The financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operation" and with the Company's Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report.

(Dollars in thousands, except for share, per share, and ratio amounts)	Fiscal Year Ended June 30,				
	2002	2001	2000	1999	1998
Net sales	**$ 84,426**	$133,250	$ 87,243	$ 63,382	$ 99,084
Gross profit	**$ 24,796**[1]	$ 61,169	$ 32,555[1]	$ 22,385	$ 41,449
% of sales	**29%**	46%	37%	35%	42%
(Loss) earnings before taxes and nonrecurring items	**$(22,111)**[1]	$ 14,113	$ 7,256[1]	$ (6,851)	$ 12,940[1]
% of sales	**(26)%**	11%	8%	(11)%	13%
(Loss) earnings before nonrecurring items	**$(13,889)**[1]	$ 10,659	$ 4,797[1]	$ (3,876)	$ 8,949[1]
% of sales	**(16)%**	8%	5%	(6)%	9%
(Loss) earnings per share before nonrecurring items					
Basic	**$ (0.80)**[1]	$ 0.69	$ 0.38[1]	$ (0.33)	$ 0.78[1]
Diluted	**$ (0.80)**[1]	$ 0.66	$ 0.34[1]	$ (0.33)	$ 0.69[1]
Net (loss) earnings	**$(11,733)**	$ 10,659	$(16,047)	$ (3,876)	$ 7,029
Net (loss) earnings per common share:					
Basic	**$ (0.67)**	$ 0.69	$ (1.28)	$ (0.33)	$ 0.61
Diluted	**$ (0.67)**	$ 0.66	$ (1.28)	$ (0.33)	$ 0.55
Weighted average number of shares:					
Basic[2]	**17,414**	15,398	12,511	11,780	11,480
Diluted[2]	**17,414**	16,063	12,511	11,780	12,877
Research and development	**$ 21,346**	$ 17,673	$ 11,270[1]	$ 9,185	$ 9,844
Capital expenditures	**$ 17,640**	$ 33,050	$ 6,513	$ 4,372	$ 9,126
Depreciation and amortization	**$ 7,251**	$ 3,996	$ 11,318[1]	$ 4,448	$ 3,412

	June 30,				
	2002	2001	2000	1999	1998
Working capital	**$ 73,931**	$ 94,112	$ 56,550	$ 43,766	$ 50,246
Current ratio	**5.7**	4.8	4.5	4.8	4.1
Total assets	**$169,201**	$186,832	$ 95,162	$ 82,442	$ 91,444
Long-term debt (excluding current portion)	**$ 11,374**	$ 12,281	$ 84	$ 36	$ 65
Stockholders' equity	**$140,005**	$149,139	$ 78,229	$ 68,712	$ 72,391
Price-earnings ratio	**N/A**	33.7	N/A	N/A	26.9
Number of employees at year end	**537**	648	486	444	466
Sales per employee – average	**$ 157**	$ 206	$ 179	$ 143	$ 213
Book value per common share	**$ 7.99**	$ 8.48	$ 5.50	$ 6.16	$ 6.60
Market price per common share at year end	**$ 8.050**	$ 22.250	$ 90.813	$ 11.438	$ 14.813

(1) Nonrecurring items include the gain on sale of the Automation Systems Group of $6,142 and related exit costs of $1,856, inventory write-downs of $808, and tax expense of $1,322 in the second quarter ended December 30, 2001; acquisition-related charges of $14,001 and $1,585, in the fourth quarter ended June 30, 2000, and in the first quarter ended September 30, 1997, respectively; West Coast operations reorganization costs 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.

(2) 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, 665, 0, 0, and 1,397, in the years ended June 30, 2002, 2001, 2000, 1999, and 1998, respectively. Accounting principles generally accepted in the United States of America require the computation of the net loss per share to be based on the weighted average basic shares outstanding.

Zygo Corporation's Value Statements are highlighted throughout this year's annual report.

Integrity — We maintain the highest ethical standards and are honest in all our business transactions.

Management's Discussion and Analysis

Critical Accounting Policies, Significant Judgments and Estimates

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

Revenue Recognition and Allowance for Doubtful Accounts The Company recognizes revenue based on guidance provided in Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements." The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, there is no significant risk pertaining to customer acceptance, our price is fixed or determinable, and collectibility is reasonably assured.

The Company maintains an allowance for doubtful accounts based on a continuous review of customer accounts, payment patterns, and specific collection issues. We perform on-going credit evaluations of our customers and do not require collateral from our customers. For many of our international customers, we require an irrevocable letter of credit to be issued by the customer before a shipment is made. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required.

Inventory Valuation Inventories are valued at the lower of cost or market, cost being determined on a first-in, first-out basis. Management evaluates the need to record adjustments for impairment of inventory on a monthly basis. The Company's policy is to assess the valuation of all inventories, including raw materials, work-in-process, and finished goods. Obsolete inventory or inventory in excess of management's estimated usage is written-down to its estimated market value, if less than its cost. Contracts with fixed prices are evaluated to determine if estimated total costs will exceed revenues. A loss provision is recorded when the judgment is made that actual costs incurred plus estimated costs remaining to be incurred will exceed total revenues from the contract. Inherent in the estimates of market value are management's estimates related to current economic trends, future demand for the Company's products, and technological obsolescence. Significant management judgments must be made when establishing the reserve for obsolete and excess inventory and losses on contracts. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Warranty Costs The Company provides for the estimated cost of product warranties at the time revenue is recognized. The Company considers historical warranty costs actually incurred to establish the warranty liability. Should actual costs differ from management's estimates, revisions to the estimated warranty liability would be required.

Accounting for Income Taxes Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases, and operating loss and tax credit carryforwards. Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," requires the establishment of a valuation allowance to reflect the likelihood of the realization of deferred tax assets. The Company records a valuation allowance to reduce its deferred tax assets to an estimated amount based on historical and forecasted results. While management has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event management were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the valuation allowance would increase income in the period such determination was made. Likewise, should management determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the valuation allowance would be charged to income in the period such determination was made. Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss, changes to the valuation allowance, changes to federal, state or foreign tax laws, and deductibility of certain costs and expenses by jurisdiction.

Valuation of Long-Lived Assets In accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," the carrying

value of intangible assets and other long-lived assets is reviewed on a regular basis for the existence of facts or circumstances, both internally and externally, that may suggest impairment. Some factors we consider important, which could trigger the impairment review, include a significant decrease in the market value of an asset, a significant change in the extent or manner in which an asset is used, a significant adverse change in the business climate that could affect the value of an asset, and an accumulation of costs for an asset in excess of the amount originally expected.

If such circumstances exist, we evaluate the carrying value of long-lived assets to determine if impairment exists based upon estimated undiscounted future cash flows over the remaining useful life of the assets and comparing that value to the carrying value of the assets. If the carrying value of the asset is greater than the estimated future cash flows, the asset is written down to the estimated fair value. We determine the estimated fair value of the assets on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in the current business model. Our cash flow estimates contain management's best estimates, using appropriate and customary assumptions and projections at the time.

Off-Balance Sheet Arrangements We have not created, and are not party to, any special-purpose or off-balance sheet entities for the purpose of raising capital, incurring debt or operating parts of our business that are not consolidated into our financial statements.

Results of Operations

Fiscal 2002 Compared to Fiscal 2001 On December 12, 2001, the Company sold its Automation Systems Group in Longmont, Colorado, to Brooks Automation, Inc. of Chelmsford, Massachusetts, in a cash transaction, for $12,165,000. Substantially all of the assets were sold to Brooks and substantially all of the liabilities were assumed by Brooks. The gain on the sale was $6,142,000 before related exit costs of $1,856,000 to be paid from the proceeds, inventory write-downs of $808,000, and tax expense of $1,322,000.

Net sales of $84,426,000 for fiscal 2002 decreased by $48,824,000, or 37%, from fiscal 2001 net sales of $133,250,000. For fiscal 2002, net sales in the semiconductor segment were $37,483,000, or 44% of total net sales, as compared to $84,561,000, or 64%, in the prior year period; net sales in the industrial segment were $40,336,000, or 48% of total net sales, as compared to $35,178,000, or 26%, in the prior year period; and net sales in the telecommunications segment were $6,607,000, or 8% of total net sales, as compared to $13,511,000, or 10%, in the prior year period. The decrease in sales is primarily due to a decrease in units sold, reflecting the downturn in the semiconductor and telecommunications industries.

