thin film magnetic heads. Veeco sells its products worldwide to many of the leading manufacturers in the data storage, semiconductor and other industries, as well as research and development centers and universities.

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

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

Revenue
Revenue is recognized when title passes to the customer, generally upon shipment. Service and maintenance contract revenues are recorded as deferred income, which is included in other accrued expenses, and recognized as income on a straight-line basis over the service period of the related contract. The Company provides for (1) the estimated costs of fulfilling its installation obligations and (2) warranty costs at the time the related revenue is recorded.

Cash Flows
The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Interest paid during 1998, 1997 and 1996 was approximately $1,415,000, $1,103,000 and $734,000, respectively. Income taxes paid in 1998, 1997 and 1996 was approximately $4,683,000, $5,370,000 and $6,706,000, respectively.

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

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

Intangible Assets
Excess of cost of investment over net assets acquired is being amortized on a straight-line basis over 40 years. Other intangible assets, included within other assets on the balance sheet, consists principally of purchased technology, patents, software licenses and deferred finance costs of $2,095,000 and $3,663,000, which are net of accumulated amortization of $1,423,000 and $1,501,000 at December 31, 1998 and 1997, respectively. Other intangible assets are amortized over periods ranging from 3 to 17 years.

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

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

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

Advertising and Promotional Expense
The cost of advertising is expensed as of the first showing. The Company incurred $3,988,000, $4,668,000 and $3,307,000 in advertising costs during 1998, 1997 and 1996, respectively.

Stock-Based Compensation

The Company accounts for its stock-based compensation plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and related Interpretations. Under APB 25, because the exercise price of the Company's employee stock options is set equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable and accrued expenses approximate fair value due to their short maturities.

The fair values of the Company's debt, including current maturities, are estimated using discounted cash flow analyses, based on the estimated current incremental borrowing rates for similar types of securities. The carrying amount of the Company's debt at December 31, 1998 and 1997 approximates fair value.

Earnings Per Share

Basic and diluted earnings per share is calculated in accordance with Statement of Financial Accounting Standards ("SFAS") No. 128, "Earnings per Share." All earnings per share amounts for all periods have been presented, and where appropriate, restated to conform to the requirements of SFAS No. 128.

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

(In thousands)	**1998**	1997	1996
Weighted average shares outstanding	**14,627**	14,392	14,251
Dilutive effect of stock options	**260**	516	239
Diluted weighted average shares outstanding	**14,887**	14,908	14,490

Reclassifications

Certain amounts in the 1997 and 1996 financial statements have been reclassified to conform with the 1998 presentation.

2. Business Combinations and Basis of Presentation

On May 29, 1998, Veeco merged with Digital Instruments, Inc. ("Digital"), a leader in scanning probe/atomic force microscopy (SPM/AFM). Under the merger, Digital shareholders received 5,583,725 shares of Veeco Common Stock. The merger was accounted for as a pooling of interests and, accordingly, historical financial data has been restated to include Digital data. Merger expenses were comprised of transaction fees and expenses of $3,300,000 and a $1,585,000 non-cash compensation charge related to stock issued in accordance with a pre-existing agreement with a key Digital employee. Reorganization expenses, principally related to the Digital Merger, consisted of $509,000 for severance costs, $750,000 for an estimated loss on a future sublease of an abandoned office and manufacturing facility, $887,000 for write-downs of long-lived assets held for sale or disposal and $469,000 for other costs. The Company implemented its reorganization plan in an effort to integrate Digital into the Company, consolidate manufacturing facilities, terminate its marketing and distribution agreements for a Metrology product which competed directly with Digital, and reduce other operating expenses. The severance costs covered 13 management and manufacturing employees located in Santa Barbara, California, and Plainview and Orangeburg, New York in the Metrology and Process Equipment segments, respectively. Termination benefits paid during 1998 approximated $300,000. The sublease loss covered an office and manufacturing facility in Santa Barbara, California. Charges associated with the sublease loss will be paid over the remaining life of the lease. The write-down of long-lived assets, to estimated net realizable value, related primarily to three SXM atomic force microscopes previously used for demonstration and testing purposes in Veeco's metrology segment.

