

Selected Financial Data

(thousands, except per share amounts)	2000 ⁽¹⁾	Fiscal Year Ended June 30,			1996
		1999 ⁽¹⁾	1998 ⁽¹⁾	1997 ⁽¹⁾	
Net sales	\$ 87,243	\$ 63,382	\$ 99,084	\$ 87,220	\$ 57,374
Gross profit	\$ 32,555 ⁽⁴⁾	\$ 22,385	\$ 41,449	\$ 41,825	\$ 25,866
% of sales	37%	35%	42%	48%	45%
Earnings before taxes and nonrecurring charges	\$ 7,256 ⁽²⁾	\$ (6,851)	\$ 12,940 ⁽²⁾	\$ 21,121 ⁽²⁾	\$ 11,558
% of sales	8%	(11)%	13%	24%	20%
Earnings before nonrecurring charges	\$ 4,798 ⁽²⁾	\$ (3,876)	\$ 8,949 ⁽²⁾	\$ 13,960 ⁽²⁾	\$ 7,799
% of sales	5%	(6)%	9%	16%	14%
Earnings per share before nonrecurring charges					
Basic	\$ 0.38 ⁽²⁾	\$ (.33)	\$ 0.78 ⁽²⁾	\$ 1.34 ⁽²⁾	\$ 0.84
Diluted	\$ 0.34 ⁽²⁾	\$ (.33)	\$ 0.69 ⁽²⁾	\$ 1.16 ⁽²⁾	\$ 0.72
Earnings per share before nonrecurring charges growth rate	203%	(148)%	(41)%	62%	121%
Net earnings	\$ (16,047)	\$ (3,876)	\$ 7,029	\$ 2,877	\$ 7,799
Net earnings per common share:					
Basic ⁽³⁾	\$ (1.28)	\$ (.33)	\$ 0.61	\$ 0.28	\$ 0.84
Diluted ⁽³⁾	\$ (1.28)	\$ (.33)	\$ 0.55	\$ 0.24	\$ 0.72
Weighted average number of shares:					
Basic	12,511	11,780	11,480	10,403	9,323
Diluted	12,511	11,780	12,877	11,998	10,878
Research and development	\$ 11,270	\$ 9,186	\$ 9,844	\$ 7,151	\$ 5,538
Capital expenditures	\$ 6,513	\$ 4,372	\$ 9,126	\$ 4,723	\$ 2,864
Depreciation and amortization	\$ 11,318	\$ 4,448	\$ 3,412	\$ 2,612	\$ 1,477
	2000 ⁽¹⁾	1999 ⁽¹⁾	June 30, 1998 ⁽¹⁾	1997 ⁽¹⁾	1996
Working capital	\$ 56,550	\$ 43,766	\$ 50,246	\$ 47,633	\$ 47,148
Current ratio	4.5	4.8	4.1	4.6	5.2
Total assets	\$ 95,162	\$ 82,442	\$ 91,444	\$ 78,799	\$ 65,895
Long-term debt (excluding current portion)	\$ 84	\$ 36	\$ 65	\$ —	\$ —
Stockholders' equity	\$ 78,229	\$ 68,712	\$ 72,382	\$ 62,408	\$ 54,087
Price-earnings ratio	N/A	N/A	26.9	128.1	30.4
Number of employees at year end	486	444	466	399	287
Sales per employee—average	\$ 179	\$ 143	\$ 213	\$ 231	\$ 224
Book value per common share	\$ 5.50	\$ 6.16	\$ 6.60	\$ 5.91	\$ 5.34
Market price at year end	\$ 90.813	\$ 11.438	\$ 14.813	\$ 30.750	\$ 21.875

(1) The results of Firefly Technologies, Inc., which is being accounted for as a pooling-of-interests, are included as of July 1, 1997. The results of Sight Systems, Inc. ("SSI"), which is being accounted for as an immaterial pooling-of-interests, are included from July 1, 1997; the results of Syncotec Neue Technologien und Instrumente GmbH ("Syncotec") are included from September 1, 1997 when the acquisition of the remaining 50% of Syncotec was completed; and the results of Technical Instrument Company ("TIC") are included in the consolidated results of the Company from August 8, 1996 when that acquisition was effective. Both Syncotec and TIC were accounted for as purchases.

(2) Nonrecurring charges include acquisition-related charges of \$14,001, \$1,585, and \$11,083 in the fourth quarter ended June 30, 2000, and in the first quarter ended September 30, 1997 and 1996, respectively; West Coast operations reorganization cost of \$10,567 in the fourth quarter ended June 30, 2000; and failed merger costs of \$335 in the first quarter ended September 30, 1997.

(3) The difference between basic shares outstanding and diluted shares outstanding is the assumed conversion of common stock equivalents (stock options) in the amounts of 0, 0, 1,397,000, 1,595,000, and 1,555,000 in the years ended June 30, 2000, 1999, 1998, 1997, and 1996, respectively.

(4) Includes nonrecurring charges of \$4,214 related to the inventory write-off in the fourth quarter of fiscal 2000 as part of the Company's reorganization of its West Coast operations.

Management's Discussion and Analysis

Results of Operations

Fiscal 2000 Compared to Fiscal 1999 Net sales of \$87,243,000 for fiscal 2000 increased by \$23,861,000 or 38% from fiscal 1999 net sales of \$63,382,000. The Company's sales were favorably impacted by the increase in demand from the semiconductor market and from the reorganization of the sales function, which moved the sales, marketing and customer service to a regional basis in order to put the critical support services closer to the customer. During each quarter of fiscal 2000 there was an increase in orders, sales and backlog. Product and system backlog is now at a record level and reflects the strong market demand for our manufacturing productivity and yield enhancement solutions. Orders for the year exceeded \$100 million for the first time.

The Company's sales outside of the United States amounted to \$38,408,000 in fiscal 2000, an increase of \$10,379,000 or 37% from fiscal 1999 levels of \$28,029,000. Sales in Japan during fiscal 2000 amounted to \$17,588,000, an increase of \$3,445,000 or 24.4% from fiscal 1999 levels. Sales in the Pacific Rim and Europe amounted to \$11,714,000 and \$9,106,000, respectively, representing 94% and 16% increases from 1999 sales levels. Substantially all of the Company's sales and costs are negotiated and paid in U.S. dollars. Significant changes in the values of foreign currencies relative to the value of the U.S. dollar can impact the sales of the Company's products in its export markets as would changes in the general economic conditions in those markets. The impact of such changes in foreign currency values on the Company's sales cannot be measured.

Gross profit in fiscal 2000 amounted to \$32,555,000, an increase of \$10,170,000 or 45.4% from gross profit of \$22,385,000 in fiscal 1999. As a percentage of net sales, gross profit in fiscal 2000 was 37.3%, as compared to 35.3% in fiscal 1999. The increase in gross profit and gross profit as a percentage of sales were primarily due to the increase in volume and a more favorable product mix.

Selling, general and administrative expenses in fiscal 2000 amounted to \$18,504,000, a decrease of \$1,129,000 or 5.8% over fiscal 1999. During fiscal 2000, the Company recorded a \$1 million credit to the selling, general and administrative expenses as a result of a legal settlement. Absent that credit, the expenses in this area remained relatively constant. As a percentage of net sales, selling, general and administrative expenses decreased in fiscal 2000 to 21.2% as compared to 31.0% in fiscal 1999, as a result of the increase in the volume of sales, increase in efficiencies of the group, and the decrease in the expense primarily as a result of the proceeds from the legal settlement.