Company sales to the Americas, primarily the United States, amounted to $41,040,000 in fiscal 2002, a decrease of $27,259,000, or 40%, from fiscal 2001 levels of $68,299,000. The Company's sales to outside the Americas amounted to $43,386,000 in fiscal 2002, a decrease of $21,565,000, or 33%, from fiscal 2001 levels of $64,951,000. Sales to Japan during fiscal 2002 amounted to $21,268,000, a decrease of $23,926,000, or 53%, from fiscal 2001 sales levels. Sales to Europe/Other, primarily Europe, amounted to $14,064,000, an increase of $1,730,000, or 14%, from fiscal 2001. Sales to the Pacific Rim, excluding Japan, amounted to $8,054,000, an increase of $631,000, or 9%, from 2001 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 2002 amounted to $24,796,000, (including $808,000 of inventory write-downs related to the sale of the Automation Systems Group in Longmont, Colorado to Brooks Automation, Inc. in December 2001), a decrease of $36,373,000, or 59%, from gross profit of $61,169,000 in fiscal 2001. Gross profit as a percentage of sales in fiscal 2002 was 29%, as compared to 46% in fiscal 2001. The decrease in gross profit and gross profit as a percentage of sales were primarily due to lower production volumes.

Selling, general and administrative expenses ("SG&A") in fiscal 2002 amounted to $25,173,000, a decrease of $3,946,000, or 14%, from fiscal 2001. SG&A as a percentage of net sales in fiscal 2002 was 30%, as compared to 22% in fiscal 2001. The decrease in SG&A for fiscal 2002 resulted from lower incentive compensation costs due to lower sales volumes and net losses for fiscal 2002.

Research, development and engineering expenses ("R&D") in fiscal 2002 totaled $21,346,000 and increased by $3,673,000, or 21%, from fiscal 2001. R&D as a percentage of net sales in fiscal 2002 was 25%, as compared to 13% in fiscal 2001. This increase was primarily due to the continued investment in the semiconductor segment, primarily in the motion measurement product line, through the first three quarters of fiscal 2002.

Amortization expense of $963,000 for fiscal 2002 increased by $166,000, or 21%, from fiscal 2001 levels of $797,000.

The Company's operating loss in fiscal 2002 was $24,542,000, (including $1,856,000 of exit costs and $808,000 of inventory write-downs related to the sale of Automation Systems Group in Longmont, Colorado), as compared to an operating profit of $13,580,000 in fiscal 2001. Operating loss as a percentage of sales in fiscal 2002 was 29%, as compared to the operating profit as a percentage of sales of 10% in fiscal 2001.

Income tax benefit in fiscal 2002 totaled $6,900,000, or 38% of pretax losses, which compares with income tax expense of $3,454,000, or 24% of pretax profits, in fiscal 2001. The change in the effective tax rate is primarily due to the impact of transactions involving the early sale of stock resulting from the exercise of stock options by former employees of Firefly Technologies, Inc. (renamed Zygo TeraOptix), and changes in the valuation for certain state tax carryforwards.

The Company recorded a net loss for fiscal year 2002 of $11,733,000, or $.67 loss per share, as compared to a net profit of $10,659,000, or $.66 on a diluted per share basis, during fiscal 2001. Excluding the gain on sale of the Automation Systems Group in Longmont, Colorado, of $6,142,000 and related exit costs ($1,856,000), inventory write-downs ($808,000), and tax expense ($1,322,000), the net loss was $13,889,000, or $.80 on a diluted per share basis, for fiscal year 2002.

The basic and diluted weighted average number of shares outstanding for the fiscal year ended June 30, 2002 were 17,414,000 as compared to 15,398,000 basic shares and 16,063,000 fully diluted shares for the fiscal year ended June 30, 2001. The increase in the number of shares outstanding

was primarily due to the 2,925,000 shares issued in March 2001 in the secondary offering of the Company's common stock.

Backlog at June 30, 2002 was $47,129,000, a decrease of $6,768,000, or 13%, as compared to $53,897,000 (excluding backlog from the Automation Systems Group in Longmont, Colorado) at June 30, 2001. The year-end fiscal 2002 backlog consisted of $21,983,000, or 47%, in the semiconductor segment, $15,700,000, or 33%, in the industrial segment, and $9,446,000, or 20%, in the telecommunications segment. Orders, net of debookings, for the fiscal year ended June 30, 2002 totaled $79,106,000 (including $1,448,000 related to the Automation Systems Group sold in December 2001) and consisted of $27,578,000, or 35%, in the semiconductor segment, $44,287,000, or 56%, in the industrial segment, and $7,241,000, or 9%, in the telecommunications segment.

Fiscal 2001 Compared to Fiscal 2000 Net sales of $133,250,000 for fiscal 2001 increased by $46,007,000, or 53%, from fiscal 2000 net sales of $87,243,000. The significant increase in sales was due to increased demand from key markets, specifically increased sales and market share in stage metrology, optical metrology, and macro optics products. For fiscal 2001, net sales in the semiconductor segment were $84,561,000, or 64%, net sales in the industrial segment were $35,178,000, or 26%, and net sales in the telecommunications segment were $13,511,000, or 10%.

Company sales to the Americas, primarily the United States, amounted to $68,299,000 in fiscal 2001, an increase of $19,464,000, or 40%, from fiscal 2000 levels of $48,835,000. The Company's sales to outside the Americas amounted to $64,951,000 in fiscal 2001, an increase of $26,543,000, or 69%, from fiscal 2000 levels of $38,408,000. Sales to Japan during fiscal 2001 amounted to $45,194,000, an increase of $27,606,000, or 157%, from fiscal 2000 sales levels. Japan sales reached record levels driven by demand for stage metrology, metrology instrumentation components and systems, and semiconductor and optical storage. Sales to Europe/Other, primarily Europe, amounted to $12,334,000, an increase of $3,228,000, or 35%, from fiscal 2000 due to increased sales in the industrial and semiconductor markets driven by the first full year of operations of the ZygoLOT joint venture. Sales to the Pacific Rim, excluding Japan, amounted to $7,423,000, a decrease of $4,291,000, or 37%, from 2000 sales levels due to reductions in sales in the semiconductor and industrial markets. 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 2001 amounted to $61,169,000, an increase of $28,614,000, or 88%, from gross profit of $32,555,000 in fiscal 2000. Excluding fiscal 2000 nonrecurring charges of $4,214,000, gross profit for fiscal 2001 increased $24,400,000, or 66%. Gross profit as a percentage of sales in fiscal 2001 was 46%, as compared to 37% in fiscal 2000. Excluding nonrecurring charges, fiscal 2000 gross profit as a percentage of net sales was 42%. On a comparable basis, excluding nonrecurring charges for fiscal 2000, the increase in gross profit and gross profit as a percentage of sales were primarily due to the increase in volume and higher productivity resulting from investments in equipment and manufacturing process enhancements.

Selling, general and administrative expenses ("SG&A") in fiscal 2001 amounted to $29,119,000, an increase of $10,615,000, or 57%, from fiscal 2000. As a percentage of net sales, SG&A has remained relatively constant at approximately 22%. The increase in fiscal 2001 resulted from increased commissions and incentive compensation costs resulting from higher sales and profit and increased administrative costs due to one new location that opened during the year, three locations which opened last fiscal year that now have been operating for a full year, and higher professional fees. During fiscal 2000, the Company recorded a $1,000,000 credit to SG&A as a result of a legal settlement.

Research, development and engineering expenses ("R&D") in fiscal 2001 totaled $17,673,000 and increased by $6,403,000, or 57%. Excluding fiscal 2000 nonrecurring charges of $875,000, fiscal 2001 R&D costs increased $7,278,000, or 70%. R&D as a percentage of net sales has remained relatively constant at approximately 13%. The Company continues to invest in technology to enhance its position in the marketplace. R&D was driven by investments in next generation lithography product requirements and investments to broaden our customer base into automotive and telecommunications.

The Company did not record any nonrecurring charges in fiscal 2001. The Company recorded nonrecurring charges in the amount of $24,568,000 in fiscal 2000. The Company recorded nonrecurring charges of $14,001,000 as a result of the acquisition of Firefly Technologies, Inc., which became Zygo TeraOptix, Inc. ("Zygo TeraOptix"). The nonrecurring charge from the acquisition consisted of $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. In 2000, 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.

Amortization expense of $797,000 for fiscal 2001 decreased by $6,305,000, or 89%, from fiscal 2000 levels of $7,102,000. Substantially all of the decrease is associated with the West Coast operations write-off of goodwill and other intangible assets in fiscal 2000.