The Company owns 50% of Digital Instruments GmbH, a German company, which exclusively distributed Digital's products in Germany and Eastern Europe through September 30, 1998. The Company accounts for its investment in Digital Instruments GmbH under the equity method of accounting. Prior to the merger, Digital had elected "S" Corporation status for income tax purposes and therefore was not subject to federal income taxes at the corporation level. As a result of the merger, Digital's "S" Corporation election was terminated. Pro forma net income and pro forma net income per share as shown in the accompanying Consolidated Statements of Income reflects income taxes for Digital as if it had been a "C" Corporation for all periods presented.

On July 25, 1997, a wholly-owned subsidiary of Veeco merged into Wyko Corporation ("Wyko") of Tucson, Arizona, a leading supplier of optical interferometric measurement systems for the data storage and semiconductor industries. Under the merger, Wyko shareholders received 2,863,810 shares of Veeco Common Stock and holders of options to acquire Wyko common stock received options to acquire an aggregate of 136,190 shares of Veeco Common Stock. The merger was accounted for as a pooling of interests transaction. Merger expenses of approximately $2,250,000 pertaining to investment banking, legal fees and other one-time transaction costs were charged to operating expenses during the year ended December 31, 1997.

The following table displays the revenues and net income of the separate companies for the periods preceding the business combinations and the amounts after the mergers through December 31, 1998:

	Year ended December 31, 1998	1997	1996
Revenues:			
Veeco (pre-mergers)	**$ 56,363**	$ 71,211	$ 96,832
Wyko	**—**	18,285	18,210
Digital	**22,667**	51,320	50,017
Veeco (post-mergers)	**127,808**	75,912	—
Combined	**$206,838**	$216,728	$165,059
Net income:			
Veeco (pre-mergers)	**$ 188**	$ 2,723	$ 8,038
Wyko	**—**	3,472	2,797
Digital	**4,242**	13,744	16,062
Veeco (post-mergers)	**8,271**	6,088	—
Combined	**$ 12,701**	$ 26,027	$ 26,897

On April 10, 1997, Veeco acquired from Materials Research Corporation, certain assets of the Physical Vapor Deposition data storage business for cash of $4,375,000 plus the assumption of certain liabilities. The acquisition was accounted for using the purchase method of accounting. Accordingly, the purchase price was allocated to the net assets acquired based on their estimated fair values as determined by an independent appraisal, including $4,200,000 allocated to in-process engineering and development projects. The associated projects had not reached technological feasibility and had no alternative future uses and thus the amounts allocated to such projects were expensed as of the date of acquisition.

3. Balance Sheet Information

(In thousands)	December 31, 1998	1997
Inventories:		
Raw materials	**$28,202**	$25,277
Work in process	**12,652**	8,528
Finished goods	**12,470**	11,020
	$53,324	$44,825

(In thousands)	December 31, 1998	1997	Estimated Useful Lives
Property, plant and equipment:			
Land	**$ 5,166**	$ 5,166	
Buildings and improvements	**18,382**	19,543	10–39 years
Machinery and equipment	**27,686**	19,708	3–7 years
Leasehold improvements	**1,831**	516	3–7 years
	53,065	44,933	
Less accumulated depreciation and amortization	**15,861**	11,589	
	$37,204	$33,344	

(In thousands)	December 31, 1998	1997
Accrued expenses:		
Litigation reserve	**$ 1,500**	$ 1,500
Payroll and related benefits	**5,090**	5,713
Taxes, other than income	**4,019**	1,996
Deferred service contract revenue	**738**	594
Customer deposits and advanced billings	**2,292**	2,262
Installation and warranty	**6,119**	4,638
Other	**4,791**	5,443
	$24,549	$22,146

4. Long-term Debt

The Company has an unsecured credit facility, as amended on January 31, 1999 (the “Credit Facility”), which may be used for working capital, acquisitions and general corporate purposes. The Credit Facility provides the Company with up to $40 million of availability. The Credit Facility’s interest rate is the prime rate of the lending banks, but is adjustable to a maximum rate of ¼% above the prime rate in the event the Company’s ratio of debt to cash flow exceeds a defined ratio. A LIBOR based interest rate option is also provided. The Credit Facility expires December 31, 2001, but under certain conditions is convertible into a term loan, which would amortize quarterly through December 31, 2005.