Research, development and engineering expenses ("R&D") in fiscal 2000 totaled \$11,270,000 and increased by \$2,085,000 from fiscal 1999. The Company's management continues to pursue projects which will enhance the Company's product offering and provide long-term strategic and financial benefits. In addition to the normal investment in Research and Development, the Company is increasing its development in the optical module market in order to develop prototypes for major users in the telecommunications industry. R&D costs as a percentage of net sales amounted to 12.9%, which compares with 14.5% of net sales in 1999.

The Company recorded nonrecurring charges in the amount of \$24,568,000 in fiscal 2000. This charge was a result of the Company's acquisition of Firefly Technologies, Inc. and the Company's decision to reorganize its West Coast operations. The Company recorded nonrecurring charges of \$14,001,000 in 2000 as a result of the acquisition of

Firefly Technologies, Inc. The nonrecurring charge from the acquisition was \$12,024,000 for compensation expense resulting from the difference in the Firefly stock option exercise price and the deemed fair market value on the date of grant for financial statement purposes and \$1,977,000 for the payment of professional fees related to the transaction. The Company recorded a charge of \$10,567,000 as a result of its reorganization of its West Coast operations, principally for the write-off of goodwill and inventory. The Company did not record any nonrecurring charges in fiscal 1999.

Amortization expense of \$7,102,000 for fiscal 2000 increased by \$5,844,000 or 465% from fiscal 1999 levels of \$1,258,000. Substantially all of the increase is associated with the West Coast operations write-off of goodwill and other intangible assets and the amortization expense recorded on the Atomic Force Microscope line of business.

The Company's operating losses in fiscal 2000 were \$18,322,000 as compared to operating losses of \$7,691,000 in fiscal 1999.

Income tax benefits in fiscal 2000 totaled \$1,459,000 or 8% of pretax losses, which compares with income tax benefits of \$2,975,000 or 43% of pretax losses in fiscal 1999. The change from year to year relates primarily to the tax benefits, that could not be recorded for financial statement purposes, associated with the compensation charge in connection with the Firefly acquisition in fiscal 2000.

The Company recorded a net loss for fiscal year 2000 of \$16,047,000 or \$(1.28) per share, as compared to a net loss of \$3,876,000 or \$(.33) per share during fiscal 1999.

Backlog at June 30, 2000 was \$45,943,000 compared to \$28,941,000 at June 30, 1999, an increase of \$17,002,000 or 59%.

Fiscal 1999 Compared to Fiscal 1998 Net sales of \$63,382,000 for fiscal 1999 decreased by \$35,702,000 or 36% from fiscal 1998 net sales of \$99,084,000. The Company's sales were adversely impacted by market conditions, which began with poor conditions in the Asian economic environment, leading to weak conditions in the semiconductor and data storage markets. These forces impacted net sales of the Company's instruments and systems, which decreased by 35.3% to \$41,020,000. Net sales of modules and components decreased by 35.1% to \$22,362,000. The decrease in modules and components was principally the result of reductions in revenue associated with the Lawrence Livermore National Laboratory National Ignition Facility Project as 1998 results included \$8,887,000 of revenue associated with the facilitation of the Company's Middlefield, Connecticut plant and to a lesser extent motion and optical component sales to OEM customers.

The Company's sales outside of the United States amounted to \$28,029,000 in fiscal 1999, a decrease of \$14,990,000 or 34.8% from fiscal 1998 levels of \$43,019,000. Sales in Japan during fiscal 1999 amounted to \$14,143,000, a decrease of \$8,141,000 or 36.5% from fiscal 1998 levels. Shortfalls were caused by lower demand from Japanese customers due to market conditions, including lower sales of motion control components to Canon Inc. for incorporation into Canon's photolithography "steppers" used in the production of semiconductors. Additional reductions occurred in mask metrology systems where macroeconomic factors impacted sales levels. Sales in the Pacific Rim and Europe amounted to \$6,038,000 and \$7,848,000, respectively, representing 46.8% and 16.4%

Management's Discussion and Analysis

reductions from 1998 sales levels. Substantially all of the Company's sales and costs are negotiated and paid in U.S. dollars. Significant changes in the values of foreign currencies relative to the value of the U.S. dollar can impact the sales of the Company's products in its export markets as would changes in the general economic conditions in those markets. The impact of such changes in foreign currency values on the Company's sales cannot be measured.

Gross profit in fiscal 1999 amounted to \$22,385,000, a decrease of \$19,064,000 or 46% from gross profit of \$41,449,000 in fiscal 1998. As a percentage of net sales, gross profit in fiscal 1999 was 35.3%, as compared to 41.8% in fiscal 1998. The decreases in gross profit and gross profit as a percentage of sales were primarily due to volume shortfalls and the associated underutilization of the Company's manufacturing facilities as well as costs, which were essentially one time in nature, incurred as the Company realigned its manufacturing operations in response to lower demand. These actions led to the elimination of manufacturing in the Company's Newbury Park and Sunnyvale, California facilities.

Selling, general and administrative expenses in fiscal 1999 amounted to \$19,633,000, an increase of \$909,000 or 4.9% over fiscal 1998. During fiscal 1999, the Company initiated substantial cost reduction efforts as well as efforts associated with creating additional sales and support infrastructure. 1999 results were also impacted by bad debt expenses, most notably with contracts associated with StorMedia, Inc. Additional costs have been incurred for the creation of sales infrastructure and the addition of Atomic Force Microscopy technology to the Company's product portfolio. As a percentage of net sales, selling, general and administrative expenses increased in fiscal 1999 to 31.0% as compared to 18.9% in fiscal 1998, as a result of such increased expenses and lower sales volume levels.

Research, development and engineering expenses ("R&D") in fiscal 1999 totaled \$9,185,000 and decreased by \$659,000 from fiscal 1998. During the third and fourth quarters, consolidations and cost reduction efforts were targeted in this functional area. Particular emphasis was given to the vision and confocal product lines where the completion of certain R&D programs and the resulting introduction of new products enabled these cost saving actions to move forward. The Company's management continues to pursue projects which will enhance the Company's product offering and provide long-term strategic and financial benefits. R&D costs as a percentage of net sales amounted to 14.5%, which compares with 9.9% of net sales in 1998.

The Company recorded nonrecurring charges in the amount of \$1,920,000 in fiscal 1998, all which were incurred in the three months ended September 30, 1997. The nonrecurring charges related to \$707,000 of expenses incurred to complete the Company's merger with SSI, recorded as a pooling-of-interests, the write-off of \$878,000 of in-process research and development costs in conjunction with the Company's acquisition of Syncotec, and failed merger costs of \$335,000 relating to the Company's failed efforts to merge with Digital Instruments, Inc. The Company did not record any nonrecurring charges in fiscal 1999.

Amortization expense of \$1,258,000 for fiscal 1999 increased by \$465,000 or 58.6% from fiscal 1998 levels of \$793,000. Substantially all of the increase is associated with the amortization expense recorded on the Atomic Force Microscope line of business.

The Company's operating losses in fiscal 1999 were \$7,691,000 as compared to operating profits of \$10,168,000 in fiscal 1998.

Income tax benefits in fiscal 1999 totaled \$2,975,000 or 43% of pretax losses which compares with income tax expenses of \$3,991,000 or 36% of pretax income in fiscal 1998.

The Company recorded a net loss for fiscal 1999 of \$3,876,000 or \$(.33) per share, as compared to net earnings of \$7,029,000 or \$.55 per share during fiscal 1998.

Backlog at June 30, 1999 was \$28,941,000 compared to \$24,410,000 at June 30, 1998, an increase of \$4,531,000. The Company's instruments and systems at June 30, 1999 increased \$6,280,000 largely due to increases in the automation backlog. The components backlog fell by \$1,749,000.