The Company's operating profit in fiscal 2001 was $13,580,000, an increase of $31,902,000 from the operating loss of $18,322,000. Excluding fiscal 2000 nonrecurring charges of $24,568,000, operating profit for fiscal 2001 increased $7,334,000. Operating profit as a percentage of sales in fiscal 2001 was 10%, as compared to the operating loss as a percentage of sales of 21% in fiscal 2000. Excluding nonrecurring charges, fiscal 2000 operating profit as a percentage of sales was 7%.

Income tax expense in fiscal 2001 totaled $3,454,000, or 24% of pretax profits, which compares with income tax benefit of $1,459,000, or 8% of pretax losses, in fiscal 2000. The effective

tax rate of 24% versus the combined federal and state statutory rate of 39% in fiscal 2001 is primarily due to the impact of transactions involving the early sale of stock resulting from the exercise of incentive stock options by former employees of Firefly (renamed Zygo TeraOptix). The effective tax rate of 8% versus the combined statutory rate of 39% in fiscal 2001 was primarily due to the tax benefits related to expenses that could not be recorded as a charge to earnings for financial statement purposes associated with the compensation charge in connection with the Firefly acquisition.

The Company recorded net earnings for fiscal year 2001 of $10,659,000, or $.66 on a diluted per share basis, as compared to a net loss of $16,047,000, or $1.28 loss per share, during fiscal 2000. Excluding nonrecurring charges for fiscal year 2000, net earnings were $4,797,000, or $.34 on a diluted per share basis. The diluted weighted average number of shares outstanding at June 30, 2001 was 16,063,000, an increase of 3,552,000 as compared to 12,511,000 at June 30, 2000. The increase is due to the shares related to the secondary offering and the impact of stock options offset by the repurchase of shares from two officers and directors.

Backlog at June 30, 2001 was $55,502,000, an increase of $9,559,000, or 21%, as compared to $45,943,000 at June 30, 2000. The year-end fiscal 2001 backlog consisted of $11,206,000, or 20%, in the semiconductor segment, $31,689,000, or 57%, in the industrial segment, and $12,607,000, or 23%, in the telecommunications segment. The backlog decreased $14,851,000 between the third and fourth quarters due to the slowdown in the semiconductor and telecommunications markets. Orders for fourth quarter fiscal 2001 totaled $23,019,000 and consisted of $17,308,000, or 75%, in the semiconductor segment, $7,711,000, or 34%, in the industrial segment, and net debooking of $2,000,000, or (9%), in the telecommunications segment. The net debooking in the telecommunications segment was primarily due to cancellations of orders totaling $8,806,000 from two major customers due to market conditions.

Liquidity and Capital Resources

At June 30, 2002, working capital was $73,931,000, a decrease of $20,181,000 from the $94,112,000 at June 30, 2001. The Company maintained cash, cash equivalents, and marketable securities (excluding restricted cash of $1,225,000) at June 30, 2002 totaling $37,247,000, a decrease of $22,504,000 from June 30, 2001. Excluding the cash received from the sale of the Automation Systems Group of $10,949,000 (net of escrow of $1,216,000) there would have been a decrease of $33,453,000 during the year ended June 30, 2002. Marketable securities are invested primarily in securities with maturity dates ranging from fiscal 2003 to fiscal 2006. The decrease in working capital was due to the operating loss, decreases in accounts payable and accrued expenses and progress payments, and investments in property, plant, and equipment, partially offset by a decrease in receivables (in all cases, after excluding the Automation Systems Group assets and liabilities from the June 30, 2001 balance sheet which were transferred to Brooks Automation, Inc.). The decrease in accrued expenses was due to payments of profit sharing and other incentive compensation liabilities that existed at June 30, 2001. Due to the current year net loss, similar liabilities did not exist as of June 30, 2002. The investments in property, plant, and equipment are primarily due to investments in optical equipment ($4,959,000) and the completion of the Zygo TeraOptix facility in Westborough, Massachusetts ($7,657,000). There were no borrowings outstanding under the Company's $3,000,000 bank line of credit at fiscal year-end 2002. Stockholders' equity at June 30, 2002 decreased by $9,134,000 from the year earlier to $140,005,000, primarily due to 2002 net loss. The Company incurred significant losses from its telecommunications segment and there is very little visibility as to when a healthy telecommunications market will occur. Management is reviewing various options to reduce the effect of its ongoing negative impact on the financial results. The Company's short-term liquidity at June 30, 2002 was adequate for its requirements and the Company expects that available cash and its existing credit facility will be sufficient to meet normal operating requirements over the near term.

Financial Market Risks

The following discussion about our market risk involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes.

Interest Rate Sensitivity We maintain a portfolio of cash equivalents and marketable securities including money market funds, commercial paper, government agency securities, and corporate bonds. Our interest income on our variable rate investments is sensitive to changes in the general level of U.S. interest rates, particularly since the majority of our investments are short-term instruments. Due to the short-term nature of our investments, we do not believe that a material risk exposure exists.

During fiscal 2001 the Company entered into a mortgage on its Westborough facility of $12,560,000 at an interest rate of LIBOR (1.8% at June 30, 2002) which is payable in full in May 2007. In addition to the normal fluctuations in LIBOR, the interest rate can increase during the life of the mortgage by up to 250 basis points depending on the Company's performance against a debt ratio. In conjunction with the mortgage, the Company entered into an interest rate swap agreement that provides for a fixed interest rate of 6% for the duration of the mortgage. In addition, the variable interest rate will continue to be applied to the outstanding mortgage amount. The effective interest rate at June 30, 2002 and 2001 was 8.5% and 7%, respectively. Due to the existence of the swap agreement, we do not believe that a material risk exposure exists.

Exchange Rate Sensitivity 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.

Effect of Recent Accounting Pronoucements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations" which addresses the financial accounting and reporting for business combinations and supersedes Accounting Principles Board (APB) Opinion No. 16, "Business Combinations," and SFAS No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." SFAS No. 141 requires that all business combinations be accounted for by a single method, the purchase method, modifies the criteria for recognizing intangible assets, and expands disclosure requirements. The provisions of SFAS No. 141 apply to all business combinations initiated after June 30, 2001. The adoption of SFAS No. 141 did not have a material effect on our results of operations or statements of financial position.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets" which addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB No. 17, "Intangible Assets." SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives. SFAS No. 142 provides specific guidance for testing goodwill and intangible assets that will not be amortized for impairment. In addition, SFAS No. 142 expands the disclosure requirements for goodwill and other intangible assets in the years subsequent to their acquisition. SFAS No. 142 is effective for our fiscal year 2003. Impairment losses for goodwill and indefinite-life intangible assets that arise due to the initial application of SFAS No. 142 are to be reported as resulting from a change in accounting principles. However, goodwill and intangible assets acquired after June 30, 2001 will be subject immediately to provisions of SFAS No. 142. Management is currently assessing the impact that this SFAS will have on our results of operations and financial position.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" which addresses financial accounting and reporting for retirement obligations associated with the retirement of tangible long-lived assets and for the associated asset retirement costs. SFAS No. 143 requires a company to record the fair value of an asset retirement obligation in the period in which it is incurred. When the retirement obligation is initially recorded, the company also records a corresponding increase to the carrying amount of the related tangible long-lived asset and depreciates that cost over the useful life of the tangible long-lived asset. The retirement obligation is increased at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the initial fair value measurement. Upon settlement of the retirement obligation, the company either settles the retirement obligation for its recorded amount or incurs a gain or loss upon settlement. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002 with earlier application encouraged. Management is currently assessing the impact that SFAS No. 143 will have on the Company's financial position and results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and also affects certain aspects of accounting for discontinued operations. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," and certain aspects of APB No. 30, "Reporting the Results of Operations — Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. Management is currently assessing the impact that SFAS No. 144 will have on the Company's financial position and results of operations.

In April 2002, SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" was issued. This statement provides guidance on the classification of gains and losses from the extinguishment of debt and on the accounting for certain specified lease transactions. The adoption of this statement will not have a material impact on the Company's current financial position and results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which addresses financial accounting and reporting for costs associated with the exit or disposal activities. SFAS No. 146 nullifies Emerging Issues Task Force (EITF) Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires companies to record liabilities for exit or disposal activities in the period in which they are incurred, except for certain types of transactions. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. Management is currently assessing the impact that SFAS No. 146 will have on the Company's financial position and results of operations.