The Credit Facility contains certain restrictive covenants, which among other things, impose limitations with respect to incurrence of certain additional indebtedness, payments of dividends, long-term leases, investments, mergers, consolidations and specified sales of assets. The Company is also required to satisfy certain financial tests.

As of December 31, 1998 and 1997, no borrowings were outstanding under the Company's Credit Facility.

In April 1995, the stockholders of Digital received distributions in the amount of $8,000,000 in the form of unsecured promissory notes, bearing interest at 7.21% per annum with interest due quarterly and principal due on or before March 31, 2000. Interest relating to these notes approximated $577,000 for each of the years ended 1998, 1997 and 1996.

Long-term debt consists of two mortgage notes payable, each secured by the land and building subject to the respective mortgage. One mortgage note payable bears interest at a rate of 8.5% and matures on October 14, 2002. The other mortgage note payable bears interest at a rate of 7.75% for the first five years with a final payment due in December 2007. At the end of five years, the interest rate will change each year based on the bank's index rate plus 1.75%.

This note payable is being amortized over 25 years with a balloon payment due at the end of ten years. Long-term debt matures as follows:

	(In thousands)
1999	$ 207
2000	245
2001	267
2002	2,181
2003	136
Thereafter	6,111
	9,147
Less current portion	207
	$8,940

5. Shareholders' Equity and Stock Compensation Plans

Net income and earnings per share determined on a pro forma basis as if the Company had accounted for its stock options granted subsequent to December 31, 1994 under the fair value method estimated at the date of grant using a Black-Scholes option pricing model follows:

		December 31,	
(In thousands, except per share amount)	**1998**	1997	1996
Pro forma net income	**$9,032**	$24,784	$26,399
Pro forma net income per share	**$ .62**	$ 1.72	$ 1.85
Pro forma diluted net income per share	**$ .62**	$ 1.67	$ 1.83

Fixed Option Plans

The Company has two fixed option plans. The Veeco Instruments Inc. Amended and Restated 1992 Employees' Stock Option Plan (the "Stock Option Plan") provides for the grant to officers and key employees of up to 2,126,787 options (104,671 options available for future grants as of December 31, 1998) to purchase shares of Common Stock of the Company. Stock options granted pursuant to the Stock Option Plan become exercisable over a three-year period following the grant date and expire after ten years. The Veeco Instruments Inc. 1994 Stock Option Plan for Outside Directors, as amended (the "Directors' Option Plan"), provides for the automatic grant of stock options to each member of the Board of Directors of the Company who is not an employee of the Company. The Directors' Option Plan provides for the grant of up to 115,000 options (15,003 options available for future grants as of December 31, 1998) to purchase shares of Common Stock of the Company. Such options granted are exercisable immediately and expire after ten years. In connection with the merger with Wyko, holders of the then outstanding Wyko stock options received options to purchase an aggregate of 136,190 shares of Veeco common stock.

The fair values of the options issued under the two plans at the date of grant were estimated with the following weighted-average assumptions for 1998, 1997 and 1996: risk-free interest rate of 5.5%, 6.3% and 6.3%, respectively, no dividend yield, volatility factor of the expected market price of the Company's common stock of 59%, 50% and 50%, respectively, and a weighted-average expected life of the option of four years.

A summary of the Company's stock option plans as of December 31, 1996, 1997 and 1998, and changes during the years ended on those dates is presented below:

	1996		1997		**1998**	
	Shares (000)	Option Price Per Share	Shares (000)	Weighted-Average Exercise Price	**Shares (000)**	**Weighted-Average Exercise Price**
Outstanding at beginning of year	606	$ 8.85	658	$ 9.44	**1,154**	**$22.64**
Granted	175	13.68	681	32.22	**1,037**	**24.49**
Exercised	(32)	2.68	(165)	9.76	**(336)**	**8.86**
Forfeited	(91)	13.67	(20)	21.60	**(168)**	**29.61**
Outstanding at end of year	658	$ 9.44	1,154	$22.64	**1,687**	**$25.46**
Options exercisable at year-end	324	$ 5.72	330	$ 9.25	**346**	**$24.42**
Weighted-average fair value of options granted during the year		$ 6.24		$14.83		**$12.36**

The following table summarizes information about fixed stock options outstanding at December 31, 1998:

	Options Outstanding			Options Exercisable	
Range of Exercise Price	Number Outstanding at December 31, 1998 (000's)	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Outstanding at December 31, 1998 (000's)	Weighted-Average Exercise Price
$ 0.69	2	3.8	$ 0.69	2	$ 0.69
2.18	8	1.5	2.18	8	2.18
4.50	18	5.6	4.50	18	4.50
9.50– 13.38	75	6.7	12.41	65	12.61
14.50– 21.63	88	7.6	16.35	39	16.32
22.00– 32.41	1,318	9.1	25.33	144	25.54
33.06– 47.44	169	8.8	39.19	67	39.10
50.25– 57.25	9	8.6	51.81	3	51.81
0.69– 57.25	1,687	8.8	$25.46	346	$24.42

Employee Stock Purchase Plan

Under the Veeco Instruments Inc. Employee Stock Purchase Plan (the "Plan"), the Company is authorized to issue up to 250,000 shares of Common Stock to its full-time domestic employees, nearly all of whom are eligible to participate. Under the terms of the Plan, employees can choose each year to have up to 6% of their annual base earnings withheld to purchase the Company's Common Stock. The purchase price of the stock is 85% of the lower of its beginning-of-year or end-of-year market price. Under the Plan, the Company issued 29,352 shares, 12,996 shares and 14,278 shares to employees in 1998, 1997 and 1996, respectively. The fair value of the employees' purchase rights were estimated using the following assumptions for 1998, 1997 and 1996, respectively: no dividend yield for all years; an expected life of one year for all years; expected volatility of 59%, 70% and 70%; and risk-free interest rates of 5.3%, 5.3%, and 5.2%. The weighted-average fair value of those purchase rights granted in 1998, 1997 and 1996 was $8.79, $6.58 and $5.20, respectively.

As of December 31, 1998, the Company has reserved 1,806,796 and 176,898 shares of Common Stock for issuance upon exercise of stock options and issuance of shares pursuant to the Plan, respectively.

Preferred Stock

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

Veeco Instruments Inc. and Subsidiaries

6. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

(In thousands)	December 31, **1998**	1997
Deferred tax liabilities:		
Tax over book depreciation	**$ 925**	$ 702
Deferred tax assets:		
Inventory valuation	**2,861**	2,247
Foreign net operating loss carryforwards	**246**	1,084
Warranty and installation	**2,380**	1,878
Other	**669**	387
Total deferred tax assets	**6,156**	5,596
Valuation allowance	**(246)**	(994)
Net deferred tax assets	**5,910**	4,602
Net deferred taxes	**$4,985**	$3,900

For financial reporting purposes, income (loss) before income taxes consists of:

(In thousands)	Year ended December 31, **1998**	1997	1996
Domestic	**$16,130**	$33,654	$34,135
Foreign	**2,015**	(17)	(297)
	$18,145	$33,637	$33,838

Significant components of the provision (benefit) for income taxes are presented below:

(In thousands)	Year ended December 31, **1998**	1997	1996
Current:			
Federal	**$ 4,436**	$ 7,371	$ 6,442
Foreign	**546**	306	129
State	**1,547**	1,642	1,542
Utilization of research tax credits	**—**	—	(277)
	6,529	9,319	7,836
Deferred:			
Federal	**(968)**	(1,517)	(795)
Foreign	**90**	—	—
State	**(207)**	(192)	(100)
	(1,085)	(1,709)	(895)
	$ 5,444	$ 7,610	$ 6,941

The following is a reconciliation of the income tax expense computed using the federal statutory rate to the Company's actual income tax expense:

(In thousands)	Year ended December 31, **1998**	1997	1996
Tax at U.S. statutory rates	**$ 6,351**	$11,773	$11,843
State income taxes (net of federal benefit)	**817**	925	856
Goodwill amortization	**46**	46	46
Nondeductible merger expenses	**1,164**	700	—
Other nondeductible expenses	**140**	116	52
Operating losses not currently realizable	**14**	335	225
Income of "S" Corporation not subject to federal corporation tax	**(1,513)**	(4,875)	(5,728)
Operating losses currently realizable	**(168)**	(13)	—
Research and development tax credit	**(796)**	(619)	(184)
Benefit of foreign sales corporation	**(457)**	(479)	(173)
Other	**(154)**	(299)	4
	$ 5,444	$ 7,610	$ 6,941

One of the Company's foreign subsidiaries has net operating loss carryforwards for foreign tax purposes of approximately $500,000 at December 31, 1998, which expire in the year 2002.