Liquidity and Capital Resources At June 30, 2000, working capital was \$56,550,000, an increase of \$12,784,000 from the amount at June 30, 1999, and the Company had cash and cash equivalents of \$15,598,000 and marketable securities amounting to \$8,268,000 for a total of \$23,866,000. Accounts payable and accrued expense increased by \$4,629,000, while accounts receivable increased by \$7,657,000. As of June 30, 2000, there were no borrowings outstanding under the Company's \$3,000,000 bank line of credit. Stockholders equity at June 30, 2000 increased by \$9,517,000 from the year earlier to \$78,229,000, largely as a result of stock option exercises and the related tax benefit and the acquisition of Firefly.

At June 30, 1999, working capital was \$43,766,000, a decrease of \$6,480,000 from the amount at June 30, 1998, and the Company had cash and cash equivalents of \$13,022,000 and marketable securities amounting to \$8,351,000 for a total of \$21,373,000. The \$9,230,000 decrease in cash, cash equivalents, and marketable securities from the amount at June 30, 1998 came primarily from net losses of \$3,989,000 and investing activities totaling \$7,320,000. Additions to property, plant and equipment account for \$4,362,000 and AFM intangible purchases requiring cash payments of \$2,250,000 were the major utilizers of cash. Lower business activity led to accounts payable and accrued expense decreases of \$4,244,000, which were largely offset by accounts receivable reductions of \$4,074,000. Management expects fiscal 2000 capital expenditures to approximate fiscal 1999 capital spending levels. At fiscal year end, the Company had \$1,410,000 in inventory and purchase commitments of approximately \$7,324,000 under its distribution agreement relating to the AFM technology and product line. As of June 30, 1999, there were no borrowings outstanding under the Company's \$3,000,000 bank line of credit. Stockholders' equity at June 30, 1999 decreased by \$3,670,000 from the year earlier to \$68,712,000, largely as a result of net losses of \$3,989,000.

Consolidated Balance Sheets

	June 30, 2000	June 30, 1999
<i>(thousands, except share and per share amounts)</i>		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 15,598	\$ 13,022
Marketable securities (Note 3)	8,268	8,351
Receivables (Note 4)	20,138	12,481
Inventories (Note 5)	11,879	15,473
Costs in excess of billings (Note 6)	5,743	660
Income taxes receivable	866	741
Prepaid expenses and taxes	1,173	804
Deferred income taxes (Note 16)	9,020	3,715
Total current assets	72,685	55,247
Property, plant and equipment, net (Notes 7 and 11)	18,493	16,437
Goodwill and other intangibles, net (Note 8)	3,078	9,939
Other assets	906	819
Total assets	\$ 95,162	\$ 82,442
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 8,380	\$ 5,140
Customer progress payments	279	784
Accrued salaries and wages	3,485	1,743
Other accrued expenses	3,934	3,782
Income taxes payable	57	32
Total current liabilities	16,135	11,481
Long-term debt	84	36
Deferred income taxes (Note 16)	271	2,213
Minority interest	443	—
Stockholders' equity (Notes 13, 14, and 15):		
Common stock, \$.10 par value per share: 15,000,000 shares authorized; 14,441,231 shares issued (13,706,359 in 1999)	1,444	1,370
Additional paid-in capital	68,304	42,667
Retained earnings	9,055	25,102
Accumulated other comprehensive income:		
Currency translation effects	(182)	(57)
Net unrealized (loss) on marketable securities (Note 3)	(91)	(69)
	78,530	69,013
Less treasury stock, at cost; 207,600 common shares	301	301
Total stockholders' equity	78,229	68,712
Total liabilities and stockholders' equity	\$ 95,162	\$ 82,442

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

Consolidated Statements of Earnings

<i>(thousands, except per share amounts)</i>	Fiscal Year Ended June 30,		
	2000	1999	1998
Net sales (Notes 17 and 18)	\$ 87,243	\$ 63,382	\$ 99,084
Cost of goods sold	54,688	40,997	57,635
Gross profit	32,555	22,385	41,449
Selling, general and administrative expenses	18,504	19,633	18,724
Research and development	11,270	9,185	9,844
Failed merger costs	—	—	335
Nonrecurring acquisition-related charges	14,001	—	1,585
Amortization and impairment of goodwill and other intangibles (Note 2)	7,102	1,258	793
Operating profit (loss)	(18,322)	(7,691)	10,168
Other income (expense):			
Interest income	1,250	1,148	1,100
Miscellaneous expense, net	(240)	(308)	(248)
Total other income	1,010	840	852
Earnings (loss) before income taxes and minority interest	(17,312)	(6,851)	11,020
Income tax expense (benefit) (Note 16)	(1,459)	(2,975)	3,991
Earnings (loss) before minority interest	(15,853)	(3,876)	7,029
Minority interest	194	—	—
Net earnings (loss)	\$ (16,047)	\$ (3,876)	\$ 7,029
Earnings (loss) per common and common equivalent share (Note 13):			
Basic	\$ (1.28)	\$ (.33)	\$ 0.61
Diluted	\$ (1.28)	\$ (.33)	\$ 0.55
Weighted average common shares and common dilutive equivalents outstanding (Note 13):			
Basic	12,511	11,780	11,480
Diluted	12,511	11,780	12,877

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

Consolidated Statements of Stockholders' Equity

<i>(thousands of dollars)</i>	Total	Comp. Income	Retained Earnings	Accum. Other Comp. Income	Common Stock	Treasury Stock	Paid-In Capital
Balance at June 30, 1997	\$62,408		\$21,405	\$ 17	\$1,077	\$(301)	\$40,210
Comprehensive income							
Net earnings	7,029	<u>7,029</u>	7,029				
Other comprehensive loss, net of tax							
Unrealized loss on marketable securities	(3)	<u>(3)</u>					
Foreign currency translation effect	1	<u>1</u>					
Other comprehensive loss, net of tax		<u>(2)</u>		(2)			
Comprehensive income		<u>7,027</u>					
Shares issued for Syncotec (Note 2)	623				2		621
Shares issued for Sight Systems (Note 2)	555		544		29		(18)
Shares issued for Firefly Technologies, Inc. (Note 2)	310				230		80
Exercise of employee stock options and related tax effect	1,468				14		1,454
Balance at June 30, 1998	\$72,391		\$28,978	\$ 15	\$1,352	\$(301)	\$42,347
Comprehensive loss							
Net loss	(3,876)	<u>(3,876)</u>	(3,876)				
Other comprehensive loss, net of tax							
Unrealized loss on marketable securities	(83)	<u>(83)</u>					
Foreign currency translation effect	(58)	<u>(58)</u>					
Other comprehensive loss		<u>(141)</u>		(141)			
Comprehensive loss		<u>(4,017)</u>					
Exercise of employee stock options and related tax effect	338				18		320
Balance at June 30, 1999	\$68,712		\$25,102	\$(126)	\$1,370	\$(301)	\$42,667
Comprehensive loss							
Net loss	(16,047)	<u>(16,047)</u>	(16,047)				
Other comprehensive loss, net of tax							
Unrealized loss on marketable securities	(22)	<u>(22)</u>					
Foreign currency translation effect	(125)	<u>(125)</u>					
Other comprehensive loss		<u>(147)</u>		(147)			
Comprehensive loss		<u>(16,194)</u>					
Unearned compensation	12,024						12,024
Exercise of employee stock options and related tax effect	13,687				74		13,613
Balance at June 30, 2000	\$78,229		\$9,055	\$(273)	\$1,444	\$(301)	\$68,304