Forward-Looking Statements

This report contains statements which, to the extent they are not statements of historical or present fact constitute "forward-looking statements" under the securities laws. From time-to-time, oral or written forward-looking statements may also be included in other materials released to the public. These forward-looking statements are intended to provide management's current expectations or plans for the future operating and financial performance of the Company, based upon information currently available and assumptions currently believed to be valid. Forward-looking statements can be identified by the use of words such as "anticipate," "believe,"

“estimate,” “expect,” “intend,” “plans,” “strategy,” “project” and other words of similar meaning in connection with a discussion of future operating or financial performance.

All forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those expressed or implied in the forward-looking statements. The following important business risks and factors could cause the Company’s actual results to differ materially from those stated in the forward-looking statements.

Impact of a Slow Economy The overall economy continues to be in a low growth period, which could have a significant impact on the Company’s near-term financial results, as customer demand remains stagnant. During the fourth quarter of 2002, the Company showed a slight increase in orders over the average of the previous three quarters. The increase was due to an increase in the industrial segment. The semiconductor and telecommunications segments continue to be adversely affected by the current economic conditions.

Uncertainty of Current Economic Conditions Current conditions in the domestic and global economies are extremely uncertain. As a result, it is difficult to estimate the level of growth for the economy as a whole. It is even more difficult to estimate growth in capital expenditures in the semiconductor, industrial and telecommunications markets. Because all of the components of the Company’s budgeting and forecasting are dependent on estimate of growth in these markets, the prevailing economic uncertainty renders estimates of future revenue and expenses even more difficult than usual to make.

Technology Change and New Product Development The market for the Company’s products is characterized by rapidly changing technology. The Company’s future success will continue to depend upon its ability to enhance current products and develop and introduce new products that keep pace with technological developments and evolving industry standards and respond to changes in customer requirements. The development of new technologically advanced products is a complex and uncertain process requiring high levels of innovation, as well as the accurate anticipation of technological and market trends.

For additional information identifying important factors that may cause actual results to differ materially from those stated in the forward-looking statements, see the Company’s reports on Forms 10-K, 10-Q, and 8-K filed with the Securities and Exchange Commission.

Stock Data The number of Stockholders of record at June 30, 2002 was 483.

Our common shares are traded over-the-counter and are quoted on the NASDAQ/National Market under the symbol “ZIGO.” Market price data for 2002 and 2001 is as follows:

	Fiscal Year Ended June 30, 2002		Fiscal Year Ended June 30, 2001	
	High	**Low**	High	Low
First Quarter	**$22**	**$8 7/10**	$93 15/16	$53 3/4
Second Quarter	**$19 17/20**	**$9 3/4**	$76 1/8	$21 15/16
Third Quarter	**$18**	**$11 1/10**	$48 3/4	$15 7/16
Fourth Quarter	**$18**	**$6 4/5**	$38 1/25	$16 5/16

consolidated balance sheets

(Dollars in thousands)	June 30, 2002	June 30, 2001
Assets		
Current assets:		
Cash and cash equivalents	**$ 28,513**	$ 52,630
Restricted cash	**1,225**	—
Marketable securities (note 3)	**8,734**	7,121
Receivables (note 4)	**21,241**	27,278
Inventories (note 5)	**23,612**	24,261
Costs in excess of billings (note 6)	**—**	1,802
Prepaid expenses	**1,444**	1,393
Deferred income taxes (note 17)	**4,899**	4,076
Total current assets	**89,668**	118,561
Property, plant and equipment, net (notes 7 and 10)	**55,045**	47,475
Deferred income taxes (note 17)	**19,981**	15,819
Goodwill and other intangibles, net (notes 8 and 20)	**4,507**	4,867
Other assets	**—**	110
Total assets	**$169,201**	$ 186,832
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt (note 10)	**$ 837**	$ 279
Accounts payable	**5,020**	8,648
Accrued progress payments	**368**	549
Accrued salaries and wages	**3,451**	7,153
Interest rate swap liability (note 10)	**832**	—
Other accrued expenses (note 2)	**4,300**	4,688
Income taxes payable	**929**	3,132
Total current liabilities	**15,737**	24,449
Long-term debt (note 10)	**11,374**	12,281
Other long-term liabilities (note 2)	**1,115**	—
Minority interest	**970**	963
Total liabilities	**29,196**	37,693
Commitments (note 11)		
Stockholders' equity (notes 13, 14, 15, and 16):		
Common stock, $.10 par value per share:		
40,000,000 shares authorized (40,000,000 in 2001);		
17,892,564 shares issued (17,803,812 in 2001);		
17,445,359 shares outstanding (17,356,607 in 2001)	**1,789**	1,780
Additional paid-in capital	**137,390**	134,380
Retained earnings	**7,981**	19,714
Accumulated other comprehensive income (loss):		
Currency translation effects	**(1,369)**	(1,786)
Net unrealized gain (loss) on swap agreement (note 10)	**(515)**	31
Net unrealized gain on marketable securities (note 3)	**16**	37
	145,292	154,156
Less treasury stock, at cost; 447,205 common shares (447,205 shares in 2001)	**5,287**	5,017
Total stockholders' equity	**140,005**	149,139
Total liabilities and stockholders' equity	**$169,201**	$ 186,832

See accompanying notes to consolidated financial statements.

(Thousands, except for per share amounts)	**2002**	Fiscal Year Ended June 30, 2001	2000
Net sales (notes 18 and 19)	**$ 84,426**	$ 133,250	$ 87,243
Cost of goods sold	**59,630**	72,081	54,688
Gross profit	**24,796**	61,169	32,555
Selling, general and administrative expenses	**25,173**	29,119	18,504
Research and development	**21,346**	17,673	11,270
Nonrecurring acquisition-related charges	**—**	—	14,001
Amortization and impairment of goodwill and other intangibles (note 2)	**963**	797	7,102
Automation Systems Group exit costs (note 2)	**1,856**	—	—
Operating (loss) profit	**(24,542)**	13,580	(18,322)
Gain on sale of Automation Systems Group (note 2)	**6,142**	—	—
Other income (expense):			
Interest income	**1,686**	1,641	1,250
Miscellaneous expense, net	**(1,443)**	(526)	(240)
Total other income	**243**	1,115	1,010
(Loss) earnings before income taxes and minority interest	**(18,157)**	14,695	(17,312)
Income tax benefit (expense) (note 17)	**6,900**	(3,454)	1,459
(Loss) earnings before minority interest	**(11,257)**	11,241	(15,853)
Minority interest	**476**	582	194
Net (loss) earnings	**$ (11,733)**	$ 10,659	$ (16,047)
(Loss) earnings per common and common equivalent share:			
Basic	**$ (0.67)**	$ 0.69	$ (1.28)
Diluted	**$ (0.67)**	$ 0.66	$ (1.28)
Weighted average common shares and common dilutive equivalents outstanding:			
Basic	**17,414**	15,398	12,511
Diluted	**17,414**	16,063	12,511

Teamwork — We recognize mutual interdependencies and work collaboratively across organizational boundaries to develop integrated business solutions.

See accompanying notes to consolidated financial statements.

consolidated statements of stockholders' equity

(Dollars in thousands)	Total	Comp. Income (Loss)	Retained Earnings	Accum. Other Comp. Income (Loss)	Common Stock	Treasury Stock	Paid-In Capital
Balance at June 30, 1999	$ 68,712		$25,102	$ (126)	$1,370	$ (301)	$ 42,667
Comprehensive loss							
Net loss	(16,047)	$(16,047)	(16,047)				
Other comprehensive loss, net of tax							
Unrealized loss on marketable securities	(22)	(22)					
Foreign currency translation effect	(125)	(125)					
Other comprehensive loss		(147)		(147)			
Comprehensive loss		(16,194)					
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
Comprehensive income (loss)							
Net earnings	10,659	10,659	10,659				
Other comprehensive income (loss), net of tax							
Unrealized gain on marketable securities	128	128					
Unrealized gain on Swap Agreement	31	31					
Foreign currency translation effect	(1,604)	(1,604)					
Other comprehensive loss		(1,445)		(1,445)			
Comprehensive income		9,214					
Repurchased common stock	(4,716)					(4,716)	
Secondary offering	51,824				292		51,532
Exercise of employee stock options and related tax effect	14,588				44		14,544
Balance at June 30, 2001	$149,139		$19,714	$(1,718)	$1,780	$(5,017)	$134,380
Comprehensive income (loss)							
Net loss	(11,733)	(11,733)	(11,733)				
Other comprehensive income (loss), net of tax							
Unrealized loss on marketable securities	(21)	(21)					
Unrealized loss on Swap Agreement	(546)	(546)					
Foreign currency translation effect	417	417					
Other comprehensive loss		(150)		(150)			
Comprehensive loss		$(11,883)					
Repurchased common stock adjustment	(270)					(270)	
Non-cash compensation charges related to stock options	83						83
Employee stock purchase	1,098				8		1,090
Exercise of employee stock options and related tax effect	1,838				1		1,837
Balance at June 30, 2002	$140,005		$ 7,981	$(1,868)	$1,789	$(5,287)	$137,390

See accompanying notes to consolidated financial statements.