7. Commitments and Contingencies and Other Matters

Minimum Lease Commitments

Minimum lease commitments as of December 31, 1998 for property and equipment under operating lease agreements (exclusive of renewal options) are payable as follows:

	(In thousands)
1999	$1,572
2000	1,301
2001	1,042
2002	986
2003	625
Thereafter	190
	$5,716

Rent charged to operations amounted to $1,702,000, $1,979,000 and $1,408,000 in 1998, 1997 and 1996, respectively. In addition, the Company is obligated under the leases for certain other expenses, including real estate taxes and insurance.

Royalties

The Company has arrangements with a number of third parties to use patents in accordance with license agreements. Royalties and license fees expensed under these agreements approximated $275,000, $716,000 and $986,000 in 1998, 1997 and 1996, respectively.

Environmental Remediation

In compliance with a Cleanup and Abatement Order ("CAO") issued by the California Regional Water Quality Control Board, Central Coast Region (the "RWQCB"), the Company, in September 1995, completed soil remediation of a site which was leased by a predecessor of the Company.

The cost of the soil remediation was approximately $35,000. The Company is currently performing post-soil remediation groundwater monitoring at the site. Reports prepared by consultants indicate certain contaminants in samples of groundwater from underneath the site. Pursuant to the CAO, in September 1998, the Company began implementation of a groundwater remediation plan approved by the RWQCB. The Company cannot at this time estimate the extent of its remaining remedial liability at the site since that will depend upon both the success of the groundwater remediation and the Company's ability to demonstrate to the RWQCB that any remaining contamination in site groundwater is migrating onto the site from other sources.

The Company may, under certain circumstances, be obligated to pay up to $250,000 in connection with the implementation of a comprehensive plan of environmental remediation at its Plainview, New York facility. The Company has been indemnified for any liabilities it may incur in excess of $250,000 with respect to any such remediation. No comprehensive plan has been required to date. Despite such indemnification, the Company does not believe that any material loss or expense is probable in connection with any remediation plan that may be proposed.

The Company is aware that petroleum hydrocarbon contamination has been detected in the soil at the site of a facility leased by the Company in Santa Barbara, California. The Company has been indemnified for any liabilities it may incur which arise from environmental contamination at the site. Despite such indemnification, the Company does not believe that any material loss or expense is probable in connection with any such liabilities.

The former owner of the land and building in which Digital's operating facilities and offices are located has disclosed that there are hazardous substances present in the ground under the building. Management believes that the comprehensive indemnification clause that is part of the purchase contract provides adequate protection against any environmental issues that may arise.

Litigation

The Company is a defendant in several litigation matters. The ultimate outcome of these matters cannot be determined at this time; however, management believes that settlements, if any, and litigation costs, will not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

Related Party Transaction

Balances and transactions with Digital GmbH that are reflected in the accompanying consolidated financial statements are as follows:

(In thousands)	**1998**	1997	1996
Accounts receivable	**$ —**	$1,788	$ 922
Sales	**4,337**	3,025	3,461

The Company makes purchases of inventory from a company, which is owned partially by an individual who is also employed by the Company. Payments to this related company in 1998, 1997 and 1996 were approximately $4,883,000, $3,120,000 and $2,937,000, respectively.

Concentration of Credit Risk

The Company's business depends in large part upon the capital expenditures of data storage and semiconductor manufacturers which accounted for the following percentages of the Company's net sales:

	December 31, 1998	1997	1996
Data storage	**54.9%**	53.2%	45.5%
Semiconductor	**19.5**	19.8	23.0

Sales to one customer accounted for approximately 17%, 6% and 4%, sales to another customer accounted for approximately 11%, 14% and 11% and sales to another customer accounted for approximately 7%, 11% and 11% of the Company's net sales during the years ended December 31, 1998, 1997 and 1996, respectively. Each of the Company's segments sell to these major customers. At December 31, 1998 and 1997, accounts receivable due from three customers represented 38% and 24% of aggregate accounts receivable, respectively.