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

Consolidated Statements of Cash Flows

<i>(thousands of dollars)</i>	Fiscal Year Ended June 30,		
	2000	1999	1998
Cash provided by (used for) operating activities:			
Net earnings (loss)	\$ (16,047)	\$ (3,876)	\$ 7,029
Adjustments to reconcile net earnings to cash provided by operating activities:			
Depreciation and amortization	11,318	4,448	3,412
Deferred income taxes	(7,247)	(1,540)	(1,103)
(Gain) loss on disposal of assets	1,176	662	(62)
Nonrecurring acquisition-related IPR&D charges (Note 2)	—	—	878
Unearned compensation related to stock options	12,024	—	—
Gain on sale of marketable securities	—	(38)	(70)
Changes in operating accounts:			
Receivables	(7,657)	4,074	5,002
Costs in excess of billings	(5,083)	522	900
Inventories	3,594	(1,043)	(2,295)
Prepaid expenses and taxes	4,770	42	53
Accounts payable and accrued expenses	4,654	(5,252)	1,117
Minority interest	194	—	—
Net cash provided by (used for) operating activities	1,696	(2,001)	14,861
Cash provided by (used for) investing activities:			
Additions to property, plant and equipment	(6,513)	(4,372)	(9,126)
Investment in marketable securities	(2,466)	(11,860)	(4,479)
Investments in other assets	—	(2,958)	(626)
Acquisition of business	—	—	(1,268)
Cash acquired from business	—	—	2,059
Proceeds from the sale of marketable securities	—	8,616	4,605
Proceeds from maturity of marketable securities	2,500	3,045	4,368
Proceeds from sale of assets	—	—	230
Net cash used for investing activities	(6,479)	(7,529)	(4,237)
Cash provided by (used for) financing activities:			
Proceeds (Repayments) of long-term debt	48	(125)	51
Exercise of employee stock options and issuance of common stock	7,062	338	678
Contributions from minority interest of consolidated subsidiaries	249	—	—
Net cash provided by financing activities	7,359	213	729
Net increase (decrease) in cash and cash equivalents	2,576	(9,317)	11,353
Cash and cash equivalents, beginning of year	13,022	22,339	10,986
Cash and cash equivalents, end of year	\$ 15,598	\$ 13,022	\$ 22,339

1. Summary of Significant Accounting Policies

Principles of Consolidation The accompanying consolidated financial statements include the accounts of Zygo Corporation and its subsidiaries ("ZYGO" or the "Company"). All material transactions and accounts with the subsidiaries have been eliminated from the consolidated financial statements. As discussed in Note 2, all the outstanding shares of Firefly Technologies, Inc. ("Firefly") were acquired by the Company on May 5, 2000, in a transaction accounted for as a pooling-of-interests. Accordingly, the financial statements of the Company have been restated to reflect the merger as if it had occurred on July 1, 1997. The Company, via its wholly-owned subsidiary, Technical Instrument Company, completed the acquisition of Syncotec Neue Technologien und Instrumente GmbH ("Syncotec"), a German-based company, effective September 1, 1997. ZYGO, prior to this acquisition, completed all necessary legal requirements allowing for appropriate transfer and registration of its original 50 percent ownership of Syncotec on June 30, 1997.

Cash and Cash Equivalents The Company considers cash and cash investments with maturities at the date of purchase of three months or less to be cash and cash equivalents.

Marketable Securities The Company considers investments in securities with maturities at the date of purchase in excess of three months as marketable securities. Marketable securities primarily consist of corporate and tax exempt bonds. All securities held by the Company at June 30, 2000 and 1999, were classified as available-for-sale and recorded at fair value or held to maturity and recorded at cost. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of stockholders' equity until realized.

Inventories Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

Depreciation Depreciation is based on the estimated useful lives of the various classes of assets and is computed using the straight-line method. See Note 7.

Impairment of Long-Lived Assets As required by Statement of Financial Accounting Standards No. 121, *Accounting for the Impairment of Long-Lived Assets for Long-Lived Assets to Be Disposed Of*, the Company evaluates the carrying value of its long-lived and intangible assets at each balance sheet date to determine if impairment exists based upon estimated undiscounted future cash flows. The impairment, if any, is measured by the difference between carrying value and estimated fair value and charged to expense in the period identified. The remaining amortization periods are periodically evaluated and would be revised if considered necessary. See Notes 8 and 20.

Revenue Recognition Revenues, other than revenue under the National Ignition Facility ("NIF") contract (Note 19) and revenue from certain automation contracts (Note 6), are recognized when units are shipped. Revenues related to NIF and automation contracts are recognized under the percentage-of-completion method of accounting.

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

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

	June 30, 2000	June 30, 1999	June 30, 1998
Weighted average shares outstanding	12,511	11,780	11,480
Dilutive effect of stock options	—	—	1,397
Diluted weighted average shares outstanding	12,511	11,780	12,877

During 2000 and 1999, the Company recorded a loss and all options were excluded from the computation because of the anti-dilutive effect on earnings per share.

Gain Contingency The Company was awarded \$2,669 plus recovery of certain costs in a judgment rendered by the United States District Court (District of Arizona) on June 2, 1994. The Court's decision was appealed to the Court of Appeals for the Federal Circuit located in Washington, D.C. by the defendant, and oral arguments of the appeal were heard by the Court on March 9, 1995. On April 1, 1996, the United States Court of Appeals for the Federal Circuit rendered an Opinion Announcing Judgment of the Court. The appellate court affirmed-in-part and reversed-in-part the District Court's earlier findings and remanded the case to the District Court for a redetermination of the damage award. ZYGO recorded a gain of \$1 million in the third quarter of 2000 when the Company received the proceeds from this settlement.

Stock-Based Compensation Stock-based compensation awards to employees under the Company's stock plans are accounted for using the intrinsic value method prescribed in Accounting Principals Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees* and related interpretations. The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*.

The Company follows the practice of recording amounts received upon the exercise of options by crediting common stock and additional capital. Except as discussed in Note 2, no charges are reflected in the consolidated statements of operations as a result of the grant or exercise of stock options, which are granted with an exercise price at fair-market value on the date of grant. The Company realizes an income tax benefit from the exercise or early disposition of certain stock options. This benefit results in a decrease in current income taxes payable and an increase in additional capital.

Fair Value of Financial Instruments Statement of Financial Accounting Standards No. 107, *Disclosures about Fair Value of Financial Instruments*, requires that reporting entities provide, to the extent practicable, the fair value of financial instruments, both assets and liabilities. The carrying amounts of cash, accounts receivable, accounts payable, and accrued expenses approximate fair value because of the short maturity of these items.

Use of Estimates Management of the Company has made a number of estimates and assumptions relating to the reporting of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities to prepare these consolidated financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements Statement of Financial Accounting Standard No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("Statement 133"), was issued in 1998 and is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. In 1999, Statement of Financial Accounting Standard No. 137, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the effective date of FASB Statement 133*, was issued which delays the required adoption of Statement 133 to the Company's fiscal year 2001. This statement is not expected to have an impact, as the Company does not significantly utilize derivatives or hedges.

2. Mergers, Acquisitions and Strategic Initiatives

On May 5, 2000, the Company entered into an agreement and plan of merger with Firefly Technologies, Inc. ("Firefly"), a Delaware corporation, Zygo TeraOptix, Inc., a Delaware corporation and a wholly-owned subsidiary of the Company, and the security holders of Firefly, pursuant to which the Company agreed to acquire Firefly. Immediately thereafter, the acquisition was consummated by the merger of Zygo TeraOptix with and into Firefly and Firefly became a wholly-owned subsidiary of the Company under the new name Zygo TeraOptix.