(Dollars in thousands)	Fiscal Year Ended June 30, **2002**	2001	2000
Cash provided by (used for) operating activities:			
Net (loss) earnings	**$(11,733)**	$ 10,659	$(16,047)
Adjustments to reconcile net (loss) earnings to cash provided by (used for) operating activities:			
Depreciation and amortization	**7,251**	3,996	11,318
Gain on sale of Automation Systems Group	**(6,142)**	—	—
Loss on disposal of assets	**2,320**	869	1,176
Deferred income taxes	**(4,705)**	2,446	(7,247)
Non-cash compensation charges related to stock options	**83**	—	12,024
Changes in operating accounts:			
Receivables	**3,975**	(7,140)	(7,657)
Costs in excess of billings	**(690)**	3,942	(5,083)
Inventories	**(727)**	(12,382)	3,594
Prepaid expenses	**(72)**	3,721	4,770
Accounts payable and accrued expenses	**(7,795)**	3,306	4,654
Minority interest	**476**	520	194
Net cash provided by (used for) operating activities	**(17,759)**	9,937	1,696
Cash provided by (used for) investing activities:			
Additions to property, plant and equipment	**(17,640)**	(33,050)	(6,513)
Investment in marketable securities	**(8,001)**	(2,155)	(2,466)
Investments in other assets	**(493)**	(1,790)	—
Proceeds from the sale of assets	**673**	—	—
Proceeds from sale of Automation Systems Group, net of cash sold ($88)	**12,077**	—	—
Restricted cash with interest from sale of Automation Systems Group	**(1,225)**	—	—
Proceeds from the sale of marketable securities	**4,248**	2,250	—
Proceeds from maturity of marketable securities	**2,155**	1,180	2,500
Net cash used for investing activities	**(8,206)**	(33,565)	(6,479)
Cash provided by (used for) financing activities:			
(Payments) proceeds of debt	**(349)**	12,556	48
Dividend payments to minority interest	**(469)**	—	—
Employee stock purchase	**1,098**	—	—
Exercise of employee stock options	**1,838**	996	7,062
Issuance and repurchase of common stock	**(270)**	47,108	—
Contributions from minority interest of consolidated subsidiaries	**—**	—	249
Net cash provided by financing activities	**1,848**	60,660	7,359
Net increase (decrease) in cash and cash equivalents	**(24,117)**	37,032	2,576
Cash and cash equivalents, beginning of year	**52,630**	15,598	13,022
Cash and cash equivalents, end of year	**$ 28,513**	$ 52,630	$ 15,598

See accompanying notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Description of Operations Zygo Corporation is a worldwide developer and supplier of high performance metrology instruments, high precision optics, optical assemblies, and automation for the semiconductor, industrial and telecommunications markets.

Principles of Consolidation The accompanying consolidated financial statements include the accounts of Zygo Corporation and its subsidiaries ("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.

Cash and Cash Equivalents The Company considers cash and investments in securities 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 bonds, government agency securities, and tax-exempt bonds. All securities held by the Company at June 30, 2002 and 2001, 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 ("SFAS") No. 121, "Accounting for the Impairment of Long-Lived Assets and 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 depreciation and amortization periods are periodically evaluated and would be revised if considered necessary.

Revenue Recognition Revenues, other than revenue from certain automation contracts (Note 6), are recognized when units are shipped. Unless there is significant uncertainty concerning customer acceptance, in which case, revenue is recognized when the customer accepts the product. Revenues related to certain automation contracts are recognized under the percentage-of-completion method of accounting.

In December 1999, the Securities and Exchange Commission ("SEC") issued SEC Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition in Financial Statements." SAB No. 101 summarized certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements. SAB No. 101 was effective for the fourth quarter of fiscal 2001. The adoption of SAB No. 101 did not have a material effect on the Company's financial position or results of operations.

Earnings Per Share Basic and diluted earnings per share are calculated in accordance with Statement of Financial Accounting Standards No. 128, "Earnings Per Share."

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

	June 30, 2002	June 30, 2001	June 30, 2000
Weighted average shares outstanding	**17,414,000**	15,398,000	12,511,000
Dilutive effect of stock options	—	665,000	—
Diluted weighted average shares outstanding	**17,414,000**	16,063,000	12,511,000

For the fiscal years ended June 30, 2002 and June 30, 2000, the Company recorded net losses. Due to these net losses, stock options of 319,000 and 1,547,000 for the fiscal 2002 and 2000, respectively, were excluded from the computation because of the anti-dilutive effect on earnings per share.

Gain on Legal Settlement The Company recorded a gain of $1 million in the third quarter of 2000 from the settlement of a legal claim.

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

Fair Value of Financial Instruments SFAS 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

Open Communication — We communicate openly and frequently with one another in order to build understanding and enhance individual and organizational alignment.

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 accounting principles generally accepted in the United States of America. On an ongoing basis, management evaluates its estimates and judgments, including those related to bad debts, inventories, long-lived assets, income taxes, and warranty obligations. Actual results could differ from those estimates.

Recently Issued Accounting Pronouncements In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations" which addresses the financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, "Business Combinations," and SFAS No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises." SFAS No. 141 requires that all business combinations be accounted for by a single method, the purchase method, modifies the criteria for recognizing intangible assets, and expands disclosure requirements. The provisions of SFAS No. 141 apply to all business combinations initiated after June 30, 2001. The adoption of SFAS No. 141 did not have a material effect on our results of operations or statements of financial position.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets" which addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB No. 17, "Intangible Assets." SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition and after they have been initially recognized in the financial statements. SFAS No. 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather tested at least annually for impairment, and intangible assets that have finite useful lives be amortized over their useful lives. SFAS No. 142 provides specific guidance for testing goodwill and intangible assets that will not be amortized for impairment. In addition, SFAS No. 142 expands the disclosure requirements for goodwill and other intangible assets in the years subsequent to their acquisition. SFAS No. 142 is effective for our fiscal year 2003. Impairment losses for goodwill and indefinite-life intangible assets that arise due to the initial application of SFAS No. 142 are to be reported as resulting from a change in accounting principles. However, goodwill and intangible assets acquired after June 30, 2001 will be subject immediately to provisions of SFAS No. 142. Management is currently assessing the impact that SFAS No. 142 will have on our results of operations and financial position.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" which addresses financial accounting and reporting for retirement obligations associated with the retirement of tangible long-lived assets and for the associated asset retirement costs. SFAS No. 143 requires a company to record the fair value of an asset retirement obligation in the period in which it is incurred. When the retirement obligation is initially recorded, the company also records a corresponding increase to the carrying amount of the related tangible long-lived asset and depreciates that cost over the useful life of the tangible long-lived asset. The retirement obligation is increased at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the initial fair value measurement. Upon settlement of the retirement obligation, the company either settles the retirement obligation for its recorded amount or incurs a gain or loss upon settlement. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002 with earlier application encouraged. Management is currently assessing the impact that SFAS No. 143 will have on the Company's financial position and results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and also affects certain aspects of accounting for discontinued operations. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," and APB No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. Management is currently assessing the impact that SFAS No. 144 will have on the Company's financial position and results of operations.

In April 2002, SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" was issued. This statement provides guidance on the classification of gains and losses from the extinguishment of debt and on the accounting for certain specified lease transactions. The adoption of this statement will not have a material impact on the Company's current financial position and results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" which addresses financial accounting and reporting for costs associated with the exit or disposal activities. SFAS No. 146 nullifies Emerging Issues Task Force (EITF) Issue 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires companies to

Development — We continuously learn and develop new skills in order to adapt to changing business needs and reach our full potential.

Notes to Consolidated Financial Statements — June 30, 2002, 2001, and 2000

Dollars in thousands, except for share and per share amounts

record liabilities for exit or disposal activities in the period in which they are incurred, except for certain types of transactions. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. Management is currently assessing the impact that SFAS No. 146 will have on the Company's financial position and results of operations.