The Company manufactures and sells its products to companies in different geographic locations. The Company performs periodic credit evaluations of its customers' financial condition, generally does not require collateral, and where appropriate, requires that letters of credit be provided on foreign sales. Receivables generally are due within 30–60 days. The Company's net accounts receivable are concentrated in the following geographic locations:

	December 31, 1998	1997
United States	**$17,858**	$22,131
Europe	**11,711**	8,856
Far East	**11,776**	12,738
Other	**1,673**	1,202
	$43,018	$44,927

8. Foreign Operations, Geographic Area and Product Segment Information

Revenue and long-lived assets related to operations in the United States and other foreign countries as of and for the years ended December 31, 1998, 1997 and 1996 are as follows:

	Net Sales to Unaffiliated Customers			Long-Lived Assets		
	1998	1997	1996	**1998**	1997	1996
United States	**$199,263**	$212,288	$160,290	**$41,024**	$37,547	$17,834
Foreign Countries	**39,103**	13,698	12,129	**367**	115	120
Eliminations	**(31,528)**	(9,258)	(7,360)	**—**	—	—
	$206,838	$216,728	$165,059	**$41,391**	$37,662	$17,954

The aggregate foreign exchange gains and (losses) included in determining consolidated results of operations were $774,000, $(34,000), and $(153,000) in 1998, 1997 and 1996, respectively.

In June 1997, the Financial Accounting Standards Board issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." As of January 1, 1998, the Company adopted SFAS No. 131 and retroactively applied it to January 1, 1996. The adoption of this statement had no impact on the Company's reported net income or shareholders' equity.

The Company has three reportable segments: metrology, process equipment and industrial measurement. The Company's metrology product line manufactures and distributes to customers in the data storage and semiconductor industries, as well as research and development centers and universities. The Company's process equipment product line includes etch and deposition systems, primarily for data storage applications. The Company's industrial measurement products have applications in a wide range of industries including electronic, aerospace, transportation and semiconductor.

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

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

The following represents the reportable product segments of the Company:

	Net Sales			Operating Income (Loss)			Total Assets		
	1998	1997	1996	**1998**	1997	1996	**1998**	1997	1996
Metrology	**$126,160**	$112,751	$ 92,107	**$26,328**	$23,748	$22,446	**$ 73,445**	$ 68,025	$ 47,136
Process equipment	**60,931**	84,530	53,198	**2,232**	19,510	12,562	**55,375**	52,028	25,325
Industrial measurement	**19,747**	19,447	19,754	**(5)**	(381)	(393)	**16,807**	13,162	12,765
Unallocated corporate amount	**—**	—	—	**(2,022)**	(2,783)	(1,122)	**27,210**	26,416	28,113
Merger and reorganization expenses	**—**	—	—	**(7,500)**	(2,250)	—	**—**	—	—
Write-off of purchased in-process technology	**—**	—	—	**—**	(4,200)	—	**—**	—	—
Total	**$206,838**	$216,728	$165,059	**$19,033**	$33,644	$33,493	**$172,837**	$159,631	$113,339

Other Significant Items

	Year ended December 31,		
	1998	1997	1996
Depreciation and amortization expense:			
Metrology	**$1,674**	$ 522	$ 582
Process equipment	**2,389**	1,320	1,131
Industrial measurement	**122**	15	1
Unallocated corporate	**518**	358	327
Consolidated depreciation and amortization expense	**$4,703**	$ 2,215	$2,041
Expenditures for long-lived assets:			
Metrology	**$1,488**	$13,216	$ 589
Process equipment	**5,907**	8,162	3,236
Industrial measurement	**65**	646	95
Unallocated corporate	**678**	1,548	147
Consolidated expenditures for long-lived assets	**$8,138**	$23,572	$4,067

9. Defined Contribution Benefit Plans

The Company maintains three defined contribution plans under Section 401(k) of the Internal Revenue Code. Principally all of the Company's domestic full-time employees are eligible to participate in one of the three plans. Under the plans, employees may contribute up to a maximum of 15% to 20% of their annual wages, depending on the plan. Employees are immediately vested in their contributions. Other than Digital's plan, the plans provide for partial matching contributions by the Company, which vest over a five-year period. Company contributions to the plans were $507,000, $296,000 and $205,000 in 1998, 1997 and 1996, respectively.