Under the terms of the acquisition, the Company exchanged an aggregate of 2,303,937 shares of its common stock, \$.10 par value per share, for all of the then outstanding capital stock and stock options of Firefly. The acquisition, which is intended to be tax free for federal income tax purposes to the Firefly security holders, has been accounted for as a pooling-of-interests transaction. Firefly manufactures metrology equipment, micro-optics, switches and filters for the telecommunications industry, as well as heads and related products for the optical data storage industry. The telecommunications components are used in wave division multiplexers to increase the capacity of optical fibers. The Company intends to continue to use the assets acquired in the acquisition for these purposes.

Related to the transaction and the vesting of certain Firefly stock options, the Company has recorded approximately \$12,024 of additional compensation expense and in addition recorded \$1,977 in acquisition related costs for legal, investment banking and accounting fees in fiscal 2000.

In the fourth quarter of fiscal 2000, the Company decided to discontinue its investment in certain product lines, which were no longer compatible with their strategic plan. Related to the discontinuance of these product lines, the Company recorded approximately \$10,567 of charges in the fourth quarter of fiscal year 2000 which consisted of the write-down of goodwill and other intangible assets (\$5,478) and inventory (\$5,089) which the Company will no longer continue to develop.

On September 1, 1997, the Company, through its Technical Instruments subsidiary, completed the purchase of the remaining 50% of Syncotec Neue Technologien und Instrumente GmbH ("Syncotec") the Company did not already own. The Company paid \$2,262 and issued 19,432 shares of common stock, \$.10 par value, valued at \$623. The transaction was accounted for as a purchase. The net purchase price was allocated to the fair value net assets acquired. This allocation resulted in a charge of \$878 of in-process research and development costs.

In October 1997, the Company terminated merger talks with Digital Instruments, Inc., resulting in a charge for failed merger costs of \$335.

3. Marketable Securities

Marketable securities at June 30, 2000 consist primarily of corporate bonds and tax exempt bonds issued by various state and municipal agencies while marketable securities at June 30, 1999 consist primarily of corporate bonds. Marketable securities at June 30, 2000 and June 30, 1999 are reported either at fair value or at cost depending on their classification. The unrealized loss on marketable securities of \$154 (gross) is shown net of its related tax effect of \$91 as a separate component of stockholders' equity.

Dividend and interest income is recognized when earned. Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of securities sold.

The cost, gross unrealized holding gains, gross unrealized holding losses, and fair value for available-for-sale securities at June 30, 2000 and 1999 were as follows:

	Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
At June 30, 2000				
State and local municipal bonds	\$ 7,240	\$ —	\$ (154)	\$ 7,086
At June 30, 1999				
Corporate bonds	\$ 5,954	\$ —	\$ (117)	\$ 5,837

The Company recorded gross realized gains on the maturity of investment securities of \$0 and \$38 in 2000 and 1999, respectively. There were no gross realized losses recorded in 2000 or 1999.

Maturities of investment securities classified as available-for-sale were as follows at June 30, 2000:

	Cost	Fair Value
Due within one year	\$ —	\$ —
Due after one year through five years	7,240	7,086
	\$ 7,240	\$ 7,086

Maturities of investment securities classified as held-to-maturity were as follows at June 30, 2000:

	Cost	Fair Value
Due within one year	\$ 1,182	\$ 1,182
Due after one year through five years	—	—
	\$ 1,182	\$ 1,182

4. Accounts Receivable

At June 30, 2000 and 1999, accounts receivable, net of allowances, were as follows:

	June 30, 2000	June 30, 1999
Trade (Note 18)	\$ 19,293	\$ 13,343
Other	1,079	462
	\$ 20,372	\$ 13,805
Allowance	(234)	(1,324)
	\$ 20,138	\$ 12,481

5. Inventories

Inventories at June 30, 2000 and 1999 were as follows:

	June 30, 2000	June 30, 1999
Raw materials and manufactured parts	\$ 7,034	\$ 7,866
Work in process	3,471	4,622
Finished goods	1,374	2,985
	\$ 11,879	\$ 15,473

6. Costs in Excess of Billings

Revenues from automation projects are accounted for under the percentage-of-completion method, using total project costs incurred to date in relation to estimated total costs of the contracts to measure the stage of completion. The cumulative effects of revisions of estimated total contract costs and revenues are recorded in the period in which the facts become known. When a loss is anticipated on a contract, the full amount of the loss is provided for currently. The differences between amounts billed and revenue recognized is shown as costs in excess of billings on the accompanying balance sheets.

Totals of revenue earned and billings issued on contracts were as follows:

	June 30, 2000	June 30, 1999
Revenue recognized to date	\$ 37,069	\$ 25,239
Billings to date	31,326	24,579
	\$ 5,743	\$ 660

7. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Costs of replacements and improvements are capitalized and depreciated over a range of 3–40 years. Maintenance and repairs are charged to expense as incurred. At June 30, 2000 and 1999, property, plant and equipment, at cost, were as follows:

	June 30, 2000	June 30, 1999
Land	\$ 897	\$ 897
Building	9,115	9,115
Machinery, equipment and office furniture	23,839	21,887
Leasehold improvements	519	431
Construction in progress	3,621	1,603
	37,991	33,933
Less accumulated depreciation	19,498	17,496
	\$ 18,493	\$ 16,437

8. Goodwill and Other Intangibles

The cost of intangible assets is amortized on a straight-line basis, which ranges from 4 to 20 years. Management evaluates, on an ongoing basis, the carrying value of its intangible assets and makes adjustments when impairments are identified. Goodwill and other intangibles, net, at June 30, 2000 and 1999 were as follows:

	June 30, 2000	June 30, 1999
Goodwill and other intangibles	\$ 5,140	\$ 12,778
Accumulated amortization	2,062	2,839
	\$ 3,078	\$ 9,939

9. Bank Line of Credit

The Company has a \$3,000 unsecured bank line of credit with interest at LIBOR plus 60 basis points (approximately 6.8% at June 30, 2000). The line of credit is available through November 22, 2000. At June 30, 2000 and 1999, no amounts were outstanding under the bank line of credit.

10. Long-Term Debt

As of June 30, 2000, the Company has \$24 in long-term debt obligations as a result of the acquisition of Firefly.

Interest payments on debt and capital leases were \$6, \$11, and \$6 in fiscal 2000, 1999, and 1998, respectively.

11. Leases

The Company leases certain manufacturing equipment and facilities under operating leases, some of which include cost escalation clauses, expiring on various dates through 2005. Total rental expense charged to operations was \$986 in 2000, \$738 in 1999, and \$600 in 1998. At June 30, 2000 the minimum future rental commitments under noncancelable leases payable over the remaining lives of the leases were:

Years ending June 30,	Capital	Operating
2001	\$ 44	\$ 1,253
2002	34	1,167
2003	—	548
2004	—	536
2005	—	877
Total minimum lease payments	78	<u>\$ 4,381</u>
Less amount representing interest	6	
Present value of minimum lease payments	72	
Less current portion of capital lease obligations	40	
Capital lease obligation, excluding current portion	<u>\$ 32</u>	

12. Profit-Sharing Plan

The Company maintains a deferred profit-sharing plan under which substantially all full-time employees of the Company are eligible to participate. Profit-sharing expense for the years ended June 30, 2000, 1999, and 1998 amounted to \$709, \$0, and \$1,370, respectively. Profit-sharing contributions are determined annually at the discretion of the Board of Directors.

Effective June 30, 1985, the existing profit-sharing plan was revised and amended to incorporate a 401(k) tax deferred payroll deduction program and an Employee Stock Ownership Program. Under the 401(k) program, employees may contribute a tax-deferred amount of up to 15% of their compensation, as defined. The Company may contribute to the 401(k) program, an amount determined annually at the discretion of the Board of Directors. The 401(k) contribution expense for the years ended June 30, 2000, 1999, and 1998 amounted to \$500, \$607, and \$603, respectively.