2. Mergers, Acquisitions and Strategic Initiatives

On December 12, 2001, the Company sold its Automation Systems Group in Longmont, Colorado, to Brooks Automation, Inc. of Chelmsford, Massachusetts, in a cash transaction, for $12,165. Substantially all of the assets were sold to Brooks and substantially all of the liabilities were assumed by Brooks. The gain on the sale was $6,142 before related exit costs of $1,856 to be paid from the proceeds, inventory write-downs of $808, and tax expense of $1,322. As of June 30, 2002, the restricted cash balance of $1,225 related to the Automation sale is being held in escrow for a period of one year from the date of sale. The Company established certain reserves of $2,333, which includes $1,115 for lease costs classified as a long-term liability, for costs to be incurred as a result of the sale.

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., ("Zygo TeraOptix") 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, Inc.

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-interest 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 its 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.

3. Marketable Securities

Marketable securities consisted primarily of corporate bonds, government agency securities and tax-exempt bonds issued by various federal, state and municipal agencies for both 2002 and 2001. Marketable securities at June 30, 2002 and June 30, 2001 are reported either at fair value or at cost depending on their classification. The unrealized gains on marketable securities of $22 and $51 at June 30, 2002 and 2001, respectively, are shown net of their related tax effects, resulting in balances of $16 and $37, respectively, 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 (losses), and fair value of available-for-sale securities at June 30, 2002 and 2001 were as follows:

	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
At June 30, 2002				
Corporate, federal, state and local municipal bonds	**$ 8,094**	**$ 75**	**$ (53)**	**$ 8,116**
At June 30, 2001				
Corporate, state and local municipal bonds	$ 5,320	$ 51	$ —	$ 5,371

There were $59 gross realized gains recorded in 2002. There were no gross realized gains or losses recorded in 2001.

Maturities of investment securities classified as available-for-sale were as follows at June 30, 2002 and 2001:

	June 30, 2002		June 30, 2001	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Due within one year	**$ 44**	**$ 91**	$ —	$ —
Due after one year through five years	**8,050**	**8,025**	5,320	5,371
	$8,094	**$8,116**	$5,320	$5,371

Maturities of investment securities classified as held-to-maturity were as follows at June 30, 2002 and 2001:

	June 30, 2002		June 30, 2001	
	Amortized Cost	**Fair Value**	Amortized Cost	Fair Value
Due within one year	**$ 618**	**$ 630**	$1,750	$1,750
Due after one year through five years	**—**	**—**	—	—
	$ 618	**$ 630**	$1,750	$1,750

4. Accounts Receivable

At June 30, 2002 and 2001, accounts receivable were as follows:

	June 30, 2002	June 30, 2001
Trade (note 19)	**$ 20,737**	$ 25,644
Other	**1,453**	2,015
	22,190	27,659
Allowance	**(949)**	(381)
	$ 21,241	$ 27,278

5. Inventories

At June 30, 2002 and 2001, inventories, net of reserves, were as follows:

	June 30, 2002	June 30, 2001
Raw materials and manufactured parts	**$ 18,695**	$ 20,359
Work in process	**8,477**	5,674
Finished goods	**179**	1,308
	27,351	27,341
Reserves	**(3,739)**	(3,080)
	$ 23,612	$ 24,261

6. Costs in Excess of Billings

Revenues from certain automation projects were 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 were recorded in the period in which the facts became known. 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 uncompleted contracts as of June 30, 2001 were as follows:

Revenue recognized to date	$ 50,529
Billings to date	48,727
	$ 1,802

As a result of the sale of the Company's Automation Systems Group in Longmont, Colorado, there were no outstanding projects accounted for under the percentage-of-completion method as of June 30, 2002.

7. Property, Plant and Equipment

Property, plant and equipment are stated at cost. Costs of additions, replacements and improvements are capitalized and depreciated over a range of 3-40 years. Maintenance and repairs are charged to expense as incurred. Management evaluates, on an ongoing basis, the carrying value of its property, plant and equipment and makes adjustments when impairments are identified. At June 30, 2002 and 2001, property, plant and equipment, at cost, were as follows:

	June 30, 2002	June 30, 2001
Land	**$ 3,822**	$ 3,778
Building	**25,252**	9,199
Machinery, equipment and office furniture	**47,640**	31,101
Leasehold improvements	**237**	625
Construction in progress	**2,878**	23,849
	79,829	68,552
Less accumulated depreciation	**(24,784)**	(21,077)
	$ 55,045	$ 47,475

8. Goodwill and Other Intangibles

The cost of goodwill and other intangible assets is amortized on a straight-line basis, which ranges from 4-20 years. Management evaluates, on an ongoing basis, the carrying value of its goodwill and other intangible assets and makes adjustments when impairments are identified. Goodwill and other intangibles, net, at June 30, 2002 and 2001 were as follows:

	June 30, 2002	June 30, 2001
Goodwill and other intangibles	**$ 8,329**	$ 7,726
Accumulated amortization	**(3,822)**	(2,859)
	$ 4,507	$ 4,867

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 2.4% at June 30, 2002). The line of credit is available through November 21, 2002. At June 30, 2002 and 2001, no amounts were outstanding under the bank line of credit.

10. Long-Term Debt

In May 2001 the Company entered into a mortgage on the newly constructed facility located in Westborough, Massachusetts. The mortgage amount is $12,560 at an interest rate of LIBOR plus a variable interest rate of 1% to 1.5%, which is based on a pricing grid related to a certain debt ratio and adjusted quarterly. The mortgage agreement contains financial covenants which, among others, relate to debt service and consolidated debt ratios. In June 2002, the mortgage agreement was amended to revise the financial covenants and adjust the variable interest rate pricing grid, such that the variable interest rate can fluctuate between 1% and 2.5% based on the debt ratio. At June 30, 2002, the LIBOR plus variable rate was 4.3%. The mortgage is amortizing on a 15-year schedule requiring level monthly principal and interest payments and is payable in full in May 2007. The Company made interest only payments through February 2002. As of June 30, 2002, long-term debt was $11,374 with a current portion of long-term debt of $837. Principal payments for fiscal years 2003-2006 will be $837 annually and principal payment for the fiscal year 2007 will be $8,862, including a balloon payment of $8,164 due in May 2007.

In conjunction with the mortgage, the Company entered into a $12,560 notional principal interest rate swap that effectively converted the variable rate LIBOR-based payments to a fixed rate of 6% for the duration of the mortgage. In addition, the variable interest rate based on a pricing grid related to a certain debt ratio will continue to be applied to the outstanding mortgage amount. The effective interest rate at June 30, 2002 and 2001 was 8.5% and 7%, respectively. In accordance with SFAS No. 133, as amended, the Company recorded a liability for the present value of the increase in interest over the remaining term of the mortgage of approximately $832. This amount, net of taxes of $317, is reflected with a corresponding debit to the stockholders' equity of $515.

Interest payments on debt were $1,158, $107, and $6 in fiscal 2002, 2001, and 2000, 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 2007. Total lease expense charged to operations was $1,603 in 2002, $1,562 in 2001, and $986 in 2000. At June 30, 2002 the minimum future lease commitments under noncancellable leases payable over the remaining lives of the leases were:

Year ending June 30,	Minimum Future Lease Commitments
2003	$ 1,382
2004	1,219
2005	743
2006	262
2007	119
Total minimum lease payments	$ 3,725

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, 2002, 2001, and 2000, amounted to $0, $2,516, and $1,209, respectively. The profit-sharing plan consists of a cash distribution and a contribution to the Company's 401(k) program. Profit-sharing contributions are determined annually at the discretion of the Board of Directors. The cash distribution for the years ended June 30, 2002, 2001, and 2000, amounted to $0, $930, and $709, respectively.

The Company also maintains 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, 2002, 2001, and 2000 amounted to $780, $1,586, and $500, respectively.

As of January 1, 2001, the employees of Zygo TeraOptix have been incorporated into the Company's 401(k) program for fiscal 2001. Prior to January 1, 2001, the Company maintained a separate defined contribution retirement plan for the employees of Zygo TeraOptix. The plan allowed employees to participate after three months of employment with the Company by deferring up to 15% of their salary on a pre-tax basis, and allowed the Company to make discretionary contributions to the plan, which were allocated to the participants' accounts. The Company did not make any contributions to the plan through January 1, 2001.

Under the Employee Stock Ownership Program, the Company may, at the discretion of the Board of Directors, contribute its own stock or contribute cash to purchase its own stock. The purchased stock's fair market value can not 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, 2002, 2001, and 2000.

13. Stockholders' Equity

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

Innovation — We take calculated risks and develop innovative solutions in all aspects of our business in order to provide leadership and competitive advantage in a dynamic industry.