10. Subsequent Events

On February 2, 1999, the Company completed a public offering pursuant to which 1,000,000 shares of Common Stock, par value $.01 per share were issued and sold for $52.00 per share, less underwriting discounts and commissions of $2.34 per share. In addition, as part of the public offering, certain stockholders of the Company sold 2,575,000 shares of Common Stock. The Company did not receive any of the proceeds from the sale of shares by the selling stockholders.

Report of Independent Auditors

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

We have audited the accompanying consolidated balance sheets of Veeco Instruments Inc. and Subsidiaries ("Veeco" or the "Company") as of December 31, 1998 and 1997, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Digital Instruments, Inc. and Affiliates ("Digital"), which merged with Veeco in May 1998, which statements reflect total assets constituting 20% as of December 31, 1997, and total revenues constituting 23% in 1997 and 30% in 1996 of the consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, in so far as it relates to data included for Digital, is based solely on the report of other auditors.

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

In our opinion, based on our audits and the report of other auditors for 1996 and 1997, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Veeco Instruments Inc. and Subsidiaries at December 31, 1998 and 1997, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Ernst + Young LLP

Melville, New York
February 8, 1999

Stock and Dividend Information

The Common Stock is quoted on the Nasdaq National Market under the symbol "VECO". The 1998 and 1997 high and low closing prices are as follows:

	1998		1997	
	High	**Low**	High	Low
First Quarter	**$37.19**	**$20.38**	$31.38	$21.88
Second Quarter	**42.13**	**22.94**	41.50	25.75
Third Quarter	**35.00**	**22.13**	72.50	38.50
Fourth Quarter	**54.38**	**21.63**	59.50	19.19

On March 19, 1999, the closing price for the Company's Common Stock on the Nasdaq National Market was $44.375. As of March 19, 1999, the Company had approximately 226 shareholders of record.

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

Board of Directors

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

Richard A. D'Amore
General Partner, North Bridge Venture Partners
and Hambro International Equity Partners

Joel A. Elftmann
Chairman and CEO,
FSI International (Nasdaq: FSII)

Virgil Elings, Ph.D.
Co-Founder, President, Digital Instruments

Heinz K. Fridrich
Courtesy Professor in the Department
of Industrial and Systems Engineering,
University of Florida

John A. Gurley
Co-Founder, Vice President, Digital Instruments

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

Roger D. McDaniel
President, CEO and Director, Integrated
Process Equipment Corp. (Nasdaq: IPEC)

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

Walter J. Scherr
Consultant and former Executive Vice President,
Veeco Instruments Inc.
Director, Valence Operating Co.

Corporate Officers

Edward H. Braun
Chairman, CEO and President

Daniel C. Croucher
Vice President, Human Resources

Don R. Kania, Ph.D.
Chief Technology Officer

John P. Kiernan
Vice President, Corporate Controller

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

Operating Officers

Virgil Elings, Ph.D.
President,
Metrology Group—California

Emmanuel N. Lakios
President,
Process Equipment Group

Lloyd J. LaComb, Jr.
Vice President, General Manager
Metrology Group—Arizona

Robert P. Oates
Vice President, General Manager
Industrial Measurement Group

Joseph F. Rivlin
Executive Vice President,
Worldwide Field Operations

Allen R. Schwartz
Vice President,
Worldwide Customer Service

Francis Steenbeke
Vice President,
International Sales and Marketing

Manufacturing & Engineering Facilities

Plainview, NY (Corporate Headquarters)
Ronkonkoma, NY
San Jose, CA
Santa Barbara, CA
Tucson, AZ

Worldwide Sales & Support Centers

Domestic
Chadds Ford, PA
Plainview, NY
Ronkonkoma, NY
San Jose, CA
Santa Barbara, CA
Tucson, AZ
Tustin, CA

International
Beijing, China
Cambridge, UK
Dourdan, France
Hsinchu, Taiwan
Mannheim, Germany
Munich, Germany
Osaka, Japan
Penang, Malaysia
Tokyo, Japan
Watford, UK

Legal Counsel

Kaye, Scholer, Fierman, Hays & Handler, LLP
425 Park Avenue
New York, NY 10022

Independent Auditors

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

Transfer Agent & Registrar

American Stock Transfer & Trust Co.
40 Wall Street
New York, NY 10005
1-800-937-5449

Investor Relations

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

Investor Relations
Veeco Instruments Inc.
Terminal Drive
Plainview, NY 11803
(516) 349-8300
or visit our website at http://www.veeco.com

Stock Listing

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

Annual Meeting

The 1998 annual meeting of stockholders will be held at 9:30 AM on Friday, May 14, 1999 at the Corporate Center, 395 North Service Road, Melville, New York.