Under the Employee Stock Ownership Program, the Company may, at the discretion of the Board of Directors, contribute its own stock or cash to purchase its own stock. The purchased stock's fair market value cannot exceed the maximum amount of employee stock ownership credit as determined under Section 416 of the Internal Revenue Code. There were no purchases and no contributions made under this program for the years ended June 30, 2000, 1999, and 1998.

With the acquisition of Firefly, the Company maintains a separate defined contribution retirement plan for the employees of Zygo TeraOptix. Employees are eligible to participate after three months of employment with the Company and may elect to defer up to 15% of their salary on a pre-tax basis. The plan allows the Company to make discretionary contributions to the plan, which are allocated to the participants' accounts. The Company has not made any contributions to the plan to date.

13. Stockholders' Equity

On July 31, 2000, the shareholders voted to increase the number of authorized shares from 15 million to 40 million.

14. Stock Compensation Plans

As of June 30, 2000, Zygo Corporation has two stock-based compensation plans, which are described below (see Note 15). The Company applies APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its plans. Since all options were granted with an exercise price equal to the fair-market value on the date of the grant, no compensation cost has been recognized for its fixed option plans. Pro forma information regarding net income and earnings per share is required by SFAS No. 123, *Accounting for Stock-Based Compensation*, which requires that the information be determined as if the Company has accounted for its stock options granted in fiscal years beginning after December 15, 1994 under the fair value method of the statement. The fair value of options at date of grant was estimated using the Black-Scholes model.

The Company's pro forma information is as follows:

	June 30, 2000	June 30, 1999	June 30, 1998
Pro forma net (loss) income	\$ (16,930)	\$ (4,697)	\$ 5,583
Pro forma (loss) earnings per share	\$ (1.35)	\$ (.40)	\$.43

The fair value of these options at the date of grant was estimated with the following weighted average assumptions of 2000 and 1999:

	June 30, 2000	June 30, 1999	June 30, 1998
Risk free rate of interest	5.9%	4.8%	5.8%
Dividend yield	0.0%	0.0%	0.0%
Volatility factor	67%	58%	69%
Expected life of option	5.6 years	5.7 years	6.2 years

The above pro forma information is based on historical activity and may not represent future trends.

15. Stock Option Plans

Employee Stock Option Plan and Data The Zygo Corporation Amended and Restated Non-Qualified Stock Option Plan permits the granting of non-qualified options to purchase a total of 4,850,000 shares (adjusted for splits) of common stock at prices not less than the fair-market value on the date of grant. The Board of Directors approved a repricing of non-qualified options greater than \$30.00 per share at the August 1998 board meeting. The average price of 112,000 shares went from \$35.12 to \$10.81. Options generally become exercisable at the rate of 25% of the shares each year commencing one year after the date of grant. The Plan as amended will expire on September 3, 2002. On July 31, 2000, the shareholders voted to increase the number of shares in the stock option plan by 1,500,000.

	June 30, 2000	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,245,299	\$ 7.2277
Granted	182,650	\$ 23.1386
Exercised	(519,200)	\$ 7.2148
Expired or canceled	(110,450)	\$ 13.2402
Outstanding at end of year	798,299	\$ 10.0199

Zygo Corporation and Subsidiaries

June 30, 1999		
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,416,779	\$ 7.2866
Granted	228,000	\$ 10.5957
Exercised	(184,480)	\$ 1.8362
Expired or canceled	(215,000)	\$ 26.6993
Outstanding at end of year	1,245,299	\$ 7.2277

June 30, 1998		
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,393,324	\$ 5.6865
Granted	280,500	\$ 32.9166
Exercised	(145,170)	\$ 4.5445
Expired or canceled	(111,875)	\$ 11.5510
Outstanding at end of year	1,416,779	\$ 7.2866

Non-Employee Director Stock Option Plan and Data The Zygo Corporation Amended and Restated Non-Employee Director Stock Option Plan permits the granting of non-qualified options to purchase a total of 620,000 shares (adjusted for splits) of common stock at prices not less than the fair-market value on the date of grant. Under the terms of the Plan, each new non-employee director is granted an option to purchase 8,000 shares of common stock, generally on his or her first day of service as a non-employee director; and each other non-employee director is granted an option to purchase 3,000 shares of common stock on an annual basis. All Options are fully exercisable on the date of grant and have a 10 year term. The Plan, as amended, will expire on November 17, 2009.

June 30, 2000		
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	450,000	\$ 6.2292
Granted	15,000	\$ 17.2500
Exercised	(216,000)	\$ 7.4983
Expired or canceled	—	\$ —
Outstanding at end of year	249,000	\$ 5.7922

June 30, 1999		
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	450,000	\$ 6.2292
Granted	—	\$ —
Exercised	—	\$ —
Expired or canceled	—	\$ —
Outstanding at end of year	450,000	\$ 6.2292

	June 30, 1998	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	450,000	\$ 6.2292
Granted	—	\$ —
Exercised	—	\$ —
Expired or canceled	—	\$ —
Outstanding at end of year	450,000	\$ 6.2292

The following table summarizes information about all fixed stock options outstanding at June 30, 2000:

Options Outstanding			
Range of Exercise Prices	Number Outstanding as of June 30, 2000	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
\$ 1.42 - \$ 1.92	44,500	1.88	\$ 1.7774
\$ 2.00 - \$ 2.00	439,374	4.04	\$ 2.0000
\$ 2.42 - \$ 9.50	183,150	5.31	\$ 5.7870
\$10.56 - \$11.75	191,425	8.29	\$10.9900
\$13.38 - \$58.75	182,050	7.85	\$26.6417
\$65.69 - \$70.44	6,800	9.90	\$69.0409
\$ 1.42 - \$70.44	1,047,299	5.65	\$ 9.0147

Options Exercisable		
Range of Exercise Prices	Number Exercisable as of June 30, 2000	Weighted Average Exercise Price
\$ 1.42 - \$ 1.92	44,500	\$ 1.7774
\$ 2.00 - \$ 2.00	439,374	\$ 2.0000
\$ 2.42 - \$ 9.50	98,850	\$ 2.8645
\$10.56 - \$11.75	33,300	\$10.8752
\$13.38 - \$58.75	54,500	\$20.4971
\$65.69 - \$70.44	—	\$ —
\$ 1.42 - \$70.44	670,524	\$ 4.0569

As discussed in Note 2, the Company recorded approximately \$12,024 of additional compensation expense to reflect the derived fair market value of certain Firefly stock options, which were exercised by Firefly employees in connection with the exchange of Firefly capital stock and stock options for Zygo Corporation. No Firefly options have been included in the tables above because all Firefly options were exercised and converted to ZYGO shares in connection with the merger.

16. Income Taxes

The components of income tax expense (benefit) for each year are as follows:

	Fiscal Year Ended June 30,		
	2000	1999	1998
Currently payable:			
Federal	\$ 1,136	\$ (1,339)	\$ 3,670
State	(71)	101	909
Foreign	604	101	285
	\$ 1,669	\$ (1,137)	\$ 4,864
Deferred:			
Federal	\$ (3,051)	\$ (1,034)	\$ (677)
State	(77)	(755)	(143)
Foreign	—	(49)	(53)
	\$ (3,128)	\$ (1,838)	\$ (873)
Total income tax (benefit) expense	\$ (1,459)	\$ (2,975)	\$ 3,991

Income taxes paid (refunded) amounted to \$(2,539), \$(848) and \$4,660, in fiscal 2000, 1999, and 1998, respectively.