On March 7, 2001 the Company closed a secondary public offering of 2,924,500 shares of common stock including 424,500 shares sold to underwriters to cover over-allotments. The offering price was $19 per share. The net proceeds to the Company including the over-allotment shares, after deducting underwriting discounts, commissions, and offering expenses totaled $51,824.

On April 11, 2001, the Company purchased 239,605 shares of its common stock from two officers and directors, pursuant to stock purchase agreements; all at a price per share of $20.81 (the closing price of the common stock in the public markets on that day) for $4,986. The funding for the purchase came from cash balances. The purpose of the purchase was to allow these two officers and directors to satisfy their tax obligations arising from the Firefly acquisition, in which they were principal stockholders, and to satisfy and extinguish the margin loans they incurred to pay additional taxes, which arose from the acquisition of Firefly. The common stock purchased is being held as treasury stock.

14. Stock Compensation Plans

As of June 30, 2002, the Company 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, 2002	June 30, 2001	June 30, 2000
Pro forma net (loss) earnings	**$ (12,161)**	$ 9,952	$ (16,930)
Pro forma net (loss) earnings per share, diluted	**$ (0.70)**	$ 0.62	$ (1.35)

The fair value of these options at the date of grant was estimated with the following weighted average assumptions of 2002, 2001 and 2000:

	June 30, 2002	June 30, 2001	June 30, 2000
Risk free rate of interest	**4.3%**	5.0%	5.9%
Dividend yield	**0.0%**	0.0%	0.0%
Volatility factor	**76%**	77%	67%
Expected life of option	**4.5 years**	4.8 years	5.6 years

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

On June 26, 2001, the Board of Directors granted a warrant to purchase 25,000 shares of the Company's common stock to the Zetetic Institute, a non-profit organization that provides assistance to the Company in connection with certain research and development activities. The warrant has an exercise price of $18.64 per share, the closing price of the common stock on the date of the grant, and will vest, in equal annual increments, over the four-year period following the date of grant.

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. There are 1,487,893 shares available under the plan as of June 30, 2002. 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, expires on September 3, 2002.

	June 30, 2002	
	Shares	**Weighted Average Exercise Price**
Outstanding at beginning of year	**1,778,308**	**$ 50.223**
Granted	**325,075**	**$ 12.870**
Exercised	**(2,125)**	**$ 10.425**
Expired or canceled	**(150,539)**	**$ 44.774**
Outstanding at end of year	**1,950,719**	**$ 44.527**

June 30, 2001	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	798,299	$ 10.020
Granted	1,386,436	$ 61.810
Exercised	(347,463)	$ 3.508
Expired or canceled	(58,964)	$ 58.527
Outstanding at end of year	1,778,308	$ 50.223

June 30, 2000	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	1,245,299	$ 7.228
Granted	182,650	$ 23.139
Exercised	(519,200)	$ 7.215
Expired or canceled	(110,450)	$ 13.240
Outstanding at end of year	798,299	$ 10.020

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, as amended on September 24, 1999, each new non-employee director (other than a person who was previously an employee of the Company or any of its subsidiaries) 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, 2002	**Shares**	**Weighted Average Exercise Price**
Outstanding at beginning of year	**182,000**	**$ 13.996**
Granted	**23,000**	**$ 16.276**
Exercised	**(10,000)**	**$ 2.000**
Expired or canceled	**—**	**$ —**
Outstanding at end of year	**195,000**	**$ 14.880**

June 30, 2001	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	249,000	$ 5.792
Granted	23,000	$ 55.873
Exercised	(90,000)	$ 2.000
Expired or canceled	—	$ —
Outstanding at end of year	182,000	$ 13.996

June 30, 2000	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	450,000	$ 6.229
Granted	15,000	$ 17.250
Exercised	(216,000)	$ 7.498
Expired or canceled	—	$ —
Outstanding at end of year	249,000	$ 5.792

The following tables summarize information about all fixed stock options outstanding at June 30, 2002:

Options Outstanding			
Range of Exercise Prices	Number Outstanding as of June 30, 2002	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
$ 1.92 - $ 2.00	175,124	2.1	$ 2.00
$ 7.44 - $11.10	212,300	6.4	$ 10.16
$ 11.40 - $17.10	335,950	8.8	$ 12.92
$ 17.18 - $24.56	463,346	8.5	$ 18.93
$ 26.38 - $39.13	69,970	6.4	$ 29.73
$ 40.38 - $58.75	80,265	8.2	$ 45.21
$ 60.75 - $90.81	808,764	8.1	$ 84.59
$ 1.92 - $90.81	**2,145,719**	**7.6**	**$41.82**

Options Exercisable		
Range of Exercise Prices	Number Exercisable as of June 30, 2002	Weighted Average Exercise Price
$ 1.92 - $ 2.00	175,124	$ 2.00
$ 7.44 - $11.10	144,652	$ 10.25
$ 11.40 - $17.10	36,200	$ 13.73
$ 17.18 - $24.56	164,434	$ 18.80
$ 26.38 - $39.13	44,630	$ 28.80
$ 40.38 - $58.75	37,210	$ 45.09
$ 60.75 - $90.81	223,951	$ 84.46
$ 1.92 - $90.81	**826,201**	**$33.04**

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 the Company's common stock. No Firefly options have been included in the tables above because all Firefly options were exercised and converted to the Company's common shares in connection with the merger.

16. Employee Stock Purchase Plan

In November 2000, the Company adopted a non-compensatory Employee Stock Purchase Plan ("ESPP"). Under the ESPP, employees of the company who elect to participate have the ability to purchase common stock at a 15% discount from the market value of such stock. The ESPP permits an enrolled employee to make contributions to purchase shares of common stock by having withheld from his or her salary an amount between 1% and 10% of compensation. The total number of shares of common stock that may be issued under the ESPP is approximately 500,000. At June 30, 2002 and 2001, the Company had withheld $532 and $613, respectively, for purchase of shares under this plan; and in July 2002 and 2001, issued approximately 64,000 and 32,000, respectively, shares of common stock.

17. Income Taxes

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

	Fiscal Year Ended June 30,		
	2002	2001	2000
Currently payable:			
Federal	**$(3,118)**	$ —	$ 1,136
State	**4**	—	(71)
Foreign	**798**	1,008	604
	$(2,316)	$ 1,008	$ 1,669
Deferred:			
Federal	**$(3,859)**	$ 2,328	$(3,051)
State	**(725)**	118	(77)
Foreign	**—**	—	—
	$(4,584)	$ 2,446	$(3,128)
Total income tax (benefit) expense	**$(6,900)**	$ 3,454	$(1,459)

Income taxes refunds, net of payments, amounted to $149, $1,979, and $2,539 in fiscal 2002, 2001, and 2000, 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 2002, 2001, and 2000 to earnings before income taxes for the following reasons:

	Fiscal Year Ended June 30,		
	2002	2001	2000
Computed "expected" tax expense (benefit)	**$(6,355)**	$ 5,143	$(5,886)
Increases (reductions) in taxes resulting from:			
Acquisition-related charges	**(72)**	(1,112)	4,329
State taxes, net of federal income tax benefit	**(1,787)**	(331)	(96)
Tax exempt interest income	**(29)**	(43)	(15)
Export tax incentives	**—**	(254)	(300)
Change in valuation allowance	**1,987**	619	—
Research credit	**(1,358)**	(1,114)	(300)
Other, net	**714**	546	809
	$(6,900)	$ 3,454	$(1,459)

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, 2002 and 2001 are presented below:

	June 30, 2002	June 30, 2001
Deferred tax assets:		
Accounts receivable	**$ 358**	$ 143
Accrued liabilities	**1,965**	610
Inventory valuation	**1,066**	1,492
One-time charges	**1,725**	1,943
Intangibles	**262**	96
Federal and state NOLs and credits	**26,207**	17,486
Other	**46**	—
	31,629	21,770
Less valuation allowance	**3,803**	1,653
Deferred tax asset	**27,826**	20,117
Deferred tax liabilities:		
Prepaid expenses	**(208)**	(92)
Plant and equipment	**(2,731)**	(111)
Unrealized gain on marketable securities	**(7)**	(19)
Deferred tax liability	**(2,946)**	(222)
Net deferred tax asset	**$24,880**	$19,895

The net current deferred tax assets and net non-current deferred tax assets as recorded on the balance sheet as of June 30, 2002 and 2001 are as follows:

	June 30, 2002	June 30, 2001
Net current deferred tax asset	**$ 4,899**	$ 4,076
Net noncurrent deferred tax asset	**19,981**	15,819
Net deferred tax asset	**$24,880**	$19,895

The Company has recorded a valuation allowance to reflect the uncertainty of realizing certain state net operating loss and credit carryforwards. The valuation allowance as of June 30, 2001 was $1,653. The net change in the total valuation allowance for the year ended June 30, 2002 was an increase of $2,150. Subsequently recognized tax benefits relating to the valuation allowance for deferred tax assets as of June 30, 2002 will be allocated as follows:

Income tax benefit	**$ 1,987**
Additional paid-in capital	**163**
	$ 2,150

Management believes it is more likely than not that the remaining net deferred tax assets of $24,880 will be realized as the results of future operations are expected to generate sufficient taxable income to do so.