Page 9: Flip Chip and Ultra CSP™ bumped wafer with inset of Ultra CSP die. Photo courtesy of Flip Chip Technologies.

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

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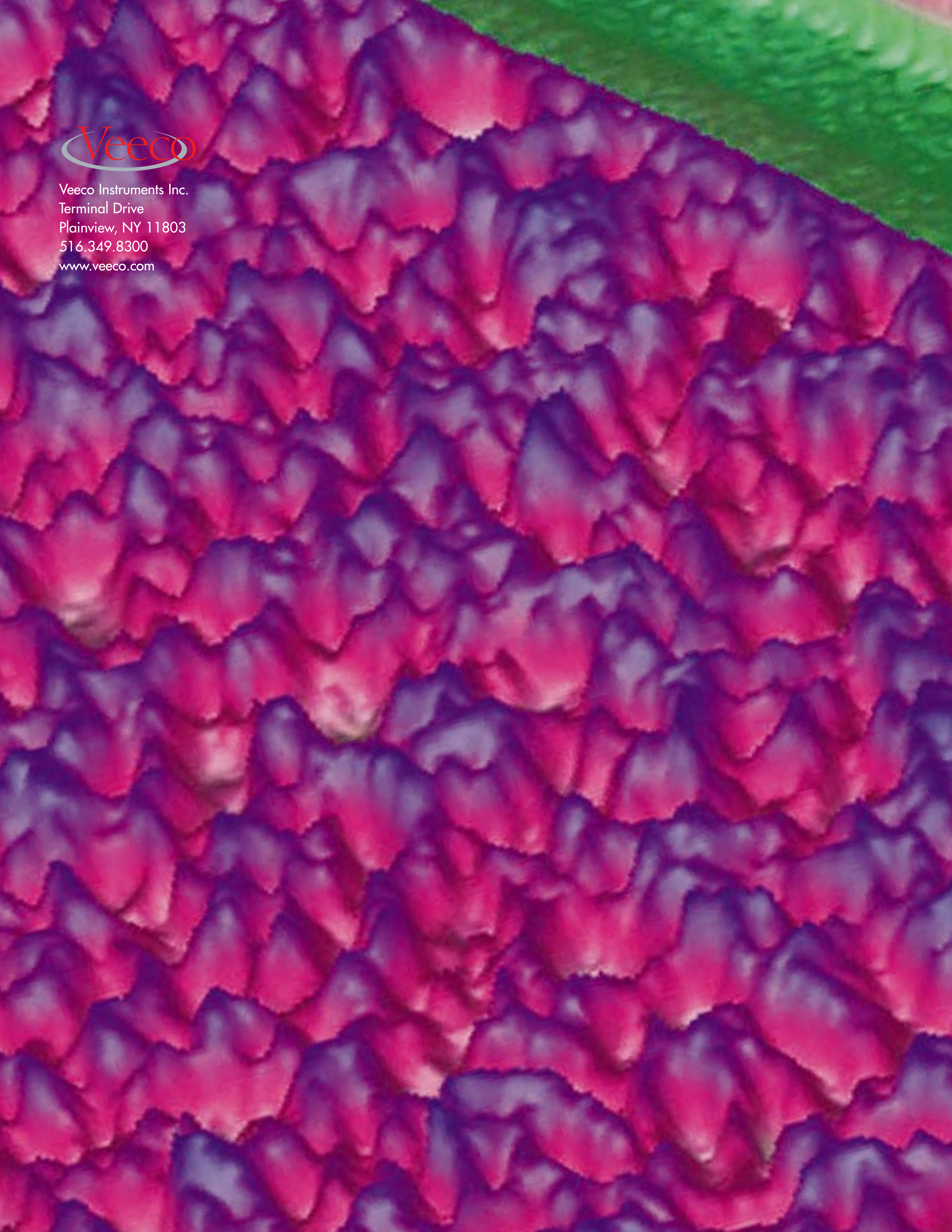

Veeco Instruments Inc.
Terminal Drive
Plainview, NY 11803
516.349.8300
www.veeco.com