The total income tax expense (benefit) differs from the amount computed by applying the applicable U.S. federal income tax rate of 35% in each of the fiscal years 2000, 1999, and 1998 to earnings before income taxes for the following reasons:

	Fiscal Year Ended June 30,		
	2000	1999	1998
Computed "expected" tax expense (benefit)	\$ (5,886)	\$ (2,400)	\$ 3,858
Increases (reductions) in taxes resulting from:			
Nondeductible acquisition-related charges	4,329	—	458
State taxes, net of federal income tax benefit	(96)	(432)	498
Tax exempt interest income	(15)	(131)	(179)
FSC benefit	(300)	—	(637)
Other, net	509	(12)	(7)
	\$ (1,459)	\$ (2,975)	\$ 3,991

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of June 30, 2000 and 1999, are presented below:

	June 30, 2000	June 30, 1999
Deferred tax assets:		
Accounts receivable, principally due to the allowance for doubtful accounts	\$ 468	\$ 501
Accrued liabilities	395	941
Inventory valuation	1,412	1,978
Unrealized gain on marketable securities	57	—
One-time charges	2,140	—
Intangibles	245	—
Federal and state NOL and credits	4,572	380
Other	30	52
	9,319	3,852
Less valuation allowance	—	—
Deferred tax asset	9,319	3,852
Deferred tax liabilities:		
Prepaid expenses	(39)	(52)
Plant and equipment, principally due to differences in depreciation expense	(516)	(290)
Intangibles	—	(1,892)
Unrealized gain on marketable securities	—	(9)
Other	(15)	(26)
Deferred tax liability	(570)	(2,269)
Net deferred tax asset (liability)	\$ 8,749	\$ 1,583

The net current deferred tax assets and net noncurrent deferred tax liabilities as recorded on the balance sheet as of June 30, 2000 and 1999 are as follows:

	June 30, 2000	June 30, 1999
Net current deferred tax asset	\$ 9,020	\$ 3,715
Net noncurrent deferred tax liability	(271)	(2,132)
Net deferred tax asset (liability)	\$ 8,749	\$ 1,583

A valuation allowance has not been recorded because the Company believes that the deferred tax assets will, more likely than not, be realized. This determination is based largely upon the Company's historical earnings trend as well as its ability to carryback reversing items and recover taxes paid in the carryback period. In addition, the Company has the ability to offset deferred tax assets against deferred tax liabilities associated with such items as depreciation and amortization.

The Company has federal and state net operating loss carryforwards of approximately \$8,220 and \$22,571 which are available to reduce federal and state taxable income, if any, through 2019.

The company also has a federal general business credit carry forward of approximately \$874, which is available to reduce federal taxable income, if any, through 2019.

17. Segment Reporting

The Company has adopted FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* ("Statement 131"). Statement 131 establishes standards, using a management approach, for reporting information regarding operating segments in annual financial statements. The management approach designates the internal reporting that is used by the chief operating decision-maker when making operating decisions and assessing performance, as the source of the Company's reportable segments. The Company's president has been determined to be its chief operating decision-maker, as defined under Statement 131. The Company is managed as a single operating segment with a centrally managed sales force selling ZYGO's products in regional offices located in the U.S., Japan, Europe, and Asia.

For its fiscal year 2000, ZYGO continued to operate in one segment, as a world leader in metrology, process control, and yield solutions servicing high precision industries. Beginning in fiscal 2001, the Company will capture and report on its operations in three segments: Semiconductor/Data Storage, Industrial, and Telecommunications. Substantially all of the Company's operating results, assets, depreciation, and amortization are U.S. based. The Company's export sales are noted below.

The Company is headquartered in Middlefield, Connecticut, and also has facilities in Asslar, Germany; Longmont, Colorado; Holliston, Massachusetts; and in Newbury Park and Sunnyvale, California.

Sales to Canon Inc. and to Canon Sales Co., Inc., accounted for more than 18% of total Company sales for each of the years ended June 30, 2000, 1999, and 1998 (see Note 18). The Company recorded 3%, 6%, and 13% of total Company sales with the University of California's Lawrence Livermore National Laboratories for the years ended June 30, 2000, 1999, and 1998, respectively (see Note 19). No other individual customer accounted for more than 10% of total Company sales for any year presented in the accompanying consolidated financial statements.

Export sales by geographic area were as follows:

	Fiscal Year Ended June 30,		
	2000	1999	1998
Far East:			
Japan	\$ 17,588	\$ 14,143	\$ 22,284
Pacific Rim	11,714	6,038	11,348
Total Far East	\$ 29,302	\$ 20,181	\$ 33,632
Europe and other	9,106	7,848	9,387
Total	\$ 38,408	\$ 28,029	\$ 43,019

18. Related Party Transactions

Sales to Canon Inc., a stockholder, and to Canon Sales Co., Inc., a distributor for certain of the Company's products in Japan and a subsidiary of Canon Inc., amounted to approximately \$16,463 (19% of net sales), \$13,375 (21% of net sales), and \$17,626 (18% of net sales), for the years ended June 30, 2000, 1999, and 1998, respectively.

Selling prices of products sold to Canon Inc. and Canon Sales Co., Inc. are based, generally, on the normal terms given to distributors. At June 30, 2000 and 1999, there was approximately, in the aggregate, \$2,171 and \$1,548, respectively, of trade accounts receivable from Canon Inc. and Canon Sales Co., Inc.

19. Material Contracts

On May 9, 1997, the Company announced it had entered into a contract with the University of California's Lawrence Livermore National Laboratory ("LLNL"), whereby the Company will be a primary supplier of large plano optical components for the National Ignition Facility ("NIF"), a \$1.2 billion Department of Energy project at LLNL to produce the world's largest laser for nuclear fusion research. The contract provided for the Company to design, manufacture, and equip a world-class optical fabrication facility at its Middlefield, Connecticut operations for a fixed price of nearly \$10 million over an 18-month time period. Revenues recognized on this contract in fiscal 2000 and 1999 amounted to \$2,802 and \$900, respectively. To accommodate the space required for the NIF facility and provide additional office facilities, the Company has built a 35,500-square-foot building addition at its Middlefield, Connecticut site.

During fiscal year 1999, the Company entered into an agreement with IBM, which allows for marketing and servicing rights for its Atomic Force Microscope (AFM) line of business for a four-year period. The Company made payments totaling \$2,250 to secure this relationship, which is being amortized over four years or less.

On March 28, 2000, the Company entered into an agreement to terminate the distribution agreement to market and sell AFM products. As part of the agreement, the Company was granted a nonexclusive license to the IBM AFM technology for the next three years and may continue to license the technology for additional terms thereafter. The Company and Veeco Corporation, who subsequently entered into the distribution agreement from IBM, have entered into an additional agreement for support and service of AFM products previously sold by ZYGO. As a result of this agreement, ZYGO's AFM sales and service department has been discontinued.

Report of Management

Management is responsible for preparing the Company's consolidated financial statements and related information that appears in this report on Form 10-K405. Management believes that the financial statements fairly reflect the form and substance of transactions and reasonably present the Company's financial condition and results of operations in conformity with generally accepted accounting principles. Management has included in the Company's financial statements amounts that are based on estimates and judgments which it believes are reasonable under the circumstances.

The Company maintains a system of internal accounting policies, procedures, and controls intended to provide reasonable assurance, at appropriate cost, that transactions are executed in accordance with Company authorization and are properly recorded and reported in the financial statements, and that assets are adequately safeguarded.

KPMG LLP audits the Company's financial statements in accordance with generally accepted auditing standards and provides an objective, independent review of the fairness of reported financial condition and results of operations.

The Board of Directors of the Company has an Audit Committee composed of nonmanagement directors. The Committee meets with financial management and the independent auditors to review internal accounting controls and accounting, auditing, and financial reporting matters.