The deferred tax provision for 2002 does not reflect tax benefits of ($328) allocated to other comprehensive income and ($73) allocated to paid-in capital.

At June 30, 2002, the Company's share of the cumulative undistributed earnings of foreign subsidiaries was $991. No provision has been made for U.S. or additional foreign taxes on the undistributed earnings of foreign subsidiaries because the Company intends to continue to reinvest these earnings. Determination of the amount of unrecognized deferred tax liability associated with these earnings is not practicable.

At June 30, 2002, the Company has federal and state net operating loss carryforwards of approximately $45,405 and $73,089, respectively, and various state credit carryforwards of $3,175, which are available to reduce income taxes in various jurisdictions through 2022. The Company also has a federal general business credit carryforward of approximately $4,592, which is available to reduce federal taxable income, if any, through 2022. In addition, the Company has alternative minimum tax credit carryforwards of approximately $206 which are available to reduce future federal regular income taxes, if any, over an indefinite period.

18. Segment Reporting

The Company has adopted the SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 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 SFAS No. 131.

The Company operates in three principal business segments globally: Semiconductor, Industrial, and Telecommunications. For fiscal 2000, the Company operated in one segment, as a world leader in metrology, process control, and yield solutions servicing high precision industries. Substantially all of the Company's operating results, assets, depreciation, and amortization are U.S. based. The segment data is presented below in a manner consistent with management's internal measurement of the business.

Fiscal Year Ended June 30, 2002

	Semi-conductor	**Industrial**	**Telecom-munications**	**Total**
Sales	$ 37,483	$ 40,336	$ 6,607	$ 84,426
Gross Profit	9,909	16,882	(1,995)	24,796
Gross Profit as a % Sales	26%	42%	(30)%	29%

Fiscal Year Ended June 30, 2001

	Semi-conductor	Industrial	Telecom-munications	Total
Sales	$ 84,561	$ 35,178	$13,511	$133,250
Gross Profit	38,737	15,969	6,463	61,169
Gross Profit as a % Sales	46%	45%	48%	46%

The total gross profit and the Semiconductor segment gross profit for the fiscal year ended June 30, 2002 included $808 of inventory write-downs related to the sale of the Automation Systems Group.

Separate financial information by segment for total assets, capital expenditures, and depreciation and amortization is not available and is not evaluated by the chief operating decision-maker of the Company.

Sales to Canon Inc. and to Canon Sales Co., Inc., accounted for more than 19% of total Company sales for each of the years ended June 30, 2002, 2001, and 2000 (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. Substantially all of the Company's operating results, assets, depreciation, and amortization are U.S. based. The Company's sales are noted below.

Customer Commitment — We are focused and integrated throughout the company in order to exceed customer expectations and to ensure superior, long-term relationships with our customers.

Sales by geographic area were as follows:

Fiscal Year Ended June 30,

	2002	2001	2000
Americas			
(primarily United States)	**$ 41,040**	$ 68,299	$48,835
Far East:			
Japan	**21,268**	45,194	17,588
Pacific Rim	**8,054**	7,423	11,714
Total Far East	**$ 29,322**	$ 52,617	$29,302
Europe and other			
(primarily Europe)	**14,064**	12,334	9,106
Total	**$ 84,426**	$133,250	$87,243

19. Related Party Transactions

Sales to Canon Inc., a stockholder, and Canon Sales Co., Inc., a distributor of certain of the Company's products in Japan and a subsidiary of Canon Inc., amounted to $17,636 (21% of net sales), $43,336 (33% of net sales), and $16,463 (19% of net sales), for the years ended June 30, 2002, 2001, and 2000, 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, 2002 and 2001, there was approximately, in the aggregate, $2,683 and $3,827, respectively, of trade accounts receivable from Canon Inc. and Canon Sales Co., Inc.

On April 11, 2001, the Company purchased 239,605 shares of its common stock from two officers and directors for $4,986 (see note 13).

20. Material Contracts

In May 1997, the Company 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"). In April 2001 and January 2002, the Company entered into related contracts with LLNL to supply additional optical components to NIF. Revenues under the NIF contract, which is presently a fixed price contract, are recorded as deliveries are made. Revenues recognized in fiscal 2002, 2001, and 2000 amounted to $3,834, $3,308, and $2,802, respectively.

Management is responsible for preparing the Company's consolidated financial statements and related information that appears in this annual report. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States of America appropriate in the circumstances and, accordingly, include some amounts based on management's best judgments and estimates. Financial information in this annual report is consistent with that in the consolidated financial statements.

The Company maintains a system of internal controls and procedures which provides reasonable assurance, at an appropriate cost/benefit relationship, that assets are safeguarded and that transactions are authorized, recorded, and reported properly. Management believes that the Company's system of internal controls provides reasonable assurance that assets are safeguarded against material loss from unauthorized use or disposition and that the financial records are reliable for preparing financial statements and other data and for maintaining accountability for assets.

The Audit Committee of the Board of Directors, composed solely of Directors who are not officers or employees of the Company, meets with the independent auditors and financial management periodically to discuss internal accounting controls, auditing and financial reporting matters, and to discharge its responsibilities outlined in its written charter. The Committee reviews with the independent auditors the scope and results of the audit effort. The Committee also meets with the independent auditors without management present to ensure that the independent auditors have free access to the Committee.

The independent auditors, KPMG LLP, were recommended by the Audit Committee of the Board of Directors and selected by the Board of Directors. KPMG LLP was engaged to audit the 2002, 2001, and 2000 consolidated financial statements of Zygo Corporation and its subsidiaries and conducted such tests and related procedures as deemed necessary in conformity with auditing standards generally accepted in the United States of America. The opinion of the independent auditors, based upon their audits of the consolidated financial statements, is included in this annual report.

Richard M. Dressler

Vice President, Finance,
Chief Financial Officer, and Treasurer

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, 2002 and 2001, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the years in the three-year period ended June 30, 2002. 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, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

KPMG LLP

Hartford, Connecticut

August 16, 2002

selected consolidated quarterly financial data (unaudited)

(Thousands, except per share amounts)	For the Fiscal Year Ended June 30, 2002			
	September 30	**December 31(1)**	**March 31**	**June 30(1)**
Net sales	**$20,956**	**$19,006**	**$21,298**	**$23,166**
Gross profit	**$ 7,025**	**$ 4,678**	**$ 6,282**	**$ 6,811**
Loss before taxes and minority interest	**$(3,711)**	**$(8,126)**	**$(5,851)**	**$(3,947)**
Income tax benefit	**1,410**	**3,088**	**2,223**	**1,501**
Minority interest	**70**	**82**	**94**	**230**
Net loss	**$(2,371)**	**$(3,019)**	**$(3,722)**	**$(2,621)**
Net loss per share:				
Basic(2)	**$ (0.14)**	**$ (0.17)**	**$ (0.21)**	**$ (0.15)**
Diluted(2)	**$ (0.14)**	**$ (0.17)**	**$ (0.21)**	**$ (0.15)**

	For the Fiscal Year Ended June 30, 2001			
	September 30	December 31	March 31	June 30
Net sales	$23,932	$32,731	$38,717	$37,870
Gross profit	$ 9,969	$13,611	$19,489	$18,100
Net earnings	$ 817	$ 1,905	$ 3,207	$ 4,730
Net earnings per share:				
Basic(3)	$ 0.06	$ 0.13	$ 0.21	$ 0.27
Diluted(3)	$ 0.05	$ 0.13	$ 0.20	$ 0.26

(1) Loss includes the gain on sale of the Automation Systems Group of $6,142 and related exit costs of $1,856, inventory writedowns of $808, and tax expense of $1,322 in the second and fourth quarters ended December 31, 2001 and June 30, 2002, respectively.

(2) Accounting principles generally accepted in the United States of America require the computation of the net loss per share to be based on the weighted average basic shares outstanding.

(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 909, 764, 440, and 547 for fiscal 2001 quarters ended September 30, December 31, March 31, and June 30, respectively.