Michael J. Auth

Vice President of Finance,

Treasurer, and Chief Financial Officer

Report of Independent Auditors

The Board of Directors and Stockholders of Zygo Corporation:

We have audited the accompanying consolidated balance sheets of Zygo Corporation and subsidiaries as of June 30, 2000 and 1999, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the years in the three-year period ended June 30, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Zygo Corporation and subsidiaries as of June 30, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2000, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP
Hartford, Connecticut
August 12, 2000

Selected Consolidated Quarterly Financial Data (Unaudited)

<i>(thousands, except per share amounts)</i>	For the Fiscal Year Ended June 30, 2000			
	September 30	December 31	March 31	June 30 ⁽³⁾
Net sales	\$ 18,603	\$ 22,362	\$ 22,408	\$ 23,870
Earnings (loss) before taxes, minority interest and nonrecurring charges	\$ 926	\$ 2,424	\$ 2,136	\$ 1,770
Income taxes	354	960	609	342
Minority interest	—	73	(6)	127
Earnings (loss) before nonrecurring charges	\$ 572	\$ 1,391	\$ 1,533	\$ 1,301
Earnings (loss) per share before nonrecurring charges:				
Basic	\$ 0.05	\$ 0.12	\$ 0.13	\$ 0.09
Diluted	\$ 0.04	\$ 0.11	\$ 0.11	\$ 0.08
Net earnings (loss)	\$ 572	\$ (949)	\$ 792	\$ (16,462)
Net earnings (loss) per share:				
Basic ⁽¹⁾	\$ 0.05	\$ (0.08) ⁽²⁾	\$ 0.06	\$ (1.17) ⁽²⁾
Diluted ⁽¹⁾	\$ 0.04	\$ (0.08) ⁽²⁾	\$ 0.06	\$ (1.17) ⁽²⁾

	For the Fiscal Year Ended June 30, 1999			
	September 30	December 31	March 31	June 30
Net sales	\$ 16,086	\$ 16,437	\$ 13,679	\$ 17,180
Earnings (loss) before taxes	\$ (1,496)	\$ (563)	\$ (5,423)	\$ 631
Income taxes	(463)	23	(1,789)	(746)
Net earnings (loss)	\$ (1,033)	\$ (586)	\$ (3,634)	\$ 1,377
Net earnings (loss) per share:				
Basic ⁽¹⁾	\$ (0.09) ⁽²⁾	\$ (0.05) ⁽²⁾	\$ (0.31) ⁽²⁾	\$ 0.12
Diluted ⁽¹⁾	\$ (0.09) ⁽²⁾	\$ (0.05) ⁽²⁾	\$ (0.31) ⁽²⁾	\$ 0.11

- (1) The difference between basic shares outstanding and diluted shares outstanding is the assumed conversion of common stock equivalents (stock options) in the amounts of 1,075,000, 0, 1,595,000, and 0 for fiscal 2000 quarters and 0, 0, 0, and 1,073,000 for the fiscal 1999 quarters ended September 30, December 31, March 31, and June 30, respectively.
- (2) Generally accepted accounting principles requires the computation of the net loss per share to be based on the weighted average basic shares outstanding.
- (3) Nonrecurring charges include acquisition-related charges of \$14,001 and the West Coast operations reorganization cost of \$10,567 in the fourth quarter ended June 30, 2000.

STOCKHOLDERS INFORMATION

Annual Meeting <i>November 15, 2000</i>	Auditors <i>KPMG LLP</i> <i>City Place II</i> <i>Hartford, Connecticut 06103</i>
Corporate Headquarters <i>Laurel Brook Road</i> <i>Middlefield, Connecticut</i> <i>06455</i>	Legal Counsel <i>Fulbright & Jaworski LLP</i> <i>666 Fifth Avenue</i> <i>New York, New York 10103</i>
Web Site: <i>www.zygo.com</i>	Transfer Agent and Registrar <i>Continental Stock Transfer and Trust Company</i> <i>2 Broadway</i> <i>New York, New York 10004</i>
E-mail: <i>inquire@zygo.com</i>	
Zygo TeraOptix <i>Holliston, Massachusetts</i>	
Facilities and Offices <i>Sunnyvale, California</i> <i>Longmont, Colorado</i> <i>Delrey Beach, Florida</i> <i>Northbrook, Illinois</i> <i>Germany</i> <i>Japan</i> <i>Singapore</i> <i>Taiwan</i>	Dividends <i>The Company has not declared or paid cash dividends since becoming a public company.</i> <i>ZYGO, and ZYGO logo, are registered trademarks of Zygo Corporation.</i>

STOCK DATA

The number of stockholders of record at June 30, 2000 was 492.

The Company's common shares are traded over-the-counter and are quoted on the NASDAQ/National Market under the symbol "ZIGO." Market price data for 2000 and 1999, is as follows:

	Fiscal Year Ended June 30, 2000		Fiscal Year Ended June 30, 1999	
	High	Low	High	Low
First Quarter	\$14 ⁵ / ₁₆	\$ 9 ¹ / ₄	\$15 ³ / ₄	\$6 ³ / ₁₆
Second Quarter	\$25 ¹ / ₁₆	\$13	\$12 ³ / ₄	\$5
Third Quarter	\$74 ⁵ / ₁₆	\$19 ³ / ₈	\$15 ³ / ₄	\$8 ¹ / ₂
Fourth Quarter	\$94	\$20 ³ / ₄	\$13 ¹ / ₈	\$7 ¹ / ₄

TRIBUTE TO GARY WILLIS

Gary K. Willis, chairman, has indicated his desire to retire from the Company at the conclusion of this year's annual meeting of shareowners. During the past decade, Zygo Corporation has experienced record revenue growth and financial performance under his leadership. For the five years ending in fiscal 1998, the Company enjoyed revenue growth of 30% CAGR and earnings per share growth of over 50% CAGR. This performance was recognized in leading business publications, with Fortune, Forbes, and Business Week magazines citing the Company as a "Top 100 Fastest Growing," "200 Best Financially Performing," and "Top Performing Nasdaq Security," respectively. In addition, as the Company enters the new century, a solid core business infrastructure exists to support an ever-rapidly-expanding growth potential. We know all of our shareowners join with the employees, management, and directors to express our appreciation for his efforts and to wish him well in the future.



DIRECTORS

John Berg
Zygo TeraOptix

Paul F. Forman
Chairman Emeritus

R. Clark Harris
Partner
NorthEast Ventures
Associates, LLC

Seymour E. Liebman
Executive Vice President
and General Counsel
Canon USA, Inc.

Robert G. McKelvey
Chairman and President
George McKelvey Co., Inc.

J. Bruce Robinson
Zygo Corporation

Patrick Tan
Vice President, Business
Operations, Zygo TeraOptix

Robert B. Taylor
Vice President and Treasurer
Wesleyan University

Gary K. Willis
Zygo Corporation

Carl A. Zanoni
Zygo Corporation

CORPORATE AND OPERATING MANAGEMENT

J. Bruce Robinson
President and
Chief Executive Officer

Michael J. Auth
Vice President, Finance and
Chief Financial Officer

William H. Bacon
Vice President,
Metrology Manufacturing

John Berg
President, Zygo TeraOptix

D.E. (Mike) Davis
Vice President, General
Manager, Automation Systems

Lawrence C. Martin
Staff Assistant to the
President

Brian J. Monti
Vice President, Worldwide
Sales and Marketing

Peter B. Mumola
Vice President, Optics Division

David J. Person
Vice President,
Human Resources

Robert A. Smythe
Vice President, Engineering

Patrick Tan
Vice President, Business
Operations, Zygo TeraOptix

Carl A. Zanoni
Vice President, Technology

Paul Jacobs
Secretary